Pillar 3 Disclosure

Update as at
30 September 2014

MONTE DEI PASCHI DI SIENA
BANK SINCE 1472

Pillar 3 Disclosure

Update as at
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GRUPPO MONTEPASCHI

Banca Monte dei Paschi di Siena SpA
Company Head Office in Siena, Piazza Salimbeni 3, www.mps.it
Recorded in the Siena Company Register – Registration no. and tax code 00884060526
Member of the Italian Interbank Deposit Protection Fund. Bank Register no. 5274
Parent Company of the Monte dei Paschi di Siena Banking Group, registered with the Banking Groups Register

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Introduction

The New Regulations for the Prudential Supervision of banks and banking groups entered into force as of 1 January 2014. The regulations aim to align national requirements with the changes introduced to the International regulatory framework, particularly the European Union's New Regulatory and Institutional Framework for Banking Supervision.

The new regulatory package, commonly known as the "Basel 3 framework" is governed by the:

- ✓ CRR – Capital Requirements Regulation (EU) 575/2013 of the European Parliament and Council of 26 June 2013 regarding prudential requirements for credit institutions and investment firms, which amends Regulation (EU) 648/2012;
- ✓ CRD IV – Capital Requirements of the European Parliament and Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

The regulatory package includes application criteria, set out in the Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) adopted by the European Commission, upon the proposal of the European Supervisory Authorities.

At national level, the new harmonised framework has been implemented by Bank of Italy with:

- ✓ Circular 285 of 17 December 2013 – Supervisory Provisions for Banks;
- ✓ Circular 286 of 17 December 2013 – Instructions for Prudential reporting for banks and securities' firm;
- ✓ Circular 154 of 22 November 1991 – 55th Update, 30 September 2014 – Supervisory reports of banks and financial institutions. Reporting templates and instructions for transmission of information flows.

The new regulatory framework aims to improve the ability of banks to absorb shocks arising from financial and economic stress, whatever the source, improve risk management and governance and strengthen the bank's transparency and disclosures, while taking into account developments from the financial crisis.

The Basel Committee has maintained a three Pillars-based approach which was at the basis of the previous capital accord known as "Basel 2", but has integrated and strengthened it to increase the quantity and quality of banks' capital base and introduce countercyclical supervisory tools as well as new standards for liquidity risk management and financial deleveraging.

More specifically, Pillar 3 was designed on the notion that Market Discipline can be harnessed to reinforce capital regulation to promote stability and soundness in banks and financial systems.

Pillar 3, therefore, aims to complement the minimum capital requirements (Pillar 1) and supervisory review process (Pillar 2) by developing a set of transparent disclosure requirements which will allow market participants to have access to key, fully comprehensive and reliable information on capital adequacy, risk exposures and risk identification, measurement and management processes.

Public Disclosure (Pillar3) is now governed directly by European Regulation no. 575/2013 of 26 June 2013 of the European Parliament and Council, Part 8 and Part 10, Title I, Chapter 3 (hereinafter referred to as "The Regulations" or "CRR").

The previous Regulations (Bank of Italy Circular 263/06, Paragraph IV) along with the reporting templates and rules provided therein are to be considered no longer applicable.

Under the new regulations, the CRR requires banks to publish information at least on an annual basis along with their financial statements and to evaluate the need to publish some or all disclosures more frequently than once a year depending on their specific activities.

Pending the EBA's release (as required by the CRR) of general guidelines by 31-12-2014 as well as the evaluation by institutions of the need for more frequent disclosure, the Montepaschi Group shall continue to publish its Pillar 3 Disclosure on a quarterly basis, although with different criteria and procedures as set by the CRR.

The current document, therefore, provides an update as at 30 September 2014 of quantitative data contained in the tables regarding the Breakdown of Regulatory Capital and Capital Adequacy, respectively.

For additional information not contained in this document, particularly regarding the general, organisational and methodological aspects relating to the different types of risk, please refer to the Annual Report as at 31 December 2013 or to the Consolidated Half-Year Report as at 30 June 2014.

The current update introduces the new information templates required by the Basel 3 framework and reports pro-forma values as at 31-12-2013, restated solely for comparative purposes.

Pillar 3 Disclosure is prepared at consolidated level by the Parent Company.

Unless otherwise indicated, all the amounts in this report are stated in TEUR (thousand Euros).

The Montepaschi Group regularly publishes its Pillar 3 disclosure on its website at: **www.mps.it/Investor+Relations.**

Own Funds

The introduction of Basel 3 regulations is subject to a transition period that extends the full application of the rules to 2019 (2022 for the phase-out of certain capital instruments) and during which the new rules will be applied in an increasing proportion.

Own Funds, an element of Pillar 1, are therefore calculated according to Basel 3 rules. For this purpose for the New Financial Instruments (NFIs), considered in the context of State aid, is permitted the computability in CET 1 up to 31.12.2017.

For a detailed description of the components of the Own Funds (CET1, AT1, T2) whether with reference to the transitional regime or with the final regime and of NFIs, please refer to the Consolidate interim results of operations as at 30 09 2014. As provided for in Circular 285 of 17 December 2013, in January 2014 MPS Group exercised the option to exclude from CET1 the unrealized profits and losses on exposures with central governments classified in the AFS portfolio, until approval by the European Commission of the IFRS that replaces IAS 39, as a result of the introduction of the CRR according to each country's discretion established as part of the transition requirements by Bank of Italy.

Below are the quantitative information of the Own Funds.

Table 1 – Own Funds

	sep-14	dec-13*
Common Equity Tier 1 (CET1) before the application of prudential filters	11,215,459	9,907,048
↳ *of which tools of CET1 subject to transitional provisions***	*1,071,000*	*4,071,000*
Prudential Filters of CET1 (+/-)	70,990	87,958
Items to be deducted from CET1	2,616,167	3,669,993
Transitional Requirements - Impact on CET1 (+/-)	1,429,975	2,600,577
Common Equity Tier 1 - CET1	**10,100,258**	**8,925,590**
Additional Tier 1 Capital (AT1) before items to be deducted and the effects of the transitional requirements	538,421	539,127
↳ *of which tools of AT1 subject to transitional provisions*	*321,347*	*321,347*
Items to be deducted from AT1	-	-
Transitional Requirements - Impact on AT1 (+/-)	(538,421)	(539,127)
Additional Tier 1 Capital (AT1)	-	-
TIER 1 Capital	**10,100,258**	**8,925,590**
Tier 2 Capital (T2) before items to be deducted and the effects of the transitional requirements	3,503,614	4,307,820
↳ *of which tools of T2 subject to transitional provisions*	-	-
Items to be deducted from T2	66,779	216,616
Transitional Requirements - Impact on T2 (+/-)	(292,737)	(583,412)
Tier 2 Capital (T2)	**3,144,098**	**3,507,792**
Own Funds	**13,244,356**	**12,433,382**

' Recalculated Data accordinding with BIS3 for comparative purposes only*

*'** The aggregate at 30 September 2014 and 31 December 2013 is referred to the amount of the New Financial Instruments.*

As at 30/09/2014 there was a significant capital strengthening compared to the pro-forma BIS3 figure as at 31/12/2013, as a result of the share capital increase of EUR 5 bn successfully completed at the end of June 2014.

The positive effect of this transaction was reduced by the impact deriving mainly from repayment of the first tranche of New Financial Instruments for EUR 3 bn, the loss recorded for the period and capitalised costs associated with the share capital increase.

In the third quarter of 2014 the total amount of Own Funds has registered an increase of 811 mln euro, amounting to 13,244.4 mln euro, compared to 12,433.4 mln euro pro forma year-end 2013.

The increase in the Own Funds is attributable to the increase in Common Equity Tier 1 for EUR 1,174.7 mln, only partly offset by the reduction of Tier 2 Capital (T2) for EUR 363.7 mln.

Common Equity Tier 1 (CET1) increased, amounting to EUR 10,100.3 mln, compared to EUR 8,925.6 mln year-end 2013 pro forma. At the same date, the Tier 2 Capital amounted to EUR 3,144.1 mln, compared with EUR 3,507.8 mln year-end 2013 pro forma.

As at 31 December 2013, the official data - calculated according to the previous regulatory framework - for T1, T2 and regulatory capital was EUR 8,973.1 mln, EUR 3,865.6 mln and EUR 12,838.7 mln, respectively.

Capital Requirements

Capital Management involves all the policies and choices necessary to define the amount of capital and the optimum combination between different alternative equity instruments, so as to ensure that the amount of capital and the correlated ratios are consistent with the risk profile assumed and compliant with regulatory requirements. From this standpoint, group-wide capital management has become increasingly more fundamental and strategic, in consideration of the fact that the quality and sizing of capital resources of Group companies are defined within the Group's more general objectives.

Following the process of Basel 3 regulatory framework implementation, Pillar 1 has been strengthened through a more harmonised definition of capital as well as higher capital requirements. Therefore, next to more stringent capital requirements that more accurately reflect the potential risk of certain activities (e.g. securitisations and trading book), a definition of higher quality capital has been added, essentially focused on common equity. Capital reserves are added to this definition, which function to conserve primary capital, provide counter-cyclical buffers, and hedge against greater losses for systemically important financial institutions. These reserves are envisaged at the discretion of Supervisory Authorities, net of the capital conservation buffer, which is required to be set up and equal to 2.5%.

In addition to the system of capital requirements aimed at covering credit, counterparty, market and operational risk, there is now a plan to introduce leverage caps (including off-balance sheet exposures) as a backstop to capital requirements based on risk and to reduce excessive leverage across the system.

"Basel 3" also introduces new liquidity risk monitoring requirements and tools which focus on short-term liquidity resilience (Liquidity Coverage Ratio - LCR) and longer term structural balance (Net Stable Funding Ratio - NSFR) as well as providing standards for liquidity risk management and monitoring at both individual and system-wide level.

The introduction of Basel 3 regulations is subject to a transition period that extends the full application of the rules to 2019 (2022 for the phase-out of certain capital instruments) and during which the new rules will be applied in an increasing proportion.

Own Funds, elements of Pillar 1, are therefore calculated according to Basel 3 rules implemented in Europe through a comprehensive body of regulations, consisting of the Capital Requirements Regulation (CRR), European Regulation no. 575/2013, and related integrations, by the Capital Requirements Directive (CRD IV), by Regulatory Technical Standards and Implementing Technical Standards issued by the EBA, and by supervisory instructions issued by Bank of Italy (specifically, Circular nos. 285 and 286).

Minimum capital requirements

The following capital requirements are envisaged for 2014:

- CET1 ratio of at least 4.5% of the Group's total risk exposure;
- Tier 1 ratio of at least 5.5% of the Group's total risk exposure; in 2015 the threshold will increase to 6%;
- Total Capital ratio of at least 8% of the Group's total risk exposure.

In addition, the Parent Company must have additional CET1 reserves.

More specifically, the new regulations envisage that banks must have the following reserves:

- *Capital conservation buffer* - aimed at conserving the minimum level of regulatory capital during difficult periods in the market, through the allocation of high quality capital in periods in which there are no market tensions. This reserve is mandatory and must be at least 2.5% of the Bank's total risk exposure. The reserve consists of CET1 capital;
- *Countercyclical capital buffer* - aimed at protecting the banking sector in phases of excessive growth in loans. The buffer provides for the accumulation of CET1 capital during phases of rapid growth in the credit cycle, which can then be used to absorb losses in the downward phase of the cycle. As opposed to the capital conservation buffer, the countercyclical buffer is imposed only during periods of loan growth and is calculated according to pre-established criteria. Supervisory Authorities have not yet defined the amount of this reserve;
- *G-SII buffer* for global systemically important banks and *O-SII buffer* for other systemically important entities - impose higher capital requirements on those entities based on their systemic relevance, at a global or national level, which pose greater risks for the financial system and for which a crisis could have impacts on contributors. The Montepaschi Group falls under the Basel Committee's definition of systemically important banks required to publish indicators according to established methods and times. Thus, as of 2016, the Group will be subject to additional loss absorbency requirements in an amount that will be determined by the Bank of Italy.

Liquidity and Leverage Ratio

In reference to the Liquidity Coverage Ratio, the observation period by the Supervisory Authorities started from March 2014, which precedes the official introduction of this ratio in January 2015. In addition, 31 March 2014 started the observation period for the Net Stable Funding Ratio. These two ratios and the associated minimum requirements will become effective 1 January 2018, upon authorisation of the European Council and Parliament.

The Leverage Ratio is calculated with a denominator that is based on the assets not risk weighted at the end of the quarter. The Leverage Ratio will come into effect in 2018. The transition observation phase will last from 2014 to the end of December 2017.

Capital Adequacy

In reference to defining regulatory requirements, in June 2008, the Montepaschi Group was authorised to use advanced internal rating-based (AIRB) systems for the determination of capital requirements for credit risk in relation to retail and corporate portfolios and Advanced Measurement Approaches (AMA) for operational risks. The company scope to which they apply internal models has been extended over time according to a roll-out plan shared with the Supervisory Board.

The key regulatory impacts of the new framework Basel 3 on capital requirements are associated with the following elements:

- increase in capital requirements associated with deferred tax assets (DTAs) that are not based on future profitability and that derive from temporary differences, which can be transformed into credits and therefore included in RWA with a weight of 100%;
- increase in capital requirements associated with financial equity investments and DTAs (that cannot be transformed into credits) not deducted from CET1 as a result of the exemption, and therefore included in RWA with a weight of 250%;
- increase in the capital requirements associated with the introduction of the Credit Value Adjustment (CVA) as part of counterparty risk;
- decrease of the requirement for credit risk for exposures with SMEs that, within certain limits, benefit from a discount of 24% (SME Supporting Factor);
- elimination of the inclusion of the capital requirement associated with Basel 1 Floor as, according to the new rules, it is no longer expressed in terms of a higher requirement, but rather in terms of a restriction on regulatory capital; this minimum amount of capital to be held cannot be less than 85% of what would be necessary to have a Total Capital ratio of 8%, considering the Basel 1 requirement.

The following table shows information about the capital adequacy highlighted by the Group in accordance with the new patterns of information “Basel 3”.

Table 2 - Capital Requirements and Regulatory Capital Ratios

Regulatory Capital Requirements	sep-14	dec-13*
Credit and Counterparty Risk	**5,098,539**	**5,333,359**
Standardised Approach	2,963,489	2,865,863
Advanced Internal Rating Based Approach	2,135,049	2,467,496
Market Risk	**400,385**	**504,621**
Operational Risk	**676,239**	**659,407**
Foundation Approach	24,186	29,343
Standardised Approach	-	-
Advanced Approach	652,053	630,064
Credit Valuation Adjustment risk	**115,689**	**93,313**
Regulatory Risk	-	-
Concentration Risk	-	-
Total	**6,290,851**	**6,590,700**
Risk-weighted assets	**78,635,640**	**82,383,750**
CET1 Capital Ratio	**12,84%**	**10.83%**
Tier1 Capital Ratio	**12,84%**	**10.83%**
Total Capital ratio	**16,84%**	**15.09%**

** Recalculated Data according with BIS3 for comparative purposes only*

Following the capital increase successfully completed at the end of June 2014 for an amount of 5 bn euro and the simultaneous repayment of 3 bn euro for NFIs, the CET1 ratio and the total capital ratio showed a significant increase, respectively + 201 bp and +175 bp with respect to the 31/12/2013 pro forma, with a value of at 12.84% and 16.84%.

The improvement in capital ratios was also enhanced by the reduction in RWA of approximately -3,75 bn compared to 31/12/2013, amounting to approximately 79 bn euro.

Table 2.1 - Capital Requirement for Credit and Counterparty Risk

Standardised Approach	sep-14
Exposures to Central Governments and Central Banks	393,298
Exposures to Regional Governments and Local Authorities	35,477
Exposures to Non-Commercial and Public Sector Entities	32,662
Exposures to Multilateral Development Banks	-
Exposures to International Organisations	-
Exposures to Supervised Institutions	333,612
Exposures to Corporates and Other Entities	750,265
Retail Exposures	215,785
Exposures Secured by Real Estate Property	58,350
Default Exposures	199,604
High-risk Exposures	9,071
Exposures in the form of Covered Bonds	5,138
Short term Exposures to Corporates and Other Entities	-
Exposures to Undertakings for Collective Investments in Transferable Securities (UCITS)	101,047
Equity Exposures	312,777
Other Exposures	428,886
Securitization Positions	87,518
Total Standardised Approach	**2,963,489**
Advanced Internal Ratings-Based Approach	
Exposures to Corporates	1,300,248
↳ *SMEs*	642,217
↳ Other Companies	658,031
Retail Exposures	834,801
↳ *Secured by real estate - SMEs*	220,237
↳ *Secured by real estate - Individuals*	240,875
↳ *Qualifying revolving*	93
↳ *Other retail exposure - SMEs*	338,054
↳ *Other retail exposures - Individuals*	35,542
Other assets	-
Total Advanced Internal Ratings-Based approach	**2,135,049**
Total Credit and Counterparty Risk	**5,098,539**

Table 2.2 - Capital Requirement for Market Risk

Standardised Approach	sep-14
Position risk on debt instruments	236,450
Position risk on equity	97,697
Foreign exchange risk	55,253
Commodities risk	10,985
Total Standardised Approach	**400,385**
Internal models	
Total Internal models	**-**
Total Market Risk	**400,385**

Table 2.3 - Capital Requirement for Operational Risk

Breakdown of Operational Risk by:	sep-14
Foundation Approach	24,186
Standardised Approach	-
Advanced Approach	652,053
Total Operational Risk	**676,239**

Declaration of the Financial Reporting Officer

Pursuant to para. 2, article 154-bis of the Consolidated Law on Financial Intermediation, the Financial Reporting Officer, Mr. Arturo Betunio, declares that the accounting information contained in this Report corresponds to the underlying documentary evidence and accounting records.

Siena, 12 November 2014

Arturo Betunio
Financial Reporting Officer

List of Tables

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