Banca Sistema Group

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

31 December 2017

BANCA SISTEMA SPECIALTY FINANCE

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INTRODUCTION

With this document the Banca Sistema Group (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 particular disclosure area.

This public disclosure has been prepared in accordance with 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;

The document also reflects the new standards governing the preparation of public disclosures set out in the document “Guidelines on disclosure requirements under Part Eight of Regulation (EU) No. 575/2013” published by the EBA on 4 August 2016.

As at 31 December 2017 the Banca Sistema Group was composed of the Parent Company, Banca Sistema S.p.A., the English company Specialty Finance Trust Holding Limited, and Largo Augusto Servizi e Sviluppo S.r.l (LASS).

The merger of Beta Stepstone S.p.A. into Banca Sistema was completed on 1 January 2017. Therefore, in accordance with Article 2504-bis of the Italian Civil Code, Banca Sistema has assumed all asset and liability relationships that previously belonged to the abovementioned merged company.

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

In this document, the information required by sections: 6 “Capital reserves”, 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, since it does not regard the scope of operations, the assumed risks, and the methods 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 DISCLOSURE

Risk Culture

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.

Since 1 January 2014, the Bank has used an integrated reference framework both to identify its own risk appetite and for the internal process of determining capital adequacy. This system is the Risk Appetite Framework (RAF), designed to make sure that the growth and development aims of the Bank are compatible with capital and financial solidity. The RAF comprises monitoring and alert mechanisms and related processes to take action in order to promptly intervene in the event of discrepancies with defined targets. The framework is subject to annual review 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 by continuously stimulating the development of risk culture in all of the Bank's functions.

Consistent with the legal and regulatory provisions in force, the Bank adopts a three-level internal control system to monitor the risks it faces:

- **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 "first level functions"). The operational structures bear primary responsibility for the risk management process.
- **second level:** risk and compliance controls. Their purpose includes ensuring:
  - proper implementation of the risk management process;
  - observance of the operating limits assigned to the various functions;
  - the statutory and regulatory compliance of business operations, including self-regulation.

  Second level controls are assigned to the Risk Management Department and the Compliance and Anti-Money Laundering Department.
- **third level** controls carried out through internal audits, focused on identifying the breaches of procedures and regulations, as well as on evaluating the completeness, adequacy, functionality, in terms of efficiency and effectiveness, and reliability of the organisational structure of the other internal control system components and of the IT system (ICT audit), at regular intervals in relation to the nature and intensity of the risks. The third level controls are performed by the Internal Audit Department.

Organisational Structure

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 Departments", are summarised as follows.

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; it relies on the following internal Board Committees:
    - Internal Control and Risk Management Committee
    - Appointments Committee
    - Remuneration Committee
    - Ethics Committee
  - The CEO / General Manager also draws on the assistance of the following Company Committees:
    - CEO Committee (Management Committee)
    - Risks and ALM Committee
    - Technical-Organisational Committee
    - Crisis Management Committee
    - Credit Committee
- Control Bodies
    - Board of Statutory Auditors
- Company control functions
    - Risks Department
    - Compliance and Anti-Money Laundering Department
    - Internal Audit Department
    - Manager in charge of financial reporting

Governance bodies: Board of Directors

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

Internal board committees

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 proposal-making functions to conduct reviews and make decisions concerning the internal control system and risk management, including those affecting the periodic financial reports and those affecting risk management in response to problems brought to the attention of the Board of Directors.

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 Independent Auditor with regard to company accounting reports, evaluating the proper use of the accounting standards and their level of standardisation for the purpose of drafting the consolidated financial statements.

Appointments Committee

The Appointments Committee consists 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 is comprised of three non-executive directors (two of which independent). It performs a proposal-making and investigation role vis-à-vis the Board of Directors, with regard to the definition of a remuneration policy for directors and key managers, including the remuneration for all of the key personnel as prescribed by Bank of Italy Circular no. 285/13. The Committee directly oversees the correct application of the rules concerning the remuneration of the managers of the company internal control functions, in accordance with the Board of Statutory Auditors.

Ethics Committee

The Ethics Committee is comprised of the Deputy Chairperson of the Board of Directors, an Independent Director and the Head of Legal Affairs. It supports the Board of Directors in identifying and assessing the ethical principles for defining the conduct policy, evaluating the degree to which said principles must be applied to the corporate environment; it supervises over the publication of the Code of Ethics and the guidelines for external corporate communications regarding this matter.

Governance bodies: CEO and General Manager

The CEO is delegated responsibility for 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 General Manager has the power and authority of managing, coordinating and supervising all Departments, Functions, units, offices and services of the banking group, without prejudice to the mandatory limits imposed by law and 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.

Risks and ALM Committee

The Risks and ALM Committee, within the purview of the internal control system, supports the CEO in defining the strategies, the risk policies, and the revenue objectives, proposing interventions and strategies, for adapting thereto; it monitors capital adequacy with respect to the risk/profitability objectives taking into account the various types of risks and the correlations between them, and the compliance with the regulatory prescriptions on risk management and compliance; it analyses the organisational model underlying the measurement process and approaches for assessing and monitoring the various types of risk. The classifications of non-performing loans and their impairment losses are decided by the Risks and ALM Committee.

Technical-Organisational Committee

The Technical-Organisational Committee supports the CEO in monitoring the organisation's technical and operational requirements, making 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 corrective measures and coordinating new projects, defining their prioritisation and managing their implementation.

Credit Committee

During the lending process, it assists the CEO in taking decisions on the assumption of risks falling under his purview. More specifically, the grant and renewal of credit lines/credit limits are reviewed at the Credit Committee meetings, where it examines the analyses prepared by the various functions involved in the loan 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 the observance of statutory and regulatory provisions and the provisions of the articles of association, proper administration, the adequacy of the organisational and accounting structure, and 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, this body avails of adequate information flows from the other corporate bodies and control departments.

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

The Supervisory Body (or "SB") is appointed by the Board of Directors with the duty to oversee the functioning, observance, and adequacy of the Organisational and Management Model (or "OMM") to prevent the offences established 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 Department.

Company control functions

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

- The **Risks Department** reports directly to the CEO. It is tasked with the identification, management and monitoring of all risks to which the Bank is or may be exposed. The Risks Department collaborates in the formulation and implementation of the Risk Appetite Framework (RAF) and the related risk governance policies, and the various stages that make up the risk management process as well as in setting operational limits for the assumption of various types of risk.

- The **Compliance and Anti-Money Laundering Department** reports to the Board of Directors and is responsible for managing non-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 non-compliance risks. This department includes the Anti-Money Laundering Department, which is responsible for performing audits concerning the application of anti-money laundering regulations using a risk-based approach.

- The **Internal Audit Department** reports directly to the Board of Directors and is managed by the CEO. The Internal Audit Department performs third level assessments of the overall functioning of the internal control system, bringing possible improvements to the attention of the Corporate bodies. In particular, 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 departments.

- The **Manager in charge of financial reporting** sets policy, coordinates administration, and monitors the account and financial reporting internal control system within the Group. The Manager in charge of financial reporting also supervises the implementation of compliance measures according to the generally applicable rules of the Bank, as approved by the Board of Directors.

The above Departments/Functions are separate from an organisational perspective. Internal regulations define the rules, responsibilities, tasks, operating procedures, reporting flows and planning of control activity at the corporate level.

In detail:

- each year, the Risks Department and the Compliance and Anti-Money Laundering Department present the corporate bodies, each based on their respective areas of competence, an activity schedule that identifies and assesses the main risks to which the Bank is exposed and the relevant management measures. The intervention scheduling takes into account both any deficiencies observed in the inspections, and any new risks identified;
- each year, the Internal Audit Department presents the corporate bodies an multi-year audit plan that indicates the mandatory activities required by the reference legislation (i.e. ICT audit, major outsourced functions, remuneration policies, etc.), in addition to the activities identified in accordance with risk-based methods.

At the end of the management cycle, hence annually, said departments 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 2017:

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

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

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

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

Pillar I

Credit risk consists of the risk that the counterparty 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 biggest risk facing the Bank, covering about 76% of the allocated internal capital.

The main components of the Bank's operations that generate credit risk are illustrated below:

a. purchase of receivables with and without recourse (factoring);

b. purchases of loans granted in the form of salary- and pension-backed loans from other intermediaries;

c. loans to small and medium-sized enterprises, granted by the National Guarantee Fund;

d. collateralised loans;

e. financial instruments held on its own account;

f. loans to supervised brokers.

The core business of the Bank is represented by its factoring activity (especially with the Public Administration entities), which features its own peculiar types of risk. This activity relies on a more complex evaluation process (debtors, transferors, and supply contract) and benefits from revolving credit.

Factoring activities make effective risk mitigation possible, through reviews of the financed transaction and observation of the transferred debtors' payment patterns.

The credit risks from factoring activities also include:

- "dilution risk", i.e. the possibility that the purchased loan or receivable is no longer fully enforceable at the due date due to offsets, abatements, disputes between the transferred debtor and the transferor. The Company has obtained appropriate protection against this risk by implementing specific contractual clauses;

- "claw-back" risk. Pursuant to Law 52/1991, when the transfer of a receivable is notified to the transferred debtor, the latter is still obligated to pay the factor for the amounts of the loan/receivable covered by the transfer agreement, even if the transferor goes bankrupt. The receiver bears the burden of proving that the factor was aware of the state of insolvency. If the receiver were to prove that the transferee was aware of the transferor's insolvency at the time of the transfer, the transfer itself would cease to be enforceable, and the payments received from the transferred debtor would have to be returned to the receiver.

These risks are monitored during the credit review process with a determination of the creditworthiness of the counterparty, the transferred debtor, and the underlying asset. These findings are then presented to the Credit Committee, which assists the decision-making bodies (CEO and Board of Directors, according to their delegated responsibilities) for the decisions to be taken.

Credit process and involvement of the control functions

The credit risk management process provides for the involvement of the various central structures of Banca Sistema. 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 credit risk generation process (the lending process) is broken down into different phases, which are summarised as follows:

- Commercial contact and preliminary activities: contact with potential customer and document gathering;
- Credit review process: analysis and assessment of the creditworthiness of the customer, the transferred debtor and the underlying asset;
- Decision and related activities: approval by the decision-making body on the factoring transaction agreed with the customer and commencement of activities to complete the transaction.
- Stipulation and execution of the transfer: execution of the agreement and execution of the transaction
- Payment and management of collections: financing of the transaction and management of collections on the purchased receivable;
- Monitoring: continuous monitoring of the position for the management of any actions to be taken in the event of default (possible judicial recovery).

The Risks Department participates in the credit review activities of compliance with the Significant Exposures and the defined Key Risk Indicators (KRI), and giving RAF compliance opinions in the case of Most Significant Transactions, while the Anti-Money Laundering and Compliance Department participates through monitoring the adequacy of customer reviews.

The Risks Department is responsible for proposing the classification of the default positions. The Department performs specific assessments on the basis of the information received from the Central Credit Department – judicial and extra-judicial Collection Department (in charge of credit recovery) and the Underwriting Department (in charge of assessing and monitoring the portfolio), as well as the direct analysis tools. Using these assessments, it proposes the appropriate classification of exposures to be submitted to the CEO for a decision. The CEO shall assess the change in status after receiving the opinion of the Risks and ALM Committee.

Finally, once a year, the Internal Audit Department audits the entire factoring process.

The credit risk management and mitigation controls specifically implemented to address the various transaction types are briefly discussed as follows.

a. **Purchase of receivables with and without recourse (factoring)**: Banca Sistema's policy predominantly consists in the purchase without recourse of business receivables owed by central administrations, territorial bodies, and, in general, by the Public Administration, 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:** beginning in June 2014, Banca Sistema ("Transferee") extended its own business to the purchase without recourse, from finance companies operating in this sector ("Transferor"), of receivables resulting from loans payable through:
   - salary-backed loans (SBL) to employees in the public and private sector;
   - pension-backed loans (PBL);
   - salary deductions to public sector employees.

   During the fourth quarter of 2017, Banca Sistema purchased without recourse a one-off portfolio relating to advances of severance indemnities.

c. **Loans contingent on issuance of guarantee by the National Guarantee Fund for SMEs:** loan made by Banca Sistema to firms classified as micro, small and 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.

Beginning in 2017, the Bank decided to halt development of this business line after regulatory changes affecting the SME Loans product with MCC guarantee, for which the guaranteed percentage will be reduced. Therefore, it is no longer deemed profitable by the Bank.

d. **Collateralised loans:** beginning in 2016, Banca Sistema extended its own business to opening credit lines on a current account secured by collateral. The loan is granted in exchange for an asset that is pledged as collateral (in the form of gold). The duration of the loan varies from three to twelve months and may be renewed for a maximum of three years.

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

Italian Government security trading operations entail a credit risk exposure to central administrations.

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

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

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

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 are 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 virtue of the type of transactions to which it refers; typically, these can be attributed to transactions that generate an exposure equal to their positive fair value, that have a market value evolving over time based on underlying variables and generate an exchange of payments, financial instruments or commodities against payments. A distinctive feature of counterparty risk consists in determining a bilateral-type risk, for which both counterparties are exposed to the risk of incurring unforeseeable losses.

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).

The Bank was exposed to Market risk at 31 December 2017, generating a risk-weighted value of 2.4 million.

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, involving the following components:

- 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 portfolio, exceed the individual credit line limits;
- foreign exchange risk, which is the risk of incurring losses as a result of adverse changes in the prices of foreign currencies.

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

The Risks Department prepares specific reports for the Risks and ALM Management Committee, the CEO, and the Board of Directors.

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

Operational risk: is the possibility of loss arising from inadequate or malfunctioning internal processes, human resources and internal 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 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.

The reference legislation with regard to prudential supervision (Bank of Italy Circular 285/13, as amended) defines **Concentration risk** 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 segment.

The Bank measures geo-sectoral concentration risk following the proposed ABI approach. This 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 method triggers a capital add-on according to the Herfindahl index, which is calculated according to exposures, and a proportionality constant, calibrated according to the riskiness of the portfolio.

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 equity, thus identifying the relative mitigation measures to be implemented.

The company departments responsible for guaranteeing the correct management of the interest-rate risk are the Treasury Department, the Risks Department, which is responsible for determining the most appropriate risk indicators and for monitoring their performance with respect to assets and liabilities, and Top Management, which has the

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

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 2017, 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 own 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, a distinction is made between:

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

The method used by the Bank to measure liquidity risk is based on the liquidity gap approach indicated in the Bank of Italy guidelines.

A propos, it should be noted that the Bank has adopted specific Key Risk Indicators (KRI) included in the RAF that verify continuous alignment with Basel regulatory targets. The Bank specifically 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 LCR 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 its 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 Supervisory Authorities may be taken in order to rectify any deficit observed.

With regard thereto, Banca Sistema, prudentially, during 2017 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 by the ratio between the available amount of stable funding and the required amount of stable funding. This indicator 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 the NSFR should prevent an excessive recourse to short-term wholesale loans on the part of the Bank.

Also in regard to the liquidity KRI, the Bank constantly monitors the level of **Readily Monetisable Assets**, i.e. the level of securities issued by Member States in the EMU that are denominated in Euro, not structured, and accepted as collateral for refinancing operations at the ECB, and by 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) which represents the first line of protection in managing liquidity risk. The department calculates and monitors the risk indicators;
- Every month, the Risks Department (second level protection) conducts the second level controls in liquidity risk management and continuously assesses the adequacy and proper implementation of the Liquidity Policy and of the Contingency Funding Plan.

The liquidity situation is subject to careful, continuous monitoring by the Treasury Department and the Risks Department, inter alia at the Risks Management and ALM Committee meetings.

The Risks Department periodically submits reports on liquidity risk to the CEO and the Board of Directors.

Through the Liquidity Policy and the Contingency Funding Plan, the Bank has structured the liquidity 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 a liquidity shortage.

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

- identifying tasks and responsibilities to be assigned to the company departments 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 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 impairment losses on its remaining assets;

The indicator is reported quarterly to the Bank of Italy for monitoring purposes. Throughout 2017, Banca Sistema always maintained an indicator level above the regulatory limit proposed by the Basel Committee.

To forestall that risk, the Bank, acting in accordance with Regulation (EU) no. 575/2013 and Bank of Italy Circular no. 285/2013, calculates the Leverage Ratio by using the method provided in that Regulation. This indicator is calculated as the ratio between Tier 1 Capital and Total Adjusted Assets, and is monitored within the Risk Appetite Framework of the Bank.

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, Supervisory Authorities). Said negative perception may be due as much to direct experiences of the considered parties, as to sensations thereof, not necessarily caused by concretely observable events.

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 not complying with laws and regulations, as well as of incurring judicial or administrative penalties, significant financial losses or damages to reputation as a consequence of violations of mandatory provisions (as prescribed by law or regulations) or also of self-regulation (for example articles of association, codes of conduct, corporate governance codes).

This risk affects all levels of the corporate structure, especially in connection with the operating lines. Prevention has to start where the risk is generated. Therefore, all personnel must be made adequately responsible for their actions.

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

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 Risks Department constantly informs the management bodies on the level of risk assumed by the Bank through a reporting system that follows a specific frequency according to the contents.

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

The Risks Department also produces different reports for internal use and for distribution to other functions. The reports prepared, their scope, their recipients and their frequency are listed as follows:

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 reports on:

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

With details on

- Credit and counterparty risk
- Pillar 2 risks
- Liquidity and Contingency Funding Plan

Stress testing

The Risk Department performs stress tests to assess the impacts on capital adequacy and other factors generated by a stress scenario.

The stress tests comprise a series of methods of varying complexity and sophistication which make it possible to simulate the sensitivity of the Bank to exceptional but plausible variations in one or more risk factors that could cause deterioration in the financial stability of the Bank.

These consist of:

a. sensitivity analyses, used to measure the adequacy of capital according to variations in just one risk factor;
b. scenario analyses, used to simulate the impact of an adverse shock on assets causing a set of risk factors to change simultaneously.

The Risks Department monitors capital adequacy on a monthly basis, doing so partly on the basis of the stress scenarios. The results of the stress scenarios are reported to 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. in accordance with Article 19 of Regulation (EU) 575/2013. That regulatory provision allows exempting companies from prudent consolidation if the total amount of assets and off-balance sheet items involved is less than the lower of either € 10 million or 1% of the total amount of assets and off-balance sheet items of the enterprise that owns the equity investment.

At 31 December 2017, Banca Sistema Group comprised the Parent, Banca Sistema S.p.A., Specialty Finance Trust Holding Limited, a company incorporated under U.K. law, and the company Largo Augusto Servizi e Sviluppo S.r.l (LASS).

SECTION 3 - OWN FUNDS

(Art. 437 CRR)

QUALITATIVE INFORMATION

Own funds, risk weighted assets and solvency ratios as at 31 December 2017 were determined based on the new regulation, harmonised for banks, contained in the Directive 2013/36/EU (CRD IV) and in the Regulation (EU) 575/2013 (CRR) of 26 June 2013, that transpose in the European Union the standards defined by the Basel Committee on banking supervision (the so-called Basel 3 framework), and based upon the Circular of the Bank of Italy no. 285 and no. 286 (enacted in 2013), and the update of Circular no. 154.

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	Subordinated Tier 2 bonds
1	Issuer	Banca Sistema S.p.A.	Banca Sistema S.p.A.	Banca Sistema S.p.A.	Banca Sistema S.p.A.
2	ISIN	IT0003173629	IT0004881444	IT0004869712	IT0005247397
3	Legislation applicable to the instrument	Italian law	Italian law	Italian law	Italian law
	Regulatory treatment				
4	Transitory measures of the CRR	Common Equity Tier 1 Capital	Additional Tier 1 Capital	Tier 2 Capital	Tier 2 Capital
5	Post transitory measures of the CRR	Common Equity Tier 1 Capital	Additional Tier 1 Capital	Tier 2 Capital	Tier 2 Capital
6	Admissible at the individual entity level; consolidated; individual entity and consolidated	Individual entity (1)	Individual entity (1)	Individual entity (1)	Individual entity (1)
7	Type of instrument	Ordinary shares art. 28 CRR	Debt instruments art. 52 CRR	Debt instruments art. 62 CRR	Debt instruments art. 62 CRR
8	Amount calculated in own funds (€/million)	9.65	8	11.7	16.5
9	Nominal amount of the instrument (€/million)	N/A	8	12	16.5
9th	Issue price	N/A	At par	At par	At par

Main characteristics of capital instruments					
no.	Characteristics	Ordinary Shares	Subordinated Tier 1 bonds	Subordinated Lower Tier 2 bonds	Subordinated Tier 2 bonds
10	Accounting classification	Shareholders' equity	Liabilities - amortised cost	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 mln on 15/11/2012 - 2 mln on 18/12/2013	- 14 mln at 30/03/2017 - 1.5 mln at 05/08/2017 - 1 mln at 13/10/2017
12	Unredeemable or at maturity	N/A	At maturity	At maturity	At 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	30/03/2027
14	Early redemption at discretion of issuer after obtaining approval from the supervisory authority	No	Yes	No	No
15	Date and amount of early redemption	N/A	The issuer reserves the right to early redeem all or part of the residual nominal value of the securities beginning on 18 December 2017. Moreover, early redemption clauses connected with tax and/or regulatory events are also envisaged. Early redemption is subject to prior authorisation by the Bank of Italy.	N/A	N/A
16	Subsequent dates of 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	N/A
Coupon / Dividends					
17	Fixed or floating dividends/ coupons	N/A	Fixed then floating	Floating	Floating
18	Coupon rate and any correlated indices	N/A	Fixed rate: 7 Variable rate: 6-month Euribor + 5%	Euribor 6 months + 5.50%	6-month Euribor + 4.50%
19	Presence of a "dividend stopper" mechanism	No	Yes	No	3

Main characteristics of capital instruments					
no.	Characteristics	Ordinary Shares	Subordinated Tier 1 bonds	Subordinated Lower Tier 2 bonds	Subordinated Tier 2 bonds
20th	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. These mechanisms are generated in those cases where a “capital event”, a significant reduction in retained earnings or other reserves occur as to trigger a “capital event” in the opinion of the issuer or the supervisory body. The term “capital event” means: a) a reduction of the capital ratios below the minimum regulatory level; b) Common Equity Tier 1 ratio 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	N/A
20b	Fully discretionary, partially discretionary, or obligatory (in terms of amount)	N/A	Partially discretionary	N/A	N/A
21	Presence of "step up" or of other repayment incentive	N/A	No	No	No
22	Non-cumulative or cumulative	N/A	Non-cumulative	N/A	N/A
23	Convertible or non-convertible	N/A	Non-convertible	Non-convertible	Non-convertible
24	If convertible, event(s) that results(result) in conversion	N/A	N/A	N/A	N/A
25	If convertible, fully or in part	N/A	N/A	N/A	N/A
26	If convertible, conversion rate	N/A	N/A	N/A	N/A
27	If convertible, mandatory or optional conversion	N/A	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	N/A
29	If convertible, specify the issuer of the instrument into which it is converted	N/A	N/A	N/A	N/A
30	Impairment mechanisms	N/A	Yes	No	No
31	In case of an impairment mechanism, event(s) that causes (cause) it	N/A	See point 20	N/A	N/A
32	In case of an impairment, full or partial impairment	N/A	Fully or partially	N/A	N/A

33	In case of an impairment, permanent or temporary impairment	N/A	Permanent	N/A	N/A
34	In case of a temporary impairment, description of the revaluation mechanism	N/A	N/A	N/A	N/A
35	Position in the subordination hierarchy in case of liquidation (specify the type of instrument of immediately senior rank)	N/A	If Banca Sistema is liquidated or subject to insolvency proceedings, the Securities and related rights for principal and interest are (i) subordinated to all non-subordinated creditors of Banca Sistema (including depositors) or those having a lower level of subordination than the level of subordination of the Securities as Tier II instruments, (ii) pari passu among them and in relation to additional Tier 1 instruments and other debt exposures of Banca Sistema that do not have a level of subordination that is higher or lower than the Securities, and (iii) senior to the ordinary shares and every class (including any preferred shares and savings shares) of Banca Sistema stock.	The bond was issued with a subordination clause to the intents and purposes of the provisions contained in the supervisory regulations for banks enacted by the Bank of Italy. Therefore, if the Issuer is subject to voluntary or compulsory winding up, the bondholders shall be repaid only after all other creditors of the Issuer that do not have the same level of subordination are repaid.	The bond was issued with a subordination clause to the intents and purposes of the provisions contained in the supervisory regulations for banks enacted by the Bank of Italy. Therefore, if the Issuer is subject to voluntary or compulsory winding up, the bondholders shall be repaid only after all other creditors of the Issuer that do not have the same level of subordination are repaid.
36	Non-complying characteristics of the instruments that benefit from transitory measures	N/A	No	No	No
37	If affirmative, specify the non-compliant characteristics	N/A	N/A	N/A	N/A

QUANTITATIVE INFORMATION

The following tables show:

- the amount of Own Funds according to the publication layout cited in the implementing Regulations (EU) no. 143/2013
- the reconciliation of the elements of Own Funds and the Statement of financial position in the Separate Financial Statements of Banca Sistema and the association of the elements of own funds with the respective items listed in the publication format as indicated at the preceding bullet item.

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	48,918,435	26, paragraph 1, 27, 28, 29, ABE list pursuant to art. 26, paragraph 3	48,918,435
2	Undistributed profits	58,806,967	26, paragraph 1, letter c)	58,806,967
3	Other comprehensive accumulated income (and other reserves, include the profits and losses not realised pursuant to the applicable accounting regulation)	366,663	26, paragraph 1	366,663
5a	Profit for the period verified by independent personnel net of all foreseeable expenses or dividends	19,877,046	26, paragraph 2	19,877,046
6	Common Equity Tier 1 (CET1) before regulatory adjustments	**127,969,111**		**127,969,111**
Common Equity Tier 1 (CET1)				
8	Intangible assets (net of the relevant tax liabilities) (negative amount)	-1,789,816	36, paragraph 1, letter b), 37, 472, paragraph 4	-1,789,816
16	Own Common Equity Tier 1 instruments held directly or indirectly by the issuer (negative amount)	-200,000	36, paragraph 1, letter f), 42	-200,000
26	Regulatory adjustments applied to Common Equity Tier 1 in relation to the amounts subject to pre-CRR treatment	-212,106		0
26a	Regulatory adjustments relative to the unrealised gains and losses pursuant to articles 467 and 468	-212,106		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	-173,467	467	0
	of which a filter for unrealised gains	-82,251	468	0
	of which a filter for unrealised losses	43,612	467	0
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**-2,201,922**		**-1,989,816**
29	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**125,767,188**		**125,979,294**
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)**	**133,767,188**		**133,979,294**
Additional Tier 2 (T2): instruments and provisions				
46	Capital Instruments and the relevant Share Premium Reserves	28,238,825	62.63	28,238,825
51	**Tier 2 (T2) before regulatory adjustments**	**28,238,825**		28,197,700
58	**Tier 2 (T2)**	**28,238,825**		28,238,825
59	**Total Capital (TC = T1 + T2)**	**162,006,014**		**162,218,120**
60	**Total risk weighted assets**	**1,058,017,351**		**1,058,017,351**
Capital ratios and Reserves				
61	Common Equity Tier 1 (as a percentage of risk exposure)	11.89%	92, paragraph 2, letter a), 465	11.91%
62	Tier 1 capital (as a percentage of risk exposure)	12.64%	92, paragraph 2, letter b), 465	12.66%
63	Total capital (as a percentage of risk exposure)	15.31%	92, paragraph 2, letter c)	15.33%
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	3.86%	CRD 128, 129, 130	3.86%
65	of which: the capital conservation buffer requirement	1.25%		1.25%

(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	1,789,816	-1,789,816	8
of which: goodwill	1,785,760	-1,785,760	8
of which: other intangible assets	4,056	-4,056	8
30. Securities issued	281,770,202	36,238,825	30,32,46
of which: subordinate instruments subject to transitional provisions	20,102,195	36,238,825	30,32,46
140. Valuation reserves	366,663	154,557	3,26,26a
of which: valuation reserves on securities available for sale	584,721	287,878	26,26a
of which: other valuation reserves	-218,058	-133,321	26,26a
170.Reserves	58,806,967	58,806,967	1.2
180. Share premiums	39,267,909	39,267,909	1
190. Capital	9,650,526	9,650,526	1
200. Treasury shares	-149,428	-200,000	5a
220. Profit (loss) for the period	26,793,257	26,793,257	5a
of which: profit for the period net of dividend distributed for the year	-6,916,210	-6,916,210	5a
Total Own Funds at 31 December 2016		**162,006,014**	

SECTION 4 - CAPITAL REQUIREMENTS
(Art. 438 CRR)

QUALITATIVE DISCLOSURE

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.

This activity is performed as part of the ICAAP process (Internal Capital Adequacy Assessment Process), whose responsibility is assigned entirely to the "body responsible for strategic supervision", which independently defines the design and organisation according to its own responsibilities 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, please note that 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 regulation was implemented in Italy with Circular no. 285 of the Bank of Italy, which contains specific rules applying to 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 coefficient is expressed as a percentage of the total risk exposure of banks that have significant credit exposures on national territory. It is between 0% and 2.5% and is fixed in intervals of 0.25 percentage points or multiples of 0.25. Using the benchmark indicator, the general approach taken by the CERS, and any other indicator signalling the emergence of systemic risks, the Bank of Italy may set an internal anti-cyclical coefficient higher than 2.5%.

Given the economic and credit situation in Italy, the Supervisory Authority decided to keep the aforementioned coefficient at zero for all of 2017.

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. Banca Sistema currently falls in class 3, consisting of "banking groups and banks that use standardised approaches, with consolidated or individual assets, respectively, amounting to € 3.5 billion or less".

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 departments.

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 adding 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 statement of financial position items available in order to quantify the total capital available.

   The following activity consists in reconciling 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 conclusion of the Process, the analysis of capital adequacy is submitted to the attention of the Internal Audit and, for approval, to the Board of Directors.

   Once the ICAAP is completed, the Internal Audit Department prepares a specific report stating the absence of material errors in the ICAAP report with respect to the regulatory requirements and identifies any anomalies or areas for improvement. This report is then sent for approval to the Board of Directors and later forwarded to the Bank of Italy as integral part of the supporting documentation of the ICAAP process.

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

   In accordance with the requirements imposed by capital adequacy rules, the Bank has completed the activities intended to meet the requirements imposed by Pillar 2, by preparing and sending to the Supervisory Authority – after approval by the Board of Directors – the ICAAP report on the data at 31 December 2016 by 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. In regard to the ICAAP/ILAAP report on the data at 31 December 2017, a document is currently being prepared that, as requested by the Supervisory Authority from the so-called less significant banks and investment companies, an extension has been granted from 30 April 2017 to 30 June 2018 to interpose the EBA/GL/2016/10 guidelines of the European Banking Authority (EBA) as interposed with the order on which the consultations on the update to Bank of Italy Circular 205 "Supervisory Rules for Banks", which began in April 2018, are based.

QUANTITATIVE DISCLOSURE

(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				
A.1 Credit and counterparty risk	2,743,813	2,469,702	909,012	652,999
1. Standardised approach	**2,743,813**	**2,469,702**	**909,012**	**652,999**
2. Internal ratings based approach	-	-	0	0
2.1 Basic	-	-	0	0
2.2 Advanced	-	-	0	0
3. Securitised debt	-	-	0	0
B. MINIMUM REGULATORY REQUIREMENTS	-	-	-	-
B.1 Credit and counterparty risk			**72,721**	**52,240**
B.2 Credit assessment adjustment risk			**249.3127**	**0**
B.3 Settlement risk			0	0
B.4 Market risk			192	367.6116904
1. Standard approach			192	367.6116904
2. Internal models			0	0
3. Concentration risk			0	0
B.5 Operational risk			**11,479**	**10,436**
1. Basic indicator approach			11,479	10,436
2. Standardised approach			-	-
3. Advanced measurement approach			-	-
B.6 Other calculation elements			0	0
B.7 Total capital requirements			**84,641**	**63,043**
C. RISK ASSETS AND CAPITAL RATIOS			**1,058,017**	**788,041**
C.1 Risk-weighted assets			1,058,017	788,041
C.2 CET1 capital/risk-weighted assets (CET1 capital ratio)			11.89%	13.28%
C.3 Tier 1 capital/risk-weighted assets (Tier 1 capital ratio)			12.64%	14.29%
C.4 Total Own Funds/risk-weighted assets (Total Capital Ratio)			15.31%	15.83%

SECTION 5 - EXPOSURE TO COUNTERPARTY RISK
(Art. 439 CRR)

QUALITATIVE INFORMATION

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

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

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

As at 31 December 2017, only repurchase agreements are outstanding with the Compensation and Guarantee Fund and with a counterparty belonging to a major banking group.

QUANTITATIVE DISCLOSURE

OUTSTANDING REPURCHASE AGREEMENTS

(Amounts in thousands of Euro)

Type of instrument	Supervisory trading book	Banking book
Reverse repurchase agreements	-	-
Repurchase agreements	-	215,623

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 main definitions of which are provided on the following pages.

The Supervisory Provisions for Banks impose specific obligations on intermediaries for the monitoring and classification of loans:

"The compliance measures adopted by operating units while the disbursed loan is being monitored must be derived from internal regulations. In particular, the terms and methods of action must be set in the event of anomalies. The criteria for measurement, management and classification of irregular loans, as well as the relative responsible units, must be set through a resolution by the Board of Directors in which the methods for connecting these criteria with those required for the supervisory reports are indicated. 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, "impaired" financial assets are defined as those that lie within the "bad exposures", "unlikely to pay" or "past due and/or overdrawn exposures" categories.

Exposures whose anomalous situation is attributable to factors related to "country risk" are not included in "impaired" financial assets.

The main definitions are provided below:

Bad exposures

On- and off-statement of financial position 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 (see 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) receivables acquired from third parties in which the main debtors are non-performing, regardless of the portfolio's accounting allocation.

Unlikely to pay

The classification in this category is first and foremost based on the Bank's judgement regarding the unlikelihood that, without having to resort to actions such as enforcing the guarantees, the debtor will completely (with regard to principal and/or interest) fulfil his credit obligations. 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-statement of financial position exposures to the same debtor in above conditions is named "unlikely to pay", save that the conditions for classifying the debtor under bad exposures do not exist.

Past due and/or overdrawn exposures

These are understood to be the on-statement of financial position exposures at carrying amount and off-statement of financial position exposures (loans, securities, derivatives, etc.), other than those classified as bad exposures, 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 factoring transactions, the following should be noted:

- for "with recourse" transactions, a past due exposure, other than one associated with the assignment of future receivables, becomes such only if both of the following conditions exist:
- the amount of the advance is equal to, or greater than the total amount of receivables that are 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, reference must be made to the invoice that is furthest past due for each assigned debtor.

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 requires that the debtor's total exposure be considered past due and/or overdrawn, on the reference date of the report, any time the 5% materiality level is exceeded.

Forborne exposures

Forborne exposures are defined as exposures that fall into the category "Non-performing exposures with forbearance measures" and "Forborne performing exposures" as defined by the International Technical Standard (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 it would have been so in the absence of the amendment;
- at the same time or near the time additional credit is granted by the intermediary, the debtor makes principal or interest payments on another contract with the intermediary that was classified as totally or partially past due by more than 30 days (without it being classified as non-performing) at least once during the three months previous to the amendment or it would have been had the amendment not been made;
- 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.

The International Accounting Standards Board (IASB), the body responsible for issuing the International Financial Reporting Standards (IFRS), acting in view of revising the methods used to determine adjustments in order to go over the limits that they had previously shown (tardy recognition of losses) and to simplify financial instrument allocation and accounting choices, decided that it was necessary to amend the IFRS by issuing the new standard IFRS 9 “Financial Instruments”, on 24 July 2014, replacing IAS 39.

The Banca Sistema Group then started planning to identify the strategic and operating impact and, consequently, to implement adjustments to its processes and procedures to comply with the new standard effective from 1 January 2018, the date it came into force.

The new IFRS 9 introduces important changes affecting lending activity:

- switch from the approach of calculating present loss on a 12-month horizon to an approach of calculating the expected loss over the entire lifetime of the loan;
- classification of the loans on three different levels (or “stages”), which correspond to distinct methods for calculating the losses to be measured. Stage 1 contains the performing loans whose credit risk has not increased significantly, otherwise they are classified in Stage 2. Stage 3 contains all loans classified as non-performing according to the current rules adopted by the Group.

The inclusion of forward looking elements in the methods used to assess performing loans stands out among the various changes introduced by the new IFRS 9.

In regard to the measurement of loans in 2017, the calculation methods used to quantify collective and analytical impairment of receivables still follow IAS 39.

QUANTITATIVE DISCLOSURE

The tables shown in the following Schedule were taken from the Financial Statements at 31 December 2017, part E of the Notes to the Financial Statements. It is deemed that the period-end values are representative of the Bank's risk exposures during the relevant period.

DISTRIBUTION OF THE FINANCIAL ASSETS BY PORTFOLIOS AND BY CREDIT QUALITY (CARRYING AMOUNTS)

(Amounts in thousands of Euro)

Portfolios / Quality	Banking group					Total
	Bad Exposures	Unlikely to pay	Impaired past due Exposures	Uninpaired past due exposures	Unimpaired Assets	
1. Available-for-sale financial assets					278,847	278,847
2. Held-to-maturity financial assets				84,178		84,178
3. Due from banks					36,027	36,027
4. Loans to customers	32,340	15,445	73,251	246,874	1,482,380	1,850,290
5. Financial assets at fair value through profit and loss						
6. Financial assets held for disposal						
Total 2016	**32,340**	**15,445**	**73,251**	**331,052**	**1,797,254**	**2,249,342**
Total 2015	**22,969**	**16,163**	**68,172**	**240,990**	**1,591,401**	**1,939,695**

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

(Amounts in thousands of Euro)

Portfolios / Quality	Impaired assets			Unimpaired assets			Total (Carrying Amount)
	Gross Exposure	Specific Adjustments	Carrying Amount	Gross Amount	Portfolio Adjustments	Carrying Amount	
1. Available-for-sale financial assets				278,847		278,847	278,847
2. Held-to-maturity financial assets				84,178		84,178	84,178
3. Due from banks				36,027		36,027	36,027
4. Loans to customers	143,328	22,292	121,036	1,734,844	5,590	1,729,254	1,850,290
5. Financial assets at fair value through profit and loss							
6. Financial assets held for disposal							
Total 2016	**143,328**	**22,292**	**121,036**	**2,133,896**	**5,590**	**2,128,306**	**2,249,342**
Total 2015	**123,760**	**16,456**	**107,304**	**1,840,960**	**8,569**	**1,832,390**	**1,939,695**

ON- AND OFF-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH BANKS: GROSS AMOUNTS AND CARRYING AMOUNTS

(Amounts in thousands of Euro)

Type of exposures / Values	Gross Amount					Individual Impairment Losses	Collective Impairment Losses	Carrying Amount
	Impaired Assets				Unimpaired 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-STATEMENT OF FINANCIAL POSITION	**1**							
a) Doubtful								
of which: forborne exposures								
b) Unlikely to pay								
of which: forborne exposures								
c) Impaired past due exposures								
of which: forborne exposures								
d) Unimpaired past due exposures								
of which: forborne exposures								
e) Other impaired exposures					36,027			36,027
of which: forborne exposures								
TOTAL A					**36,027**			**36,027**
B. OFF-STATEMENT OF FINANCIAL POSITION								
f) Impaired								
g) Unimpaired					2,159			2,159
TOTAL B								
TOTAL (A+B)					**38,186**			**38,186**

On-statement of financial position loans and receivables with banks - gross impaired positions and subject to "country risk": On-statement of financial position loans and receivables with banks are all unimpaired.

On-statement of financial position loans and receivables with banks - changes in impaired positions: There are no impaired loans and receivables with banks.

ON- AND OFF-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH CUSTOMERS: GROSS AMOUNTS AND CARRYING AMOUNTS

(Amounts in thousands of Euro)

Type of exposures / Values	Gross Exposure					Individual Impairment Losses	Collective Impairment Losses	Carrying Amount
	Impaired Assets				Unimpaired 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	11	422	358	43,787		12,237		32,340
of which: forborne exposures								
b) Unlikely to pay	23,461	285	315			8,616		15,445
of which: forborne exposures								
c) Impaired past due exposures	26,718	4,419	12,051	31,502		1,439		73,251
of which: forborne exposures								
d) Unimpaired past due exposures					331,780		728	331,051
of which: forborne exposures								
e) Other unimpaired exposures					1,766,090		4,862	1,761,228
of which: forborne exposures								
TOTAL A	**50,190**	**5,125**	**12,723**	**75,289**	**2,097,870**	**22,292**	**5,590**	**2,213,315**
B. OFF-BALANCE SHEET EXPOSURES								
a) Impaired	-	-	-	-	-	-	-	-
b) Unimpaired	-	-	-	-	645	-	-	645
TOTAL B	**-**	**-**	**-**	**-**	**645**	**-**	**-**	**645**
TOTAL (A+B)	**50,190**	**5,125**	**12,723**	**75,289**	**2,098,515**	**22,292**	**5,590**	**2,213,960**

ON-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH CUSTOMERS: GROSS IMPAIRED POSITIONS

(Amounts in thousands of Euro)

Reasons/Categories	Doubtful	Unlikely to pay	Impaired past due exposures
A. Opening gross balance	**35,231**	**20,189**	**68,342**
- of which: positions transferred but not derecognised			
B. Increases	**27,611**	**17,816**	**157,076**
B.1 transfers from performing loans	6,321	11,639	120,568
B.2 transfers from other categories of impaired loans	8,009	1,699	-
B.3 other increases	13,281	4,478	36,508
C. Decreases	**18,264**	**14,384**	**154,292**
C.1 transfers to performing loans	219	260	76,323
C.2 derecognitions			
C.3 collections	13,469	8,170	74,215
C.4 gains on sales			
C.5 losses on sales			
C.6 transfers to other categories of impaired loans		5,954	3,754
C.7 other decreases	4,576		
D. Closing gross balance	**44,578**	**23,621**	**71,126**
- of which: positions transferred but not derecognised			

ON-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH CUSTOMERS: CHANGES IN IMPAIRED POSITIONS

(Amounts in thousands of Euro)

Causali/Categorie	Bad exposures		Unlikely to pay		Impaired past due exposures		Unimpaired 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. Opening total impairment losses	**12,260**	**-**	**4,026**	**-**	**168**	**-**	**-**	**-**	**-**	**-**
- of which: positions transferred but not derecognised	-	-	-	-	-	-	-	-	-	-
B. Increases	**4,161**		**4,940**		**1,391**	**-**	**-**	**-**	**-**	**-**
B.1 impairment losses	3,721		4,870		198		-	-	-	-
B.2 losses from sales							-	-	-	-
B.3 transfers from other categories of impaired exposures	30		1				-	-	-	-
B.4 other increases	110		69		1,193		-	-	-	-
C. Decreases	**4.184**		**350**		**120**		**-**	**-**	**-**	**-**
C.1 valuation write-backs	3.446		11		40		-	-	-	-
C.2 reversals of impairment losses due to collections	738		8		24		-	-	-	-
C.3 gains on sales							-	-	-	-
C.4 derecognitions							-	-	-	-
C.5 transfers to other categories of impaired loans			330		1		-	-	-	-
C.6 other decreases			1		55		-	-	-	-
D. Closing total impairment losses	**12.237**		**8.616**		**1.439**		**-**	**-**	**-**	**-**
- of which: positions transferred but not derecognised	-	-	-	-	-		-	-	-	-

BREAKDOWN BY BUSINESS SEGMENT OF ON- AND OFF-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH CUSTOMERS (CARRYING AMOUNT)

(Amounts in thousands of Euro)

Exposures/Counterparties	Governments			Other public institutions			Financial companies			Insurance companies			Non-financial companies			Other		
	Net amount	Specific impairment	Portfolio impairment	Net amount	Specific impairment	Portfolio impairment	Net amount	Specific impairment	Portfolio impairment	Net amount	Specific impairment	Portfolio impairment	Net amount	Specific impairment	Portfolio impairment	Net amount	Specific impairment	Portfolio impairment
A. On-statement of financial position																		
A.1 Bad exposures				20,374	2,660								11,811	8,992		155	585	
- of which: forborne exposures																		
A,2 Unlikely to pay													13,854	8,135		1,591	481	
- of which: forborne exposures																		
A,3 Impaired past due exposures	89			62,668	1,209					13			9,705	221		776	9	
- of which: forborne exposures																		
A,4 Unimpaired exposures	788,540		501	532,848		2,070	6,033			3			229,356		2,405	535,499		614
- of which: forborne exposures																		
Total A	**788,629**		**501**	**615,890**	**3,869**	**2,070**	**6,033**			**16**			**264,726**	**17,348**	**2,405**	**538,021**	**1,075**	**614**
B, Off-statement of financial position																		
B,1 Bad exposures																		
B,2 Unlikely to pay																		
B,3 Other impaired assets																		
B,4 Unimpaired exposures													609			36		
Total B													**609**			**36**		
Total (A+B) at 31/12/2017	**788,629**		**501**	**615,890**	**3,869**	**2,070**	**6,033**			**16**			**265,335**	**17,348**	**2,405**	**538,057**	**1,075**	**614**
Total (A+B) at 31/12/2016	**744,956**		**108**	**566,698**	**5,267**	**6,132**	**2,223**			**3**			**283,549**	**10,605**	**1,689**	**268,817**	**585**	**641**

BREAKDOWN BY GEOGRAPHICAL SEGMENT OF ON- AND OFF-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH CUSTOMERS (CARRYING AMOUNT)

(Amounts in thousands of Euro)

Exposures/Geographical Segments	Italy		Other European Countries		America		Asia		Rest of the world	
	Net amount	Total impairment	Net amount	Total impairment	Net amount	Total impairment	Net amount	Total impairment	Net amount	Total impairment
A. On-statement of financial position										
A.1 Bad exposures	32,340	12,237								
A.2 Unlikely to pay	15,445	8616								
A.3 Impaired past due exposures	73,251	1439								
A.4 Other unimpaired exposures	2,075,742	5,542	13,440	39	1,079	3	2,018	6		
Total A	**2,196,778**	**27,834**	**13,440**	**39**	**1,079**	**3**	**2,018**	**6**		
B. Off-statement of financial position										
B.1 Bad exposures										
B.2 Unlikely to pay										
B.3 Other impaired assets										
B.4 Other unimpaired exposures	645									
Total B	**645**									
Total (A+B) at 31/12/2017	**2,197,423**	**27,834**	**13,440**	**39**	**1,079**	**3**	**2,018**	**6**		
Total (A+B) at 31/12/2016	**1,845,013**	**24,787**	**9,609**	**25**	**1,625**	**5**				

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
Assets	**939,863**	**26**	**2,096**	**14,384**	**38,635**	**66,926**	**455,923**	**480,431**	**217,984**	**6,959**
A.1 Government securities			2001		11,006	25	265,602	84,500		
A.2 Other debt securities										
A.3 UCI units										
A.4 Financing	939,863	26	95	14,384	27,629	66,901	190,321	395,931	217,984	6,959
- banks	28,832			18						6,959
- customers	911,031	26	95	14,366	27,629	66,901	190,321	395,931	217,984	
Liabilities	**535,838**	**179,078**	**4,007**	**28,113**	**241,986**	**354,209**	**106,797**	**586,706**	**49,261**	
B.1 Deposits and current accounts	535,396	51,157	3,983	27,972	241,174	104,992	88,952	211,719	13,474	
- banks	13,969	47,500		20,000	201,500	42,500				
- customers	521,427	3,657	3,983	7,972	39,674	62,492	88,952	211,719	13,474	
B.2 Debt securities					373	71,304	4,031	187,000	25,500	
B.3 Other liabilities	442	127,921	24	141	439	177,913	13,814	187,987	10,287	
Off-statement of financial position transactions	**2,159**				**27**			**618**		
C.1 Financial derivatives with exchange of principal	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.2 Financial derivatives without exchange of principal	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.3 Deposits and financing to be received	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.4 Irrevocable commitments to disburse funds	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.5 Financial guarantees issued	2,159				27			618	-	-
C.6 Financial guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of principal	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
C.8 Credit derivatives without exchange of principal	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-

BREAKDOWN OF GEOGRAPHICAL SEGMENT OF ON- AND OFF-STATEMENT OF FINANCIAL POSITION LOANS AND RECEIVABLES WITH BANKS (CARRYING AMOUNT)

(Amounts in thousands of Euro)

Exposures / Geographical Segments	Italy		Other European Countries		America		Asia		Rest of the world	
	Net Amount	Impairment Total Value	Net Amount	Impairment Total Value	Net Amount	Impairment Total Value	Net Amount	Impairment Total Value	Net Amount	Impairment Total Value
A. On-statement of financial position	-	-	-	-	-	-	-	-	-	-
A.1 Bad exposures	-	-	-	-	-	-	-	-	-	-
A.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
A.3 Impaired past due exposures	-	-	-	-	-	-	-	-	-	-
A.4 Other unimpaired exposures	35.868	-	159	-	-	-	-	-	-	-
Totale A	**35.868**	**-**	**159**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
B. Off-statement of financial position	-	-	-	-	-	-	-	-	-	-
B.1 Bad exposures	-	-	-	-	-	-	-	-	-	-
B.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
B.3 Other impaired assets	-	-	-	-	-	-	-	-	-	-
B.4 Other unimpaired exposures	2.159	-	-	-	-	-	-	-	-	-
Total B	**2.159**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) at 31/12/2017	**38.027**	**-**	**159**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) at 31/12/2016	**83.493**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

At 31 December 2017, the Large Exposures of the Parent (exposures equal to or greater than 10% of Own Funds) consist of 16 positions for a sum of:

a) Carrying amount € 1,144,068 (in thousands)

b) Weighted amount € 136,263 (in thousands)

SECTION 9 - UNENCUMBERED ASSETS
(Art.443 CRR)

QUALITATIVE DISCLOSURE

The encumbered assets of the Bank include debt instruments pledged as security for refinancing operations at the ECB and debt instruments used as collateral in repurchase agreements. The encumbered assets also include trade receivables as security c/o the Central Bank via ABACO.

In order to avoid excessive recourse to over collateralisation of the securities available, the Bank, starting from 2016, consistent with the prudential supervisory provisions, anticipated, within the purview of the Risk Appetite Framework, that an adequate level of readily monetisable assets be available in line with the foreseeable evolution of operations, as forecast by the 2017 budget.

As at 31 December 2017, the encumbered debt instruments amounted to approximately Euro 55 million while the carrying amount of the credits in ABACO and the security deposit with Cassa Depositi e Prestiti fell mainly among the other encumbered assets (Euro 363 million).

In particular, “Collateral received” includes the securities purchased by the bank in repurchase transactions.

The Table C shows the amount of liabilities associated with the encumbered assets and guarantees received which can be associated with repurchase agreements.

Pursuant to the rules issued by the EBA, institutions have to indicate the quantity of encumbered and unencumbered assets broken down by type of asset recognised in the financial statements which have been pledged as collateral or transferred without being eliminated or otherwise encumbered, and the received guarantees that meet the conditions for recognition in the transferee’s financial statements.

QUANTITATIVE DISCLOSURE

MODEL A – ENCUMBERED ASSETS

(Amounts in thousands of Euro)

	Carrying amount of the encumbered assets	Fair value of the encumbered assets	Carrying amount of the unencumbered assets	Fair value of the unencumbered assets
Assets of the reporting institution	419,374		1,886,155	
Equity instruments	0		7,964	7,964
Debt instruments	55,494	55,494	307,530	307,530
Other assets	363,879		1,570,660	

MODEL B - COLLATERAL RECEIVED

(Amounts in thousands of Euro)

	Fair value of the encumbered collateral received or of the own debt instruments issued	Fair value of the collateral received or of the own debt instruments issued and which could be encumbered	Nominal amount of the guarantees received or of the own debt instruments issued which cannot be encumbere
Collateral received by the reporting institution	-	-	-
Equity instruments	-	-	92,725
Debt instruments	-	-	1,425
Other collateral received	-	-	-
Own debt instruments issued other than own secured 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 debt instruments issued other than secured bonds and encumbered ABS
Carrying amount of selected financial liabilities	407,689	417,004

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

QUALITATIVE DISCLOSURE

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

As at 31 December 2017, the Bank availed itself of the rating issued by the ECAI:

- "Dominion Bond Rating Service" (DBRS), for exposures to: Central authorities and central banks; Supervised Brokers, Public Sector Institutions and Territorial Entities;
- "Fitch Ratings", with regard to exposures to businesses and other parties.

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.

QUANTITATIVE DISCLOSURE

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

(Amounts in thousands of Euro)

Regulatory class	Weighting							Total
	0%	20%	50%	75%	100%	150%	250%	
Central authorities and central banks	828,309	-	-	-	4,994	-	1,733	**835,037**
Territorial entities, public sector institutions, non-profit entities	-	511,140	-	-	21,691	-	-	**532,831**
Supervised brokers	-	148,755	-	-	-	-	1,190	**149,945**
Multilateral development banks	-	-	-	-	-	-	-	**0**
International organisations	-	-	-	-	-	-	-	**0**
Businesses and other parties	-	-	-	-	507,034	-	-	**507,034**
Detail	-	-	-	542,374	-	-	-	**542,374**
OEIC	-	-	-	-	-	-	-	**0**
Securitisations	-	-	-	-	-	-	-	**0**
Secured bank bonds	-	-	-	-	-	-	-	**0**
Exposures secured by properties	-	-	-	-	-	-	-	**0**
Exposures in equity instruments	-	-	-	-	6,763	-	-	**6,763**
Impaired exposures	-	-	-	-	26,823	113,865	-	**140,688**
Other exposures	161	-	-	-	28,981	-	-	**29,142**

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

QUALITATIVE DISCLOSURE

Market risk represents the downside risk deriving from adverse changes in market prices (stock prices, interest rates, exchange rates, commodity prices, risk factor volatility, etc.) related to the regulatory trading portfolio (position, regulatory and concentration risks) and to the entire accounts of the Bank (exchange risk and commodity position risk).

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

The regulation identifies and governs the treatment of different types of market risk related to the regulatory trading portfolio.

As at 31 December 2017, the Bank is marginally exposed to market risk as a result of an equity security position in the trading portfolio. The security is denominated in Swedish Krona and thus also results in exchange rate risk, albeit limited, given the small size of the position.

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 DISCLOSURE

On the basis of the approach illustrated above, the capital requirement covering market risk at 31 December 2017 was € 0.2 mln.

(Amounts in thousands of Euro)

Standardised Approach	Weighted amounts 12/2017	Requirement 12/2016
Position risk on debt instruments	0	0
Position risk on CIUs	0	0
Position risk on capital instruments	2,402	192
Exchange risks	0	0
Position risk on commodities	0	0

SECTION 12 - OPERATIONAL RISK

(Art. 446 CRR)

QUALITATIVE DISCLOSURE

Operational risk is the risk of loss arising from inadequate or non-functioning internal processes, human resources or systems, or from external events. This type of risk includes the following events:

- 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 adopts the Basic Indicator Approach, 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 DISCLOSURE

On the basis of the approach illustrated above, the capital requirement covering operational risk at 31 December 2017 was € 11.5 mln.

SECTION 13 - EXPOSURES IN EQUITIES NOT INCLUDED IN THE TRADING BOOK (ART.447 CRR)

QUALITATIVE DISCLOSURE

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

Accounting techniques

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

Available-for-sale financial assets - accounting policies

Classification criteria

The non-derivative financial assets that are not classified as "financial assets held for trading" or "financial assets at fair value through profit or loss" or "held-to-maturity investments" or "loans and receivables" are classified in this item.

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 disbursement, based on their fair value including the transaction costs/income 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, recognised in a specific equity reserve recognised in the statement of comprehensive income up until said financial asset is derecognised or an impairment loss is recognised.

Impairment testing is performed in accordance with paragraphs 58 et seq. of IAS 39 at every year-end. As regards equity instruments 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 carrying amount (acquisition cost net of any impairment losses already recognised in the income statement) and the current fair value.

The amount of any impairment is recognised under the income statement item “net impairment losses on available-for-sale financial assets”. This amount also includes the reversal to the income statement of the gains/losses on the fair value measurement previously recognised in the specific equity reserve. If, in a future period, the fair value of the financial instrument increases and the increase can objectively be correlated to an event that occurred after the impairment loss was recognised in the income statement, the impairment loss must be eliminated by recognising a reversal of impairment losses in the same income statement line where monetary items (debt instruments, for example) are recognised, and to equity when they relate to non-monetary elements (equity instruments, for example). The reversal of impairment losses that can be recognised in the income statement cannot in any case exceed the amortised cost that the instrument would have had in the absence of previous impairment losses.

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

The gains and losses deriving from the disposal or reimbursement of the aforementioned financial assets are recognised in the income statement item “Gain (loss) from sales or repurchase of: available- for-sale financial assets” and include the possible reversal to the income statement of the gains/losses on the fair value measurement previously recognised in the specific 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 rewards 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 DISCLOSURE

(Amounts in thousands of Euro)

Type of exposures/Values	Carrying Amount			Fair Value			Market Value	Profits/Losses realized and impairment		Gains/losses unrealized in Statement of Financial Position	
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Profits	Losses	Gains(+)	Losses(-)
Available-for-sale financial assets			6,763	1,763		5,000					
Financial assets at fair value through profit and loss						-					
Equity investments			1,190			1,190					
Goodwill			1,786			1,786					

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

Equity investments include the Bank's current equity investment of 10% in Axactor Italia Srl. (formerly C.S. Union S.p.A., a company resulting from the merger of Candia S.p.a. and St. Ing. S.p.A.), purchasing and managing doubtful financial and trade receivables, as well as recovering debt from and for private companies.

The goodwill originates from the consolidation of the former SF Trust Group of Solvi S.r.l. which was subsequently merged into the Parent.

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

QUALITATIVE DISCLOSURE

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, this risk on the positions included in the banking book consists of the possibility of negative changes in the cash flows or in 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 at a fixed rate, just as for the interbank funding are predominantly at a fixed rate with very short duration.

The interest rate risk connected with the deposits and savings received by the Treasury Department is assumed in accordance with the policies and limits set by the Board of Directors.

Interest rate risk is monitored by identifying the most appropriate indicators for monitoring the changes in assets and liabilities with respect to the limits, investment and funding policies, and interest rate risk management policies, and any appropriate measures to ensure that the activity is operated in accordance with the risk policies.

As at 31 December 2017, no interest rate risk hedging instruments were used.

QUANTITATIVE DISCLOSURE

In accordance with the guidelines given in Bank of Italy Circular no. 285/2013, the Internal Capital used to cover interest rate risk is calculated according to a simplified method that breaks down the assets and liabilities in the banking book of the Banks into 14 time brackets according to their residual lifetime. Variable rate assets and liabilities are assigned to the various time brackets according to the 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 no. 272 “Manual for filling out the Accounts Matrix” and in Circular no.115 “Instructions for filling out the supervisory reports of credit institutions on a consolidated basis”, with the exception of:

- 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:
  - o in the “On demand” bracket, by convention, a fixed quota of 25% (the so-called “non-core component”);
  - o 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” by considering the embedded option of early redemption. In particular, the historical percentage of recorded early redemptions is calculated for that item; said value is applied to the entire savings and deposits recovered from the product and the quota is entered in the bucket at 1 day. The remaining sums are “bucketised “ as a function of the contractual maturity chosen by the customer.

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

To calculate the interest rate risk of the banking book, the Bank of Italy envisages that under “normal business operations” conditions, the annual changes in interest rates recorded over a six-year observation period may be used, considering the 99th percentile (increase)”.

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 31/2/2017
INTERNAL CAPITAL FOR INTEREST RATE RISK	2,755
OWN FUNDS	162,006
RISK INDICATOR	1.7%
THRESHOLD LIMIT DEFINED BY CODE	20%

SECTION 15 - SECURITISATION
(ART. 449 CRR)

QUALITATIVE DISCLOSURE

The securitisation of loans and receivables is a financial technique that permits transformation of illiquid "assets" (loans and receivables, properties, other rights) into credit securities negotiable on the "bond" market. It is also a tool for funding and transferring risk.

During 2016 and 2017 (SPV 2016 – SPV 2017), Banca Sistema structured two securitisation transactions as originator (while also acting as Master Service). These transactions are described as follows:

- Quinto Sistema: securitisation of the receivables portfolio deriving from *salary-* and *pension-backed loans*.
- Atlantis: securitisation of receivables from debtors falling in the "public" category and subject to legal recovery proceedings.

Objectives of Quinto Sistema

The CQS/CQP securitisation transaction has the following objectives:

- Expansion of the sources of financing, by selling to investors "other" than those with which the Bank normally has relations, as institutional investors specialising in senior, mezzanine, and junior risk classes.
- Reduction of funding costs through the use of ABS as collateral for ECB loans.
- Optimisation of regulatory capital: the creation of ABS securities (senior, mezzanine, and junior) allows, at higher and higher costs, the possibility of considering the sale of higher risk securities on the market, in compliance with the CRR Directive, while realising the goal of freeing up the regulatory capital absorbed by the portfolio of salary-backed loans for the desired portion.
- Strategy of dynamic maintenance of balance between investments (Receivables deriving from salary-backed loans) and bank funding sources (specific funding). A typical characteristic of ABS securities, when sold on a final basis on the market, is to be perfectly "self-repaying", with perfect matching between the duration of the investment and the duration of the funding, without any refinancing risk. Therefore, the duration contribution of the ABS is always proportionate to the duration of the securitised asset.

Atlantis Objectives

With this structure, the Bank aims to continue reorganising and rationalising the management of its own factoring portfolio. In accordance with the organisational changes implemented in 2016 (with the creation of a Collection Department), and with the organisational and strategic possibilities deriving from the integration of the company Beta Stepstone, the Bank aims to rethink its approach to the management of loans and receivables under litigation. The structure of the transaction calls for the securitisation of unopposed court orders. Therefore, those orders that gradually satisfy that requirement may be securitised in future. Consequently, the benefits will be "indirect", deriving from standardisation of the servicing activities connected with the securitised portfolio, the transparency that will result from the management of the securitised receivables, and the establishment of a management method which is scalable according to the new receivables to be covered by an "unopposed court order".

Securitisation risks

Securitisation risks refer to various types of risk that substantially relate to four specific roles/circumstances involving Banca Sistema:

- Investor in the ABS securities resulting from its own securitisation. When the portfolio is derecognised, and when certain securities continue to be recognised in the financial statements, the “ABS securities”, and no longer the “loans and receivables”, will have to be measured for financial reporting and prudential purposes;
- Servicer of the securitisation. With the natural Operational Risks that already existed before securitisation but which assume the nature of contractual and regulatory risks;
- Originator of the transaction. In addition to the foregoing, the Bank ultimately runs a reputational risk on the market in general, due to the greater transparency of the performance of the securitised portfolio (periodically analysed by rating agencies and investors) and the general performance of the securitisation;
- Failure in selling the notes.

The bank reports the securitised portfolios as loans in its statement of financial position and supervisory reports, as if the exposures had never been securitised.

The standardised approach is applied to these exposures.

The Bank does not hold the securitised exposures of third parties in its banking book.

ECAI

The rating agencies for Quinto Sistema (SPV 2016) were Moody’s and DBRS insofar as:

- two ratings are needed to render the senior ABS securities usable in refinancing operations with the ECB;
- they are the only two agencies that use a method for rating a securitisation transaction involving salary-backed loans (the other agencies should undertake a process of drafting the criteria, at the expense of the transaction, and without any guarantee as to the result).

SECTION 16 - REMUNERATION POLICY
(ART. 450 CRR)

QUALITATIVE DISCLOSURE

Information about the existing remuneration policies is provided in the “Report on Remuneration”. The “Report” may be consulted in the “Governance” section of the Bank’s 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 DISCLOSURE

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 minimum level of the indicator was set at 3% by the Basel Committee.

The Leverage Ratio is calculated as the ratio between the Tier 1 Capital and the overall exposure. In particular, the denominator of the indicator consists of the total correct exposures, excluding the assets deducted from the Tier 1 Capital and including the off-statement of financial position exposures.

Instead, in reference to the numerator, the Leverage Ratio is calculated during the period from 1 January 2015 to 31 December 2021 by using:

- the "transitional" Tier 1 Capital, i.e. the sum of the Tier 1 (CET1) Capital and Additional Tier 1 (AT1) Capital of the bank calculated according to the applicable rules;
- the "full phase-in" Tier 1 Capital, i.e. stripped of the exemptions pursuant to the transitory measures.

As at 31 December 2017, a leverage indicator equal to 5.7% 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 considers its leverage risk to be low, partly given that about 16% of the total assets used to calculate the index consists of the treasury portfolio that is wholly comprised of Government Securities having a duration of less than one year. The short duration of the portfolio guarantees both limited changes in the fair value of the securities and, in the event of significant negative changes in fair value, the possibility of deciding whether to keep the security until maturity, de facto cancelling any losses that might be realised.

QUANTITATIVE DISCLOSURE

Leverage	31.12.2017
Total assets	**2,307,896**
Items deducted from Own Funds - Full phase-in	-1,990
Items deducted from Own Funds - Transitional	-2,151
Repurchase agreement add-ons	62
Derivative add-ons	0
Off-statement fo financial position items	24,927
Overall exposure of leverage ratio - Full phase-in	2,330,895
Overall exposure of leverage ratio - Transitional	2,330,733
Tier 1 - Full phase-in	133,979
Tier 1 - Transitional	133.767
Leverage - Full phase-in	5.75%
Leverage - Transitional	5.74%

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

QUALITATIVE DISCLOSURE

Lending to SMEs is contingent upon the presence of the guarantee issued by the National Guarantee Fund (the average guarantee of outstanding loans at 31 December is about 80%) for SMEs (Italian Law no. 662/96 as amended) managed by Mediocredito Centrale S.p.A. (MCC).

These exposures fall in the regulatory segments “Retail Exposures” and “Exposures to companies”.

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 2017, transactions of “credit lines opening on a current account secured by collateral” were granted for an amount equal to approximately € 2 million. The value of the exposure is backed by eligible collateral for the purpose of credit risk mitigation(5).

In regard to the exposures deriving from the salary- and pension-backed loans, the Bank recognises the life insurance policies taken out in favour of the lending institution as a means of reducing the credit risk (after the loan is granted, the Bank becomes the beneficiary of the policies), provided that those policies meet the conditions specifically indicated in EU Regulation 575/13, Art. 212 – Requirements for other funded credit protection, paragraph 2.

To be able to use the personal loan protection, the Bank identifies the life insurance policies that it intends to use to replace the weighting ratio of the guarantor with the ratio of the guaranteed party, while verifying that the insurance company is authorised to offer insurance and that it has an ECAI credit rating.

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

QUANTITATIVE DISCLOSURE

(Amounts in thousands of Euro)

Segment	On-balance exposure	Off-balance exposure	Post CRM on-balance exposure	Post CRM off-balance exposure	RWA
Central authorities and central banks	835,037	0	879,683	0	9,328
Territorial Entities	317,552	0	317,552	0	63,510
Public Sector Institutions	215,279	0	215,279	0	60,409
Supervised brokers	23,787	126,158	23,787	308	7,556
Companies and other parties	229,483	227,552	335,364	32,786	294,904
Detail	535,843	6,531	373,630	0	278,972
Impaired exposures	121,036	19,651	110,977	0	158,564
Exposures in equity instruments	6,763	0	6,763	0	6,763
Other exposures	29,142	0	29,142	0	28,981

STATEMENT OF THE MANAGER IN CHARGE OF FINANCIAL REPORTING

The Manager in charge of financial reporting, Alexander Muz, hereby declares that, pursuant to Art. 154-bis, paragraph 2 of the Consolidated Law on Finance, the accounting information contained in this Disclosure by Entities pursuant to Regulation (EU) no. 575/2013 – 31 December 2017 corresponds to the company's documents, books and accounting records.

Alexander Muz
Manager in charge of financial reporting

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 measured 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 recognised in the income statement in compliance with certain case studies provided for by IAS 39; held-to-maturity investments, non-derivative financial assets with established maturity date and fixed or determinable payment schedule for which the actual intention and capacity to hold them until maturity exists; loans and receivables non-derivative assets with fixed or determinable payments, not listed in an active market; available-for-sale financial assets.

CET1

Common Equity Tier 1 capital.

Common equity tier 1 ratio (CET1 Ratio)

This is the ratio between the Tier 1 (CET1) Capital and the total of risk-weighted assets.

CRM

Credit Risk Mitigation.

Default

The declared inability to honour one's own debts and/or payment of interest thereon.

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.

ICAAP

The regulation of the "Second Pillar" requires that the banks implement the processes and instruments of Internal Capital Adequacy Assessment Process (ICAAP) 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 developments in the economic and business environment.

Impairment

With reference to a financial asset, a situation 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 is generally defined as the ratio between the net equity of the bank and its total assets.

Non-performing

A term generally referring to irregular loans.

Probability of Default (PD)

This represents the probability that the debtor will default over a one-year time horizon.

Rating

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

Credit risk

This represents the risk that 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 fluctuations in the value of the financial instruments traded on the market (shares, bonds, derivatives, securities denominated in foreign currency) and of financial instruments whose value is connected with market variables (loans to customers as concerns the interest rate component, deposits in euro and in foreign currency, etc.).

Liquidity risk

The possibility that the entity be unable to meet its own payment obligations due to its inability to liquidate assets or obtain adequate funding from the market (funding liquidity risk) or due to the difficulty/impossibility of easily converting financial assets into cash without significantly and negatively affecting their price due to insufficient depth of the financial market or temporary market disruptions (market liquidity risk).

Operational risk

Operational risk is the risk of loss arising from inadequate or non-functioning processes, human resources or

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

systems, or from external events. Operational risk includes legal risk, i.e. the risk of losses deriving from statutory or regulatory violations, from contractual or non-contractual liability, or from other disputes, ICT risk (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 their hedging.

RWA (Risk Weighted Assets)

On- and off-statement of financial position assets (derivatives and guarantees) that are classified and weighted according to different coefficients tied to the risks, pursuant to the banking regulations issued by regulatory bodies to calculate the solvency ratios.

Tier 1

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

Tier 1 ratio

This is the ratio between Tier 1 Capital , which includes the Common Equity Tier 1 Capital (CET1) and the Additional Tier 1 Capital (AT1), and the total of risk-weighted assets.

Tier 2

Tier 2 Capital is largely composed of calculable subordinated liabilities.

Total capital ratio

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