BANCA SISTEMA Group

DISCLOSURE BY ENTITIES PURSUANT TO REGULATION (EU) NO. 575/2013 "THIRD PILLAR"

31 december 2019

CONTENTS

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 mandatory publication is of both a quantitative and a qualitative nature. It is divided into blocks ("sections"), and each of these addresses a specific 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 2017.

At 31 December 2019, the Banca Sistema Group comprised the Parent, Banca Sistema S.p.A., Specialty Finance Trust Holding Limited, a company incorporated under UK law, the company Largo Augusto Servizi e Sviluppo S.r.l. (LASS), and ProntoPegno S.p.A., a company focused on collateralised lending which has been in operation since 1 August 2019.

Following the acquisition of Atlantide which was then merged on 30 June 2019, the Group also began working in the direct origination of salary- and pension-backed loans which, at the end of 2019, was rather limited when compared to the indirect origination business.

On 26 June 2019, the Bank of Italy issued authorisation to ProntoPegno S.p.A. to engage in the activities referred to in art. 106 of the Consolidated Law on Banking. The company was thus authorised to grant collateralised loans to the public. Subsequently, on 23 July 2019, the deed of transfer of Banca Sistema's "Collateralised Lending" business unit to the subsidiary ProntoPegno S.p.A. was signed. The transfer became effective beginning on 1 August 2019, the date the company was entered in the register pursuant to art. 106 of the Consolidated Law on Banking and began operating.

On 18 November 2019, the Banca Sistema Group entered into a binding agreement to acquire the collateralised lending business unit of the Intesa Sanpaolo Group. The transaction will be carried out by the subsidiary ProntoPegno S.p.A., which will be adequately capitalised and is subject to the authorisation of the competent authorities.

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)	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)	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 adopted 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 Group 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 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 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 "General Bank Rules", are summarised as follows.
The corporate bodies, the internal governance structures and the departments responsible for ensuring the completeness, adequacy and reliability of the internal control system are:

Governance bodies

- The Board of Directors, which relies on the following internal Board Committees
    - Internal Control and Risk Management Committee
    - Appointments Committee
    - Remuneration Committee
    - Ethics Committee

- The CEO/General Manager, who draws on the assistance of the following company committees:
    - CEO Committee (Management Committee)
    - Risk and ALM Committee
    - Technical-Organisational Committee
    - Crisis Management Committee
    - Credit Committee

Control bodies

- Board of Statutory Auditors

Company control functions

- Risk 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 of 4 independent members 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 and risk management system, 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 system, 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 (at least two of which are 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 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. The Committee supports the process of appointing or co-opting directors and sets a target level for the less represented gender in order to ensure an adequate degree of diversification in the overall composition of the management body.

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 made up of three members, of which at least two meet the independence requirements. The office of Deputy Chairperson of the Bank's Board of Directors is an ex-officio member and is also the Chairperson of the Committee. The other two members of the Committee are chosen from among the non-executive directors of the Board of Directors. The Committee supports the Board of Directors in identifying and assessing the ethical principles for defining the conduct policy, evaluating the degree to which said principles must be applied to the corporate environment; it supervises over the publication of the Code of Ethics and the guidelines for external corporate communications regarding this matter.

Governance bodies: CEO and General Manager

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

Risk and ALM Committee

IThe Risk 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 provisions 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 Risk 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 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 granting 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 legal, regulatory, and statutory provisions, 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 system and of the RAF.

To perform its functions, this body uses 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 is composed of the Chairperson of the Board of Statutory Auditors (Chairperson), an independent director and the head 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:

Risk 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 Risk 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.

Compliance and Anti-Money Laundering Department

Which reports to the Board of Directors and is managed by the Chief Executive Officer, 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 compliance risks. This Department includes the Anti-Money Laundering Function, which is responsible for performing audits on the application of relevant laws and regulations using a risk-based approach.

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, adequacy, functioning, and 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.

Manager in charge of financial reporting

Sets policies, coordinates administration, and monitors the accounting 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 aforementioned Departments are organisationally separate from each other. Internal regulation defines the roles, responsibilities, tasks, operating procedures, reporting flows and planning of control activity at the corporate level.

In detail:

- Each year, the Risk 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 audit plan that indicates the scheduled auditing activities, taking into account the risks of the various activities and company structures. The plan contains a specific section relative to the auditing activity on the IT system (ICT auditing).

At the end of the management cycle, hence annually, said 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 and hedging policies

Based on the analysis conducted, the Bank, considering its current and future operations, is exposed to the following risks at 31 December 2019:

Pillar 1 risks: typical banking risks, such as credit risk (which also includes counterparty risk), market risk and operational risk.

Following the introduction of the rules on liquidity risk management, short-term liquidity risk (Liquidity Coverage Ratio - LCR) and long-term liquidity risk (Net Stable Funding Ratio - NSFR) are also included.

Pillar 2 risks include

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

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

To determine the prudential 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 78% of the allocated internal capital.

The principal types of Bank operations that originate credit risk are listed as follows:

- **a.** acquisition 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.** direct granting of loans in the form of salary- and pension-backed loans
- **d.** loans to small and medium-sized enterprises, covered by the National Guarantee Fund;
- **e.** collateralised loans;
- **f.** financial instruments held on its own account;
- **g.** loans to supervised brokers.

The core business of the Bank is represented by its factoring activity (especially with the Public Administrations), 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 assigned debtor and the transferor. The Bank 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 assigned 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 latter 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 assigned 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 assigned 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 made.

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 assigned 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;
- Execution and completion of the transfer: execution of the agreement and completion 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). Inthis regard, in the second half of 2019, the Banca Sistema Group established the Credit Monitoring Function. This function is responsible for all monitoring activities or all those activities aimed at controlling the performance of the counterparty from the moment the decision is taken to grant the loan to the time it is placed in out-of-court collection.

The Risk Department participates in the credit review activities of compliance with the Key Risk Indicators (KRI) for Large exposures and in issuing opinions on compliance with the RAF in the event of More Significant Transactions (MST), while the Anti-Money Laundering and Compliance Department participates through monitoring the adequacy of customer reviews.

The Credit Department is responsible for proposing the classification of the default positions. Based on the assessments made, 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 Risk and ALM Committee.

Finally, the Internal Audit Department performs a specific annual audit of the entire factoring process.

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

a. **Acquisition 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 (indirect channel)**: Beginning in June 2014, Banca Sistema ("Transferee") extended its own business to the purchase without recourse, from financial 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.

c. **Salary- and Pension-Backed Loans (direct channel):** Starting from the second quarter of 2019, following the acquisition of Atlantide, the Banca Sistema Group has expanded its retail offering with the direct origination of salary- and pension-backed loans through a new product, QuintoPuoi. QuintoPuoi is distributed through a network of single-company agents and specialised brokers located throughout Italy and is supported by a dedicated structure within the Bank. The Bank has started an un-brokered direct origination activity whereby bank employees telephone customers who may be interested in taking out a loan. These customers make their intentions known through specific internet searches which are collected and reported by specialist operators (leads) or by applying directly through the bank's portal. They are then contacted by telephone by a bank employee who offers them the possibility of taking out a loan. The activities tied to finalising the loan that require the client's presence (e.g. customer identification and obtaining signatures) can be carried out in the bank's branches or through the agency network.

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 Regulation (EU) 575/13, Art. 212, paragraph 2 – Requirements for other funded credit protection.

d. **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 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.

e. **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 generally granted in exchange for an asset that is pledged as collateral (in the form of gold) that mitigates the risk. The duration of the loan varies from three to twelve months and may be renewed for a maximum of three years. On 1 August, ProntoPegno S.p.A., a company wholly owned by the Parent Banca Sistema focused on collateralised lending, began operating.

f. **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.

g. **Loans 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.

With regard to protecting against credit risk, along with the well-established second level controls and the periodic monitoring put in place by the Risk Department, a specific project has been implemented related to the introduction of the new definition of default, whose implementation date is 31 December 2020. This initiative will enable the determination of the qualitative and quantitative impact on the financial statements, and the identification and implementation of the necessary organisational, internal policy and applicable IT system changes. Regarding the monitoring of credit risk, the Group, with the goal of attaining greater operating synergies, has launched the divisionalisation project which aims to maximise the value of each individual line of business, making it easily comparable with its respective specialist peers.

Regarding the monitoring of credit risk, the Group, with the goal of attaining greater operating synergies, has launched the divisionalisation project which aims to maximise the value of each individual line of business, making it easily comparable with its respective specialist peers.

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].

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

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

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

As at 31 December 2019, the Bank was not exposed to market risk.

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

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

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 between the functions affected by the information risk assessment, assuring 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 stipulated 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. Moreover, effective 31 December 2018, the Bank entered into a cyber risk policy to attenuate the impact stemming from possible information technology attacks for unauthorised access to corporate systems.

Basel III Indicators - Liquidity Coverage Ratio and Net Stable Funding Ratio: The LCR is a regulatory liquidity indicator that measures the short-term (30-day) liquidity position and is calculated as the ratio between the stock of High-Quality Liquid Assets (HQLA) and the net outflows over a 30-day period.

The monitoring of this indicator 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 2019 constantly maintained a large quantity of securities and readily liquid assets hedging potential outflows of liquidity.

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.

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. Use of the NSFR indicator should prevent an excessive recourse to short-term wholesale funding on the part of the Bank.

Pillar II

The Bank is exposed to the following Pillar 2 risks.

The relevant 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 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 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 light of the proposed amendments to Circular 285/2013, the Risk Department will update the simplified calculation approach based on the new regulatory provisions.

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 Risk Department, which is responsible for determining the most appropriate risk indicators and for monitoring the performance of the assets and liabilities, and management which has the specific duty of annually presenting the Board of Directors with the lending, deposits and savings, and interest-rate risk management policies, as well as suggesting during the year any expedient interventions to ensure the performance of the activity consistent with the approved risk policies.

As at 31 December 2019, 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 sale of assets or of losses on the sale of the said assets.

In detail, the following distinctions can be made concerning liquidity risk:

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

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

Also in regard to the liquidity KRI, the Bank constantly monitors the level of **Readily Monetizable 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 issued by the 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;

(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

- 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 Risk 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 Risk Department, inter alia at the Risk and ALM Committee meetings.

The Risk 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), which regulates the process, the roles and the responsibilities in case of liquidity crisis situations.

The liquidity management policy and the CFP provide 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 the activities to be carried out;
- determining the measurement tools;
- defining the Operating Limits, Warning Indicators, and Tolerance Thresholds.

<u>Risk of Excessive Leverage</u> means the risk that a level of debt particularly high with respect to the bank's own funds renders the Bank vulnerable, and corrective measures have to be adopted 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 2019, Banca Sistema has 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 capable of worsening the image of the bank 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 this aspect;
- 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 in 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. Conversely, the risk in question may be considered substantially non-existent in the presence of presumable stability of the normal course of business management.

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

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

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

Compliance Risk is the risk of non-compliance with laws and regulations and 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, consumer protection laws.

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.

The Bank has also initiated a process of assessing conduct risk within ICAAP. This risk is defined as the actual or prospective risk of loss resulting from an inappropriate offer of financial services and the resulting legal costs, including cases where conduct is intentionally improper or careless.

Reporting system

The Risk 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 Risk 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 Risk 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:

Reporting/control	Description	Addressee	Frequency
Monitoring loans and receivables portfolio	Analysis of contingent risks of every portfolio to be purchased (e.g. Large Exposures, MST, etc.)	Risk Department	By event
Treasury position	Review of compliance with treasury powers delegated to the CEO	Risk Department	Daily
Credit Risk Report	Monitoring trend of Bank loan portfolio	Risk and ALM Committee	Monthly
RAF	Monitoring of risk indicators defined in the RAF	CEO	Weekly
Risk Reporting	Report containing overall level of Bank risk	Risk and ALM Committee, CEO Committee / Board of Directors Bank of Italy	Quarterly
Impairment	Generic and specific assessment of the loans and receivables portfolio	Risk and ALM Committee	Quarterly
Risk Management Report	Report on activity performed, reviews performed, results, measured weaknesses, and actions to be taken for their removal	Risk and ALM Committee/ Bank of Italy	Annual

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 Risk Department monitors capital adequacy on a monthly basis, 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 DISCLOSURE

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 entity that owns the equity investment.

At 31 December 2019, the Banca Sistema Group comprised the Parent, Banca Sistema S.p.A., Specialty Finance Trust Holding Limited, a company incorporated under the laws of England and Wales, the company Largo Augusto Servizi e Sviluppo S.r.l. (LASS), and the newly incorporated ProntoPegno S.p.A.

SECTION 3 - OWN FUNDS
(ART. 437 CRR)

QUALITATIVE DISCLOSURE

Own funds, risk-weighted assets and solvency ratios as at 31 December 2019 were determined based on the new harmonised provisions for Banks contained in Directive 2013/36/EU (CRD IV) and in 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 on Bank of Italy Circulars no. 285 and no. 286 (enacted in 2013), and the update of Circular no. 154.

The above regulatory framework provides that own funds have a structure based on two tiers:

- Tier 1 Capital, in turn composed of:
  - Common Equity Tier 1 (CET1) capital;
  - Additional Tier 1 (AT1) capital;
- Tier 2 (T2) capital.

The introduction of the Basel 3 framework was subject to a transitional period, during which the new rules were applied on an expanding basis until 2018, when they were fully applied.

Having met the conditions for inclusion provided for by art. 26(2) of Regulation (EU) no. 575 of 26 June 2013 (CRR), the profit for the year – net of the portion intended for dividends – was included in Common Equity Tier 1 capital, in accordance with board resolutions.

The following table summarises the terms and conditions of Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments:

Main characteristics of equity 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	Unique identifier (ISIN)	IT0003173629	IT0004881444	IT0005247397	IT0005373060
3	Legislation applicable to the instrument	Italian law	Italian law	Italian law	Italian law
Regulatory treatment					
4	Transitional provisions of the CRR	Common Equity Tier 1 Capital	Additional Tier 1 Capital	Tier 2 Capital	Tier 2 Capital
5	Post-transitional provisions 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 level; individual entity and consolidated level	Individual entity and consolidated	Individual entity and consolidated	Individual entity and consolidated	Individual entity and consolidated
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 included in own funds (€/million)	9.65	8	19.5	18
9	Nominal amount of the instrument (€/million)	N/A	8	19.5	18
9a	Issue price	N/A	At par	At par	At par
9b	Redemption price	N/A	At par	At par	At par
10	Accounting classification	Equity	Liabilities - amortised cost	Liabilities - amortised cost	Liabilities - amortised cost
11	Original issue date	N/A	- 5 million at 18/12/2012 - 3 million at 18/12/2013	- 14 million at 30/03/2017 - 1.5 million at 5/8/2017 - 1 million at 13/10/2017 - 3 million at 16/04/2018	- 6 million at 23/05/2019 - 12 million at 27/09/2019
12	Unredeemable or at maturity	N/A	Unredeemable	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)	30/03/2027	23/05/2029
14	Early redemption at discretion of issuer after obtaining approval from the supervisory authority	No	Yes	No	No

Main characteristics of equity instruments					
no.	**Characteristics**	**Ordinary shares**	**Subordinated Tier 1 bonds**	**Subordinated lower Tier 2 bonds**	**Subordinated Tier 2 bonds**
15	Date and amount of early redemption	N/A	The issuer reserves the right to early redemption of all or part of the residual nominal amount 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
Coupons/dividends					
17	Dividends/fixed- or floating-rate coupons	N/A	Fixed then floating	Floating	Fixed
18	Coupon rate and any correlated indices	N/A	Fixed rate: 7% Floating rate: 6-month Euribor + 5%	6-month Euribor + 5.50%	7%
19	Presence of a "dividend stopper" mechanism	No	Yes	No	3
20a	Fully discretionary, partially discretionary or mandatory (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 nominal amount of the securities, are provided for. These mechanisms are generated in those cases where a "capital event" occurs, or when a significant reduction in retained earnings or other reserves occur, thereby triggering 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) a drop of the Common Equity Tier 1 ratio 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

Main characteristics of equity instruments					
no.	**Characteristics**	**Ordinary shares**	**Subordinated Tier 1 bonds**	**Subordinated lower Tier 2 bonds**	**Subordinated Tier 2 bonds**
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	N/A	Partially discretionary	N/A	N/A
21	Presence of "step up" or of other redemption 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 item 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

Main characteristics of equity instruments					
no.	**Characteristics**	**Ordinary shares**	**Subordinated Tier 1 bonds**	**Subordinated lower Tier 2 bonds**	**Subordinated Tier 2 bonds**
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 provisions 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 provisions 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-compliant characteristics of the instruments that benefit from transitional measures	N/A	No	No	No
37	If affirmative, specify the non-compliant characteristics	N/A	N/A	N/A	N/A

QUANTITATIVE DISCLOSURE

The following tables show:

- the amount of Own Funds according to the publication format prescribed in Implementing Regulation (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 Banca Sistema shares 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) Amounts upon full implementation
	Common Equity Tier 1 Capital: instruments and reserves			
1	Equity instruments and associated Share Premium Reserves	48,750,694	26, paragraph 1, 27, 28, 29, EBA list pursuant to art. 26, paragraph 3	48,750,694
2	Undistributed profits	95,975,085	26, paragraph 1, letter c)	95,975,085
3	Other accumulated comprehensive income (and other reserves, including the profits and losses not realised pursuant to the applicable accounting regulation)	2,909,059	26, paragraph 1	2,909,059
5a	Profit for the period verified by independent third parties, net of all foreseeable expenses or dividends	22,240,061	26, paragraph 2	22,240,061
6	Common Equity Tier 1 (CET1) before regulatory adjustments	**169,874,899**		**169,874,899**
	Common Equity Tier 1 (CET1): regulatory adjustments			
7	Additional impairment losses	-556,383	105	-556,383
8	Intangible assets (net of the relevant tax liabilities) (negative amount)	-3,920,808	36, paragraph 1, letter b), 37, 472, paragraph 4	-3,920,808
16	Own Common Equity Tier 1 instruments held directly or indirectly by the issuer (negative amount)	-278,632	36, paragraph 1, letter f), 42	-278,632
26	Regulatory adjustments applied to Common Equity Tier 1 in relation to the amounts subject to pre-CRR treatment	0		0
26a	Regulatory adjustments relative to the unrealised gains and losses pursuant to articles 467 and 468	0		0
	of which unrealised profits on exposures to the central administrations and classified in the IAS 39 category “Available-for-sale financial assets” endorsed by the EU	0	467	0
	of which a filter for unrealised profits	0	468	0
	of which a filter for unrealised losses	0	467	0
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**-4,755,823**		**-4,755,823**
29	**COMMON EQUITY TIER 1 (CET1)**	**165,119,076**		**165,119,076**
	Additional Tier 1 (AT1): instruments			
30	Equity instruments and associated 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	**Additional Tier 1 Capital (AT1)**	**8,000,000**		**8,000,000**
45	**Tier 1 Capital (T1=CET1+AT1)**	**173,119,076**		**173,119,076**
	Tier 2 Capital (T2): instruments and provisions			
46	Equity instruments and associated Share Premium Reserves	37,500,000	62.63	37,500,000
51	**Tier 2 Capital (T2) before regulatory adjustments**	**37,500,000**		**37,500,000**
58	**Tier 2 Capital (T2)**	**37,500,000**		**37,500,000**
59	**Total Capital (TC = T1 + T2)**	**210,619,076**		**210,619,076**
60	**Total risk-weighted assets**	**1,405,890,093**		**1,405,890,093**

(Amounts in thousands of Euro)

	Equity components	(A) Amount	(B) Reference article of Regulation (EU) No. 575/2013	(C) Amounts upon full implementation
Capital ratios and reserves				
61	Common Equity Tier 1 (as a percentage of risk exposure)	11.74%	92, paragraph 2, letter a), 465	11.74%
62	Tier 1 capital (as a percentage of risk exposure)	12.31%	92, paragraph 2, letter b), 465	12.31%
63	Total capital (as a percentage of risk exposure)	14.98%	92, paragraph 2, letter c)	14.98%
64	The institution-specific capital buffer requirement (requirement relative to the Common Equity Tier 1 in compliance with article 92, paragraph 1, letter a), the capital conservation buffer, the countercyclical capital buffer, the systemic risk buffer, institute systemic risk buffer in percentage of the risk exposure requirement	2.51%	CRD 128, 129, 130	2.51%
65	of which: the capital conservation buffer requirement	2.50%		2.50%

(Amounts in thousands of Euro)

	Assets	Accounting Data	Amount Relevant to Own Funds	Ref. Transitory model table for the publication of information regarding equity funds
100.	Intangible assets	-3,920,808	-3,920,808	8
	of which: goodwill	-3,919,700	-3,919,700	8
	of which: other intangible assets	-1,108	-1,108	8
	Liabilities	**Accounting Data**	**Amount Relevant to Own Funds**	**Ref. Transitory model table for the publication of information regarding equity funds**
10c.	Securities issued	476,526,964	45,500,000	30,32,46
	of which: subordinate instruments not subject to transitional measures	45,500,000	45,500,000	30,32,46
120.	Valuation reserves	266,932	266,932	3,26,26a
	of which: valuation reserves on securities available for sale	477,667	477,667	26,26a
	of which: other valuation reserves	-210,735	-210,735	26,26a
150.	Reserves	98,617,212	98,617,212	1.2
160.	Share premiums	39,100,168	39,100,168	1
170.	Share capital	9,650,526	9,650,526	1
180.	Treasury Shares	-233,632	-233,632	5a
200.	Profit (loss) for the period	29,719,219	29,719,219	5a
	of which: profit for the period net of dividend distributed for the year	-7,479,158	-7,479,158	5a
Total Own Funds at 31 December 2019			**210,619,076**	

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/ILAAP process (Internal Capital Liquidity 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 process 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 ratio 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 counter-cyclical ratio higher than 2.5%.

Given the economic and credit situation in Italy, the Supervisory Authority decided to keep the aforementioned ratio at zero also for all of 2019.

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 € 4 billion or less".

The following First and Second Pillar risks are included in the reference scope for the purposes of ICAAP/ILAAP 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)
	Liquidity Risk	Basel III Indicators (LCR and NSFR)
Second Pillar	Concentration Risk	Granularity Adjustment / Single name ABI-PwC /Geo-Sectoral
	Interest Rate Risk	Standard Approach
	Liquidity Risk	Net financial position
	Reputational Risk	Qualitative Assessment
	Risk of Excessive Leverage	Leverage Ratio
	Strategic Risk	Qualitative Assessment
	Compliance Risk	Qualitative Assessment

The ICAAP/ILAAP is divided into five 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 statement of financial position aggregates;
   - the Strategic Business Plan, within which the top management illustrates 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 observed risks 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/ILAAP:** 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.

   Upon completion of the ICAAP/ILAAP, the Internal Audit Department issues an opinion that the ICAAP/ILAAP report does not contain material errors with respect to regulatory requirements, while highlighting any anomalies or areas for improvement in a special report that is submitted for approval to the Board of Directors and, afterwards, is sent to the Bank of Italy as an integral part of the documentation supporting the ICAAP/ILAAP.

   With regard to the ICAAP/ILAAP report on the data at 31 December 2019, as requested by the Supervisory Authority, a document is being prepared which calls for an extension of the reporting deadline for 2020 moving it from 30 April 2020 to 30 June 2020 to assist banks and supervised non-bank intermediaries in carrying out their activities, which have been adversely affected by the current health emergency.

QUANTITATIVE DISCLOSURE

(Amounts in thousands of Euro)

Categories/Amounts	Unweighted amounts		Weighted amounts/ requirements	
	31/12/2019	31/12/2018	31/12/2019	31/12/2018
A. EXPOSURES				
A.1 Credit and counterparty risk	**4,453,157**	**3,577,376**	**1,236,603**	**1,160,521**
1. Standardised approach	4,453,157	3,577,376	1,236,603	1,160,521
2. Internal ratings based approach	-	-	0	0
2.1 Basic	-	-	0	0
2.2 Advanced	-	-	0	0
3. Securitisations	-	-	0	0
B. CAPITAL REQUIREMENTS				
B.1 Credit and counterparty risk			**98,928**	**92,842**
B.2 Credit assessment adjustment risk			**3**	**0**
B.3 Settlement risk			0	0
B.4 Market risk			**0**	**0**
1. Standard approach			**0**	**0**
2. Internal models			0	0
3. Concentration risk			0	0
B.5 Operational risk			**13,540**	**12,522**
1. Basic indicator approach			**13,540**	**12,522**
2. Standardised approach			-	-
3. Advanced measurement approach			-	-
B.6 Other calculation elements			0	0
B.7 Total prudential requirements			**112,471**	**105,363**
C. EXPOSURES AND CAPITAL RATIOS			**1,405,890**	**1,317,043**
C.1 Risk-weighted assets			1,405,890	1,317,043
C.2 CET1 capital/risk-weighted assets (CET1 Capital Ratio)			11.74%	10.96%
C.3 Tier 1 capital/risk-weighted assets (Tier 1 Capital Ratio)			12.31%	11.56%
C.4 Total Own Funds/risk-weighted assets (Total Capital Ratio)			14.98%	13.75%

Each year, following the Supervisory Review and Evaluation Process (SREP), the Bank of Italy gives notice of the final decision regarding the consolidated capital requirement to be met by Banca Sistema.

As a result, starting 1 January 2019, the Banca Sistema Group has had to comply with the following capital ratios, which have been revised from the 2017 SREP Decision, only on the basis of the regulatory provision contained in Circular no. 285 concerning the phase-in of the capital conservation buffer (an increase of 0.625% over the 31 December 2018 figure of 1.875%):

- **CET1 Ratio of 7.75%,** which is binding in the amount of 5.25% (of which 4.5% for the minimum regulatory requirements and 0.75% to cover the additional requirements determined upon completion of the SREP); for the remainder, this measure also includes the capital conservation buffer component;
- **Tier1 Ratio of 9.5%,** which is binding in the amount of 7.00% (of which 6.0% for the minimum regulatory requirements and 1.00% to cover the additional requirements determined upon completion of the SREP); for the remainder, this measure also includes the capital conservation buffer component;
- **Total Capital Ratio of 11.85%,** which is binding in the amount of 9.35% (of which 8.0% for the minimum regulatory requirements and 1.35% to cover the additional requirements determined upon completion of the SREP); for the remainder, this measure also includes the capital conservation buffer component.

Under the Supervisory Review and Evaluation Process ("2019 SREP Decision"), the Banca Sistema Group, starting from the reporting of own funds as at 31.03.2020, is required to comply with the following capital ratios at consolidated level:

- **CET1 Ratio** of **7.75%**, which consists of a binding component of 5.25% (of which 4.5% for the minimum regulatory requirements and 0.75% to cover the additional requirements determined upon completion of the SREP) and, for the remainder, of the capital conservation buffer component[5]
- **Tier 1 Ratio** of **9.55%**, which consists of a binding component of 7.05% (of which 6% for the minimum regulatory requirements and 1.05% to cover the additional requirements determined upon completion of the SREP) and, for the remainder, of the capital conservation buffer component
- **Total Capital Ratio** of **11.90%**, which consists of a binding component of 9.40% (of which 8% for the minimum regulatory requirements and 1.40% to cover the additional requirements determined upon completion of the SREP) and, for the remainder, of the capital conservation buffer component. These capital ratios correspond to the Overall Capital Requirement (OCR) ratios as defined in the Guidelines and represent the sum of the binding provisions (Total SREP Capital Requirement ratio - TSCR) and the combined capital buffer requirement.

Moreover, the Banca Sistema Group has not exercised the right granted under Art. 473 bis of Regulation (EU) no. 575/2013 (CRR), which concerns the transitional provisions aimed at attenuating the impact of the introduction of IFRS9. Consequently, it has not filled out the "***IFRS 9-FL Template***", whose purpose is to give a comparison between own funds, CET1, Tier 1 Capital, risk weighted assets, the CET1 Ratio, the Tier 1 Ratio, the Total Capital Ratio, and the Leverage Ratio of the entities, with and without application of the transitional provisions for IFRS 9 or similar expected losses on loans.

(5) Starting on 1 January 2019, the CCB is 2.5% (see Circular No. 285, Part I, Title II, Chapter 1, Section II).

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

QUALITATIVE DISCLOSURE

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 Cassa di Compensazione e Garanzia (being an indirect participant, Banca Sistema avails itself of the clearing system provided by the depositary bank) or institutional counterparties.

As at 31 December 2019, only repurchase agreements are outstanding with Cassa di Compensazione e Garanzia.

QUANTITATIVE DISCLOSURE

OUTSTANDING REPURCHASE AGREEMENTS

(Amounts in thousands of Euro)

Type of instrument	Regulatory trading portfolio	Banking book
Reverse repurchase agreements	0	0
Repurchase agreements	0	457,070

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

QUALITATIVE DISCLOSURE

The Banca Sistema Group defined its credit quality policy based on the provisions in the Bank of Italy Circular no. 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 related 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 key definitions are shown as follows.

Bad exposures

On- and off-balance sheet exposures (loans, securities, derivatives, etc.) owed by a party in state of insolvency (even if not judicially ascertained) or in broadly similar situations, regardless of any loss forecast formulated by the Group (see Art. 5 bankruptcy law). The definition therefore applies regardless of the existence of any collateral or personal guarantee 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 its 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-balance sheet exposures to the same debtor in the above conditions is named "unlikely to pay", unless the conditions for classifying the debtor under bad exposures exist.

Past due and/or overdrawn exposures

These are understood to be the on-balance sheet exposures at carrying amount and off-balance sheet 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 related 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 Implementing Technical Standards (ITS).

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

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

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

- a modified contract was classified as non-performing or would in the absence of modification be classified as non-performing;
- the modification made to a contract involves a total or partial cancellation by write-offs of the debt;
- the institution approves the use of embedded forbearance clauses for a debtor who is under non-performing status or who would be considered as non-performing without the use of these clauses;
- simultaneously with or close in time to the concession of additional debt by the institution, the debtor made payments of principal or interest on another contract with the institution that was non-performing or would in the absence of refinancing be classified as non-performing.

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

- the modified contract was totally or partially past-due by more than 30 days (without being non-performing) at least once during the three months prior to its modification or would be more than 30 days past-due, totally or partially, without modification;

- simultaneously with or close in time to the concession of additional debt by the institution, the debtor made payments of principal or interest on another contract with the institution that was totally or partially 30 days past due (without being non-performing) at least once during the three months prior to its modification or would be more than 30 days past-due, totally or partially, without modification;
- the institution approves the use of embedded forbearance clauses for 30 days past-due debtors or debtors who would be 30 days past-due without the exercise of these clauses.

During 2014, the IASB issued the new financial reporting standard "IFRS9: Financial Instruments", replacing IAS 39 and in force from 1 January 2018. The final version of the new IFRS9 requires that banks revise their financial instrument management processes and criteria in terms of:

- "Classification and Measurement": a new classification method based on analysis of the business model for the management of financial assets and related contractual cash flows. According to the results of those analyses, the assets are measured at: Amortised cost, fair value through other comprehensive income (FVOCI); fair value through profit or loss (FVTPL). In this case, reference should be made to the Business Model Policy issued by the Bank.
- "Impairment", whose principal changes concern:
  - **a.** the introduction of an impairment model based on expected credit loss, with the adoption of a forward looking approach;
  - **b.** the classification of financial instruments into three stages of credit quality and the consequent need to establish a specific "Stage Assignment Framework";
  - **c.** the calculation of impairment losses according to the assigned credit quality stage.
- "Hedge Accounting".

The Stage Assignment Framework adopted by Banca Sistema sets out the requirements needed to classify financial instruments on the basis of supervening "deterioration" in credit quality, in accordance with the requirements of IFRS9, i.e. with a method that is consistent among the various portfolios and within the Bank. The classification into growing stages of risk is assessed by using all the significant information contained in current processes, including credit monitoring (i.e. "reasonable and supportable information that is available without undue cost and effort"), in addition to any updates.

The method consists in the classification of financial assets in three stages of increasing risk, which correspond to the different methods for measuring impairment losses according to the uniform concept of "expected credit losses" (ECL). For this purpose, Banca Sistema has implemented a model for the calculation of provisions covering expected losses on financial instruments based on:

- the portion of lifetime ECL resulting from possible default events within the 12 months after the reporting date, or over a shorter period when the expected contractual duration is shorter (Stage 1);
- the estimate of the lifetime ECL, when the credit risk of the credit instrument is deemed to have increased significantly after initial recognition (Stage 2).

So, the Stage Assignment Framework requires classifying the performing financial instruments in two different stages, with each one representing an increasing level of risk:

- Stage 1 contains all performing loans that, whether originated or purchased, have not undergone an "SICR" or, although their credit risk has changed over time, they are characterised by a low level of credit risk at the reporting date;
- Stage 2 contains the loans and receivables which, at the reporting date, have had an SICR since their initial recognition and that risk level is no longer considered to be low.

Classification in Stage 3 is instead required for all relationships in default at the reporting date according to the definition of non-performing loan given in current regulatory instructions, and thus aligned with the 7th update to Bank of Italy Circular no. 272 of 30 July 2008, i.e. those which have the characteristics mentioned in paragraph B5.5.37 of IFRS9, which correspond to the "FINAL draft Implementing Technical Standards" ("ITS") containing the technical standards for implementation of forbearance (FBE) and non-performing exposures (EBA/ITS /2013/03/rev1 24/7/2014). Moreover, Stage 3 maintains without any changes the classification into administrative stages of credit quality pursuant to Bank of Italy regulations.

The loans and receivables measurement process is carried out in the following steps:

- **identification,** in the loans and receivables portfolio, of objective evidence of impairment (in Stage 3) or a supervening significant increase in credit risk (in Stage 2);
- **analysis** of the significance of the individual asset subject to impairment. In particular, after having found objective evidence of impairment of the loans and receivables portfolio, the measurement process must determine whether that evidence refers to: a single significant exposure, which necessarily has to be subject to an individual measurement process;
- **measurement** of the impairment on an individual basis (individual measurement) or by uniform classes of assets **(collective measurement).**

The loans and receivables that do not show objective evidence of impairment, and as such are not subject to individual measurement, or the loans and receivables for which the individual measurement process produces a forecast of full recovery, must undergo a collective measurement process (Stage 1 or Stage 2 scope).

The accounting standard requires that in the case of non-performing loans, including those for which the measurement process produces a forecast of full recovery, are subject to individual impairment, which is determined individually or through the use of predetermined percentages.

The loans and receivables classified in Stage 3 and in the following risk classes defined in Bank of Italy Circular no. 272/08 are subject to individual impairment:

- Bad exposures
- Unlikely to pay
- More than 90 days past due.

QUANTITATIVE DISCLOSURE

The tables shown in the following Schedule were taken from the Financial Statements at 31 December 2019, part E of the Notes to the Financial Statements, or prepared based on the information required for the consolidated FINREP reporting at 31 December 2019, in accordance with the Guidelines on disclosure of non-performing and forborne exposures (EBA/GL/2018/10).

It is deemed that the period-end values are representative of the Bank's risk exposures during the relevant period.

BREAKDOWN OF FINANCIAL ASSETS BY PORTFOLIO AND BY CREDIT QUALITY (CARRYING AMOUNTS)

(Amounts in thousands of Euro)

	Portfolios/quality	Bad exposures	Unlikely to pay	Impaired past due exposures	Other impaired exposures	Unimpaired exposures	Total
1.	Financial assets measured at amortised cost	30,544	123,306	54,549	709,093	2,194,896	3,112,388
2.	Financial assets measured at fair value through other comprehensive income					550,219	550,219
3.	Financial assets designated at fair value through profit or loss						
4.	Other financial assets mandatorily measured at fair value through profit or loss						
5.	Financial assets held for sale						
Total at 31.12.2019		**30,544**	**123,306**	**54,549**	**709,093**	**2,745,115**	**3,662,606**
Total at 31.12.2018		**39,017**	**77,912**	**79,066**	**265,500**	**2,623,491**	**3,084,986**

BREAKDOWN OF FINANCIAL ASSETS BY PORTFOLIO AND BY CREDIT QUALITY (GROSS AMOUNT AND CARRYING AMOUNT)

(Amounts in thousands of Euro)

	Portfolios/quality	Impaired				Unimpaired			Total (carrying amount)
		Gross amount	Total impairment losses	Net exposure	Overall partial write-offs	Gross amount	Total impairment losses	Net exposure	
1.	Financial assets measured at amortised cost	245,616	37,217	208,399		2,909,822	5,834	2,903,989	3,112,388
2.	Financial assets measured at fair value through other comprehensive income					550,373	154	550,219	550,219
3.	Financial assets designated at fair value through profit or loss					X	X		
4.	Other financial assets mandatorily measured at fair value through profit or loss					X	X		
5.	Financial assets held for sale								
Total at 31.12.2019		**245,616**	**37,217**	**208,399**		**3,460,195**	**5,988**	**3,454,207**	**3,662,606**
Total at 31.12.2018		**225,163**	**29,169**	**195,994**		**2,895,407**	**6,415**	**2,888,992**	**3,084,986**

ON- AND OFF-BALANCE SHEET LOANS AND RECEIVABLES WITH BANKS: GROSS AMOUNTS AND CARRYING AMOUNTS

(Amounts in thousands of Euro)

Type of exposure / amounts	Gross amount		Total impairment losses and accruals to provisions	Net exposure	Overall partial write-offs
	Impaired	Unimpaired			
A. ON-BALANCE SHEET LOANS AND RECEIVABLES					
a) Bad exposures		X			
- of which: forborne exposures		X			
b) Unlikely to pay		X			
- of which: forborne exposures		X			
c) Impaired past due exposures		X			
- of which: forborne exposures		X			
d) Unimpaired past due exposures	X				
- of which: forborne exposures	X				
e) Other unimpaired exposures	X	81,536	26	81,510	
- of which: forborne exposures	X				
TOTAL A		**81,536**	**26**	**81,510**	
B. OFF-BALANCE SHEET LOANS AND RECEIVABLES					
a) Impaired		X			
b) Unimpaired	X	2,446		2,446	
TOTAL B		**2,446**		**2,446**	
TOTAL (A+B)		**83,982**	**26**	**83,957**	

On-balance sheet loans and receivables with banks - gross impaired positions subject to "country risk": On-balance sheet loans and receivables with banks are all unimpaired.

On-balance sheet loans and receivables with banks - changes in impaired positions: There are no impaired loans and receivables with banks.

ON- AND OFF-BALANCE SHEET LOANS AND RECEIVABLES WITH CUSTOMERS: GROSS AND NET AMOUNTS

(Amounts in thousands of Euro)

Type of exposure / amounts	Gross amount		Total impairment losses and accruals to provisions	Net exposure	Overall partial write-offs
	Impaired	Unimpaired			
A. ON-BALANCE SHEET LOANS AND RECEIVABLES					
a) Bad exposures	50,622	X	20,078	30,544	
- of which: forborne exposures		X			
b) Unlikely to pay	139,348	X	16,042	123,306	
- of which: forborne exposures	1,294	X	259	1,035	
c) Impaired past due exposures	55,646	X	1,097	54,549	
- of which: forborne exposures	763	X	176	587	
d) Unimpaired past due exposures	X	710,677	1,584	709,093	
- of which: forborne exposures	X				
e) Other unimpaired exposures	X	2,668,982	4,377	2,663,605	
- of which: forborne exposures	X				
TOTAL A	**245,616**	**3,378,659**	**43,179**	**3,581,096**	
B. OFF-BALANCE SHEET LOANS AND RECEIVABLES					
a) Impaired	22,196	X		22,196	
b) Unimpaired	X	213,447	44	213,404	
TOTAL B	**22,196**	**213,447**	**44**	**235,600**	
TOTAL (A+B)	**267,812**	**3,592,106**	**43,223**	**3,816,696**	

ON-BALANCE SHEET LOANS AND RECEIVABLES WITH CUSTOMERS: GROSS IMPAIRED POSITIONS

(Amounts in thousands of Euro)

Reasons/Categories		Bad exposures	Unlikely to pay	Impaired past due exposures
A.	**Opening gross balance**	**57.468**	**87.188**	**80.508**
	- of which: positions transferred but not derecognised			
B.	**Increases**	**16.813**	**91.084**	**146.046**
	B.1 transfers from performing loans	32	49.231	83.357
	B.2 transfers from purchased or originated credit-impaired financial assets	1.734	491	166
	B.3 transfers from other categories of impaired loans	6.512	11.519	2.649
	B.4 contract amendments without derecognition			
	B.5 other increases	8.536	29.843	59.875
C.	**Decreases**	**23.659**	**38.924**	**170.908**
	C.1 transfers to performing loans	7.487	527	82.034
	C.2 write-offs	105		
	C.3 collections	13.673	32.436	75.080
	C.4 gains on sales			
	C.5 losses on sales			
	C.6 transfers to other categories of impaired loans	2.394	5.961	13.793
	C.7 contract amendments without derecognition			
	C.8 other decreases			
D.	**Closing gross balance**	**50.622**	**139.348**	**55.646**
	- of which: positions transferred but not derecognised			

ON-BALANCE SHEET NON-PERFORMING LOANS AND RECEIVABLES WITH CUSTOMERS: CHANGES IN IMPAIRED POSITIONS

(Amounts in thousands of Euro)

Reasons/Categories		Bad exposures		Unlikely to pay		Impaired past due exposures	
		Total	of which: forborne exposures	Total	of which: forborne exposures	Total	of which: forborne exposures
A.	**Opening total impairment losses**	**18,451**		**9,277**		**1,442**	**15**
	- of which: positions transferred but not derecognised						
B.	**Increases**	**3,659**		**8,262**	**259**	**1,024**	**176**
B.1	impairment losses on purchased or originated credit-impaired financial assets	14	X	3	X	10	X
B.2	other impairment losses	3,297		8,104	259	720	176
B.3	losses on sales						
B.4	transfers from other categories of impaired loans	274		35		218	
B.5	contract amendments without derecognition		X		X		X
B.6	other increases	73		120		76	
C.	**Decreases**	**2,032**		**1,496**		**1,368**	**15**
C.1	impairment gains	1,429		1,032		876	
C.2	impairment gains due to collections	55		176		79	
C.3	gains on sales						
C.4	write-offs						
C.5	transfers to other categories of impaired loans	209		272		51	15
C.6	contract amendments without derecognition		X		X		X
C.7	other decreases	339		16		363	
D.	**Closing total impairment losses**	**20,078**		**16,042**	**259**	**1,097**	**176**
	- of which: positions transferred but not derecognised						

BREAKDOWN BY BUSINESS SEGMENT OF ON- AND OFF-BALANCE SHEET LOANS AND RECEIVABLES WITH CUSTOMERS

(Amounts in thousands of Euro)

Exposures/Counterparties	Public administrations		Financial companies		Financial companies (of which: insurance companies)		Non-financial companies		Households	
	Net exposure	Total impairment	Net exposure	Total impairment	Net exposure	Total impairment	Net exposure	Total impairment	Net exposure	Total impairment
A. On-balance sheet loans and receivables										
A.1 Bad exposures	17,573	1,493	0	0	0	0	12,816	17,988	155	597
- of which: forborne exposures										
A.2 Unlikely to pay	90,470	4,751	0	0	0	0	30,475	10,216	2,361	1,075
- of which: forborne exposures							1,035	259		
A.3 Impaired past due exposures	34,604	502	4	0	3	0	13,581	539	6,360	57
- of which: forborne exposures							587	176		
A.4 Unimpaired exposures	2,242,908	3,157	72,341	57	9	0	210,459	1,137	847,988	1,609
- of which: forborne exposures										
Total (A)	**2,385,555**	**9,902**	**72,345**	**57**	**12**	**0**	**267,331**	**29,880**	**855,865**	**3,340**
B. Off-balance sheet loans and receivables										
B.1 Impaired exposures							22,196			
B.2 Unimpaired exposures			121,035				98,760	43	5,127	0
Total (B)			**121,035**				**120,956**	**43**	**5,127**	**0**
Total (A+B) at 31.12.2019	**2,385,555**	**9,902**	**193,380**	**57**	**12**	**0**	**388,287**	**29,924**	**860,992**	**3,340**
Total (A+B) at 31.12.2018	**1,957,131**	**8,567**	**148,013**	**55**	**5**		**453,170**	**24,434**	**686,261**	**2,527**

BREAKDOWN BY GEOGRAPHICAL SEGMENT OF ON- AND OFF-BALANCE SHEET LOANS AND RECEIVABLES WITH CUSTOMERS

(Amounts in thousands of Euro)

Exposures/Geographical areas	Italy		Other European countries		America		Asia		Rest of the world	
	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses
A. On-balance sheet loans and receivables										
A.1 Bad exposures	30,544	20,078								
A.2 Unlikely to pay	123,306	16,042								
A.3 Impaired past due exposures	54,549	1,097								
A.4 Unimpaired exposures	3,317,643	5,759	53,915	198	1,094	4			46	
Total (A)	**3,536,052**	**42,975**	**55,763**	**198**	**1,094**	**4**			**46**	
B. Off-balance sheet loans and receivables										
B.1 Impaired exposures	22,196									
B.2 Unimpaired exposures	210,220	44	3,184							
Total (B)	**232,416**	**44**	**3,184**							
Total (A+B) at 31.12.2019	**3,758,458**	**43,020**	**57,099**	**198**	**1,094**	**4**			**46**	
Total (A+B) at 31.12.2018	**3,213,690**	**35,421**	**34,402**	**108**	**5,011**	**19**	**5,044**	**34**	**400**	**1**

BREAKDOWN OF FINANCIAL ASSETS AND LIABILITIES BY REMAINING CONTRACTUAL TERM

(Amounts in thousands of Euro)

	Item/Time buckets	on demand	from more than 1 day up to 7 days	from more than 7 days up to 15 days	from more than 15 days up to 1 month	from more than 1 month up to 3 months	from more than 3 months up to 6 months	from more than 6 months up to 1 year	from more than 1 year up to 5 years	over 5 years	Open term
A.	**On-balance sheet assets**	**1,347,486**	**6,080**	**833**	**22,689**	**50,708**	**64,173**	**464,756**	**1,319,805**	**300,507**	**19,912**
A.1	Government securities						13,285	150,320	821,759		
A.2	Other debt instruments										
A.3	OEIC units										
A.4	Loans	1,325,838	6,291	1,227	23,433	53,243	56,182	314,446	498,047	300,507	19,912
	- banks	61,021			35		55				19,912
	- customers	1,286,466	6,080	833	22,654	50,708	50,833	314,436	498,047	300,507	
B.	**On-balance sheet liabilities**	**693,405**	**704,759**	**65,112**	**120,033**	**263,997**	**165,790**	**580,628**	**577,684**	**247,979**	
B.1	Deposits and current accounts	690,594	19,743	64,458	119,903	263,083	160,521	391,686	299,675	24,423	
	- banks	108		8,000	7,000	15,000					
	- customers	690,486	19,743	56,458	112,903	248,083	160,524	391,686	299,675	24,423	
B.2	Debt instruments					401	1,830	180,293	90,000	45,500	
B.3	Other liabilities	2,811	685,016	654	131	512	3,438	8,649	188,009	178,055	
C.	**Off-balance sheet transactions**	**91,129**	**6**			**209**	**60**		**657**		
C.1	Financial derivatives with exchange of principal		6								
	- long positions										
	- short positions		6								
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	88,656				209	60		56		
	- long positions	44,165				209	60		56		
	- short positions	44,490									
C.5	Financial guarantees issued	2,473							601		
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 BY GEOGRAPHICAL SEGMENT OF ON- AND OFF-BALANCE SHEET LOANS AND RECEIVABLES WITH BANKS

(Amounts in thousands of Euro)

Exposures/Geographical areas	Italy		Other European countries		America		Asia		Rest of the world	
	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses
A. On-balance sheet loans and receivables										
A.1 Bad exposures										
A.2 Unlikely to pay										
A.3 Impaired past due exposures										
A.4 Unimpaired exposures	81,393	26	117							
Total (A)	**81,393**	**26**	**117**							
B. Off-balance sheet loans and receivables										
B.1 Impaired exposures										
B.2 Unimpaired exposures	2,446									
Total (B)	**2,446**									
Total A+B at 31.12.2019	**83,840**	**26**	**117**							
Total A+B at 31.12.2018	**38,027**	**159**								

At 31 December 2019, the Large Exposures of the Parent (exposures equal to or greater than 10% of Own Funds) consist of 19 positions for a sum of:

a. Carrying amount € 2,291,599 (in thousands)

b. Weighted value € 187,666 (in thousands)

CREDIT QUALITY OF FORBORNE EXPOSURES

(Amounts in thousands of Euro)

		Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
		Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures		Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
				Of which defaulted	Of which impaired				
1	**Loans and advances**		**2,056**	**2,056**	**2,056**		**435**	**1,035**	**1,035**
2	Central banks								
3	General governments								
4	Credit institutions								
5	Other financial corporations								
6	Non-financial corporations		2,056	2,056	2,056		435	1,035	1,035
7	Households								
8	**Debt Securities**								
9	**Loan commitments given**								
10	**Total**		**2,056**	**2,056**	**2,056**		**435**	**1,035**	**1,035**

This table has been developed, in line with the Guidelines on disclosure of non-performing and forborne exposures (EBA/GL/2018/10), in coherence with the information requested in FINREP at consolidated level at 31 December 2019.

CREDIT QUALITY OF PERFORMING AND NON-PERFORMING EXPOSURES BY PAST DUE DAYS

(Amounts in thousands of Euro)

		Gross carrying amount/nominal amount											
		Performing exposures			Non-performing exposures								
			Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
1	**Loans and advances**	**2,474,522**	**2,108,988**	**365,534**	**245,616**	**58,627**	**17,430**	**23,967**	**115,156**		**30,432**		**245,616**
2	Central banks	19,966	19,966										
3	General governments	1,284,008	924,339	359,669	149,391	32,733	15,297	14,776	67,602		18,981		149,391
4	Credit institutions	61,570	61,570										
5	Other financial corporations	62,425	62,425		3.76	2.37	0.62	0.02	0.75				3.76
6	Non-financial corporations	197,954	194,870	3,083	85,614	24,519	450.23	6,391	42,803		11,450		85,614
7	Of which SMEs	11,995	11,991	3.49	11,123	7,367	1.96	0.32	3,752				11,122
8	Households	848,598	845,817	2,781	10,605	1,372	1,683	2,799	4,750				10,605
9	**Debt securities**	**985,672**	**985,672**										
10	Central banks												
11	General governments	985,672	985,672										
12	Credit institutions												
13	Other financial corporations												
14	Non-financial corporations												
15	**Off-balance-sheet exposures**	**209,579**			**22,196**								
16	Central banks												
17	General governments												
18	Credit institutions	2,446											
19	Other financial corporations	112,371											
20	Non-financial corporations	89,634			22,196								
21	Households	5,126											
22	**Total**	**3,669,774**			**267,812**								

This table has been developed, in line with the Guidelines on disclosure of non-performing and forborne exposures (EBA/GL/2018/10), in coherence with the information requested in FINREP at consolidated level at 31 December 2019.

PERFORMING AND NON-PERFORMING EXPOSURES AND RELATED PROVISIONS

(Amounts in thousands of Euro)

		Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
			Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3			
1	**Loans and advances**	**2,474,522**	**2,350,270**	**124,253**	**245,616**		**245,616**	**-5,711**	**-5,044**	**-667.09**	**-37,217**		**-37,217**			
2	Central banks	19,966	19,966					-0.11	-0.11							
3	General governments	1,284,008	1,258,969	25,039	149,391		149,391	-2,881	-2,790	-91.58	-6,745		-6,745			
4	Credit institutions	61,570	61,570	0.43				-25.57	-25.56	-0.00						
5	Other financial corporations	62,425	62,425		3.76		3.76	-56.74	-56.74		-0.00		-0.00			
6	Non-financial corporations	197,954	176,948	21,005	85,614		85,614	-1,137	-1,059	-77,536	-28,742		-28,742			
7	Of which SMEs	23,118			11,122		11,122	-48.31			-353.34		-353.34			
8	Households	848,598	770,390	78,207	10,605		10,605	-1,610	-1,112	-497,970	-1,728		-1,728			
9	**Debt securities**	**985,672**														
10	Central banks	0														
11	General governments	985,672	985,672						-275.81							
12	Credit institutions	0														
13	Other financial corporations	0														
14	Non-financial corporations	0														
15	**Off-balance-sheet exposures**	**209,579**			**22,196**											
16	Central banks	0	0	0	0		0									
17	General governments	0	0	0	0		0									
18	Credit institutions	2,446	2,446	0	0		0		-0.09							
19	Other financial corporations	112,371	112,371													
20	Non-financial corporations	89,634	82,578	7,056	22,196		22,196		-43.42							
21	Households	5,126	5,126						-0.09							
22	**Total**	**3,669,774**			**267,812**											

This table has been developed, in line with the Guidelines on disclosure of non-performing and forborne exposures (EBA/GL/2018/10), in coherence with the information requested in FINREP at consolidated level at 31 December 2019.

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 overcollateralisation 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 2019 budget.

As at 31 December 2019, the encumbered debt instruments amounted to approximately € 450,5 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 (€ 454,6 million).

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

In accordance with the regulations issued by the EBA, institutions have to indicate the quantities of encumbered and unencumbered assets, broken down by type of asset, on the statement of financial position that have been posted as collateral or transferred without derecognition 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	905,089		2,824,911	
Equity instruments	0		6,164	6,164
Debt instruments	450,497	450,497	331,926	331,926
Other assets	454,593		2,486,901	

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
Collateral received by the reporting institution		
Equity instruments		0
Debt instruments		0
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	815,320	875,210

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 2019, 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	1,654,980	-	-	-	4,350	-	4,132	**1,663,462**
Territorial entities, public sector institutions, non-profit entities	-	624,947	-	-	14,415	-	-	**639,362**
Supervised brokers	-	567,651	-	-	-	-	-	**567,651**
Multilateral development banks	-	-	-	-	-	-	-	**0**
International organisations	-	-	-	-	-	-	-	**0**
Companies and other parties	-	0.58	-	-	421,561	-	-	**421,561**
Retail	-	-	-	825,796	-	-	-	**825,796**
OEIC units	-	-	-	-	-	-	-	**0**
Securitisations	-	-	-	-	-	-	-	**0**
Covered bonds	-	-	-	-	-	-	-	**0**
Exposures secured by properties	-	-	-	-	-	-	-	**0**
Exposures in equity instruments	-	-	-	-	6,164	-	0	**6,164**
Impaired exposures	-	-	-	-	32,143	197,310	-	**229,454**
Other exposures	652	-	-	-	41,166	-	-	**41,818**

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 2019, the Bank was not exposed to market risk.

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;
- business disruption;
- 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 Regulation (EU) 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 2019 was € 13.5 million.

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 Financial assets measured at fair value through other comprehensive income.

Financial assets measured at fair value through other comprehensive income (FVOCI)

- **Classification criteria**

  This category includes the financial assets that meet both the following conditions:

  - financial assets that are held under a business model whose aim is achieved both through the collection of contractual cash flows and through sale ("Held to Collect and Sell" business model);
  - the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding ("SPPI Test" passed).

  This item also includes equity instruments, not held for trading, for which the option was exercised upon initial recognition of their designation at fair value through other comprehensive income.

  In particular, this item includes:

  - debt instruments that can be attributed to a Held to Collect and Sell business model and that have passed the SPPI test;
  - equity interests, that do not qualify as investments in subsidiaries, associates or joint ventures and are not held for trading, for which the option has been exercised of their designation at fair value through other comprehensive income.

  Except for the equity instruments which cannot be reclassified, financial assets may be reclassified to other categories of financial assets only if the entity changes its own business model for management of the financial assets.

  In such cases, which are expected to be absolutely infrequent, the financial assets may be reclassified from those measured at fair value through other comprehensive income to one of the other two categories established by IFRS 9 (Financial assets measured at amortised cost or Financial assets measured at fair value through profit or loss). The transfer value is the fair value at the time of the reclassification and the effects of the reclassification apply prospectively from the reclassification date. In the event of reclassification from this category to the amortised cost category, the cumulative gain (loss) recognised in the valuation reserve is allocated as an adjustment to the fair value of the financial asset at the reclassification date. In the event of reclassification to the fair value through profit or loss category, the cumulative gain (loss) previously recognised in the valuation reserve is reclassified from equity to profit (loss).

- **Recognition criteria**

  Initial recognition of the 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, 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.

  Equity instruments, for which the choice has been made to classify them in this category, are measured at fair value and the amounts recognised in other comprehensive income cannot be subsequently transferred to profit or loss, not even if they are sold (the so-called OCI exemption). The only component related to these equity instruments that is recognised through profit or loss is their dividends. Fair value is determined on the basis of the criteria already described for Financial assets measured at fair value through profit or loss.

  For the equity instruments included in this category, which are not quoted on an active market, the cost approach is used as the estimate of fair value only on a residual basis and in a small number of circumstances, i.e., when all the measurement methods referred to above cannot be applied, or when there are a wide range of possible measurements of fair value, in which cost represents the most significant estimate.

  Financial assets measured at fair value through other comprehensive income are subject to the verification of the significant increase in credit risk (impairment) required by IFRS 9, with the consequent recognition through profit or loss of an impairment loss to cover the expected losses.

- **Derecognition criteria**

  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 policies

- **Classification criteria**

  This category includes equity investments in subsidiaries, associates, and joint ventures by Banca Sistema.

- **Recognition criteria**

  Equity investments are recognised in the financial statements at purchase cost plus any related charges.

- **Measurement criteria**

  In the consolidated financial statements, equity investments in subsidiaries are consolidated using the full line-by-line method. Equity investments in associates and joint ventures are both measured at equity. At the end of each financial year or interim report date, an assessment is performed to determine if any objective evidence exists that an investment has been impaired. The recoverable value is then calculated taking into account the present value of the future cash flows that the investment will be able to generate, including the final disposal value of the investment. Any lower value, compared to the carrying amount, resulting from this calculation is charged to the income statement under “250 Gains (losses) on equity investments”. The item also includes any future impairment gains where the reasons for the previous impairment losses no longer apply.

- **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 rewards. Gains and losses on the sale of equity investments are charged to the income statement under the item “240 Gains (losses) on equity investments"; gains and losses on the sale of investments other than those measured at equity are charged to the income statement under the item "280 Gains (losses) on sales of investments".

QUANTITATIVE DISCLOSURE

(Amounts in thousands of Euro)

Type of exposures/Amounts	Carrying amount			Fair value			Market value	Profits/Losses realised and impairment		Unrealised Gains/ Losses recognised in the Statement of Financial Position	
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Gain	Loss	Gains (+)	Losses (-)
Available-for-sale financial assets	1,164		5,000	1,164		5,000					
Financial assets at fair value through profit or loss						-					
Equity investments											
Goodwill			3,920			3,920					

The value reported in Financial assets measured at fair value through other comprehensive income 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 and the shares of Axactor Norway.

“Equity investments” is zero. The equity investments in ADV Finance S.p.A (ADV Finance) and its subsidiary ProCredit S.r.l were sold in 2019.

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 and unexpected movements of market rates.

Customer deposits on savings accounts and current accounts are at a fixed rate, as interbank funding transactions are predominantly at a fixed rate and with very short duration.

The interest rate risk connected with the funding transactions carried out 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 carried out in accordance with the risk policies.

As at 31 December 2019, 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:
  - in the “On demand” bracket, by convention, a fixed share of 25% (the so-called "non-core component");
  - for the remaining amount (the so-called "core component") in the subsequent eight time brackets (from "up to 1 month" to "4-5 years"), in proportion to the number of the months contained therein.

Furthermore, the Bank models its savings product “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 bracket, 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)”.

Both the internal capital determined for the interest rate risk and the risk indicator calculated as the ratio between the above-described internal capital and own funds are shown as follows.

(Amounts in thousands of Euro)

EXPOSURE TO INTEREST RATE RISK	AMOUNTS AT 31/12/2019
INTERNAL CAPITAL FOR INTEREST RATE RISK	4,085
OWN FUNDS	210,619
RISK INDICATOR	1.94%
THRESHOLD LIMIT DEFINED BY THE REGULATION	20%

SECTION 15 - SECURITISATIONS (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.

Starting in 2016, Banca Sistema structured four securitisation transactions as originator (while also acting as Master Service). These transactions are described as follows:

- Quinto Sistema Sec 2016 (redeemed in 2018) and Quinto Sistema Sec 2017 (currently outstanding, rated, listed and whose senior securities are eligible as collateral for Eurosystem refinancing transactions) and Quinto Sistema Sec 2019. All three transactions involved receivables portfolios deriving from salary- and pension-backed loans.
- Atlantis SPV: securitisation of factored receivables from debtors falling in the "public" category.

Objectives of the Quinto Sistema Sec. transactions

The CQS/CQP securitisation transaction has the following objectives:

- Expansion of the sources of financing, by reaching investors "different" from those with which the Bank normally has relations, as institutional investors specialising in senior and mezzanine risk classes.
- Reduction of funding costs through the use of ABS as collateral for ECB loans and bilateral transactions.
- 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, to realise the goal of freeing up the desired portion of any regulatory capital absorbed by the portfolio of salary-backed loans.
- 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

The Bank intended to benefit from certain characteristics of securitisation structures for loans and receivables deriving from the factoring business (particularly in terms of standardising the management process and potentially refinancing assets using dedicated transactions for each type of risk).

Securitisation risks

Securitisation risks refer to various types of risk that substantially relate to three 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.

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 third-party securitised exposures in its banking book.

ECAI

As previously done for the preceding transaction on the Quinto Sistema Sec 2016 CQS/CQP assets, the rating agencies for Quinto Sistema Sec 2017 were Moody's and DBRS insofar as:

- two ratings are needed to render the senior ABS securities eligible for refinancing operations with the ECB;
- they are the only two agencies that use an established method for rating a securitisation transaction involving salary-backed loans.

SECTION 16 - REMUNERATION POLICY (ART. 450 CRR)

QUALITATIVE DISCLOSURE

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

The Remuneration Report 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 funds. 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 adjusted exposures, excluding the assets deducted from Tier 1 Capital, and including the off-balance sheet exposures.

Instead, in reference to the numerator, during the period from 1 January 2015 to 31 December 2021 the Leverage Ratio is calculated 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 2019, a leverage ratio equal to 4.6%, above the minimum regulatory level proposed by the Basel Committee, was recorded. The ratio 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 26% of the total assets used to calculate the ratio consists of the treasury portfolio that is wholly comprised of Government Securities having a duration of less than two years. 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

(Amounts in thousands of Euro)

Leverage	31.12.2019
Total assets	3,744,247
Items deducted from Own Funds – Full phase-in	-4,165
Items deducted from Own Funds – Transitional	-4,165
Repurchase agreement add-ons	143
Derivative add-ons	0
Off-balance sheet items	25,938
Total exposure of the Leverage Ratio – Full phase-in	3,766,163
Total exposure of the Leverage Ratio – Transitional	3,766,163
Tier1 – Full phase-in	173,119
Tier1 – Transitional	173,119
Leverage – Full phase-in	4.60%
Leverage – Transitional	4.60%

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 converges in particular in the "Retail exposures" segment. The loan granted is guaranteed by the encumbered sums.

Moreover, as at 31 December 2019, transactions of "credit lines opening on a current account secured by collateral" were granted for an amount equal to approximately € 11.8 million. The value of the exposure is backed by eligible collateral for the purpose of credit risk mitigation[6].

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 Regulation (EU) 575/13, Art. 212 – Requirements for other funded credit protection, paragraph 2.

To be able to use the unfunded credit 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.

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

QUANTITATIVE DISCLOSURE

(Amounts in thousands of Euro)

Segment	On-balance sheet exposure	Off-balance sheet exposure	Post CRM on-balance sheet exposure	Post CRM off-balance sheet exposure	RWA
Central authorities and central banks	1,663,462	-	1,671,843	-	14,680
Territorial Entities	429,783	-	429,783	-	85,957
Public Sector Institutions	209,579	-	209,579	-	53,448
Supervised brokers	88,092	479,560	88,092	6,775	18,973
Companies and other parties	243,590	177,972	406,970	2,616	276,187
Retail	816,024	9,772	591,251	-	442,623
Impaired exposures	210,081	19,373	207,060	-	297,125
Exposures in equity instruments	6,164	-	6,164	-	6,164
Other exposures	41,819	-	41,819	-	41,166

INCOUNTRY BY COUNTRY REPORTING

The 4th update of Bank of Italy Circular no. 285/2013, under Title III, Chapter 2, transposes the rules on country-by-country reporting, introduced by Article 89 of Directive 2013/36/EU ("CRD IV"), into Italian law. In line with this provision, the Bank is required to disclose annually qualitative and quantitative information, as an annex to the financial statements or on its website. For this reason, the information indicated in letters a), b) and c) of Annex A to Part One, Title III, Chapter 2, with reference to the situation at 31 December 2019, needs to be disclosed.

In detail:

a. Name of the company and nature of its activities;

b. Turnover;

c. Number of employees on a full-time equivalent basis;

d. Profit or loss before tax;

e. Tax on profit or loss;

f. Public subsidies received.

Banca Sistema only operates in Italy. Therefore, the information required by the regulations set out in the table below only applies to Italy.

The required information is provided below:

a) Name of the company and nature of its activities

The Banca Sistema Group operates in Italy and is composed of the following companies:

- Banca Sistema S.p.A. - Parent of the Banca Sistema Group - Banking
- Specialty Finance Trust Holdings Limited – Vehicle - Based in London
- Largo Augusto Servizi e Sviluppo S.r.l. - Vehicle
- Newly incorporated ProntoPegno S.p.A - Financial Intermediary

b) Turnover

The turnover of a bank is the "total income" reported in "item 120" of the income statement. Therefore, the turnover reported by the Banca Sistema Group at 31 December 2019 was: **€ 100,913 thousand**.

c) Number of employees on a full-time equivalent basis

This section illustrates the ratio between the total number of hours worked in 2019 by all employees of the Banca Sistema Group, excluding overtime, and the total number of hours per year under the national collective bargaining agreement for a full-time employee.

Total hours worked in 2019/Total hours per year under the national collective bargaining agreement (CCNL) for a full-time employee

In 2019, the number of employees calculated on this basis was **170.**

d) Profit or loss before tax

"Profit or loss before tax" refers to item 290 of the income statement under Circular no. 262.

Pre-tax profit from continuing operations: **€ 41,349 thousand.**

e) Tax on profit or loss

"Tax on profit or loss" refers to item 300 of the income statement under Circular no. 262 and Income taxes: **€ 12,192 thousand.**

f) Public subsidies received

"Public subsidies received" includes subsidies received directly from public administrations. This item does not include transactions executed by central banks for financial stability purposes or transactions aimed at facilitating the transmission mechanism of monetary policy. Similarly, transactions that fall under the state aid schemes approved by the European Commission have not been considered. Public subsidies received: the Group did not receive any public subsidies during 2019.

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 2019" 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 assets, 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, for which the IAS allow the assets which the institute nevertheless decides to recognise at fair value to be classified in that category with the change in 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 Common equity tier 1 (CET1) Capital and 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 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 covered 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 amount 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. Said evaluation 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 regards the interest rate component, deposits in euro and in foreign currency, etc.).

Liquidity risk
The possibility that the entity is 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 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-balance sheet assets (derivatives and guarantees) that are classified and weighted according to different ratios tied to the risks, pursuant to the banking regulations issued by regulatory bodies to calculate the solvency ratios.

GLOSSARY

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

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 eligible subordinated liabilities.

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