

Pillar 3 Disclosure

Update as at
31 March 2015



**MONTE
DEI PASCHI
DI SIENA**
BANK SINCE 1472



Pillar 3 Disclosure

Update as at
31 March 2015



Banca Monte dei Paschi di Siena SpA

Company Head Offices in Siena, Piazza Salimbeni 3, www.mps.it

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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 harmonized 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 – 57th Update, 10 March 2015 – 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 transparency and disclosure, 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.

The EBA Guidelines (EBA / GL / 2014/14) of 23.12.2014, on the frequency of Pillar3 publication, confirmed the minimum requirement for all to take out an yearly publication, together with the financial statements, including the possibility that, in accordance with Article 106 of the CRD IV, each National Competent Authority may impose a higher frequency than that provided by the CRR, within their own country, by requiring each bank to do a self-evaluation about the need to provide with

a more frequent disclosure. The current document, therefore, provides an update as at 31 March 2015 of quantitative information deemed most by the Group and in particular the quantitative information concerning Own Funds, Capital requirements and the Leverage Ratio.

For additional information not contained in this document, particularly regarding the general, organizational and methodological aspects relating to the different types of risk, please refer to the Annual Report as at 31 December 2014.

Further information on the risk profile of the Group, based on Art. 434 of the CRR, are also published in the Quarterly Report as at 31 March 2015, in the Report on Corporate Governance and Compensation Report.

The current update introduces the new information templates required by the Basel 3 framework and reports also values as at 31 December 2014.

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.



Executive Summary on Own Funds and Capital Requirements

Data in thousands of euros

Own Funds	mar-15	dec-14	Delta vs. 31-12-2014	
			Absolute	%
Common Equity Tier 1 (CET1)	6,217,301	6,607,509	-390,209	-5.9%
Additional Tier 1 Capital (AT1)	469,680	-	469,680	-
Tier 2 Capital (T2)	2,935,133	3,292,608	-357,475	-10.9%
Own Funds	9,622,115	9,900,117	-278,002	-2.8%
↳ of which Delta PA*	168,943	174,843	-5,900	-3.4%
Capital Requirements				
Credit and Counterparty Risk	4,978,345	5,001,640	-23,294	-0.5%
↳ of which Standardised Approach	2,725,776	2,670,400	55,376	2.1%
↳ of which Airb Approach	2,252,569	2,331,240	-78,671	-3.4%
Market Risk	344,828	289,142	55,686	19.3%
↳ of which Standardised Approach	337,527	286,106	51,421	18.0%
↳ of which Concentration Risk	7,301	3,036	4,265	140.5%
Operational Risk	706,245	708,267	-2,022	-0.3%
↳ of which Foundation Approach	18,585	20,212	-1,627	-8.0%
↳ of which Advanced Approach	687,660	688,055	-395	-0.1%
CVA Risk	79,423	98,579	-19,156	-19.4%
Regulatory Capital Requirements	6,108,841	6,097,628	11,214	0.2%
Risk-weighted assets	76,360,513	76,220,350	140,163	0.2%
			Delta vs. 31-12-2014	
Capital Ratio			in bp	in %
CET1 Ratio	8.14%	8.67%	-53	-0.5%
Tier 1 Ratio	8.76%	8.67%	9	0.1%
Total Capital Ratio	12.60%	12.99%	-39	-0.4%

* The sign of the delta PA is represented, as a positive element or element to be deducted based on the contribution to the determination of the Own Funds. In 2014, the Montepaschi Group shows a surplus of value adjustments to loans compared to expected losses and therefore constitutes a positive element of the Tier2 computable within the limits of 0.6% of RWA due to the method Airb. The positive amount calculable in T2 for 2015 amounts to 168,943 € / thousand (174,843 € / thousand at december 2014) and the aggregate amount of the delta PA amounts to -1,082,360 € / thousand (-981,903 € / thousand at december 2014).

The Total capital ratio and the CET1 ratio were respectively 12.60% and 8.14%, a slight decrease compared to 31 December 2014, they were still higher than the regulatory minimum ratios. The Tier 1 instead is slightly up compared to 31 December 2014, as benefits from the positive buffer arisen in capital Additional Tier 1 (AT1).



3. Own Funds

Regulatory capital, an element of Pillar 1, is 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). 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, calculated according to the transitional arrangements in force, differ from the net equity book value since prudential regulations aim to protect the quality of assets and reduce any potential volatility caused by the application of IAS/IFRS. The items that constitute own funds, therefore, must be fully available to the Group so that they may be used to cover risks and losses without any restrictions. Institutions are, in fact, required to demonstrate the quality and quantity of own funds in compliance with applicable European legislation. The Bank's Own Funds is made up of the following:

- ✓ Tier 1 (T1) capital, consisting of Common equity Tier 1 (CET1) and Additional Tier 1 (AT1);
- ✓ Tier 2 (T2).

For a detailed description of the items included in Own Funds (CET1, AT1, T2) whether relating to transitional or final requirements, and of the NFIs, please refer to the Consolidated interim results of operations as at 31 March 2015. As provided for in Circular 285 of 17 December 2013, in January 2014 MPS Group exercised the option to exclude from CET1 the unrealised 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 following the introduction of national discretion rules provided for by the CRR established as part of the transition requirements by Bank of Italy.

The AFS reserve linked to AFS securities (BTP) related to the Alexandria transaction constitutes a derogation to this regime. More specifically, the ECB, following the Supervisory Review and Evaluation Process (SREP), has requested the inclusion of 100% of unrealised losses on Italian government bonds (BTP) encompassed in the 'Alexandria transaction' for the calculation of the CET 1. In accordance with this request, the entire amount of the negative reserve related to the government bonds that were the subject of the transaction, above mentioned (amounting



to EUR 239 mln as at 31 March 2015, EUR 423 mln as at 31 December 2014) was considered in the CET 1 calculation. Unrealised losses relating to exposures to central administrations classified as AFS and not included in the Capital calculation amount to EUR 41.5 mln. The amount takes into account the treatment of the Alexandria transaction as requested by the Supervisory Authority. Subsequent to the SREP, and as requested by the Supervisory Authorities, the Patagonia vehicle was consolidated, also for prudential purposes. This accounting treatment resulted in a Tier 2 reduction by approximately EUR 88 mln as at 31 March 2015. Patagonia Finance S.A. is a vehicle that issued asset-backed securities (ABS) which were subscribed by insurance companies and pledged as collateral of unit-linked policies. The vehicle invests in subordinated securities issued by BMPS. In light of the above, the treatment adopted on a prudential basis following the ECB's indications represents a deviation from the more favourable general rule, under which the AFS reserve relating to government bonds, until validation of IFRS 9, is not relevant for determining capital. Below are the main features of the financial instruments which are included in Common Equity Tier 1.



Tab. 3.1.1 – Own Funds: Common Equity Tier 1 (CET1) capital

	mar-2015 (A) - Amount at disclosure date	mar-2015 (C) - Amounts subject to pre- regulation (EU) no. 575/2013 treatment or prescribed residual Amount of regulation (EU) No 575/2013	dec-2015 (A) - Amount at disclosure date	dec-2015 (C) - Amounts subject to pre- regulation (EU) no. 575/2013 treatment or prescribed residual Amount of regulation (EU) No 575/2013
Common Equity Tier 1 (CET1) capital: instruments and reserves				
1 Capital instruments and the related share premium accounts	12,288,689		12,297,339	
<i>of which: Ordinary Shares</i>	12,286,398		12,295,049	
2 Retained earnings	-5,543,433		-200,541	
3 Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	-293,039		-557,915	
4 Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	-		-	
Public sector capital injections grandfathered until 1 January 2018	1,071,000		1,071,000	
5 Minority Interests (amount allowed in consolidated CET1)	-		-	
5a Independently reviewed interim profits net of any foreseeable charge or dividend	72,629		-	
6 Common Equity Tier 1 (CET1) capital before regulatory adjustments	7,595,846		12,609,883	
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
7 Additional value adjustments	-41,221		-61,317	
8 Intangible assets (net of related tax liability)	-505,813		-511,727	
10 Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met)	-112,324	-	-66,002	-264,009
11 Fair value reserves related to gains or losses on cash flow hedges	180,524		184,473	
12 Negative amounts resulting from the calculation of expected loss amounts	-		-	
14 Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	-107,600		-124,338	
16 Direct and indirect holdings by an institution of own CET1 instruments				
17 Holdings of the CET1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution	-		-	
18 Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above the 10% threshold and net of eligible short positions)	-23	-58		
19 Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions)	-318,327	-318,327		
21 Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38 (3) are met)	-151,899	-151,899		
22 Amount exceeding the 15% threshold	-262,348	-794,208	-40,844	-264,022
23 <i>of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities</i>	-192,127	-480,318	-29,951	-119,806
25 <i>of which: deferred tax assets arising from temporary differences</i>	-70,221	-313,890	-10,893	-144,217
25a Losses for the current financial year	-	-	-1,068,578	-4,274,314
26 Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment	-431,113		-596,677	
26a Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	-169,037		-10,114	
<i>Of which: unrealised losses on UCITS</i>	1,696		1,084	
<i>Of which: unrealised losses on EU government bonds</i>	41,452		164,334	
<i>Of which: unrealised losses on debt securities</i>	-60,053		-66,335	
<i>Of which: unrealised losses on Equity Investments</i>	-14,641		-10,710	
<i>Of which: unrealised losses on Investments valued at equity</i>	-122,619		-97,217	
<i>Of which: unrealised losses on trading shares</i>	-6,120		-303	
<i>Of which: unrealised losses on exchange differences</i>	-8,751		-967	
26b Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre CRR	70,411		88,014	
27 Qualifying AT1 deductions that exceed the AT1 capital of the institution	-		-3,795,262	
28 Total regulatory adjustments to Common equity Tier 1 (CET1)	-1,378,545		-6,002,373	
29 Common Equity Tier 1 (CET1) capital	6,217,301		6,607,509	



Tab. 3.1.2 – Own Funds: Additional Tier 1 (AT1) capital

	mar-2015 (A) - Amount at disclosure date	mar-2015 (C) - Amounts subject to pre- regulation (EU) no. 575/2013 treatment or prescribed residual Amount of regulation (EU) No 575/2013	dec-2015 (A) - Amount at disclosure date	dec-2015 (C) - Amounts subject to pre- regulation (EU) no. 575/2013 treatment or prescribed residual Amount of regulation (EU) No 575/2013
Additional Tier 1 (AT1) capital: instruments				
30 Capital instruments and the related share premium accounts	209,900		217,073	
31 <i>of which: classified as equity under applicable accounting standards</i>	181,985		189,158	
32 <i>of which: classified as liabilities under applicable accounting standards</i>	27,915		27,915	
33 Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	402,056		321,347	
Public sector capital injections grandfathered until 1 January 2018	-		-	
34 Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	-		-	
35 <i>of which: instruments issued by subsidiaries subject to phase out</i>	-		-	
36 Additional Tier 1 (AT1) capital before regulatory adjustments	611,956		538,421	
Additional Tier 1 (AT1) capital: regulatory adjustments				
37 Direct and indirect holdings by an institution of own AT1 Instruments				
38 Holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution				
39 Direct and indirect holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above the 10% threshold and net of eligible short positions)				
40 Direct and indirect holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above the 10% threshold net of eligible short positions)				
41 Regulatory adjustments applied to additional tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)				
41a Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	-142,276		-4,333,682	
<i>of which: Losses for the current financial year</i>	-		-4,274,314	
<i>of which: significant financial instruments</i>	-142,259		-59,368	
41b Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013	-		-	
41c Amount to be deducted from or added to Additional Tier 1 capital with regard to additional filters and deductions required pre-CRR	-		3,795,262	
42 Qualifying T2 deductions that exceed the T2 capital of the institution	-		-	
43 Total regulatory adjustments to Additional Tier 1 (AT1) capital	-142,276		-538,420	
44 Additional Tier 1 (AT1) capital	469,680		-	
45 Tier 1 capital (T1 = CET1 + AT1)	6,686,982		6,607,509	



Tab. 3.1.3 – Own Funds: Tier 2 (T2) capital

	mar-2015 (A) - Amount at disclosure date	mar-2015 (C) - Amounts subject to pre- regulation (EU) no. 575/2013 treatment or prescribed residual Amount of regulation (EU) No 575/2013	dec-2015 (A) - Amount at disclosure date	dec-2015 (C) - Amounts subject to pre- regulation (EU) no. 575/2013 treatment or prescribed residual Amount of regulation (EU) No 575/2013
Tier 2 (T2) capital: instruments and provisions				
46 Capital instruments and the related share premium accounts	3,016,761		3,182,232	
47 <i>Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2</i>	-		-	
<i>Public sector capital injections grandfathered until 1 January 2018</i>	-		-	
48 Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	-		-	
49 <i>of which: instruments issued by subsidiaries subject to phase out</i>	-		-	
50 Credit risk adjustments	168,943		174,843	
51 Tier 2 (T2) capital before regulatory adjustments	3,185,704		3,357,075	
Tier 2 (T2) capital: regulatory adjustments				
52 Direct and indirect holdings by an institution of own T2 instruments and subordinated loans	-101,574		-5,867	
53 Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution	-		-	
54 Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions)	-245		-	
55 Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions)	-67,067		-68,516	
56 Regulatory adjustments applied to tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	-		-	
56a Residual amounts deducted from Tier 2 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	-81,684		-59,368	
<i>Of which: significant share holdings</i>	-142,259		-59,368	
56b Residual amounts deducted from Tier 2 capital with regard to deduction from Additional Tier 1 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013	-		-	
56c Amount to be deducted from or added to Tier 2 capital with regard to additional filters and deductions required pre CRR	-		69,284	
<i>Of which: unrealised gains</i>	-		69	
57 Total regulatory adjustments to Tier 2 (T2) capital	-250,570		-64,467	
58 Tier 2 (T2) capital	2,935,133		3,292,608	
59 Total capital (TC = T1 + T2)	9,622,115		9,900,117	

**Tab. 3.1.4 – Own Funds: Capital ratios and buffers**

Capital ratios and buffers		mar-2015 (A) - Amount at disclosure date	dec-2015 (A) - Amount at disclosure date
60	Total risk weighted assets	76,360,513	76,220,350
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	8.14%	8.67%
62	Tier 1 (as a percentage of risk exposure amount)	8.76%	8.67%
63	Total capital (as a percentage of risk exposure amount)	12.60%	12.99%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	7.00%	7.00%
65	<i>of which: capital conservation buffer requirement</i>	2.50%	2.50%
67a	<i>of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer</i>	-	-
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	3.64%	4.17%
Amounts below the thresholds for deduction (before risk weighting)			
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	124,338	62,505
73	Direct and indirect holdings by the institution of the CET 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	867,650	919,278
74	Empty set in the EU	-	-
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	799,864	952,131
Applicable caps on the inclusion of provisions in Tier 2			
76	Credit risk adjustments included in T2 in respect of exposures subject to standardized approach (prior to the application of the cap)		
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach		
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	1,082,360	981,903
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	168,943	174,843
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)			
80	Current cap on CET1 instruments subject to phase out arrangements		
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)		
82	Current cap on AT1 instruments subject to phase out arrangements	650,000	401,684
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)		
84	Current cap on T2 instruments subject to phase out arrangements		
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)		

**Tab. 3.2 – Reconciliation of shareholders' equity and the Common Equity Tier 1**

Items	mar-2015	dec-2014
Group Equity	6,471,031	5,965,027
Minority Equity	24,109	23,625
Net Assets of the Balance Sheet	6,495,140	5,988,652
Net Assets after distribution to shareholders		
Adjustments for instruments computable in AT1 or T2		
- Capital share computable in AT1	-181,985	-189,158
- Minority interests computable	-24,109	-23,625
- Own shares included in the regulatory adjustments		
- Other components non computable in regime	177,522	181,471
Common Equity Tier 1 (CET1) before the regulatory adjustments	6,466,568	5,957,340
Regulatory adjustments (including adjustments of the transitional period)	-249,266	650,169
Common Equity Tier 1 (CET1) net of regulatory adjustments	6,217,302	6,607,509



4. Capital requirements and leverage

The capital management activity involves all the policies and choices necessary to define the size of capital and the optimum combination between different alternate capitalization instruments, so as to ensure that the amount of capital and related ratios are consistent with the risk profile assumed to observe regulatory requirements. From this standpoint, Group-wide capital management has become increasingly more fundamental and strategic, taking into account that the quality and sizing of capital resources of the individual companies belonging to the Group are defined as part of the more general objectives of the Group itself.

Following the implementation of the “Basel 3” regulatory framework, Pillar 1 was strengthened through a more harmonised definition of capital as well as higher capital requirements. In the face of 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 is 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 mandatory capital conservation buffer of 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.

Minimum capital requirements

The minimum capital requirements for 2014 are as follows:

- CET1 ratio of at least 4.5% of the Group’s total risk exposure;
- AT1 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.

Additionally, 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 Group falls under the Basel Committee's definition of systemically important banks, required to publish indicators according to the established times and methods. Hence, from 2016, the Group will be subject to additional loss absorbency requirements, the extent of which will be defined by the Bank of Italy.

Capital adequacy

As to the definition of regulatory capital requirements, in June 2008 the Montepaschi

Group was authorised to use the Advanced Internal Rating Based (AIRB) models for the measurement of capital requirements against credit risk in the retail and corporate portfolios and the Advanced Measurement Approach (AMA) for operational risk. In particular, whereas the Montepaschi Group uses the standardised approach ratios for Exposure at default (EAD) pending validation by the Supervisory Authorities, the Group is instead authorised to use:

- Internal Probability of Default (PD) estimates, for the portfolio of exposures to corporates and retail exposures;
- Internal Loss Given Default (LGD) estimates for the portfolio of exposures to corporates and retail exposures.

For portfolios other than those mentioned above, the standardised approach will be used and applied according to the roll-out plan submitted to the Supervisory authorities. As for legal entities, the scope of application of the authorised approaches shall be the following:

- AIRB: Banca Monte dei Paschi di Siena, MPS Capital Services, Banca Antonveneta, MPS Leasing & Factoring;
- the remaining legal entities of the Montepaschi Group use the standardised approach.

Capital requirements in relation to market risk are instead calculated for all Group entities by adopting the standardized approach. Capital ratios for Operational Risk are calculated according to the AMA – Advanced Measurement Approach for an extent equal to 95%. The standardized approach is used for the remaining part



of the scope. Furthermore, in 2014 the ECB performed, in collaboration with the national competent authorities responsible for the supervision of banks, a system-wide Comprehensive Assessment, pursuant to the regulations on the Single Supervisory Mechanism (EU Regulation no. 1024/2013 of the European Council on 15 October 2013), which became effective on 3 November 2013. The results of the Comprehensive Assessment, published by the EBC on 26 October 2014, identified for the MPS Group a shortfall of EUR 2.1 bn. The Bank is required to cover the shortfall within the 9 months following 26 October 2014 and to comply, once the shortfall is made up, with the Total Capital and Common Equity Tier 1 target ratios of 10.9% and 10.2% respectively. The target ratios required by the EBC must be complied, once the shortfall is made up, with at all times when the Authority's Decision is in force. In order to have a capital buffer with respect to the CET1 threshold required under the SREP (10.2%), the Bank's Board of Directors approved a resolution to propose to the Shareholders' Meeting an increase in the amount of the planned capital increase up to a maximum of EUR 3 bn. The rights issue is backed by a pre-underwriting agreement entered into with global investment banks to underwrite – pursuant to standard terms and conditions for a transaction of this nature – the newly issued ordinary shares in respect of which rights were not be subscribed, up to the maximum amount Euro 3 bn. In order to have a capital buffer with respect to the CET1 threshold required under the SREP,

the Shareholders' Meeting of the Parent Company approved a capital increase in the amount up to a maximum of EUR 3 bn. The rights issue is backed by an underwriting agreement. The target ratios required by the EBC must be complied with at all times when the Authority's Decision is in force; similarly, at those times the Bank may not distribute dividends.

The capital adequacy figures illustrated in this report were all calculated by including the positive effect of profit for the period. In this respect, note that based on article 26 of EU Regulation 575/2013, the inclusion among profit of own funds is subject to specific authorisation from the corresponding JST (Joint Supervisory Team) of the ECB, for which the Montepaschi Group has duly made official request.

**Tab. 4 – Capital requirements and capital ratios**

Regulatory Capital Requirements	mar-15	dec-14
Credit risk	4,978,345	5,001,640
Standard Approach	2,725,776	2,670,400
Advanced IRB Approach	2,252,569	2,331,240
Market Risks	344,828	289,142
Standardised Approach	337,527	286,106
Internal Models	-	-
Concentration Risk	7,301	3,036
Operational Risk	706,245	708,267
Foundation Approach	18,585	20,212
Standardised Approach	-	-
Advanced Approach	687,660	688,055
CVA Risk	79,423	98,579
Ordinary Exposure Method (OEM)	-	-
Standardised Approach	79,423	98,579
Advanced Approach	-	-
Settlement Risk	-	-
Regulatory Capital Requirements	6,108,841	6,097,628
Risk-weighted assets	76,360,513	76,220,350
CET1 Capital Ratio	8.14%	8.67%
Tier1 Capital Ratio	8.76%	8.67%
Total Capital Ratio	12.60%	12.99%

The decrease of approx. EUR -390 mln in CET1 was determined by two phenomena of opposite signs:

- a negative effect came mainly from certain regulatory impacts such as the percentage increase of the phasing-in of deductions envisaged in the new Basel 3 regulations (increasing from 20% in 2014 to 40% in 2015) and the 2014 loss coverage from reserves, which at the end of 2014 was included in Additional Tier 1 (AT1) with a total impact of these two phenomena of approx. EUR -735 mln;
- particularly positive effects came from
 - net profit generated in the period for approx. EUR 73 mln ;
 - the decrease in the negative AFS reserve underlying the Alexandria transaction with Nomura for approx. EUR 183 mln;

- the decrease in non-transformable DTAs, tax losses and other prudential filters for approx. EUR 60 mln;
- the positive change in the AFS reserve on the non-government securities portfolio for around EUR 22 mln.

The surplus expected loss compared to the impairment losses on loans remains negative and therefore has no impact on regulatory capital in terms of deductions. Net of regulatory impact (planned increase in the phasing-in and coverage of 2014 losses from reserves previously calculated in AT1), the CET1 consequently shows a positive change of approx. EUR 345 mln.

Tier1 decreased mainly due to the effect of regulatory amortisation of subordinated securities as envisaged in Basel 3. Overall, To-



tal Capital was down by around EUR -280 mln compared to 31 December 2014. RWA remained essentially stable (EUR +140 mln) due to offsetting effects of the increase in credit and market risk and the reduced deductions in excess weighted under RWA.

The CET1 ratio and TC ratio therefore decreased but in any event remain above the regulatory minimum limits, whilst the T1 ratio benefits from the positive buffer created in AT1. Note that the risk weighted assets (RWA) were calculated by taking into consideration the Probability of Default (PD) and Loss Given Default (LGD) benchmarks in force at year end. The benchmark recalibration, all things remaining equal, could lead to an increase in RWA. As the process adopted for estimating and validating these benchmarks ends only after approval of the interim report and as at present the effective value of the benchmarks cannot be quantified with precision, since it depends on changes in performance indicators and, in particular, the rating assignment process, the current and forward-looking figures do not take these potential effects into account. It should also be considered that the effects could be offset, fully or in part, by those deriving from credit portfolio performance in 2015.

The exposure to Nomura, net of guarantees received, was EUR 4,696 mln as at 31 March 2015, higher than the EUR 693 mln of 31 December, mainly due to the increase in counterparty risk on the Long Term Repo transaction (EUR 575 mln) and to the collateral paid against the derivative and repurchase agreement operations (EUR

146 mln), both transactions associated with the “Alexandria” transaction. The increases derive solely from the performance of the market benchmarks underlying the existing transactions (higher market value of the government securities given as guarantees in the repo transaction and the increase in losses on asset swap contracts used to hedge interest rate risk on the security). The exposure represents 48.81% of Own Funds (34.68% as at 31 December 2014) and therefore exceeds the regulatory limit of 25%.

Considering the effects of the aforementioned EUR 3 bn share capital increase to be implemented by the end of June, the ratio would drop to 39.44%.

With regard to the position in question, it should be remembered that with the SREP closure measure notified to the Bank on 10 February 2015 the ECB - as an exception to the “neutralisation” rule for the AFS reserve of government securities envisaged until endorsement of IFRS 9 - ordered MPS to immediately include the negative AFS reserve from the “Alexandria” transaction, EUR -239 mln, in the own funds calculation as the net effect of the gain on the security underlying the repo transaction and the loss on the hedging asset swap.

In relation to this specific treatment, BMPS considers significant the guidance expressed by the EBA, which in responding to a query as part of the public Q&A recently confirmed (on 6 March 2015) that the value of exposures must be consistent with the plus/minus treatment of own funds, stating: “However, in case filters on unrealised gains or



losses in relation to such assets exist..., the exposure value of such assets will need to be adjusted by the amount of the corresponding unrealised losses or gains which have been filtered in or out from own funds respectively...” (Single Rulebook Q&A, 2014_716). Given the prudential treatment requested by the ECB for this exposure and considering the symmetry rule pronounced by the EBA, it is considered that the underlying exposure must consider a level of fair value that takes into account all the components that generate the effects included in the regulatory capital. In view of this, the value of the exposure to Nomura in relation to the Long Term Repo transaction should reduce by around EUR 1,679 million, consistent with the real risk profile of the transaction. As a result of this classification, the exposure to Nomura would drop to approx. EUR

3,000 million. To conclude, taking into account the future share capital increase and the disposal now in progress of certain derivatives for around EUR 200 mln on positions other than “Alexandria”, the total exposure to Nomura would in structural terms fall to within the regulatory limit of 25% of the regulatory capital.

On the forecast effects of the EBA interpretation, BMPS has begun specific discussions with the relevant ECB departments and, pending receipt of the final guidance, has decided at present not to reflect them in the financial reports and regulatory data as at 31 March 2015.

The details of capital requirements broken down by type of risk and regulatory portfolio are reported in the following tables.



Tab. 4.1 – Credit and Counterparty Risk capital requirement

Standard Approach	mar-15	dec-14
Exposures to central governments and central banks	425,819	500,704
Exposures to regional governments and local authorities	35,496	34,147
Exposures to public sector entities	30,371	30,288
Exposures to Multi-lateral development banks	-	-
Exposures to International Organisations	-	-
Exposures to Supervised institutions	408,956	320,196
Exposures to Corporates	655,215	633,173
Retail Exposures	178,630	199,176
Exposures secured by mortgages on immovable property	66,911	54,423
Exposures in Default	266,698	222,053
Exposures associated with high-risk	7,339	6,141
Exposures in the form of covered bonds	17,944	15,985
Exposures to institutions and corporates with a short-term credit assessment	-	-
Exposures to UCITs	78,012	69,695
Equity Exposures	196,521	231,789
Other Exposures	353,813	338,904
Securitization positions	3,456	13,093
Exposures to Central Counterparties in the form of pre-funded contributions to the guarantee fund	595	633
Standard Approach Total	2,725,776	2,670,400
AIRB Approach		
Exposures to or secured by corporates:	1,413,085	1,467,873
- SMEs	722,758	751,742
- Other companies	690,327	716,132
Retail exposures:	839,484	863,367
- secured by real estate: SMEs	227,494	241,168
- secured by real estate: Individuals	206,541	213,701
- Qualifying revolving	72	77
- Other retail exposures: SMEs	374,921	377,765
- Other retail exposures: Individuals	30,455	30,656
AIRB Approach Total	2,252,569	2,331,240
Credit and Counterparty Risk Total	4,978,345	5,001,640

**Tab. 4.2 – Market Risk capital requirement**

	mar-15	dec-14
Position risk on debt instruments	184,161	173,170
Position risk on equity	100,087	75,456
Foreign exchange risk	39,845	29,734
Commodities risk	13,432	7,745
Total Standardised Approach	337,527	286,106
Concentration Risk	7,301	3,036
Total Market Risks	344,828	289,142

Liquidity indicators and Leverage Ratio

With reference to the Liquidity Coverage Ratio and the Net Stable Funding, the observation period, which precedes its official introduction, by the Supervisory Authorities began in March 2014. The introduction of these two indicators and their minimum threshold will be, with the approval of the Council and the European Parliament, as of 1 January 2018. Also in the case of the Net Stable Funding Ratio, the observation period started on 31 March 2014. These two ratios and the associated minimum requirements will become effective 1 January 2018, upon authorisation of the European Council and Parliament. In addition to the system of capital requirements aimed at covering credit, counterparty, market, operational, CVA and regulatory risks, it is expected that Basel 3 will introduce a limit on leverage (including off-balance sheet exposures) with a twofold purpose to limit the accumulation of debt within the banking industry so as to avoid destabilising deleveraging process which may harm the financial system and the economy in general, and to strengthen the system of capital requirements associated with risk with a simple backstop measure that is not based on risk profile.

To this end, Circular no. 285 of 17 December 2013 of the Bank of Italy, “Supervisory Provisions for banks” requires banks to calculate their leverage ratio. The Leverage Ratio is calculated with a denominator that is based on the assets not risk weighted at the end of the quarter. The exposures must be reported net of regulatory adjustments envisaged in the T1 calculation in order to avoid double counting. In fact, items fully deducted from capital do not contribute to the Leverage Ratio and are deducted to the extent of the exposure. The indicator will become binding in 2018, the transition observation phase will take place from 2014 until 31 December 2017. To date, the Supervisory Authorities have not yet determined the minimum Leverage Ratio thresholds. However, as of 1 January, quarterly disclosure has become obligatory in addition to the disclosure requirement already in force. From the first quarter onwards, Banks are required to publish all the data necessary to calculate the indicator: numerator, denominator and leverage ratios (see table 4.3).

In accordance with public disclosure requirements, the basic data necessary for its calculation is provided below.

**Tab. 4.3 - Leverage ratio**

	mar-15
Capital and total exposures	
Tier 1 capital	6,686,982
Total exposures	190,436,373
Leverage ratio	
Basel III leverage ratio	3.51%



Declaration of the Financial Reporting Officer

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

Siena, 08 May 2015

Arturo Bertunio
Financial Reporting Officer



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