Pillar 3 Disclosure

31 December 2009

MONTE DEI PASCHI DI SIENA
BANCA DAL 1472

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Banca Monte dei Paschi di Siena SpA
Company Head Office in Siena, Piazza Salimbeni 3, www.mps.it
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Parent Company of the Monte dei Paschi di Siena Banking Group registered in the Roll of Banking Groups

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Introduction

The existing prudential supervisory framework, commonly referred to as "Basel 2", was developed by the Basel Committee and transposed into European Union Directives 2006/48 and 2006/49.

The Basel 2 framework is based on three mutually underpinning concepts (so called "Pillars").

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.

The purpose of Pillar 3 therefore is to complement the operation of minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2) by developing a set of disclosure recommendations and requirements which will allow market participants to assess key, fully comprehensive and reliable information on capital adequacy, risk exposures and risk identification assessment and management processes.

In Italy, Pillar 3 disclosure is pursuant to Paragraph IV, Chapter 1 of Bank of Italy Circular no. 263 of 27.12.2006 ("New Regulations for the Prudential Supervision of Banks", hereafter "Circular").

Under the Circular, banks that are authorised to use internal methodologies in their assessment of capital requirements for credit or operational risk - as is the case with the Montepaschi Group - are required to publish a quarterly report setting out the specific criteria and methodologies adopted.

The information provided is both qualitative and quantitative and is presented under fourteen synoptic tables as defined in Appendix A, Paragraph IV, Chapter 1 of the aforementioned Circular.

The Pillar 3 disclosure is structured in such a way as to provide as full a picture as possible of the risks assumed, the characteristics of the management and control systems used and the capital adequacy of the Montepaschi Group.

The disclosure is prepared at consolidated level by the Parent Company.

In accordance with the Bank of Italy's Circular Letter 263, calling upon banks to avoid publishing tables without information if not applicable, Table 11 on internal models for Market Risk has not been published since it is non-applicable to the Montepaschi Group at present.

ss otherwise indicated, all the amounts in this report are stated in TEUR (thousands of Euro).

In order to facilitate reading and better clarify certain terminology and abbreviations used in the text, a Glossary can be found at the end of the current document.

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

Table 1 - General Requirements

Qualitative disclosure

1.1 The Risk Management process in the Montepaschi Group

The Montepaschi Group attaches the utmost importance to the process of identifying, monitoring, measuring and controlling risk. The risk management process within the Group was further enhanced in 2009 with the gradual extension of the advanced management and reporting models to the various entities of the Montepaschi Group. Furthermore, following the international financial crisis which gave rise to a further impetus for improving the efficiency of risk management and control systems worldwide, the Montepaschi Group also developed its risk management methods, models and processes.

The fundamental principles of the Montepaschi Group's Risk Management process are based on a clear-cut distinction of the roles and responsibilities of the different functions at first, second and third-levels of control.

The Board of Directors of the Parent company is responsible for defining strategic guidelines and risk management policies at least on a yearly basis and setting the overall level of risk appetite for the Group also quantitatively in terms of Economic Capital. The Board of Statutory Auditors and the Internal Controls Committee are responsible for evaluating the level of efficiency and adequacy of the Internal Controls systems with particular regard to risk control.

Top Management is responsible for ensuring compliance with risk policies and procedures. The Risk Committee of the Parent Company establishes Risk Management policies and ensures overall compliance with the limits defined for the various operating levels. The Risk Committee is also responsible for assessing initiatives for capital allocation and submitting them to the Board of Directors and assessing Regulatory and Economic capital consumption at Group level and for each strategic business area and/or company of the Group as well as the trends of risk-adjusted performance indicators. The Finance Committee of the Parent Company has the task of setting the principles of - and providing strategic guidance for - Proprietary Finance for both the Trading Book and the Banking Book.

Furthermore, it deliberates and submits proposals concerning the interest rate and liquidity risk exposure of the Banking Book and defines Capital Management actions required.

The Internal Controls Area of the Parent Company is responsible for defining the rules pertaining to the internal controls system and ensuring they are applied and complied with.

The Risk Management Area of the Parent Company defines integrated analysis methodologies needed to measure overall risks so as to guarantee they are accurately measured and constantly monitored. It also quantifies Economic Capital consumption as well as the minimum amount of capital to be held to cover all existing risks. The Area produces control reports and ensures compliance with the operational limits set by the Board of Directors on the basis of internally-developed models.

At the end of October 2009 the Risk Management Area also took on the responsibility of measuring, monitoring and controlling risk relating to investment services/products offered to or held by the Group's customerbase, a task which had previously been assigned to the Wealth Risk Management service under the Consumer banking division.

The Business Control Units (BCUs), which are internal to the business and operating units of the Parent Company and Group subsidiaries, carry out conformity checks on the transactions they are responsible for and are the first level of organisational supervision of operations within the more general system of Internal Controls.

From an overall organisational and governance point of view with regard to Group risk, it should be noted that in the first half of 2009, the Risk Management Area was put under the direct responsibility of the Chief Executive Officer and the Chairman of the Board of Directors while maintaining a functional connection with the CFO also. The change was in alignment with regulatory dispositions and international best practices and aims at guaranteeing greater autonomy and forcefulness to risk management actions and to the effectiveness of the entire risk management and control process. As a consequence of the re-allocation, new risk information flows were designed for the Group's Top Management (Chairman, CEO and Internal Controls Committee) and for the Board of Directors in addition to already-existing

reporting flows.

The main types of risk incurred by the Montepaschi Group in its day-to-day operations can schematically be presented as follows:

- credit risk,
- counterparty risk,
- issuer risk,
- concentration risk,
- market risk (price, interest rate and foreign exchange) in relation to the Trading Book,
- interest rate risk for the Banking Book (Asset & Liability Management - ALM),
- liquidity risk,
- equity investments risk,
- UCITs risk (alternative funds),
- operational risk,
- business risk,
- real-estate risk,
- reputational risk.

In accordance with the principles contained in the New Accord on Capital Adequacy (Basel 2) in relation to First Pillar risks, in the first half of 2008, the Montepaschi Group completed its work on the internal models for credit and operational risks. Pursuant to Circular Letter 263/2006 of the Bank of Italy, on 12 June 2008 the Montepaschi Group was officially authorised to use the advanced models for the measurement and management of credit risk (AIRB - Advanced Internal Rating Based) and operational risk (AMA - Advanced Measurement Approach) as of the first consolidated report at 30-06-2008.

Throughout 2009 work continued on the completion and extension of these models to those entities not included in the initial scope of validation. With a more specific regard to operational risk, the use of the AMA model was extended to Banca Antonveneta leading to significant improvements in efficiency in terms of economic and regulatory capital.

Furthermore, activities continued in relation to Second Pillar compliance. The first quarter of 2009 saw the completion of methodological and organisational activities aimed at coordinating the optimization and control of all processes relating to the ongoing self-assessment of the Group's internal Capital Adequacy Assessment Process (ICAAP).
As per regulations a comprehensive report (ICAAP document) was prepared in April and submitted to the Supervisory Authority.
With regard to the Third Pillar, the Montepaschi Group, as a class 1 bank under Su-

pervisory classifications, fulfilled the obligation of quarterly disclosure as instructed in Supervisory regulations. In order to ensure compliance with the disclosure obligations set forth in the regulations, specific planning initiatives were put forth with the objective of optimizing the drafting and timely publication of the document as well as the relevant organisational and control processes. The work group, coordinated by the Risk Management Area, under the responsibility of the relevant manager in charge, has seen the cooperation of all the Group's main functions.

The report is published on the Montepaschi Group website and is regularly updated on the basis of the currently regulatory framework.

1.2 Organisation of the Risk Management Area

The Risk Management Area (ARM) is responsible for centralized operation of the Group's risk management system and verifies the overall risk profile as well as compliance with - and the adequacy of - the mitigation measures adopted. It carries out controls according to the "Bank of Italy - Consob regulations" regarding the organisation of intermediaries and compliance with the prudential supervisory regulations of the Bank of Italy. Moreover, the Risk Management Area develops and implements the risk measurement and control system to determine the economic and regulatory capital (in relation to validated internal models) by different types of risk and supplies information to the business units, the Board of Directors and Top Management through appropriate reporting systems.

The Risk Management Area reports directly to the CEO and has a functional connection with the Board of Directors and the CFO.

Autonomy and independence are assured through relational mechanisms and functional connections with the corporate bodies having functions of strategic supervision, management and control, in particular through:

- the appointment/revocation of the Head of Risk Management of the Par-

ent Company and the Heads of the relative Services by the Board of Directors against proposal of the Chairman who is advised by the Areas of Human Resources and Organisation & Logistics, upon prior opinion obtained from the Internal Controls Committee;

- definition of the remuneration structure for the Head of Risk Management and the Heads of the related units by the Board of Directors against the proposal of the Chairman, who is advised by the Areas of Human Resources and Organisation & Logistics, upon prior opinion obtained from the Internal Controls Committee.

A Risk Disclosure function (under the responsibility of the Area Manager), a Credit Risk, ALM and Liquidity Management function, a Market Risk Management function and an Operational Risk Management function all report directly to the **Risk Management Area of the Parent Company** (hereinafter RMA) in the form of three separate "Services".

- **Risk disclosure** has the task of:
  - compiling and coordinating the Group's Basel 2, Pillar 3 disclosure as required by Supervisory regulations, with the support of Financial Accounting, Planning and other related functions of the Group;
  - compiling and submitting the sections relating to overall internal capital and risk management for the preparation of the Quarterly, Mid-year and Annual reports of both the Parent Company and the Subsidiaries;
  - producing and coordinating reports on management risk for the Board of Directors, the Chairman, the CEO, the CFO, the Internal Controls Committee, Top Management and the Risk Committee of the Parent Company;
  - preparing material for meetings with rating companies and supporting Investor Relations in risk management issues;
  - supervising the production of operational risk reports drawn up by the various divisions within the Risk Management Area, supporting the business of the Parent Company and the Subsidiary companies.
- **Credit risk, ALM and Liquidity Management** has the task of:
  - defining, developing and updating

models (PD, LGD, EAD) for the measurement of credit risk monitoring the internal model in compliance with qualitative and quantitative requirements provided for by the Supervisory Authorities;

- monitoring credit VaR measurements for each single business unit and at Group level;
- quantifying the effects on expected and unexpected loss on credit risk and therefore on absorbed economic capital of the Group portfolio and of the single business and proposing any corrective actions, taking into account any effects on mitigation actions;
- determining the internal capital measure used to calculate the risk-adjusted performance measures;
- defining, developing and updating models for the measurement of risks inherent in the interest rate and liquidity risk profile of the banks of the Group (ALM Banking Book);
- measuring the interest rate and liquidity risk exposures, verifying the compliance with any operational threshold limit value and activating the appropriate initiatives aimed at an overall optimisation, also in consideration of adequate scenario analyses;
- quantifying the scenario analyses and stress tests on credit, ALM and liquidity;
- developing and maintaining the methodologies used for identifying and mapping the relevant and non-relevant risks of the Group, both by each business unit and by legal entity, for the purposes of risk integration and support to the ICAAP process;
- defining, developing and updating the risk integration models used to quantify the overall Economic Capital;
- developing and implementing, from an operational point of view, Pillar 2 stress and scenario testing methodologies, supporting and coordinating forecast scenario methodologies for the ICAAP process ;
- supporting the calculation of operational economic capital absorbed by legal entity, business unit and at Group level.

- **Market risk management** has the task of:
  - defining, developing and updating the methodologies underlying

the various internal management models inherent in the Group's market and counterparty risk profile, in coordination with the business control units (BCUs) of the individual business units for the appropriate methodologies to be shared;

- monitoring and validating the production of market and counterparty risk measurements for each business unit, Group company and for the Group as a whole;
- defining the structure of operating limits on market and counterparty risk in compliance with the Group's risk measurement system and for the purpose of financial instruments holding, by verifying the methodological alignment of their overall structure with the Group's risk objectives;
- monitoring the limits established by the Board of Directors of the Parent Company in relation to market and counterparty risk at all delegated levels and verifying the application of corrective actions taken due to any mismatches or other vulnerable factors that emerge when monitoring risk;
- steering and coordinating market risk control activities relating to first level BCUs in compliance with the guidelines set out on financial controls within the Group;
- defining risk assessment and valuation methods for new financial instruments (product approval process);
- defining, determining and validating the methodologies chosen for aspects relating to the fair value of financial instruments traded by Group: valuation models, usage criteria and hierarchy of pricing sources, rules, sources and methodologies for feeding market parameters, criteria and rules of classification into the fair value hierarchy;
- controlling and validating the designation at fair value of financial instruments contained in the supervisory trading book and in the financial assets of the banking book;
- controlling and validating the market parameters used to assess and measure risk related to the financial instruments held by the Group;
- validating P&L data at mark-to-market on the basis of fair value control activities carried out di-

rectly and first-level control activities carried out by the BUCs of the single business units;

- defining, developing and updating the internal models as per regulations with regard to market risk in the Supervisory Trading Book and in the internal model of counterparty risk exposure in compliance with qualitative and quantitative requirements set out by the Supervisory Authorities;
- quantifying market risk scenario analysis and stress tests.

- **Operational Risk Management** has the task of:
  - defining, developing and updating the operational risk measurement models, monitoring the internal model in compliance with the qualitative and quantitative requirements set out by the Supervisory Authorities;
  - coordinating the data collection process for operational losses, the risk assessment process as well as the process used to identify the more critical operational areas on the basis of scenario analyses;
  - monitoring the measurements of internal capital in relation to operational risks for each business unit and globally for the Group (Operational VaR);
  - measuring the effects of the Group's operational-risk mitigating transactions on absorbed economic capital;
  - defining, implementing, managing and updating the mathematical/statistical algorithms underlying the various measurement models and quantifying the scenario analyses and stress tests on operational risks;
  - carrying out the process for the validation and preparation of the final report for the Operational Risk internal model, to be submitted to the Risk Committee for approval;
  - defining and developing risk valuation models and methodologies for investment products/services offered to or held by customers, both for purposes of internal and external regulatory compliance as well as customer service;
  - defining and developing methodologies for verifying the appropriateness/adequacy of investment products/services, both for purposes of regulatory compliance as

well as a risk management service for customers as part of investment advisory services;

- assessing and updating the risk profile of the individual investment products/services offered to Group customers, certifying assessment of related financial, operational and reputational risks.
- Identifying, measuring and monitoring reputational risk for the Group inherent in investment products/services offered to customers.

The Risk Management Area of the Parent Company as at 31.12.2009 consists in 48 resources overall. Human resources have an average age of 36 and an average seniority in the banking sector of approximately 7-8 years. Resources show to have taken internal professional paths that are also outside the risk management area with significant experience gained in credit, finance, planning and sales for the Group. In terms of academic background, there is a prevalence of degrees in Economics/Banking/Business related subjects (59%), followed by degrees in Mathematics/Statistics (21%), Engineering (8%), Physics and IT (6%) and other degrees (6%). Approximately one fourth of resources hold a post-degree qualification (Masters or PhD) or an international professional certification (e.g. FRM certification issued by GARP).

1.3 Credit risk

The Budgeting, Planning, Capital and Risk Management processes of the Montepaschi Group are based on the "Risk Adjusted Performance Management" (RAPM) logic. In the development of these management processes, the definition of adequate credit policies - under the responsibility of the Parent Company's Credit Management Area - plays a relevant role which finds its operational expression in the implementation of the strategies (i.e. credit portfolio quality objectives), to be applied to the credit processes. The Montepaschi Group's strategies in risk management mainly aim at limiting the economic impact of insolvency on the credit portfolio, exploiting, in particular, the full potential of the internal rating models and loss estimates in the case of insolvency. Strategies are defined on a yearly basis, except otherwise provided for under exceptional circumstances due to external conditions, and are identified for

two main areas:

- loan disbursement strategies (definition of quality targets for access to credit);
- credit monitoring strategies (definition of minimum quality targets for maintenance of the loan disbursed).

The definition of customer acceptance policies, based on the analysis of the customer's prospective solvency, plays a major role in loan disbursement strategies. Only after having identified the customer with the required creditworthiness are other credit risk mitigation factors (guarantees) taken into account. The information on client quality and transaction risk is essential in identifying the decision-making body for loan granting.

The follow-up strategies are based on systems used to detect monthly changes in the customer's risk profile. The identification of events likely to affect the credit risk triggers a set of obligations for the commercial network, who is assigned the key task of keeping communication channels with the customer open and obtaining all useful information needed to verify the changes in the risk profile. If changes are confirmed, the client account manager is supported by personnel specialized in credit quality management and by legal staff to define the credit risk management procedures required.

The quantitative identification of credit risk is mainly applied, at operational level, to the measurement of the risk adjusted return of each individual operating unit. This process is carried out with management control instruments. The credit risk identification and quantification instruments allow the Montepaschi Group to define hedging policies mainly consisting of defining "risk-adjusted pricing" which includes risk coverage and capital return planning.

Risk mitigation policies are defined in the Credit Risk Mitigation (CRM) process, whereby the legal, operational and organisational conditions necessary to use collateral guarantees for credit risk-mitigation purposes are identified and met. Three sets of guarantees complying with mitigation requirements are defined in the process: Personal securities, Financial collaterals and Mortgage collaterals. Other types of credit protection guarantees do not mitigate credit risk. With a specific regard to collaterals, a system has been developed to monitor the value of the collateralized asset, based on the measurement of market value

(daily for securities and annually for real estate). Within the credit-granting process, the Montepaschi Group has adopted a risk-adjusted system for borrower identification, which is sensitive to the customer's rating and to the presence of collaterals. Should the value of the collateralized asset be subject to market or foreign exchange rate risk, a "safety margin" is used, i.e a percentage of the current value of the collateral pledged, which is a function of the volatility of the collateralized asset. In the authorizing stages, only the part of the financing covered by the value of the asset net of the safety margin is considered as guaranteed. In the monitoring stages, an adjustment is required on guarantees for which the market value results as being lower than the authorised value net of the safety margin; notification of this step is channelled into the implementation process of the credit monitoring strategies.

Credit risk management policies and disbursement processes are governed by Group directives.

In terms of Credit risk measurement models, credit risk is analysed using the Credit Portfolio model, which was developed internally by the Risk Management Area of the Parent Company and produces detailed outputs in the form of traditional risk measures such as Expected Loss, Unexpected Loss and inter-risk diversified Economic Capital over a time horizon of one year and a confidence interval calibrated to the official rating assigned to the Montepaschi Group.

There are several inputs: Probability of default (PD), Loss Given Default (LGD) rates, number and types of guarantees supporting the lending relationship, internal management Exposure at Default (EAD) coefficients and correlation matrices. The latter component, which is based on internal estimates (and which is periodically fine tuned in order to introduce more advanced measurement methods), makes it possible to quantify, for individual positions, the diversification/concentration components among the positions contained in the portfolio. The economic capital calculation approach is based on Credit-VaR metrics and uses methods consistent with the best practices in the industry. The portfolio model's output provides detailed measures for individual positions as well as the absorbed operating capital component and indicates the impact of diversification as compared to a building-block approach. The model makes it possible to show the change in credit risk over time, based on

various ways of aggregating the variables to be analyzed: by legal entity, customer type, geographic area, economic sector, rating class and continental area.

Other information derived from the Credit Portfolio Model concerns "what-if" analyses produced for certain discriminating variables such as the Probability of default, LGD rates, changes in the value of collaterals and in margins available on the lines of credit in order to quantify the levels of Expected Loss and Economic Capital if the underlying (hypothetical or historical) assumptions prove to be true.

In accordance with the provisions of the Second Pillar of Basel 2, the Montepaschi Group is committed to the continuing development of methodologies and models in order to assess the impact on the loan portfolio of stress conditions produced using sensitivity analyses with respect to individual risk factors or through scenario analyses.

For further information, especially regarding the internal AIRB model, please refer to Table 7.

1.4 Operational risk

The Montepaschi Group has adopted a management system for operational risk, with the aim of guaranteeing effective risk prevention and mitigation measures. The management system consists in a structured process which identifies, assesses and monitors operational risks. This process is defined in the Group's Directive on the Management and Control of Operational Risk.

The management system adopted by the Group is divided into the following macro-processes:

- identification,
- measurement,
- monitoring,
- management and control,
- maintenance,
- internal validation,
- review.

Each process is clearly documented and is subject to the responsibility of a specific corporate unit.

The organisational units of the various companies controlled by the Group are also involved in the processes.

Corporate policies and procedures assign the task of operational risk control to the Risk Management Area. To this end, the Operational Risk Service has been set up within this Area and is responsible for:

- defining, developing and updating operational risk management and measurement systems;
- coordinating data collection and storage systems;
- the reporting system;
- assessing the operational risk profile and measuring the relative capital adequacy requirements at both individual and consolidated levels.

The management and measurement model designed and implemented by the Montepaschi Group incorporates the following four components:

- internal data on operational loss of;
- external data on operational loss of;
- factors regarding the operating context and the internal controls system;
- scenario analyses.

The classification of this data adopts the event and business line model established by Basel 2 and adds further classifications such as process, organisational unit, geographical area etc. The bank has defined a Loss Data Collection (LCD) process aimed at collecting and storing the data on operational risk: this includes both the information relating to the four components strictly provided for by the measurement system and other information considered significant for management purposes.

The Loss Data Collection process has been designed to ensure that data is complete, reliable and up-to-date and, therefore, that the management and measurement system using it is effective. The single operational risk management application and the related database are also subject to business continuity and disaster recovery plans.

As far as the external data on operational loss is concerned, the Montepaschi Group has opted for a strongly prudential approach. External data derives from the Italian Operational Losses Database (Italian: DIPO) consortium to which the Montepaschi Group has belonged since its founding in 2003. In addition to the complete

utilization of external loss data, the DIPO is also used for methodological purposes and for resolving any doubts in interpretation.

The analysis of contextual and control factors identifies the operational vulnerabilities to which the bank is exposed. For the purpose of granularity of the analysis, which is carried out with the individual process owners through annual self assessments of operational risk control the identification of vulnerabilities is a prospective evaluation aimed at highlighting the difficulties inherent in day-to-day operations.

Lastly, the Montepaschi Group carries out scenario analyses for its Top Management on a yearly basis: the forward-looking analyses are aimed at measuring - in terms of capital - exposure to individual vulnerabilities with a view to capturing the developments in the business and organisational framework.

To ensure the correct application of this methodology and its compliance with current regulations, the operational risk internal validation process has been allocated to the Risk Management Area. The quality of the operational risk management and measurement systems is assessed on an ongoing basis as is their compliance with regulatory provisions, company needs and trends in the market of reference. Within this framework, it is also particularly important not only to verify the reliability of the methodology used in the calculation of capital adequacy, but also to ascertain the actual use of this system in decision-making processes as well as in the daily operational risk management systems.

Furthermore, the Risk Management Area is in charge of producing reports on the operational risk measurement and control system, both for the internal units and for the Supervisory Authorities. Each macro-process in which the system is structured produces its own report within a widerreporting framework. By defining a grid of contents, recipients and the frequency of updates, the objective of this activity is to ensure timely horizontal and vertical communication of information on operational risks among the different corporate units concerned.

Corporate regulations allocate the activity of internal review to the Internal Controls Area. This consists in periodic checks on the overall functioning of the Montepaschi Group's operational risk management and control systems, so as to achieve an inde-

pendent and organic assessment in terms of efficiency and effectiveness. Once a year, the Internal Controls Area compiles a report updating the various company entities on the revision activities executed, specifically highlighting the vulnerabilities identified, the corrective measures proposed and the related findings.

For further information on Operational Risk, please refer to Table 12.

1.5 Market Risk in the Trading Book

The Montepaschi Group's Regulatory Trading Book (RTB), simply Trading Book, is made up of all the Regulatory Trading Portfolios managed by the Parent Company (BMPS), MPS Capital Services (MPSCS) and to a residual extent by BiverBanca and the Irish subsidiary Monte Paschi Ireland. The addition of Banca Antonveneta to the Group in 2008 had no effect on the scope of the trading book since the management approach used called for centralising all market risks at BMPS and MPSCS. The portfolios of the other commercial subsidiaries are immune to market risk since they only contain their own bonds held to service retail customers. Operations involving derivatives, which are brokered on behalf of the same customers, also call for risk to be centralised at, and managed by MPSCS.

Market risks of the trading book are monitored for Value-at-Risk (VaR) management purposes of, both in relation to the Parent Company and the other Group companies which are relevant as independent market risk-taking centres.

The Group's Finance Committee is responsible for directing and coordinating the overall process of managing the Group's proprietary finance thereby ensuring that the management strategies of the various business units are consistent.

Market risk assumption, management and monitoring are governed Group-wide by a specific resolution approved by the Board of Directors.

The Montepaschi Group Trading Book is subject to daily monitoring and reporting by the Risk Management Area of the Parent Company on the basis of proprietary

systems. VaR for management purposes is calculated independently from the trading units, using the internal model of risk measurement implemented by the Risk Management Area in keeping with international best practices.

The Group uses the standardised methodology in the area of market risk solely for reporting purposes.

Operating limits to trading activities, which are established by the Board of Directors of the Parent Company, are expressed by level of delegated authority in terms of VaR, which is diversified by risk factors and portfolios, and in terms of monthly and annual Stop Loss. The limits are monitored on a daily basis.

In particular, the Trading Book's credit risk in addition to being included in VaR computations and in the respective limits for the credit spread risk component, is also subject to specific operating limits for issuer and bond concentration risk which specify maximum notional amounts by type of guarantor and rating class on all investments in debt securities (bonds and credit derivatives).

VaR is calculated with a 99% confidence interval and a holding period of 1 business day. The Group adopts the method of historical simulation with daily full revaluation of all basic positions, out of 500 historical entries of risk factors (lookback period) with daily scrolling. The VaR calculated in this manner takes account of all diversification effects of risk factors, portfolios and types of instruments traded. It is not necessary to assume, a priori, any functional form in the distribution of asset returns, and the correlations of different financial instruments are implicitly captured by the VaR model on the basis of the combined time trend of risk factors. The daily management reporting flow on market risks is periodically transmitted to the CEO, the Risk Committee, the Chairman and to the Board of Directors of the Parent Company within the Risk Management Report, which keeps Top Management and other senior management areas up to date on the overall risk profile of the Montepaschi Group.

The macro-categories of risk factors covered by the Internal Market Risk Model are as follows:

- interest rates on all relevant curves and relative volatilities;
- share prices, indexes, baskets and relative volatilities;

- exchange rates and relative volatilities;
- credit spread levels.

VaR (or diversified or net VaR) is calculated and broken down daily for internal management purposes, including with respect to other dimensions of analysis:

- organisational/management analysis of portfolios,
- analysis by financial instrument,
- analysis by risk family.

It is then possible to assess VaR along each combination of these dimensions in order to facilitate highly detailed analyses of phenomena involving the portfolios.

The following risk factors have been identified: Interest Rate VaR, Equity VaR, Forex VaR and Credit Spread VaR. The algebraic sum of these components produces the so-called Gross VaR (or non-diversified VaR) which, when compared with diversified VaR makes it possible to quantify the benefit of diversifying risk factors resulting from holding portfolios with asset class and risk factor allocation which are not perfectly correlated. This information can also be analysed along all the dimensions referenced above.

The model enables the production of diversified VaR metrics for essentially the entire Montepaschi Group in order to get an integrated overview of all the effects of diversification that can be generated among the various banks on account of the specific joint positioning of the various business units.

Lastly, scenario and stress-test analyses are regularly conducted on various risk factors with different degrees of granularity.

1.6 Counterparty risk

Counterparty risk is linked to potential losses due to the default of counterparties in financial transactions prior to settlement and to financial instruments which have a positive value upon insolvency of the counterparty. The financial instruments which point to this kind of risk:

- generate an exposure that is equal to their positive fair value;
- have a market value which evolves over time depending on underlying market variables;

- generate an exchange of payments or an exchange of financial instruments or goods against payment.

The prudential treatment of Counterparty Risk is applied to the following types of financial instruments:

- credit and financial derivative instruments traded Over The Counter (OTC derivatives);
- Securities Financing Transactions (SFTs) such as: repos and reverse repos on securities or commodities, securities or commodities lending or borrowing transactions and borrowing on margin;
- long settlement transactions (LST) such as: forward transactions in which a counterparty commits to delivering (receiving) a security, commodity or foreign currency against receipt (delivery) of cash payment, other financial instruments or goods with settlement upon a pre-established contractual date, later than the one determined by market practice for these types of transaction.

The scope of measurement for Counterparty Risk includes all banks and subsidiaries belonging to the Group and refers to positions held in the Banking Book and the Trading Book.

As referred to in the Supervisory Regulations, when measuring exposure to Counterparty Risk, the Montepaschi Group adopts the regulatory current exposure method to determine the Exposure at Default (EAD) for OTC and LST transactions and the comprehensive approach to calculate EAD for SFT transactions.

For further quantitative details on Counterparty Risk, please refer to Table 9.

1.7 Interest Rate risk in the Banking Book

The term "Banking Book" refers, in accordance with International best practices, to all of the non-trading operations of the Bank in relation to the transformation of maturities with respect to balance-sheet assets and liabilities, Treasury, foreign branches and hedging derivatives. The scope of the Banking Book (in line with that for the regulatory book) and the ALM centralisation are defined in a resolution by the Board of Directors of the Parent Bank which sets rules for centralized Asset & Liability Management

and operating limits for the interest rate risk of the Group Banking Book.

The Banking Book also contains active bonds held for investment purposes, posted to the accounts as AFS or L&R. The same ALM interest rate risk measurement metrics, used for the other accounts, have also been extended to this aggregate.

The operational and strategic choices for the Banking Book, adopted by the Finance Committee and monitored by the Risk Committee of the Parent Bank, are based first on exposure to interest rate risk by a variation in the economic value of the Banking Book assets and liabilities that is calculated by applying a parallel shift of 25bp, 100bp and 200bp, the latter in accordance with in the requirements set out in the Second Pillar of Basel 2.

The Group adopts a system of interest rate risk governance and management which, in accordance with the provisions of the Regulatory Authority, avails itself of:

- a quantitative model, on the basis of which the exposure to interest rate risk of the Group and the individual companies/ entities thereof is calculated, in terms of risk indicators;
- risk monitoring processes, aimed at ongoing verification of compliance with operating limits assigned to the Group overall and to the individual business units;
- risk control and management processes, geared toward bringing about adequate initiatives for optimising the risk profile and activating any necessary corrective actions.

For further details on the methodologies developed in relation to the interest rate risk in the Banking Book (Banking Book ALM) and related quantitative findings, please refer to Table 14.

1.8 Liquidity Risk

The Montepaschi Group structurally addresses Liquidity Risk with a formal LR management policy which also complies with the Basel 2, Pillar 2 requirements.

The Group adopts a governance and management system for liquidity risk which, in accordance with the provisions of the Regulatory Authority, pursues the following objectives:

- ensure the solvency of the Group and all its subsididaries, both under the normal course of business as well as in crisis conditions;
- optimise the cost of funding in relation to current and future market conditions;
- adopt and maintain risk mitigation instruments.

Within the above system, the following responsibilities are centralised in the Parent Bank:

- definition of the Group's policies for liquidity management and control of the respective risk;
- coordination of the implementation of these policies at companies included within the scope in question;
- governance of the Group's short-, mid- and long-term liquidity position, both overall and at individual company level, through centralised operational management;
- governance and management of liquidity risk, both short- and long-term, ultimately guaranteeing the solvency of all subsidiaries.

In its governance function, the Parent Bank therefore defines criteria, policies, responsibilities, processes, limits and instruments for managing liquidity risk, both in business as usual and in liquidity stress and/or crisis conditions, formalizing the Group's Liquidity Policy and Liquidity Contingency Plan.

The Group Companies included in the scope of application, to the extent that they exhibit a liquidity risk deemed significant, are responsible for abiding by the liquidity policies and limits defined by the Parent Bank and the capital requirements set by the relevant Regulatory Authorities.

The overall structural liquidity profile is monitored on the basis of quantification of mismatches, by settlement date, of maturing cash flows. Items of an optional nature have representative models consistent with those used for interest rate risk.

The planning of the funding policies Group-wise (Funding Plan) is coordinated and directed by the Treasury and Capital Management Area (in cooperation with the Planning Area), which:

- submits the plan of the initiatives on the financial markets to the Finance Committee for approval, with the aim of achieving the objectives set out in the business plan and in accordance with capital management requirements;

- coordinates access to domestic and International long- and short-term capital markets for all the banks belonging to the Group, as well as access to the European Central Bank re-financing transactions and centralised management of statutory reserves;
- makes projections on future liquidity on the basis of different market scenarios.

1.9 Equity investment risk

The instrument used to measure the price risk of the Montepaschi Group's equity investments portfolio is Value-at-Risk (VaR). The VaR model used (contrary to the one used for the Trading Book) is a parameter model based on the traditional variance-covariance matrix approach.

To estimate price volatility, time series of market yields for listed companies and time series of sector-based indices for unlisted ones are used. The VaR of the equity investment portfolio is determined with a confidence interval of 99% and a holding period of 1 quarter, in line with the mid-long term holding periods of positions.

Moreover, the above-described model, developed and maintained by the Risk Management Area of the Parent Company, makes it possible to measure the marginal risk contribution of each equity investment and to disaggregate the measurement made from the Group's perspective with respect to the investment shares held by each Legal Entity.

Risk analysis results are regularly entered in the risk reporting flow generated by the Risk Management Area and are submitted to the Parent Company's Risk Committee and Top Management.

1.10 Business risk

Business Risk is a particular realm within Strategic Risk. Using an internally-developed model, the Montepaschi Group constantly measures Business Risk, which is included in the calculation of the Group's Overall Internal Capital.

The main risk factors are identified in the:

- revenue volatility (particularly decreases); the item Net income from banking activities is used as a proxy;
- cost volatility (particularly increases); the item Operating Expenses is used as a proxy.

The algebraic sum of these two items is the Operating Income; this indicator is illustrative of the Group's earning capacity.

On the basis of these considerations, it is possible to define Business Risk as the volatility of the Operating Income, with a particular focus on the non-perfect correlation between net income and expenses. Indeed, the Economic Capital used to mitigate Business Risk is calculated as the capital required to cover the maximum mismatch between Net Income from banking activities and Operating expenses, assuming a sudden reduction in Net Income and an unexpected upturn in Expenses.

Internal Capital to face Business Risk is calculated on the basis of the Group's Operating Income (namely an indicator for the Bank's profitability) using an Earnings at Risk (EaR) parametric approach.

The time series of this indicator is provided monthly by the Operational Planning Area on the basis of data from the Consolidated Balance Sheet. The Economic Capital is quantified by the Risk Management Area of the Parent Company.

1.11 Real estate risk

Real estate risk is the risk of incurring potential losses arising from unexpected changes in the value of the real estate portfolio as a result of the real estate market performance in general. The Risk Management Area believed it appropriate to adopt internal approaches for the quantification of Economic Capital for this particular type of risk. For operating purposes, the Montepaschi Group quantifies Real estate risk using a VaR type parametric approach, assuming normal distribution for the logarithmic returns of the Real estate portfolio, which can be broken down into the following stages:

- acquisition of data concerning the real estate portfolio and values of real estate indices;
- analytical correlation of each property with a suitable real estate benchmark index based upon the type of real estate, its use and its location;
- definition of annual logarithmic returns of all indices;
- calculation of the Economic Capital of the Real estate portfolio.

1.12 Risks inherent in investment products/services and Reputational Risk

The Montepaschi Group's organisational structure includes a specific unit dedicated to wealth risk management, to be understood as all activities for measurement and monitoring, as well as procedures for control of the risks and returns of investment services/products offered to customers. These activities particularly concern the operational procedures, the tools and methods aimed at ensuring overall consistency between the customer's propensity for risk and his return expectations out of the risk profile of the products, managed accounts and portfolios held in order to prevent and minimize the occurrence of reputational risks identifiable in the deterioration of the relationship of trust between Bank and customers.

All investment products (both Group and third-party), included in the catalogue of products offered to Group customers are subject, within a codified production-distribution supply-chain management process, to a specific multivariate quali-

quantitative risk assessment, including, market, credit and liquidity risk factors. The risk assessments are pegged to specific risk classes identified with specific legends, which are available to customers within information sheets regarding securities being placed and which therefore represent one of the guiding criteria on the basis of which the verifications of appropriateness and compliance provided for by the European MiFID regulations and by Consob Regulation 16190 are made. The same quantitative assessment is also made for financial instruments purchased directly by customers and dealt with in managed portfolios. Group customers are regularly informed of changes in the risk of the financial instruments held, so as to ensure timely informational transparency and facilitate possible decisions aimed at rebalancing the risk profile of the investments held.

In 2009, the regulatory instructions contained in Consob Communiqué No. 9019104 dated 2 March 2009, known as "Level 3- Illiquid financial products" were transposed and made operational. The bank also transposed the instructions issued as part of the "Inter-association guidelines for the application of Consob Level 3 measures for illiquid financial products", published in early August and to the preparation of which it actively contributed.

The interfunctional technical body, "Customer Protection", set up in early July 2009, operates with the objective of identifying companies characterised by a particular temporary critical state, associated primarily with specific macroeconomic, corporate and/or sector-related situations or by a lack of sufficient market information, in order to assign a maximum level of risk to the financial instruments issued by them, which makes it impossible to offer them on an advisory basis and makes them inappropriate in terms of suitability.

Reputational risk, measured on the basis of the procedures outlined, is not included in the quantification of Economic Capital for the Montepaschi Group. The charts below illustrate the treatment of risks under Pillars 1 and 2 as defined by Supervisory Regulations.

The salient features for each type of risk factor and the main as-is and to-be methodological activities, identified for self-assessment purposes are summarised below.

Pillar 1 risks

Type of risk	Current management	Present (as is) or future (to be) activities
Credit	• Internal Credit VaR Model, inclusive of inter-risk correlation. • Measurement of Expected Loss and Economic Capital.	"Loss based" integrated internal model based on Montecarlo simulations.
	• Usual mitigations to reduce risk of losses.	Management of the credit portfolio
Market ***(Trading Book)*** **and Counterparty**	• Internal management model for Generic and Specific risks based on *historical simulation* with analytical *full revaluation.*	Evolution of risk-specific internal model.
	• Internal management model for specific risks with Credit Spread VaR	
	• Counterparty Risk: Current Value method.	Counterparty Risk: evolving towards EPE models via Montecarlo scenarios.
Operational	• Internal AMA model	Refinements.
	• Mitigation and insurance allocation of risk.	

Pillar 2 risks

Type of risk	Current management	Present (as is) or future (to be) activities
Concentration	• Credit VaR internal model already includes concentration risk in the calculation of Economic Capital. • Control and follow-up through internal policies, determination of concentration and entropy indices.	Further *clustering* refinements for concentration calculation
Market ***(ALM Banking Book)***	• Internal Model based on the Economic Value approach, to determine the impact of interest rate variation on the bank's economic value (assets/liabilities).	Development of behavioural models
	• Use of maturity gap to determine the impact. Shift of 25 bp, 100 bp and 200 bp. • On demand items and prepayment have been modelled and are included in periodically submitted risk measures the model (prepayment rate model in particular).	Refinements
Equity Investments	• VaR Model based on direct observation or on comparable items. Variance/co-variance approach and equity VaR calculation.	Refinements.
Liquidity	• Cash flows mismatching model, *counterbalancing capacity* determination; setting of operational (short term) and structural (medium/long term) limits. • Mitigation and control on the basis of liquidity policy. • Development of Contingency Plan.	The liquidity measurement model is being refined. Modelling of uncertain cash flows is being completed.
Business	• Model based on internal estimates.	The model is being further developed.
Reputation	• Control based on specific organisational policies.	Specific reputational risk control/mitigation policies are being issued.

1.13 An analysis of the Montepaschi Group's Economic Capital and the Risk Integration Model

The Overall Economic Capital is intended as the minimum amount of capital resources required to cover economic losses resulting from unforeseen events generated by the simultaneous exposure to different types of risk.

In order to quantify Economic Capital all types of risk come into play with the exception of liquidity and reputational risk which, instead, are mitigated through organisational policies and processes.

The Risk Management Area of the Parent Company periodically quantifies the Economic Capital for each type of risk, mainly on the basis of internally-developed models for each risk factor. The methodologies are largely developed with a Value-at-Risk (VaR) approach and are thus aimed at determining the maximum loss the Group may incur with a specific holding period and within a pre-set confidence interval.

For certain risk factors and specific portfolio categories (Credit Risk and Operational Risk in particular), the models were officially validated by the Supervisory Authorities for regulatory purposes. The outputs from the models developed internally for the different risk factors (validated and operational) constitute the main tool for the day-to-day control and monitoring of the risk exposures generated in these areas and for the control of operating limits and delegated powers in accordance with the guidelines given and approved by the Parent Company.

The Economic Capital by risk factor, therefore, results from the corresponding operating metrics of risk quantification. VaR measurements by risk factor maintain their own "individual" validity in accordance with current regulations and International best practices and are determined with generally differentiated holding periods and confidence intervals.

The total of these micro risk-factors, which directly impact the Group's net equity, is subject to regular measurement by the Parent Company's Risk Management Area which prepares all the periodical documentation for the Parent Company's Risk Committee and for the Board of Directors.

Planning & Control, on the other hand, is responsible for reporting risk-adjusted

results and determining the specific value creation in a risk-adjusted logic using metrics of measurement consistent with income and absorbed economic capital. Moreover, it reformulates the risk measures received from the Risk Management Area for the Group's individual legal entities and business units. The allocation of capital, in terms of balance, forecasts and periodical monitoring, is also determined -on the basis of measurements from the Risk Management Area- by Planning & Control in conjunction with the corporate bodies of each legal entity, with specific reports prepared according to the individual business lines of the banks included in the scope of consolidation. The reports are submitted to the Parent Company's Risk Committee for approval.

The Overall Economic Capital is calculated by the Risk Management Area of the Parent Company through the application of a suitable method of integration and results from the combined measurement of each risk factor listed. The measurements are standardized both in terms of, time horizon (yearly holding period) and selected confidence interval (99.93%) - in line with the rating assigned to the Montepaschi Group by the official rating agencies - and are subject to intra-risk and inter-risk diversification processes.

The methodologies at the basis of integration are founded upon the principle that the overall internal capital needed to cover the Group's exposure to all risks, does not simply involve adding up the individual risks *(building block approach)*. This principle lies in the imperfect correlation among the risk factors. The joint impact of all risk factors is usually less severe for the reason that, because they are not perfectly correlated, benefits may emerge from diversification. The initial risk integration methodologies used by the Montepaschi Group were based upon the variance-covariance approach.

In 2009, subsequent to in-depth analyses and developments, the integration methodology was fine-tuned and a multivariate "t-student copula" approach was adopted. Against a simpler and less expensive implementation in terms of IT software and calculation times, the variance-covariance model is penalized by extremely strong underlying methodological assumptions (all marginal distributions and the joint distribution of losses follow a Normal distribution pattern) and does not correctly capture the tail dependences which are, on the other hand, fundamental to determin-

ing Economic Capital with the percentiles normally used for this type of analysis.

Using the actual loss data observed, the "copula t-Student" model is capable of more efficiently modelling the correlation among risk factors, without making assumptions on the marginal distributions and more appropriately capturing the *tail dependences* (and therefore the extreme episodes of joint losses simultaneously linked to the different risks.). In addition to being more robust, this approach also results as being more prudential. In order for this model to be implemented, it was necessary to retrieve and reconstruct the time series of risk factor-induced losses and engineer an IT and computational infrastructure capable of producing this kind of data. The final output reveals the Overall Economic Capital or the Overall Internal Capital at Group-level, broken down by the different risk type, Legal Entity and business unit, indicating the impact of intra-risk diversification with respect to the building block approach which, on the other hand, does not entail quantification. The calculation, analysis and reporting frequency with which the Group's Economic Capital is measured currently stands at one month.

The table below illustrates the salient features of the individual internal models adopted by risk type, with the final column showing the result from their reconciliation and processing within a logic of risk integration for the purpose of calculating Economic Capital.

Main characteristics of models

Type of risks	Measure	Model	Risk factors	Correlation	Reconciliation
Performing loans	1 Y VaR, 99.93%	Beta Distribution weighted on MPS Group parameters	PD and LGD differentiated by type of counterparty, CCF differentiated by product	Correlations based on multivariate analysis between internal default rates and macroeconomic variables	t-Student Copula
Equity investments	3 M VaR, 99%	Parametric VaR	Volatility in stock prices and *comparable* indices	Correlations between stock prices Correlation between proxy indices	1 Y, 99.93%, t-Student Copula
Market (Banking Book)	1 Y, shift 25bp sensitivity	Maturity Gap	*Bucketing* on parallel and *twist* shift nodes of Interest rates		1 Y, 99.93%, t-Student Copula
Market (Trading Book)	1day VaR 99%	VaR hystorical simulation - full revaluation	All market risk factors (IR, EQ, FX, CS,…)	Implicit in the full revaluation historical simulation	1 Y, 99.93%, t-Student Copula
Operational	1 Y VaR, 99.9%	LDA integrated with external data, in addition to qualitative self assessment	Frequency and *severity* by *event type*	Perfect correlation for conservative reasons	99.93%, t-Student Copula
Business	1 Y EaR, 99%	Parametric EaR	Volatility of costs and revenues	Correlation between costs and revenues	99.93%, t-Student Copula
Real Estate	1 Y VaR, 99%	Parametric VaR	Volatility of real estate indices	Correlation between *proxy* indices	99.93%, t-Student Copula

Other measurable risk factors of significance (e.g. Issuer Risk, UCITS risk) are included in the Economic Capital, on an add-on, non-diversified basis.
Their quantification for Economic Capital purposes is carried out on the basis of methodologies borrowed from the regulatory supervisory approaches.

1.14 Stress Test Analyses

In compliance with the guidelines set forth by the Basel Committee and Best Practices, new prudential supervisory provisions for banks require credit institutions to carry out adequate stress testing exercises. Stress testing is commonly described as "the set of quantitative and qualitative techniques with which banks assess their vulnerability to exceptional but plausible events". The objective is thus to evaluate the impact of a "state of the world" that is considered extreme, but which, despite a low probability of occurrence, may generate significant economic consequences for the Group.

Among the events considered plausible for the

definition of tension-inducing scenarios, the following are to be taken into consideration:

- *historical scenarios:* assumptions are made of shocks that are due to a combination of risk factors which were historically observed in the past and whose recurrence and plausibility retain a certain degree of likelihood;
- *discretionary scenarios:* assumptions are made of shock that are due to a combination of risk factors which may emerge in the near future, depending on the foreseeable environmental, social and economic developments.

Under 'exceptional events', low-frequency circumstances are considered, whose occurrence would have an extremely serious impact on the banking Group.

Within this area, the Montepaschi Group's methodological approach to stress-testing is based upon the identification of main risk factors whose objective is to select events or combinations of events (scenarios) which reveal specific vulnerabilities at Group-level.

To this end, specific stress plans have been put in place on Pillar I risks (credit, market and operational) which were then made to converge - together with stress events designed ad hoc on other risk factors - into an overall Pillar II stress test plan, aimed at determining the potential impact on the Group within the ICAAP process.

With regard to Credit risk in particular, the Montepaschi Group has defined a macro-economic regression model to estimate the variations in the Probability of Default as a function of changes in the main credit drivers. Credit drivers which significantly describe PD variations are identified beforehand. On the basis of the regression model, credit driver disturbances are then estimated according to the current and prospective economic situation. The shock applied to the *credit drivers* determines the change in credit portfolio PD, triggering the simulation of a hypothetical counterparty downgrading, with consequent risk variations in terms of Expected Loss, Unexpected Loss and input from new Defaults.

With regard to Operational Risk, appropriate historical scenarios are defined, which are relevant in terms of both severity and frequency. In this way, it is possible to evaluate the Group's vulnerability to *exceptional* events - in the case of *severity* - and *plausible* events, in terms of *frequency*.

As for Market Risk, stress tests consist in the definition of historical scenarios (main crises historically observed in International markets), or discretionary, isolating those components towards which the Group is particularly exposed and, therefore, more vulnerable. These stress events are applied and simulated upon Equity, Credit Spread, Forex and Inter-

est Rate on a daily basis.

In terms of Counterparty, Concentration and Issuer Risk, a stress scenario has been defined that is consistent with the scenario used for Credit Risk.

For Equity Investment, Business and Real Estate, on the other hand, sensitivity tests are defined with respect to specific, appropriately identified risk factors, thus determining scenarios of maximization of historical volatility for the indices of reference.

With regard to Interest Rate Risk in the Banking Book, stress scenarios are defined and differentiated shocks are applied to the individual nodes of the curves for the terms of reference.

The results from the stress test are submitted to the Top Management and Board of Directors. They are formally examined by the BoD as part of the ICAAP Annual Report approval process, with a view to providing a self-assessment of the current and prospective capital adequacy of the Montepaschi Group.

1.15 The Risk Disclosure Process

An effective Risk Management Process involves the setting up of a specific Risk Disclosure subprocess, with the intent to properly produce, distribute and communicate risk data to all relevant parties with appropriate timing and methods. This is, first and foremost, an internal management need for every bank, both with regard to awareness of corporate issues and in terms of input needed to make appropriate management choices when it comes to governance. The importance of formalising an adequate internal process for the communication of relevant data is explicitly required by national legislation (see for ex. Bank of Italy's "Circular Letter no. 263/2006" and "Supervisory Provisions concerning Banks' Organisation and Corporate Governance" and by the main international bodies (Basel Committee, CEBS, …), for the purpose of increasing the awareness of corporate entities with regard to risk management at banking group level, with regard to the Risk Disclosure Process, the Montepaschi Group has, over the years, prepared an overall framework of reference, through the following organisational and governance solutions:

- regulations governing the operations of the Parent Company's Risk Committee, with the explicit intention to regulate communication to the BoD of the docu-

ments discussed and the major decisions taken;

- organisational allocation of the Risk Management Area with direct reporting to the Chairman of the BoD, the CEO and a functional connection with the CFO, with the aim of increasing the independence and effectiveness of its actions with respect to the Business Units and the related disclosure requirements;
- creation of Risk Disclosure Staff within the Risk Management Area of the Parent Company;
- regulations envisaging adequate risk reporting to be incorporated, for internal and external purposes, in all major Group directives concerning Risk, Internal Models, Financial Accounting and Public Disclosure.

Furthermore, in the course of 2009 the BoD of the Parent Company issued a specific resolution, which established that an additional risk information flow be addressed, at least once a month, to the Chairman of the BoD, the Internal Controls Committee and the CEO with a summary of these risk reports being submitted to the BoD at least on a quarterly basis. This reporting flow should be intended as forming part of the Risk Management Area's regular disclosure on risk control. In this way, the intention was to further reinforce the risk communication process towards the Group's senior management.

The Risk Management Area includes the Risk Disclosure Staff, who have the task of supervising, developing and coordinating the Group's Risk Disclosure Model, through the identification of all relevant players, systems, processes and reports. The Model is structured into two levels. At a first level:

- each Service of the Risk Management Area produces and validates its own Risk metrics based on its internal management models and autonomously governed procedures;
- each Service of the Risk Management Area produces its own operating Risk Reporting for internal operating purposes (i.e. validation report, control of operating limits) and for reconciliation with the BUs.

At a second level, the Risk Disclosure Staff:

- starts from results produced by the various Services and summarizes the Management Risk Reporting for internal and external purposes;
- integrates the Management Risk Reporting with "key risk messages" highlighting issues of particular/critical significance, for submission to the Top Management and other Corporate Bodies;

- interfaces with: Investor Relations, units under the relevant Manager in charge, the CFO, the CEO and Chairman *Business Management Offices* (it. *Segreterie*) on *risk reporting* issues.

By way of example, some salient features of the *"Parent Company's Risk Committee Disclosure"* process are reported below.

Pursuant to Regulation no. 1 of Banca MPS, the Parent Company's Risk Committee is, inter alia, entrusted with the task of *"[…] preparing the risk management policies to be submitted to the BoD, assess the Group's risk appetite, in line with the Group's annual and multiannual value creation objectives, verify and monitor the overall risk trends and the comprehensive compliance with the limits set at the various levels of operations. In particular, [the Risk Committee] reviews the reports prepared by the functions in charge of positions exposed to the different risk factors measured and to the absorption of regulatory and economic capital […]. It ensures that a comprehensive risk measurement and reporting system is maintained over time, through the production of appropriate management and operational reports".*

Business management for the Committee is taken care of by the Risk Management Area, which is also in charge of drafting the documents for discussion. The Committee's main resolutions and a summary of its findings are later submitted to the BoD by way of a regular communication process.

Within the framework of all information flows directed to the Risk Committee, at least one Group-wide Report is envisaged to be drafted specifically by the Risk Management Area (hereinafter the "Risk Management Report") with the following items being its main focus.

With regard to the operational **Economic Capital**, analyses are carried out in order to:

- quantify and determine the absorption of the Montepaschi Group's diversified and non- diversified Economic Capital by risk factor and Bank/BU;
- compare against budgeted risk appetite.

As far as **Credit Risk** is concerned, analyses are mainly conducted on the following:

- risks of the performing and defaulting loan portfolio by Legal Entity, Client Segment, *Master Scale* and Industrial clusters;
- trends in the risks of the performing and defaulting loan portfolio;
- *quality breakdown* of the risks of the performing loan portfolio and composition of the defaulting loan portfolio;
- geographical and sectorial concentration analysis into different areas of economic

activity.

With respect to **Assets & Liabilities Management,** analysis is mainly conducted on the following:

- impact on the economic value (Sensitivity), by Legal Entity, BU, curve bucket;
- analysis of Liquidity Risk;
- analysis of on demand accounts;
- monitoring of operating limits.

As for **Market Risk in the Trading Book,** analyses are mainly focused on:

- trend in the market risk profile of the Group's Trading Book: operational VaR;
- VaR disaggregation by Legal Entity and Risk Factor, diversified and non diversified VaR;
- main portfolio exposures;
- analysis of issuer risk;
- analysis of concentration risk;
- monitoring of operating limits.

In terms of **Operational Risk,** analyses are mainly conducted on the following:

- data on losses (quantitative information);
- major-impact losses tracked in the quarter and analysis of causes;
- Operational VaR analysis on different regulatory event types.

As needed, the Risk Management Report is integrated with specific points/issues of attention (i.e. Equity Investment Portfolio Risk Analysis, "ad hoc" simulations, Scenario/Stress analyses, etc.). The report also provides information with regard to progress made by the relevant units on main projects underway, as well as regulatory updates and in-depth reviews of primary topics of interest that, on a case by case basis, result as being of particular importance.

The basic contents of the Report enable the Risk Committee to gain a sufficiently complete - though concise - overview of the Montepaschi Group's main risks, highlighting any possible vulnerabilities in the overall risk profile and its development over time, risk concentration in specific segments or Business Units, tensions in terms of 'erosion' of the operating limits delegated to the BoD, exposures to new markets/risk factors. Analysis of the actual Economic Capital, in particular, makes it possible to assess the actual and prospective absorption at both cumulative level and with regard to each individual risk factor, even with reference to Second Pillar risks which fall within the assessment of Group Capital Adequacy for ICAAP purposes. Reporting is subject to continuous improvement with a view to making it increasingly more in line with control, operating guidance and corporate governance requirements.

1.16 Governance of the 'Pillar 3 (Third Pillar of Basel 2) - Disclosure to the Public' process

The process of the Third Pillar of Basel 2 ("Pillar3 - Disclosure to the Public") is internally regulated and governed by the Montepaschi Group in Regulation no. 1 of the Parent Company and a specific Group Directive.

The BoD, in its capacity as the Group's **Strategic Supervision Body:**

- defines the Disclosure to the Public process;
- approves the organisational procedures and units identified, as well as Group guidelines on the definition of the table contents;
- approves periodic updates to the Pillar3 Report.

With regard to the Pillar 3 Disclosure production process, the **Managing Body,** represented by the Parent Company's General Management:

- defines the objectives, roles and responsibilities of the Group's units involved in the process;
- submits periodic Pillar3 report updates to the BoD.

The Pillar3 Report production process incorporates the following phases:

- Report definition;
- periodic drafting of the Report;
- data quality and overall consistency checks;
- Report approval and publication.

The Risk Disclosure Staff of the parent Company's Risk Management Area is responsible for the overall supervision and general coordination of the above-described process and for the final drafting of the Report. To this end, it avails itself of support from the following functions: Balance Sheet, Supervisory Reporting, Capital Adequacy Control and all other designated Group functions which contribute to and validate the information falling within their spheres of competence.

In the Montepaschi Group, a statement of responsibility by the Chief Reporting Officer is envisaged for the Pillar3 Report. With regard to the validation and approval process, the Pillar3 Report as a whole is shared by and between the Risk Management Area, the CFO and the Chief Reporting Officer. It is later forwarded to the CEO and eventually to the BoD for final approval.

Once BoD approval is obtained, the Report is published on the Montepaschi Group's website, as provided for by supervisory regulations.

The coordination function supports Investor Relations on Pillar3 related issues and collaborates in dealing with any *feedback* from the Market on these issues. The Parent Company's Risk Committee is informed of any irregularities detected in the review phase while drafting the Pillar3 Report.

In accordance with external provisions and with the internal controls system model adopted by the Montepaschi Group, the Internal Controls Area periodically reviews the entire process, with a view to verifying its set-up and making sure that implementation is appropriate and effective and results are correct.

Table 2 - Scope of application

Qualitative disclosure

The disclosure contained in this document (Disclosure to the Public) refers solely to the Monte dei Paschi di Siena "Banking Group" as defined by Supervisory provisions. It is noted no restrictions or other impediments exist that may prevent a prompt transfer of regulatory capital or funds within the Group.

In compliance with supervisory provisions, there being no capital deficiencies at consolidated level, the individual capital requirement for the Group banks is reduced by 25%.

It is further noted that no non-consolidated entities are included in the Montepaschi Group.

Quantitative disclosure

The following table reports all entities included in the scope of consolidation as at 31.12.2009, broken down by type of business: Banking, Financial, Non-Financial, Special-Purpose and Insurance.

Table 2.1 - Scope of consolidation as at 31.12.2009

	Registered office	Sector	"Shareholding %"	"Type of relationship (a)"	"% voting rights (b)"	Treatment in the Balance Sheet	Treatment for Supervisory purposes
BANCA MONTE DEI PASCHI DI SIENA S.P.A.	Siena	Banking				Full	Full
MPS BANCA PERSONALE S.p.A.	Lecce	Savings promotion	100.00	1	100.00	Full	Full
MPS GESTIONE CREDITI S.p.A.	Siena	Credit recovery management	100.00	1	100.00	Full	Full
MPS LEASING E FACTORING S.p.A.	Siena	Leasing and factoring	100.00	1	100.00	Full	Full
MPS COMMERCIALE LEASING SPA	Siena	Leasing and factoring distribution through non-banking channels	100.00	1	100.00	Full	Full
BANCA MONTE PASCHI BELGIO S.A.	Brussels	Banking	100.00	1	100.00	Full	Full
MONTE PASCHI BANQUE S.A.	Paris	Banking	100.00	1	100.00	Full	Full
MONTE PASCHI MONACO S.A.M.	Montecarlo	Banking	100.00	1	100.00	Full	Full
BANCA ANTONVENETA S.P.A.	Padova	Banking	100.00	1	100.00	Full	Full
MPS CAPITAL SERVICE BANCA PER LE IMPRESE S.p.A.	Florence	Banking	99.92	1	99.92	Full	Full
MPS VENTURE SGR S.P.A.	Florence	Private equity fund management	70.00	1	70.00	Full	Full
BIVERBANCA CASSA RISP. BIELLA E VERCELLI S.P.A.	Biella	Banking	59.00	1	59.00	Full	Full
BANCA POPOLARE DI SPOLETO S.P.A.	Spoleto	Banking	26,05	7	26,05	Proportional	Proportional
MONTE PASCHI IRELAND LTD	Dublin	Financial activity	100.00	1	100.00	Full	Full
MONTE PASCHI FIDUCIARIA S.P.A.	Siena	Trust company	100.00	1	100.00	Full	Full
CONSUM.IT S.P.A.	Siena	Consumer credit	100.00	1	100.00	Full	Full
MPS PREFERRED CAPITAL I LLC	Delaware	Financial vehicle	100.00	1	100.00	Full	Full
MPS PREFERRED CAPITAL II LLC	Delaware	Financial vehicle	100.00	1	100.00	Full	Full
MONTE PASCHI CONSEIL FRANCE	Paris	Financial intermediary	100.00	1	100.00	Full	Full
MONTE PASCHI INVEST FRANCE S.A.	Paris	Financial intermediary	100.00	1	100.00	Full	Full
MONTEPASCHI LUXEMBOURG S.A.	Brussels	Financial vehicle	100.00	1	100.00	Full	Full
MPS INVESTMENTS S.P.A.	Siena	Equity investments management	100.00	1	100.00	Full	Full
MPS SIM S.P.A.	Milan	Securities intermediation	100.00	1	100.00	Full	Full
ANTONVENETA CAPITAL LLC I	Delaware	Financial vehicle	100.00	1	100.00	Full	Full
ANTONVENETA CAPITAL LLC II	Delaware	Financial vehicle	100.00	1	100.00	Full	Full
ANTONVENETA CAPITAL TRUST I	Delaware	Financial vehicle	100.00	1	100.00	Full	Full
ANTONVENETA CAPITAL TRUST II	Delaware	Financial vehicle	100.00	1	100.00	Full	Full

Table 2.1 - Scope of consolidation as at 31.12.2009 *(continued)*

	Registered office	Sector	"Shareholding %"	"Type of relationship (a)"	"% voting rights (b)"	Treatment in the Balance Sheet	Treatment for Supervisory purposes
SIENA MORTGAGES 00-01 S.P.A.	Milan	Credit securitisation vehicle	100.00	1	100.00	Full	Full
AGRISVILUPPO S.p.A.	Mantova	Financing for agricultural development	99.07	1	99.07	Full	Full
ANTENORE FINANCE S.P.A.	Padova	Credit securitisation vehicle	98.00	1	98.00	Full	Full
THEANO FINANCE S.P.A.	Padova	Credit securitisation vehicle	100.00	1	100.00	Full	Full
GIOTTO FINANCE 2 S.P.A.	Padova	Credit securitisation vehicle	98.00	1	98.00	Full	Full
CIRENE FINANCE Srl	Conegliano	Credit securitisation vehicle	60.00	1	60.00	Full	Full
ULISSE S.p.A.	Milan	Credit securitisation vehicle	100.00	1	100.00	Full	Full
ULISSE 2 S.p.A.	Milan	Credit securitisation vehicle	60.00	1	60.00	Full	Full
INTEGRA SPA	Florence	Consumer credit	50.00	7	50.00	Proportional	Proportional
MAGAZZINI GENERALI FIDUCIARI DI MANTOVA	Mantova	Deposit and custody warehouses (for third parties)	100.00	1	100.00	Full	Full
MPS TENIMENTI FONTANAFREDDA e CHIGI SARACINI S.p.a.	Siena	Wine industry	100.00	1	100.00	Full	Consolidated at Equity
IMMOBILIARE VICTOR HUGO	Paris	Real estate	100.00	1	100.00	Full	Full
G.IMM.ASTOR Srl	Lecce	Real estate renting	52.00	1	52.00	Full	Full
MPS IMMOBILIARE S.p.A.	Siena	Real estate	100.00	1	100.00	Full	Full
PASCHI GESTIONI IMMOBILIARI S.p.A.	Siena	Real estate management	100.00	1	100.00	Full	Full
CONSORZIO OPERATIVO GRUPPO MPS	Siena	IT and Information services	100.00	1	100.00	Full	Full
PERIMETRO GEST. PROP. IMM. Sc.p.a	Siena	Real estate	11.50	1	11.50	Full	Full
M.P. ASSURANCE S.A.	Paris	Insurance	99.40	1	99.40	Full	Excl. from Cons.

(a) Type of relationship:
1 majority of voting rights at ordinary shareholders' meetings
2 dominant influence at ordinary shareholders' meetings
3 agreements with other shareholders
4 other forms of control
5 unified management under art. 26. 1 of Leg. Decree 87/92
6 unified management under art. 26. 2. of Leg. Decree 87/92
7 joint control

(b) Actual voting rights in ordinary shareholders' meetings.

Table 3 - Regulatory capital structure

Qualitative disclosure

The regulatory capital and capital ratios are calculated on the basis of capital and P&L results as determined by applying the IAS/IFRS international accounting principles and taking account of the Supervisory instructions issued by the Bank of Italy in the twelfth update to Circular no. 155/91 "Instructions for preparing reports on regulatory capital and prudential ratios". Capital for regulatory purposes is calculated as the sum of positive and negative items, based on their capital quality. Positive items must be fully available to the bank for them to be used in the calculation of capital absorption.

The regulatory capital differs from net accounting equity as determined on the basis of IAS/IFRS international accounting principles, since Supervisory regulations are aimed at safeguarding capital quality and reducing the potential volatily induced by IAS/IFRS application.

The elements that constitute the regulatory capital need to be readily available to the Group, for them to be used, with no limitation, to absorb risks and corporate losses. These components need to be stable and their amount is stripped of any tax charges.

Regulatory capital is made up of core capital and supplementary capital. Both core capital (Tier 1) and supplementary capital (Tier 2) are determined as the algebraic sum of all of their positive and negative items, subject to prior consideration of the so-called "prudential filters".

This expression identifies all of the regulatory capital adjusting elements (both positive and negative) which were introduced by Supervisory Authorities to reduce capital volatility. Deduction of the elements described in Table 3.1.1. must be taken from core and supplementary capital (50% from Tier 1 and 50% from Tier 2 capital).

Tier 1

The main contractual characteristics of the innovative instruments which, together with share capital and reserves, are included in the calculation of Tier 1 capital, are summarised in the following table:

Main features of subordinated instruments

Type of instrument	Interest rate	Step Up	Issue date	Maturity	Prepayment effective as of	Curr.	Original amount in currency units	Contrib. to Reg. Capital (euro/ thousands)
F.R.E.S.H. (Floating Rate Exchangeable Subordinated Hybrid) - deposit	Euribor 3m + 0.88%	NO	31/12/2003	N.A.	(a)	EUR	700,000	470,596
Capital Preferred Securities 1st tranche	Euribor 3m + 3.75%	YES	21/12/2000	N.A.	(b)	EUR	80,000	80,000
Capital Preferred Securities 2nd tranche	Euribor 3m + 3.10%	YES	27/06/2001	N.A.	(b)	EUR	220,000	220,000
Preferred Capital I LLC	7.59% fixed: from 07/02/2011 Euribor to 3m +220 b.p.	YES	07/02/2001	07/02/2031	(c)	EUR	350,000	350,000
"Tremonti bond"	8.50%	YES	30/12/2009	N.A.	(d)	EUR	1,900,000	1,900,000
Total preference shares and capital instruments (Tier I)								3,020,596

(a) ***F.R.E.S.H****. (Floating Rate Equity-linked Subordinated Hybrid) instruments, issued by vehicle "MPS Preferred Capital II LLC" for a nominal value of EUR 700 mln, are perpetual innovative instruments with no repayment or step-up clauses, which are convertible into shares. In September of each year from 2004 through 2009 and however, at any time effective as of 1 September 2010, the instruments are convertible upon investor request. In addition, an automatic conversion clause is provided for in the event that, after the seventh year from the issue date, the reference price of the ordinary shares should exceed a set amount. The return is non-cumulative, with an option for it not to be paid if, during the previous year, the Bank did not register any distributable profits and/or did not pay any dividends to its shareholders. The unpaid return is considered as definitely lost. The rights of the instrument holders are guaranteed on a subordinated basis. In the event of liquidation of the Parent Bank, the rights of the investors will be subordinated to all of the Parent Bank's creditors who are not equally subordinated, including holders of securities coming under Tier 2 capital and will override the rights of Parent Bank's shareholders. In virtue of these characteristics, these instruments can be calculated in the core Tier1 capital. A limited liability company and a business trust were established which issued convertible preferred securities and convertible trust securities, respectively. The Parent Bank undersigned an on-lending contract in the form of a subordinated deposit contract The on-lending contract and the convertible preferred securities have broadly similar conditions. In 2009 a partial conversion took place for a nominal value of EUR 61.3 mln.*

(b) ***Securities are unredeemable.*** *Only a total and partial repayment option of the notes is provided for in favour of the issuer, exercisable respectively after 21/12/2010 and 27/06/2011. Should the repayment option not be exercised, the spread on the reference base will be increased by 50%.*

(c) ***Preference shares,*** *(CPS), amounting to a nominal value of EUR 350 mln, have a thirty-year life subject to the possibility of extending it on the basis of a subsequent agreement and may not be repaid upon request of the underwriters but only upon initiative of the issuer, Banca Monte dei Paschi di Siena Spa, after 10 years from issue date and subject to previous authorisationa from the Bank of Italy.*

(d) The so-called ***Tremonti Bonds*** *are "convertible financial instruments" issued by the Parent Company on 30 December 2009 and underwritten by the Ministry of Economy and Finance (MEF) pursuant to art. 12 of legislative decree no. 185 of 28 November 2008 ("Legislative Decree no. 185"), amended and transposed into Law no. 2 of 28 January 2009. Interest is paid annually on the basis of a fixed 8.5% rate until 2010.*

These instruments are designed to strengthen the Group's regulatory capital position and support economic development with a particular focus on small-medium enterprises.

Tier 2

The following sections set out in tabular form the main contractual characteristics of the hybrid capital instruments and subordinated liabilities that contribute to supplementary capital.

Main features of subordinated instruments

Type of instrument	Interest rate	Step Up	Issue date	Maturity	Prepayment effective as of	Curr.	Original amount in currency units	Contrib. to Reg. Capital (euro/ thousands)
Subordinated bond loan	4.875% fixed	NO	31/05/2006	31/05/2016	(*)	EUR	750,000	743,331
Subordinated bond loan	5.750% fixed	NO	31/05/2006	30/09/2016	(*)	GBP	200,000	294,055
Subordinated bond loan	Euribor 6m+ 2.50%	NO	15/05/2008	15/05/2018	(*)	EUR	2,160,558	2,154,592
Totale Strumenti ibridi (Upper Tier II)								**3,191,978**
Subordinated bond loan	CMS Convexity Notes	NO	07/07/2000	07/07/2015	(*)	EUR	30,000	30,000
Subordinated bond loan	CMS Volatility Notes	NO	20/07/2000	20/07/2015	(*)	EUR	25,000	25,000
Subordinated bond loan	4.50% fixed until 24/09/2010, then Euribor 3m+1.20%	YES	24/09/2003	24/09/2015	24/09/2010	EUR	600,000	585,505
Subordinated bond loan	Euribor 3m + 0.40 % until 30/06/2010, then Euribor 3m+1%	YES	30/06/2005	30/06/2015	30/06/2010	EUR	350,000	340,770
Subordinated bond loan	Euribor 3m+0.40 % until 30/11/2012, then Euribor 3m+1%	YES	30/11/2005	30/11/2017	30/11/2012	EUR	500,000	497,961
Subordinated bond loan	Euribor 3m+0.40% until 15/01/13, then Euribor 3m+1%	YES	20/12/2005	15/01/2018	15/01/2013	EUR	150,000	141,895
Subordinated bond loan	7.44% fixed	NO	30/06/2008	30/12/2016	(*)	EUR	250,000	247,697
Subordinated bond loan	Euribor 3m+0.60% until 1/11/07, then Euribor 3m+0.90%	YES	01/11/2002	01/11/2012	01/11/2007	EUR	75,000	43,035
Subordinated bond loan	Euribor 6m+0.33% until 29/06/2012, then Euribor 6m+0.93%	YES	29/06/2007	29/06/2017	29/06/2012	EUR	50,000	50
Subordinated bond loan	Euribor 3m+1.40% until 30/04/2013, then Euribor 3m+2%	YES	30/04/2008	30/04/2018	30/04/2013	EUR	450,000	1,687
Subordinated debt	Euribor 3m + 2.8%	NO	10/10/2006	10/10/2016	10/10/2011	EUR	400,000	400,000
Subordinated bond loan	6.4% until 31/10/2013, then Euribor 3m +3%	YES	31/10/2008	31/10/2018	31/10/2013	EUR	100,000	102,078
Subordinated bond loan	7% fixed	NO	04/03/2009	04/03/2019	(*)	EUR	500,000	496,879
Bond loan	adjustable	NO	30/09/2003	30/09/2013	30/09/2008	EUR	73,000	263
Bond loan	adjustable	NO	30/09/2003	30/09/2013	30/09/2008	EUR	7,000	5,620

Main features of subordinated instruments *(continued)*

Type of instrument	Interest rate	Step Up	Issue date	Maturity	Prepayment effective as of	Curr.	Original amount in currency units	Contrib. to Reg. Capital (euro/ thousands)
Bond loan	adjustable	NO	22/12/2003	22/12/2013	22/12/2008	EUR	50,000	0
Bond loan	adjustable	NO	30/06/2005	30/06/2015	not applicable	EUR	50,000	0
Bond loan	Euribor 6m+0.60%	NO	07/12/2005	07/12/2015	not applicable	EUR	7,786	7,786
Bond loan	Euribor 6m+0.60%	YES	15/04/2008	15/04/2018	15/04/2013	EUR	2,140	2,140
Bond loan	Euribor 6m+0.60%	YES	18/04/2008	18/04/2018	18/04/2013	EUR	2,834	2,834
Total Subordinated Instruments (Lower Tier II)								**2,931,200**
Total Hybrid and Subordinated Instruments included in Tier II								**6,123,178**

(*) No pre-payment clauses are envisaged

Quantitative disclosure

Table 3.1 - Breakdown of Regulatory Capital

	dec-09	dec-08
Total Tier 1 positive items	17,689,738	15,664,030
Total Tier 1 negative items	8,028,078	8,338,205
Total items to be deducted	568,233	527,439
Tier 1 capital (Tier 1)	**9,093,427**	**6,798,386**
Total Tier 2 positive items	6,349,436	6,063,403
Total Tier 2 negative items	84,385	10,777
Total items to be deducted	568,233	527,439
Tier 2 capital (Tier 2)	**5,696,818**	**5,525,187**
Items to be deducted from Tier 1 and Tier 2 capital	409,818	327,583
Regulatory Capital	**14,380,427**	**11,995,990**
Tier 3 capital (Tier 3)	**-**	**344,395**
Regulatory Capital inclusive of Tier 3	**14,380,427**	**12,340,385**

In 2009, Regulatory Capital (inclusive of Tier 3) increased by EUR 2,040 mln (+16.5%), coming to EUR 14,380,4 mln vs. EUR 12,340.4 mln at the end of 2008. The Regulatory Capital increase was accounted for by a EUR 2,295 mln increase in Tier 1 which, in turn, stands at EUR 9,093.4 mln from EUR 6,798.4 mln at the end of 2008.

The most significant increase was in the "Prudential filters" item, to which the issuance of the "Tremonti -Bonds" was posted for an amount of EUR 1,900 mln, as evidenced in table 3.1.1, which was intended to improve the Group's regulatory capital position.

Tier 1 was also positively influenced by:

- near-total capitalisation of profits for the year, in the amount of EUR 224.4 mln;
- reduction of goodwill by approximately EUR 101.5 mln, as a result of the disposal of the asset management business, the sale of branches to Banca Popolare della Puglia e Basilicata and the effects arising from pre-existing contractual agreements;
- improvement of valuation reserves for AFS assets from being negative as at 31 December 2008 (and therefore subject to deduction from Tier 1 capital) to being positive in 2009, thus contributing 50% to Tier 2.

By contrast, it was negatively influenced by:

- the annual fee paid on account of the acquisition by the Parent Bank BMPS of the right of enjoyment of the ordinary shares and the contribution to the guarantee fund for the financing disbursed to small- and mid-sized enterprises in accordance with art. 11 of Legislative Decree no. 185/08, recognised following the issuance of the "Tremonti Bonds";
- the negative filter of 50% (equal to EUR 54.5 mln) quantified on the net profit recognised on the 2009 P&L statement deriving from the accounting treatment of substitute tax due to the tax deduction for goodwill made by the subsidiary Banca Antonveneta.

For the sake of completeness, it is to be recalled that 23,319,082 ordinary shares were issued in 2009 for the partial conversion of the convertible preferred securities issued on 30/12/2003.

The conversion involved an increase of share capital and an issue premium of € 61.3 mln corresponding to a reduction in non-innovative capital instruments in the same amount.

In 2009, Tier 2 capital increased by € 171.6 mln, reaching € 5,696.8 mln compared to € 5,525.2 million at the end of 2008; the increase is attributable mainly to the issuance of a lower Tier 2 security in the amount of € 500 mln, net of early redemption on 1 June 2009 of the lower Tier 2 in the amount of € 250 mln in addition to the maturity of the subordinated upper Tier 2 in the amount of € 44.4 mln.

At 31 December 2009, there were no subordinate Tier 3 securities.

The regulatory capital quantified at 31 December 2009 also takes into account the items introduced by banks which apply internal models for the determination of capital requirements in view of credit and operational risks. Among such corrections we must mention the adjustments to be made directlyto capital due to the differences resulting between overall impairment losses on loans and the respective expected losses quantified according to the criteria of internal models. For the Group, since the expected losses exceed the net impairment losses, the difference was deducted by 50% from Tier 1 capital and 50% from Tier 2 capital (table 3.1.1.).

The following table illustrates the constituents of Tier 1 and Tier 2, with a focus on the Group's most relevant aspects.

Table 3.1.1 - Breakdown of Tier 1 and Tier 2 Capital

	dec-09	dec-08
Share capital	4,553,774	4,538,145
Share premium	4,048,671	4,094,592
Reserves	5,842,272	5,016,794
Non-innovative capital instruments	470,596	531,925
Innovative capital instruments	650,000	650,000
Profit for the period	224,426	832,520
Prudential filters: increases in Tier 1 capital	1,900,000	54
Total Tier 1 positive items	**17,689,738**	**15,664,030**
Treasury shares	32,079	36,963
Goodwill	6,723,204	6,824,699
Other intangible assets	803,156	796,836
Loss for the period	-	-
Other negative items	-	-
Prudential filters: decreases in Tier 1 capital	469,639	679,707
Total Tier 1 negative items	**8,028,078**	**8,338,205**
Shareholdings in credit and financial institutions with a share of ≥ 20% of the equity of the investee	50,566	49,081
Shareholdings in credit and financial institutions with a share of > 10% but <20% of the equity of the investee	30,090	31,215
Shareholdings in credit and financial institutions with a share of ≤ 10% of the equity of the investee	-	-
Shareholdings in insurance companies	62,332	68,655
Surplus of expected losses in respect of related write-downs	425,245	378,488
Total items to be deducted	**568,233**	**527,439**
Total Tier 1 capital	**9,093,427**	**6,798,386**

Table 3.1.1 - Breakdown of Tier 1 and Tier 2 Capital *(continued)*

	dec-09	dec-08
Valuation reserve	226,258	94,845
Non-innovative capital instruments not eligible for inclusion in Tier 1 capital	-	-
Hybrid capital instruments	3,191,978	3,190,555
Subordinated liabilities	2,931,200	2,778,003
Total Tier 2 positive items	**6,349,436**	**6,063,403**
Other negative items	5,462	4,708
Prudential filters: deductions from Tier 2 capital	78,923	6,069
Total Tier 2 negative items	**84,385**	**10,777**
Shareholdings in credit and financial institutions with a share of ≥ 20% of the equity of the investee	50,566	49,081
Shareholdings in credit and fi nancial institutions with a share of > 10% but < 20% of the equity of the investee	30,090	31,215
Shareholdings in insurance companies	62,332	68,655
Surplus of expected losses in respect of overall write-downs value adjustments	425,245	378,488
Total items to be deducted	**568,233**	**527,439**
Total Tier 2 capital	**5,696,818**	**5,525,187**
Items to be deducted from Tier 1 and Tier 2 capital	409,818	327,583
Regulatory Capital	**14,380,427**	**11,995,990**
Tier 3 Capital	-	344,395
Regulatory Capital inclusive of Tier 3	**14,380,427**	**12,340,385**

With regard to Tier 1, its positive items include paid up capital, share premium, profit and capital reserves, innovative and non-innovative capital instruments and retained earnings; added to these items are the positive prudential filters represented by the issuance of so-called "Tremonti bonds". In fact, the Group has participated in the initiative brought about by the Ministry of Economy and Finance, aimed at ensuring an adequate flow of financing to the economy and an adequate level of capitalisation to the banking system. Pursuant to Art. 12 of Legislative Decree No. 185 of 28 November 2008, transposed, as amended, into Law no. 2 of 28 January 2009 ("Legislative Decree No. 185"), on 30 December 2009 the Group issued "Convertible financial instruments" ("Tremonti bonds") subscribed by the Minister of Economy and Finance (MEF). The process for the issuance of the Tremonti bonds involved the Group in a number of activities aimed at fulfilment of the commitments undertaken upon signing of a "Memorandum of understanding." In short, by signing the Memorandum of Understanding the group undertook to:

- make € 10 bln in financial resources available to small- and mid-sized companies over the next three years;
- start up activities in support of small- and mid-sized enterprises and families through specific products (new or existing);
- have a code of ethics governing the compensation of corporate top managers and market traders;
- provide adequate disclosure among its customers of the initiatives undertaken to implement the commitments signed.

The negative items in the Tier 1 capital, on the other hand, include treasury shares in the portfolio, intangible assets (including goodwill), any losses posted in previous years and in the current period, and the negative balance of the reserves for assets available for sale. Among the negative prudential filters noted in the Tier 1 capital, the following are worth mentioning:

- the 50% decrease in net profits, already computed entirely in the basic capital, recognised on the 2008 and 2009 profit and loss statements as a result of the accounting treatment of substitute tax due to the tax deduction for goodwill (regulations provide that such filters must be reduced by 1/8 per year in the years after the deduction);
- the net accrued capital gain (write-down of liabilities), net of tax effects, relative to hybrid capitalisation instruments and subordinated debt issued by the Group, classified among financial liabilities val-

ued at fair value and computed in Tier 2.

The overall Tier 1 capital is made up of the difference between the algebraic sum of the positive and negative items and the items to be deducted, the criteria for the determination of which are indicated below:

- equity investments and other items (innovative capital instruments, hybrid capitalisation instruments and subordinate debt) issued by banks and financial firms not fully or proportionately consolidated are deducted 50% from the core capital and 50% from the supplementary capital. The regulations previously in force provided instead for deducting that aggregate from the sum of core and supplementary capital;
- the use of internal models for the determination of capital requirements in view of credit risks entails identifying in the regulatory capital the difference between expected losses and net impairment losses; if the expected losses exceed the impairment losses, the difference is deducted 50% from the Tier 1 capital and 50% from the supplementary capital; if the expected losses are lower than the net impairment losses, the difference is computed in the supplementary capital within the limit of 0.6% of credit risk weighted assets;
- the equity investments held in insurance companies and the subordinate debt issued by such companies are deducted 50% from Tier 1 and 50% from Tier 2 when they have been acquired after 20/07/2006; if they were acquired prior to that date, on the other hand, they continue to be deducted from the sum of the core and supplementary capital until 31/12/2012.

As far as supplementary capital is concerned, the positive items comprising it include valuation reserves, hybrid capitalisation instruments, subordinated debt and the positive net balance of reserves for assets available for sale.

The negative items include the negative prudential filter proportionately at 50% of the positive balance of the AFS reserve computed among the positive items of the supplementary capital; in fact, these reserves are computed 50% in the supplementary capital.

The overall supplementary capital is made up of the difference between the algebraic sum of the positive and negative items and the items to be deducted, determined according to the criteria described above.

As far as prudential filters are concerned, it is also worth mentioning the following:

- for hedging transactions, the profits and

losses not realised on cash flow hedges, recognised in the appropriate reserve under shareholders' equity, are not computed in the regulatory capital;

- as to fair value option liabilities of natural hedge both unrealised capital gains and capital losses recorded in the profit and loss account are fully relevant except for the component due to changes in its creditworthiness;
- the equity investment in the Bank of Italy is not considered for purposes of quantifying capital and therefore the respective capital gain deriving from valuation at fair value is not computed in the reserves for instruments available for sale.

Table 4 - Capital adequacy

Qualitative disclosure

The capital management activity involves all the policies and choices necessary to define the size of the capital and the optimum combination between different alternate capitalization instruments, so as to ensure that the amount of capital and the correlated ratios are consistent with the risk profile assumed and so as 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 the capital resources of the individual companies that form part of it are defined in keeping with the more general objectives of the Group itself.

The Group is subject to the capital adequacy requirements established by the Basel Committee according to the rules defined by the Bank of Italy ("New prudential supervisory instructions for banks," Circular 263 of 27 December 2006 and "Instructions for preparing reports on regulatory capital and prudential ratios", 12th update of Circular No. 155/91).

Based on such rules, the ratio between capital and risk weighted assets must be at least 8% on a consolidated level; compliance with the requirement on a consolidated basis is verified every six months by the Bank of Italy. At the individual level, for banks belonging to a banking group, it is provided that the requirements in terms of credit, market, counterparty and operational risk are reduced by 25%, subject to meeting the afore-mentioned overall capital requirement of 8% on a consolidated basis.

Along with the observance of mandatory minimum capital ratios ("pillar one"), the regulations require the use of internal methodologies intended for determining current and future capital adequacy ("pillar two"). The existence, along with the mandatory minimum ratios, of "pillar two" in fact expands the concept of capital adequacy, which takes on a more global connotation aimed at overall verification of capital needs and the sources actually available, consistent with the strategic and developmental objectives of the Group itself.

For purposes of ensuring continual and effective oversight of all aspects of capital adequacy, the Group recently introduced a Capital Adequacy Function, in order to:

- coordinate on an ongoing basis the different activities carried out by other functions which directly or indirectly generate differ-

ent impacts on current and future capitalisation levels;

- monitor capital level on an ongoing basis;
- implement effective capital management processes.

All of this is in accordance with formalised rules of governance, in line with regulations provided for by the Bank of Italy and consistent with the Group's strategic and operational development. In fact, the Group has defined an independent internal process for evaluating its current and future capital adequacy, based on methodologies applied to prepare the different information contained in the consolidated ICAAP (Internal Capital Adequacy Assessment Process) report; these methodologies are aimed at both the determination of overall internal capital in terms of a wider number of risks as compared to those in "pillar one", as well as at the identification of overall capital, using Available Financial Resources (AFR) logics.

In this context, considering the across-the-board extent and pervasiveness that this process takes both with reference to the functions of the Parent Bank and the individual legal entities, the Board of Directors of the Parent Bank approved a specific internal directive on ICAAP and additional guidelines for the self-assessment of risk management processes deemed material and significant; the resulting output of this process contributes to the final evaluation of capital adequacy.

The CFO is responsible for the ICAAP process, while the Capital Adequacy function coordinates the different functions involved and materially prepares the content of the report. Since ICAAP also requires an evaluation of future capital adequacy, the Group has implemented a structured capital simulation process, whereby it estimates future capital requirements and the associated regulatory capital ratios, the overall internal capital and the future AFRs. In addition, the outputs produced are predetermined subjecting the input variables to stress conditions, based on a hypothetical recessive scenario and prepared by the competent functions. Through this scenario, which identifies the shocked levels of some macroeconomic and financial variables, the impacts produced are broken down by all profit-and-loss and balance sheet items and risk factors, so as to determine the overall impact on capital ratios and evaluate the sustainability of the correlated contingency plans.

In addition to the above-described processes, a further method of monitoring capital adequacy is the activity of capital targeting - both regulatory and operational - which the Group has adopted, together with the Capital Planning activity, for several years now. These activities are at the basis of the Risk Appetite and Capital Allocation processes.

The Capital Planning activity is geared towards identifying the dynamics of capital and regulatory ratios, in line with current and future developments of the Group's activities and in consideration of market and regulatory potential changes.

The Capital Allocation activity, on the other hand, allows for making allocation of the internal capital to the Group's different business areas and territorial divisions, to which risk-adjusted income components are also allocated. All this is aimed at determining the creation of value and performance of each business unit, which allows for guiding value creation objectives by implementing risk-return remixing procedures among the different risk-taking entities or portfolios. For this latter purpose, with the "Value Creation" Project, carried out by the Capital Adequacy function, a systematic analysis was begun of the added value with individual customers, aimed - through active management by the commercial network of inefficient capital positions - at reducing the operational absorption of internal capital, curbing the associated capital requirements and, in general, maximising the yield on portfolio assets.

Periodic activity of monitoring the regulatory ratios ("pillar one") and the operational capital ratios ("pillar two"), together with space and time analyses of individual events that have an impact on the types of risk measured, allow for prompt intervention either through appropriate activities for redirecting the underlying operating assets or through actions on capital aggregates. All this is aimed at compliance with the adequacy indices set in the Business Plan and in the annual Risk Appetite plan.

Furthermore, a multi-period Capital Planning framework allows for evaluating the extent to which the Group's growth targets have been achieved, while the development of scenario or what-if analyses on capital adequacy levels, together with monitoring progress made on the achievement of capitalisation objectives, allows for an ex-ante understanding of specific operational policies and one-off operations.

In terms of action plans, observance of capital adequacy is pursued by using several levers, including first and foremost those centred on the composition and level of capital (capital increases, convertible bonds, subordinate bonds, etc.), policies for optimisation and mitigation of all types of risks, such as, for example, those based on managing loans in keeping with the embedded risk reflected by the type of counterparty or product, and, lastly, on policies for generating financing internally and correlated payout policies.

Quantitative disclosure

Effective as of 2008, the Group has been calculating prudential ratios in accordance with the principles contained in the New Accord on Capital Adequacy known as Basel II; additionally, following authorisationa from Supervisory Authorities, the Montepaschi Group has been using internal advanced ratings-based (AIRB) models since 30 June 2008 for the calculation of capital requirements for credit and operational risks, in relation to the regulatory "Retail exposures" and "Exposures to corporates" portfolio. The scopeof application of the AIRB method as at today includes the Parent Company Banca Montepaschi and MPS Capital Services. Capital requirements for the remaining portfolios and entities of the Group are calculated according to the standardized 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 95.4% of the Banking Group's scope, as estimated on the basis of consolidated income from banking activities as at 31.12.2009. The standardized approach is used for the remaining part of the scope.

The consolidated requirement is conceived of as a sum of the individual requirements of the individual entities of the Banking Group, net of exposures arising from intragroup relations falling within the calculations of credit, counterparty and settlement risk as well as application of adjustment factors (floors").

The application of internal models is in fact allowed on condition that it is in compliance with a number of qualitative and quantitative limits set forth in the Supervisory regulations. In particular, limits ("floors") have been set, for which any capital savings achieved through internal models are subject to ceilings to be benchmarked against the requirements calculated under the previous Basel 1 regulations. Such limitations are expected to be eliminated in the future, taking into account the continuous fine-tuning and consolidation of the internal models adopted. In addition to the Total Capital Ratio, expressed as a ratio between regulatory capital and risk weighted assets which, pursuant to Basel 2 regulations, must be at least equal to 8% on a consolidated level, the Group ascertains its capital soundness also by

mans of its Tier 1 Ratio expressed as a ratio between Core Capital and risk-weighted assets. The following table reports the Group's capital requirements as at 31 December 2009 and 31 December 2008, calculated as indicated above, broken down by type of risk/methodology and related capital ratios.

Table 4.1 - Capital requirements and capital ratios

	dec-09	dec-08
Credit Risk		
Standardised approach	6,453,797	7,207,957
Advanced Internal Ratings Based approach	2,958,171	3,102,761
Total	**9,411,968**	**10,310,718**
Market Risk		
Standardised approach	580,144	482,292
Internal models approach	-	-
Concentration risk	-	54
Total	**580,144**	**482,346**
Operational Risk		
Foundation approach	53,714	59,076
Standardised approach	-	216,481
Advanced Measurement Approach	648,544	480,640
Total	**702,258**	**756,197**
Adjustment to capital requirements for intra-group transactions	-1,072,389	-1,470,298
Regulatory Capital Floor	49,961	513,705
Other requirements	-	-
Aggregate Capital Requirements	**9,671,942**	**10,592,668**
Risk-weighted assets	**120,899,279**	**132,408,337**
Tier 1 Ratio	**7.5%**	**5.1%**
Total Capital Ratio	**11.9%**	**9.3%**

Total risk-weighted assets as of 31 December 2009 amounted to € 120,899 mln, reporting a decrease (-8.7%) compared to the end of the previous financial year (see table 4.1). This contraction is mainly due to the application of a 90% floor level compared to the previous level set at 95%. In addition, for some significant aggregates, the dynamic of allocation of assets at risk reflected a remodulation with a shift toward those less at-risk.

Increased alignment with the trends for the period, as far as the risk measures underlying regulatory models are concerned, completes the picture of the factors that mark out the conditions for generation of the number relative to the level of risk-weighted assets.

At the end of 2009, the Tier 1 capital ratio was 7.52%, while the total capital ratio was 11.89%. Without applying the limitation of the 90% floor, the Tier 1 capital ratio would be 7.56%, while the Total capital ratio would be 11.96%.

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

Table 4.2 - Capital requirements for Credit Risk

Standardised approach	dec-09	dec-08
Exposures to central governments and central banks	363	632
Exposures to regional governments and local authorities	52,307	57,999
Exposures to non-commercial and public sector entities	81,787	100,386
Exposures to multilateral development banks	-	9
Exposures to international organisations	-	-
Exposures to supervised institutions	325,301	364,317
Exposures to corporates	3,778,744	4,675,308
Retail exposures	782,819	912,971
Exposures secured by real estate property	355,302	324,878
Past due exposures	448,817	372,404
High-risk exposures	96,606	79,414
Exposures in the form of covered bonds	-	-
Short term exposures to corporates	-	-
Exposures to Undertakings for Collective Investments in Transferable Securities (UCITS)	27,886	16,032
Other exposures	466,126	278,235
Securitisation exposures	37,739	25,372
Total Standardised Approach	**6,453,797**	**7,207,957**
Advanced Internal Ratings-Based approach		
Corporate exposures	2,186,615	2,809,475
Retail exposures	769,712	293,020
↳ *Secured by real estate property*	*312,801*	*239,641*
↳ *Qualifying revolving retail exposures*	*36*	*1*
↳ *Other exposures*	*456,874*	*53,378*
Other assets	1,844	265
Total Advanced Internal Ratings-Based approach	**2,958,171**	**3,102,761**
Total Credit Risk	**9,411,968**	**10,310,718**

Table 4.3 - Capital Requirements for Market Risk

Standardised approach	dec-09	dec-08
General market risk	337,647	262,122
Specific risk	179,507	174,856
Position risk of Undertakings for Collective Investments in Transferable Securities (UCITS)	29,874	1,966
Options	9,113	3,107
Foreign exchange risk	24,004	40,242
Commodities risk	-	-
Total Standardised Approach	**580,144**	**482,292**
Internal models		
Total Internal models	**-**	**-**
Concentration risk	**-**	**54**
Total Market Risk	**580,144**	**482,346**

Table 4.4 - Capital Requirements for Operational Risk

Breakdown of Operational Risk by:	dec-09	dec-08
Foundation approach	53,714	59,076
Standardised approach	-	216,481
Advanced approach	648,544	480,640
Total Operational Risk	**702,258**	**756,197**

Table 5 - Credit risk: general disclosures for all banks

Qualitative disclosure

For classification of impaired loans into the various categories of risk (non-performing, watchlist, restructured and past due exposures), the Montepaschi Group refers to the regulations issued by the Bank of Italy, as supplemented with internal provisions which set out automatic criteria and rules for the transfer of receivables from and to different risk categories. In line with supervisory definitions, impaired loans are intended to include the following:

- loans more than 180 days past due;
- restructured loans or loans being restructured;
- watchlist loans;
- non-performing loans.

The definition of watchlist loans, following the amendment introduced by the Bank of Italy in the course of 2008, was broadened to include loans that are more than 270 days overdue.

The classification is autonomously made by the units involved, except for past-due loans or overdrafts that are more than 180 days overdue and watchlist loans objectively included among past-due loans or overdrafts that are more than 270 days overdue, which are identified through the use of automated procedures. With regard to other defaulted loan categories, the Montepaschi Group has drawn up an accurate process of classification and determination of value adjustments to be applied based on the expertise of relationship managers and support provided by dedicated units specialised in the management of impaired loans. When classifying loans as watchlist or non-performing, the relationship manager defines, on the basis of evidence available, an estimated measurement of failed recovery, broken down into exposure related to the actual loan and exposure related to interest and other expenses. Subsequently, the head office departments specialised in the management of impaired loans periodically review these loan positions and the relative estimated failed recoveries, inserting changes, if any, in estimated losses. These estimates are the calculation basis for the analytical valuation and subsequent determination of the balance sheet value adjustments.

Regarding the provisions made with respect

to collaterals issued and obligations undertaken with third parties, if these are classified as defaulted, the same methodology is followed as the one described above.

Methodology for determining value adjustments

For the purpose of determiningadjustments to the book-value of loans (customer loans, loans to banks, unsecured loans), an analytical and collective valuation is carried out considering the various levels of impairment as indicated below.

An **analytical assessment** is made of:

- non performing loans;
- watchlist loans;
- restructured loans.

Whereas the following are subject to **collective assessment:**

- past due loans and/or overdrafts that are more than 180 days overdue;
- exposures subject to country risk;
- performing loans.

In line with the indications set out in the Bank of Italy's recent update of Circular no. 262/2005, for loans past due and/or overdrawn for more than 180 days, the following tables, however, are reflective of an analytical assessment.

For loans subject to analytical assessment, the amount of value adjustment for each loan is equal to the difference between the loan book value at the time of valuation (amortized cost) and the current value of estimated future cash flows, as calculated by applying the original effective interest rate.

Expected cash flows take account of the expected repayment schedule, the expected recovery value of the collaterals, if any, as well as the costs expected to be incurred for the recovery of the credit exposure.

The value adjustment is posted to profit and loss under account 130 net adjustments/writebacks due to impairment of loans.

The adjustment component attributable to the discounting of financial flows is calculated on an accrual basis in accordance with the effective interest rate method and posted under write-backs.

If the quality of the impaired receivable has improved to such a point that there is reasonable certainty of timely recovery of the principal and interest, its original value is reinstated in the following years to the extent in which the reasons determining the adjustment disappear, provided that

such valuation can be objectively linked with an event which occurred after the adjustment. The write-back is posted to the profit and loss statement and may not in any case exceed the amortised cost that the receivable would have had without prior adjustments.

Receivables with no objective evidence of loss are subject to collective valuation. Such valuation, developed on the basis of a risk management model, is carried out by category, with receivables grouped together according to credit risk, and the relative loss percentages are estimated taking into account historical series based on elements noticeable on the date of valuation which allow an estimate of the value of latent loss in each category.

The model, for this type of valuation, involves the following steps:

- Segmentation of the loan portfolio by:
  - client segment (turnover);
  - economic business sector;
  - geographical location.
- Determination of the loss rate of individual portfolio segments, using the historical experience of the Group as reference.

The procedure for calculation of provisions in relation to guarantees issued and commitments with third parties, follows the same rules as those envisaged for provisions made with regard to cash positions included in the performing loan portfolio.

Valuation adjustments determined collectively are posted to the profit and loss statement. Any additional write-downs or write-backs are recalculated differentially, at year-end or on the dates of interim reports, with reference to the entire loan portfolio on the same date.

Quantitative disclosure

A breakdown of financial assets by portfolio and credit quality is reported in Tables 5.1.1 and 5.1.2 below.

Table 5.1.1 - Summary of financial assets by portfolio

Portfolio	Total		Period average	
	dec-09	dec-08	dec-09	dec-08
1. Financial assets held for trading	23,178,781	21,797,696	22,637,675	23,113,168
2. Available-for- sale financial assets	12,527,322	4,996,021	9,027,984	4,922,446
3. Held-to-maturity financial assets	3	3	3	3
4. Due from banks	10,327,520	17,615,716	13,653,357	15,314,476
5. due from customers	152,413,441	145,353,190	147,625,884	127,527,911
6. Financial assets valued at fair value	39,564	180,038	143,012	190,133
7. Financial assets on sale	-	64,214	21,405	651,939
8. Hedging derivatives	198,703	99,160	142,034	57,382
Total	198,685,334	190,106,038		

Values reported in the tables above reflect those used in the Financial Statements and refer to positions in both the Banking Book and Regulatory Trading Book. Data reflects the logic of the Financial Statements and is therefore reported net of permitted offsetting, but does not take account of any credit risk mitigation actions.
The table refers to Table A.1.1., "Credit Quality" Section, part E of the Consolidated Notes to the Financial Statements.

Table 5.1.2 - Breakdown of financial assets by portfolio and to credit quality

Portfolio/Quality	NPLs	Watchlist loans	Restructured loans	Past-due	Other assets	Total
1. Financial assets held for trading	3,779	1,980	1,512	6	23,171,504	23,178,781
2. Financial assets available for sale	5,519	-	-	-	12,521,803	12,527,322
3. Financial assets held to maturity	-	-	-	-	3	3
4. Loans and advances to banks	9,797	14,520	-	20	10,303,183	10,327,520
5. Loans and advances to customers	4,653,018	3,758,154	701,346	1,108,724	142,192,199	152,413,441
6. Financial assets designatd at fair value	-	-	-	-	39,564	39,564
7. Financial assets held for sale	-	-	-	-	-	-
8. Hedging derivatives	-	-	-	-	198,703	198,703
Total 31/12/2009	**4,672,113**	**3,774,654**	**702,858**	**1,108,750**	**188,426,959**	**198,685,334**
Total 31/12/2008	**3,641,972**	**2,595,557**	**196,909**	**955,522**	**182,716,078**	**190,106,038**

The table provides a breakdown of financial assets by accounting portfolio and credit quality. Values reported in the table reflect those used in the Financial Statements and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.2 - On- and off- balance sheet exposures to customers: geographical breakdown

ITALY	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	10,431,882	4,608,419	5,823,463	8,271,938	3,581,662	4,690,276
A.2 Watchlist loans	4,567,480	3,687,996	879,484	3,150,025	2,482,155	667,870
A.3 Restructured loans	726,042	701,346	24,696	208,280	196,909	11,371
A.4 Past due	1,173,964	1,106,177	67,787	1,015,688	949,989	65,699
A.5 Other exposures	139,827,960	139,020,657	807,303	143,480,317	142,408,806	1,071,511
Total A	**156,727,328**	**149,124,595**	**7,602,733**	**156,126,248**	**149,619,521**	**6,506,727**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	99,088	79,334	19,754	108,932	87,193	21,739
B.2 Watchlist loans	59,785	56,504	3,281	22,880	21,272	1,608
B.3 Other impaired assets	48,121	46,062	2,059	12,511	11,628	883
B.4 Other exposures	16,369,893	16,342,234	27,659	18,700,121	18,679,217	20,904
Total B	**16,576,887**	**16,524,134**	**52,753**	**18,844,444**	**18,799,310**	**45,134**
Total (A+B)	**173,304,215**	**165,648,729**	**7,655,486**	**174,970,692**	**168,418,831**	**6,551,861**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.2 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.2 - On- and off- balance sheet exposures to customers: geographical breakdown *(continued)*

OTHER EUROPEAN COUNTRIES	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	122,920	43,539	79,381	94,567	36,062	58,505
A.2 Watchlist loans	103,666	69,394	34,272	131,157	94,200	36,957
A.3 Restructured loans	-	-	-	-	-	-
A.4 Past due	2,163	2,054	109	3,655	3,510	145
A.5 Other exposures	25,611,516	25,605,444	6,072	5,027,532	5,021,321	6,211
Total A	**25,840,265**	**25,720,431**	**119,834**	**5,256,911**	**5,155,093**	**101,818**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	-	-	-	-	-	-
B.3 Other impaired assets	8,101	7,724	377	326	326	-
B.4 Other exposures	9,681,744	9,681,563	181	5,243,139	5,243,139	-
Total B	**9,689,845**	**9,689,287**	**558**	**5,243,465**	**5,243,465**	**-**
Total (A+B)	**35,530,110**	**35,409,718**	**120,392**	**10,500,376**	**10,398,558**	**101,818**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.2 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.2 - On- and off- balance sheet exposures to customers: geographical breakdown *(continued)*

USA	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	39,145	7,760	31,385	9,308	6,220	3,088
A.2 Watchlist loans	708	655	53	6,636	2,013	4,623
A.3 Restructured loans	-	-	-			-
A.4 Past due	457	447	10	340	333	7
A.5 Other exposures	805,397	803,824	1,573	1,067,296	1,065,370	1,926
Total A	**845,707**	**812,686**	**33,021**	**1,083,580**	**1,073,936**	**9,644**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	645	516	129	777	621	156
B.2 Watchlist loans	31	31	-			-
B.3 Other impaired assets	2	2	-			-
B.4 Other exposures	1,532,798	1,532,693	105	1,117,557	1,117,342	215
Total B	**1,533,476**	**1,533,242**	**234**	**1,118,334**	**1,117,963**	**371**
Total (A+B)	**2,379,183**	**2,345,928**	**33,255**	**2,201,914**	**2,191,899**	**10,015**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.2 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.2 - On- and off- balance sheet exposures to customers: geographical breakdown *(continued)*

ASIA	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	2,841	92	2,749	2,836	82	2,754
A.2 Watchlist loans	578	109	469	593	108	485
A.3 Restructured loans	-	-	-			-
A.4 Past due	22	21	1	5	4	1
A.5 Other exposures	148,465	147,808	657	242,443	241,581	862
Total A	**151,906**	**148,030**	**3,876**	**245,877**	**241,775**	**4,102**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	-	-	-			-
B.3 Other impaired assets	-	-	-			-
B.4 Other exposures	41,568	41,544	24	48,975	48,975	-
Total B	**41,568**	**41,544**	**24**	**48,975**	**48,975**	**-**
Total (A+B)	**193,474**	**189,574**	**3,900**	**294,852**	**290,750**	**4,102**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.2 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.2 - On- and off- balance sheet exposures to customers: geographical breakdown *(continued)*

REST OF THE WORLD	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	1,538	215	1,323	1,589	308	1,281
A.2 Watchlist loans	-	-	-	7	5	2
A.3 Restructured loans	-	-	-			-
A.4 Past due	27	26	1	36	33	3
A.5 Other exposures	691,945	691,616	329	642,832	642,517	315
Total A	**693,510**	**691,857**	**1,653**	**644,464**	**642,863**	**1,601**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	-	-	-			-
B.3 Other impaired assets	-	-	-			-
B.4 Other exposures	75,099	75,099	-	35,763	35,763	-
Total B	**75,099**	**75,099**	**-**	**35,763**	**35,763**	**-**
Total (A+B)	**768,609**	**766,956**	**1,653**	**680,227**	**678,626**	**1,601**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.2 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.3 - On-and off-balance-sheet exposures to banks: geographical breakdown

ITALY	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	6,000	-	6,000	2,145	299	1,846
A.2 Watchlist loans	-	-	-			-
A.3 Restructured loans	-	-	-			-
A.4 Past due	19	19	-	1,739	1,652	87
A.5 Other exposures	6,034,311	6,025,087	9,224	14,290,493	14,206,717	83,776
Total A	**6,040,330**	**6,025,106**	**15,224**	**14,294,377**	**14,208,668**	**85,709**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-	1,428	1,143	285
B.2 Watchlist loans	-	-	-			-
B.3 Other impaired assets	1,109	1,054	55	1,697	1,612	85
B.4 Other exposures	2,619,355	2,618,854	501	1,438,845	1,437,882	963
Total B	**2,620,464**	**2,619,908**	**556**	**1,441,970**	**1,440,637**	**1,333**
Total (A+B)	**8,660,794**	**8,645,014**	**15,780**	**15,736,347**	**15,649,305**	**87,042**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to banks. Values reported in the table reflect those used in the Financial Statements (see Table B.3 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.3 - On-and off-balance-sheet exposures to banks: geographical breakdown *(continued)*

OTHER EUROPEAN COUNTRIES	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	21,448	9,457	11,991	38,482	14,795	23,687
A.2 Watchlist loans	35,307	12,971	22,336	37,220	16,940	20,280
A.3 Restructured loans	-	-	-			-
A.4 Past due	-	-	-			-
A.5 Other exposures	6,721,729	6,719,388	2,341	7,689,955	7,686,461	3,494
Total A	**6,778,484**	**6,741,816**	**36,668**	**7,765,657**	**7,718,196**	**47,461**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	-	-	-			-
B.3 Other impaired assets	-	-	-			-
B.4 Other exposures	4,640,270	4,639,738	532	4,254,720	4,254,698	22
Total B	**4,640,270**	**4,639,738**	**532**	**4,254,720**	**4,254,698**	**22**
Total (A+B)	**11,418,754**	**11,381,554**	**37,200**	**12,020,377**	**11,972,894**	**47,483**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to banks. Values reported in the table reflect those used in the Financial Statements (see Table B.3 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.3 - On-and off-balance-sheet exposures to banks: geographical breakdown *(continued)*

USA	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	26,460	2,492	23,968	26,452	2,453	23,999
A.2 Watchlist loans	-	-	-			-
A.3 Restructured loans	-	-	-			-
A.4 Past due	-	-	-			-
A.5 Other exposures	518,447	518,362	85	448,850	448,744	106
Total A	**544,907**	**520,854**	**24,053**	**475,302**	**451,197**	**24,105**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	-	-	-			-
B.3 Other impaired assets	-	-	-			-
B.4 Other exposures	390,494	390,479	15	413,827	413,826	1
Total B	**390,494**	**390,479**	**15**	**413,827**	**413,826**	**1**
Total (A+B)	**935,401**	**911,333**	**24,068**	**889,129**	**865,023**	**24,106**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to banks. Values reported in the table reflect those used in the Financial Statements (see Table B.3 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.3 - On-and off-balance-sheet exposures to banks: geographical breakdown *(continued)*

ASIA	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	-	-	-			-
A.2 Watchlist loans	2,141	1,549	592			-
A.3 Restructured loans	-	-	-			-
A.4 Past due	-	-	-			-
A.5 Other exposures	407,479	407,103	376	316,440	316,060	380
Total A	**409,620**	**408,652**	**968**	**316,440**	**316,060**	**380**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	2,234	2,078	156			-
B.3 Other impaired assets	-	-	-			-
B.4 Other exposures	71,132	71,063	69	165,774	165,711	63
Total B	**73,366**	**73,141**	**225**	**165,774**	**165,711**	**63**
Total (A+B)	**482,986**	**481,793**	**1,193**	**482,214**	**481,771**	**443**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to banks. Values reported in the table reflect those used in the Financial Statements (see Table B.3 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Table 5.3 - On-and off-balance-sheet exposures to banks: geographical breakdown *(continued)*

REST OF THE WORLD	dec-09			dec-08		
	Exposure		Adjustments	Exposure		Adjustments
	Gross	Net		Gross	Net	
A. Balance-sheet exposures						
A.1 Non-performing loans	233	123	110	232	94	138
A.2 Watchlist loans	-	-	-			-
A.3 Restructured loans	-	-	-			-
A.4 Past due	-	-	-			-
A.5 Other exposures	344,346	344,306	40	127,299	127,246	53
Total A	**344,579**	**344,429**	**150**	**127,531**	**127,340**	**191**
B. Off-balance-sheet exposures						
B.1 Non-performing loans	-	-	-			-
B.2 Watchlist loans	-	-	-			-
B.3 Other impaired assets	-	-	-			-
B.4 Other exposures	164,654	164,524	130	111,736	111,638	98
Total B	**164,654**	**164,524**	**130**	**111,736**	**111,638**	**98**
Total (A+B)	**509,233**	**508,953**	**280**	**239,267**	**238,978**	**289**

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to banks. Values reported in the table reflect those used in the Financial Statements (see Table B.3 in part E of the Consolidated Notes to the Financial Statements) and refer to positions in both the Banking Book and Regulatory Trading Book.

Tab. 5.4 - On- and off-balance sheet exposures to customers: breakdown by sector

Governments and Central Banks	dec-09				dec-08			
	Exposure		Adjustments		Exposure		Adjustments	
	Gross	Net	specific	portfolio	Gross	Net	specific	portfolio
A. Balance-sheet exposures								
A.1 Non-performing loans	27	-	27	x	25		25	-
A.2 Watchlist loans	-	-	-	x	3	1	2	
A.3 Restructured loans	-	-	-	x				
A.4 Past due	12	12	-	x	-	-		
A.5 Other exposures	17,533,367	17,532,810	x	557	4,681,167	4,680,796	x	371
Total A	**17,533,406**	**17,532,822**	**27**	**557**	**4,681,195**	**4,680,797**	**27**	**371**
B. Off-balance-sheet exposures								
B.1 Non-performing loans	-	-	-	x				
B.2 Watchlist loans	-	-	-	x				
B.3 Other impaired assets	-	-	-	x				
B.4 Other exposures	982,094	982,094	x	-	2,145,404	2,144,260	x	1,144
Total B	**982,094**	**982,094**	**-**	**-**	**2,145,404**	**2,144,260**	**-**	**1,144**
Total (A+B)	**18,515,500**	**18,514,916**	**27**	**557**	**6,826,599**	**6,825,057**	**27**	**1,515**

x: no value attributable

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.1 in part E of the Consolidated Notes to the Financial Statements) and refer to both the Banking and Trading Book for supervisory purposes.

Tab. 5.4 - On- and off-balance sheet exposures to customers: breakdown by sector *(continued)*

Other public entities	dec-09				dec-08			
	Exposure		Adjustments		Exposure		Adjustments	
	Gross	Net	specific	portfolio	Gross	Net	specific	portfolio
A. Balance-sheet exposures								
A.1 Non-performing loans	565	438	127	x	538	274	264	
A.2 Watchlist loans	44	11	33	x	8,990	4,526	4,464	
A.3 Restructured loans	-	-	-	x				
A.4 Past due	-	-	-	x	39	37	2	
A.5 Other exposures	3,833,935	3,831,776	x	2,159	3,662,507	3,660,964	x	1,543
Total A	**3,834,544**	**3,832,225**	**160**	**2,159**	**3,672,074**	**3,665,801**	**4,730**	**1,543**
B. Off-balance-sheet exposures								
B.1 Non-performing loans	-	-	-	x				
B.2 Watchlist loans	-	-	-	x				
B.3 Other impaired assets	-	-	-	x				
B.4 Other exposures	339,966	339,946	x	20	467,438	467,050	x	388
Total B	**339,966**	**339,946**	**-**	**20**	**467,438**	**467,050**	**-**	**388**
Total (A+B)	**4,174,510**	**4,172,171**	**160**	**2,179**	**4,139,512**	**4,132,851**	**4,730**	**1,931**

x: no value attributable

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.1 in part E of the Consolidated Notes to the Financial Statements) and refer to both the Banking and Trading Book for supervisory purposes.

Tab. 5.4 - On- and off-balance sheet exposures to customers: breakdown by sector *(continued)*

Financial companies	dec-09				dec-08			
	Exposure		Adjustments		Exposure		Adjustments	
	Gross	Net	specific	portfolio	Gross	Net	specific	portfolio
A. Balance-sheet exposures								
A.1 Non-performing loans	134,771	28,313	106,458	x	95,913	39,674	56,239	
A.2 Watchlist loans	75,152	28,390	46,762	x	223,011	155,097	67,914	
A.3 Restructured loans	-	-	-	x	-	-	-	
A.4 Past due	1,852	1,769	83	x	13,202	13,112	90	-
A.5 Other exposures	16,592,581	16,573,575	x	19,006	9,828,062	9,774,259	x	53,803
Total A	**16,804,356**	**16,632,047**	**153,303**	**19,006**	**10,160,188**	**9,982,142**	**124,243**	**53,803**
B. Off-balance-sheet exposures								
B.1 Non-performing loans	1,197	958	239	x	996	797	199	
B.2 Watchlist loans	1,307	1,305	2	x	26	26	-	
B.3 Other impaired assets	5,279	5,014	265	x	9	9		
B.4 Other exposures	3,651,788	3,650,845	x	943	5,779,160	5,772,573	x	6,587
Total B	**3,659,571**	**3,658,122**	**506**	**943**	**5,780,191**	**5,773,405**	**199**	**6,587**
Total (A+B)	**20,463,927**	**20,290,169**	**153,809**	**19,949**	**15,940,379**	**15,755,547**	**124,442**	**60,390**

x: no value attributable

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.1 in part E of the Consolidated Notes to the Financial Statements) and refer to both the Banking and Trading Book for supervisory purposes.

Tab. 5.4 - On- and off-balance sheet exposures to customers: breakdown by sector *(continued)*

Insurance companies	dec-09				dec-08			
	Exposure		Adjustments		Exposure		Adjustments	
	Gross	Net	specific	portfolio	Gross	Net	specific	portfolio
A. Balance-sheet exposures								
A.1 Non-performing loans	13	10	3	x	1,098	315	783	
A.2 Watchlist loans	20	14	6	x	595	476	119	
A.3 Restructured loans	-	-	-	x				
A.4 Past due	-	-	-	x	300	289	11	
A.5 Other exposures	797,370	795,854	x	1,516	213,242	213,198	x	44
Total A	**797,403**	**795,878**	**9**	**1,516**	**215,235**	**214,278**	**913**	**44**
B. Off-balance-sheet exposures								
B.1 Non-performing loans	-	-	-	x				
B.2 Watchlist loans	-	-	-	x				
B.3 Other impaired assets	-	-	-	x				
B.4 Other exposures	1,161,501	1,161,358	x	143	496,594	496,387	x	207
Total B	**1,161,501**	**1,161,358**	**-**	**143**	**496,594**	**496,387**	**0**	**207**
Total (A+B)	**1,958,904**	**1,957,236**	**9**	**1,659**	**711,829**	**710,665**	**913**	**251**

x: no value attributable

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.1 in part E of the Consolidated Notes to the Financial Statements) and refer to both the Banking and Trading Book for supervisory purposes.

Tab. 5.4 - On- and off-balance sheet exposures to customers: breakdown by sector *(continued)*

Non-financial companies	dec-09				dec-08			
	Exposure		Adjustments		Exposure		Adjustments	
	Gross	Net	specific	portfolio	Gross	Net	specific	portfolio
A. Balance-sheet exposures								
A.1 Non-performing loans	8,697,862	3,841,865	4,855,997	x	6,928,215	2,971,199	3,947,700	9,316
A.2 Watchlist loans	3,780,228	3,080,167	700,061	x	2,380,484	1,886,762	493,123	599
A.3 Restructured loans	724,911	700,273	24,638	x	202,552	191,752	10,800	-
A.4 Past due	803,418	761,841	41,577	x	610,437	578,058	31,455	924
A.5 Other exposures	84,152,928	83,484,908	x	668,020	90,737,617	89,819,331	x	918,286
Total A	**98,159,347**	**91,869,054**	**5,622,273**	**668,020**	**100,859,305**	**95,447,102**	**4,483,078**	**929,125**
B. Off-balance-sheet exposures								
B.1 Non-performing loans	98,142	78,544	19,598	x	108,053	86,493	12,427	9,133
B.2 Watchlist loans	57,143	53,926	3,217	x	21,768	20,228	1,391	149
B.3 Other impaired assets	49,663	47,534	2,129	x	10,012	9,393	619	-
B.4 Other exposures	20,086,061	20,059,594	x	26,467	14,455,546	14,445,369	x	10,177
Total B	**20,291,009**	**20,239,598**	**24,944**	**26,467**	**14,595,379**	**14,561,483**	**14,437**	**19,459**
Total (A+B)	**118,450,356**	**112,108,652**	**5,647,217**	**694,487**	**115,454,684**	**110,008,585**	**4,497,515**	**948,584**

x: no value attributable

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.1 in part E of the Consolidated Notes to the Financial Statements) and refer to both the Banking and Trading Book for supervisory purposes.

Tab. 5.4 - On- and off-balance sheet exposures to customers: breakdown by sector *(continued)*

other	dec-09				dec-08			
	Exposure		Adjustments		Exposure		Adjustments	
	Gross	Net	specific	portfolio	Gross	Net	specific	portfolio
A. Balance-sheet exposures								
A.1 Non-performing loans	1,765,086	789,399	975,687	x	1,354,449	612,873	597,273	144,303
A.2 Watchlist loans	816,988	649,571	167,417	x	675,336	531,619	120,957	22,760
A.3 Restructured loans	1,130	1,073	57	x	5,728	5,157	571	-
A.4 Past due	371,353	345,102	26,251	x	395,746	362,373	20,612	12,761
A.5 Other exposures	44,175,103	44,050,428	-	124,675	41,337,825	41,231,047	x	106,778
Total A	**47,129,660**	**45,835,573**	**1,169,412**	**124,675**	**43,769,084**	**42,743,069**	**739,413**	**286,602**
B. Off-balance-sheet exposures								
B.1 Non-performing loans	393	348	45	x	660	525	135	
B.2 Watchlist loans	1,366	1,304	62	x	1,086	1,018	68	
B.3 Other impaired assets	1,282	1,239	43	x	2,817	2,553	264	
B.4 Other exposures	1,479,693	1,479,297	x	396	1,801,413	1,798,797	x	2,616
Total B	**1,482,734**	**1,482,188**	**150**	**396**	**1,805,976**	**1,802,893**	**467**	**2,616**
Total (A+B)	**48,612,394**	**47,317,761**	**1,169,562**	**125,071**	**45,575,060**	**44,545,962**	**739,880**	**289,218**

x: no value attributable

The table provides a geographical breakdown of balance-sheet and off-balance-sheet exposures to customers. Values reported in the table reflect those used in the Financial Statements (see Table B.1 in part E of the Consolidated Notes to the Financial Statements) and refer to both the Banking and Trading Book for supervisory purposes.

Table 5.5 - Time breakdown by contractual residual maturity of financial assets

Account/Maturity	On demand	1 to 7 days	7 to 15 days	15 days to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Unspecified maturity
Government securities	3	-	104,019	7	576,139	525,083	1,354,779	4,359,500	8,808,610	-
Other debt securities	507,311	9,015	27,362	116,859	226,354	510,800	670,601	4,300,114	3,684,733	5,358
Units in UCITS	910,477	158	-	-	-	2,595	-	136,659	138,128	-
Loans	32,018,614	11,371,821	2,103,219	4,985,326	6,369,566	12,888,454	9,802,007	32,794,068	46,012,668	2,707,878
- to banks	4,889,057	3,117,513	39,643	209,603	223,153	471,922	357,152	150,545	87,219	6,120
- to customers	27,129,557	8,254,308	2,063,576	4,775,723	6,146,413	12,416,532	9,444,855	32,643,523	45,925,449	2,701,758
Balance sheet assets (31/12/2009)	**33,436,405**	**11,380,994**	**2,234,601**	**5,102,192**	**7,172,058**	**13,926,932**	**11,827,387**	**41,590,341**	**58,644,139**	**2,713,236**
Balance sheet assets (31/12/2008)	**34,200,990**	**3,420,587**	**3,883,274**	**5,041,184**	**9,389,090**	**10,956,645**	**10,521,253**	**34,927,755**	**49,829,732**	**14,679,650**
Financial derivatives with exchange of principal	758,314	3,889,184	3,428,817	6,112,677	11,714,970	9,427,476	7,912,809	3,502,281	1,951,494	3,547
- Long positions	469,245	1,657,992	1,688,765	3,089,089	5,993,877	4,899,380	3,817,636	1,962,620	940,409	1,181
- Short positions	289,069	2,231,192	1,740,052	3,023,588	5,721,093	4,528,096	4,095,173	1,539,661	1,011,085	2,366
Financial derivatives without exchange of principal	3,416,465	180,483	245,764	582,964	1,966,407	23,082,272	5,631,683	32,785,167	33,214,237	7,229
- Long positions	376,630	160,579	231,098	508,632	1,756,271	10,557,838	5,142,303	31,270,141	31,323,700	-
- Short positions	3,039,835	19,904	14,666	74,332	210,136	12,524,434	489,380	1,515,026	1,890,537	7,229
Deposits and borrowings receivable	900,324	122,241	1,888,093	6,471	73,262	14,196	-	-	-	-
- Long positions	898,798	-	601,689	-	1,783	24	-	-	-	-
- Short positions	1,526	122,241	1,286,404	6,471	71,479	14,172	-	-	-	-
Irrevocable commitments to disburse funds	7,578,843	309	4,842	1,830	92,097	289,244	740,291	21,857,152	8,980,750	512,532
- Long positions	991,840	309	4,842	1,830	56,597	167,044	397,932	11,188,143	6,966,143	473,125
- Short positions	6,587,003	-	-	-	35,500	122,200	342,359	10,669,009	2,014,607	39,407
Financial guarantees issued	9,647,082	-	-	-	6,954	8,906	41,648	118,589	102,555	174,674
Off-balance-sheet transactions (31/12/2009)	**22,301,028**	**4,192,217**	**5,567,516**	**6,703,942**	**13,853,690**	**32,822,094**	**14,326,431**	**58,263,189**	**44,249,036**	**697,982**
Off-balance-sheet transactions (31/12/2008)	**12,791,304**	**8,686,410**	**6,086,120**	**10,319,038**	**15,890,797**	**11,714,601**	**15,674,632**	**11,213,563**	**9,859,844**	**1,486,016**

The table shows the time distribution by residual contractual life of financial assets. The values indicated are those used In the financial statements and refer to both the banking book and trading portfolio for supervisory purposes.

Table 5.6 - Balance sheet exposures to banks: changes in overall value adjustments

Source/Categories	NPLs	Watchlist	Restructured	Past due	Total 31/12/2009	Total 31/12/2008
A. Gross exposure, opening balance	**49,675**	**20,281**	**-**	**87**	**70,043**	**7,941**
↳ of which: financial assets sold and not derecognised						
B. Increases	**7,656**	**6,163**	**-**	**86**	**13,905**	**66,715**
B.1 Value adjustments	6,253	6,163	-	-	12,416	22,073
B.2 Transfers from other impaired exposures						-
B.3 Other increases	1,403	-	-	86	1,489	44,642
C. Reductions	**15,261**	**3,516**	**-**	**172**	**18,949**	**3,907**
C.1 Writebacks from evaluation	540	52	-	86	678	3,852
C.2 Writebacks from recoveries	-	-	-	-	-	-
C.3 Write-offs	-	-	-	-	-	-
C.4 Transfers to other impaired exposures	-	-	-	-	-	-
C.5 Other reductions	14,721	3,464	-	86	18,271	55
D. Gross exposure, closing balance	**42,070**	**22,928**	**-**	**1**	**64,999**	**70,749**
↳ of which: financial assets sold and not derecognised	-	-	-	-	-	-

Data reported in the 31/12/2008 column was restated as compared to previously published reports according to new provisions set out in Bank of Italy's Circular letter no. 262, with a view to making it comparable with data as at 31/12/2009.

Table 5.7 - Balance sheet exposures to customers: changes in overall value adjustments

Source/Categories	NPLs	Watchlist	Restructured	Past due	Total 31/12/2009	Total 31/12/2008
A. Gross exposure, opening balance	**4,755,904**	**709,938**	**11,371**	**65,855**	**5,543,068**	**2,557,826**
↳ of which: financial assets sold and not derecognised	760,411	757	-	1,288	762,456	803,594
B. Increases	**1,786,035**	**678,335**	**25,542**	**61,659**	**2,551,571**	**4,292,738**
B.1 Value adjustments	1,334,965	616,338	24,769	50,246	2,026,318	1,704,395
B.2 Transfers from other impaired exposures	235,405	6,518	773	10,048	252,744	146,716
B.3 Other increases	215,665	55,479	-	1,365	272,509	2,441,627
C. Reductions	**603,638**	**473,994**	**12,218**	**59,605**	**1,149,455**	**1,307,496**
C.1 Writebacks from evaluation	335,035	128,189	7,979	36,275	507,478	331,214
C.2 Writebacks from recoveries	62,211	21,675	237	1,065	85,188	319,367
C.3 Write-offs	189,873	106,187	3,082	4,830	303,972	292,918
C.4 Transfers to other impaired exposures	1,092	212,155	920	16,914	231,081	146,716
C.5 Other reductions	15,427	5,788	-	521	21,736	217,281
D. Gross exposure, closing balance	**5,938,301**	**914,279**	**24,695**	**67,909**	**6,945,184**	**5,543,068**
↳ of which: financial assets sold and not derecognised	2,339	3,848	-	2,241	8,428	762,456

Data reported in the 31/12/2008 column was restated as compared to previously published reports according to new provisions set out in Bank of Italy's Circular letter no. 262, with a view to making it comparable with data as at 31/12/2009.

Table 6 - Disclosures for portfolios treated under the standardised approach and specialised lending and equity exposures treated under IRB approaches

Qualitative disclosure

The Montepaschi Group uses the following official rating agencies for legal entities not subject to AIRB validation as well as for statutory portfolios, for which the advanced internal rating system to calculate capital absorption on credit risk is not used:

- Standard & Poor's;
- Moody's Investor Service;
- Fitch Ratings.

The Montepaschi Group, with the above exceptions, uses the official ratings on the following portfolios:

Portfolios and official ratings

Rating characteristics (a)	ECA/ECAI	Portfolios
Exposures to governments and central banks	• Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited/Unsolicited
Exposures to multilateral development banks		
Exposures to international organisations	• Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited
Exposures to corporates and other persons		
Exposures to undertakings for collective investment in transferable securities (UCITS)		
Securitization positions with short-term ratings	• Standard & Poor's Moody's Investor Service Fitch Ratings	NA
Securitization positions other than those with short-term rating		

(a)
- ***solicited rating:*** *a rating assigned for a fee following a requestfrom the entity evaluated. Ratings assigned without such a request shall be treated as equivalent to solicited ratings if the entity had previously obtained a solicited rating from the same ECAI*
- ***unsolicited rating:*** *a rating assigned without a request from the entity evaluated and without payment of a fee*

Quantitative disclosure

Table 6.1 - Portfolios treated under the standardised approach

Standard portfolios	Classes of creditworthiness							Total	Deductions from regulatory capital
	1	2	3	4	5	6	No credit-worthiness class applied		
Central governments and central banks	24,835,826	88,003	-	1,094	-	-	238,765	25,163,688	-
Supervised institutions	15,793,612	866,740	104,877	143,945	35,967	-	276,818	17,221,959	161,312
Regional governments and local authorities	3,254,250	-	1,443	-	-	-	15,615	3,271,308	-
Non-commercial and Public Sector Entities	1,094,850	-	7,275	1	-	-	798,941	1,901,066	-
Multi-lateral development banks	299,468	-	-	-	-	-	866	300,334	-
International Organisations	-	-	-	-	-	-	102	102	-
Corporates and other persons	948,367	610,176	792,053	107,813	-	6,300	32,862,788	35,327,497	-
Retail exposures	-	-	-	-	-	-	13,180,645	13,180,645	-
Exposures to UCITS	-	-	-	-	-	-	348,570	348,570	-
Exposures secured by real estate property	-	-	-	-	-	-	11,556,015	11,556,015	-
Past due exposures	-	-	-	-	-	-	4,514,414	4,514,414	-
High-risk exposures	-	-	-	-	-	-	717,446	717,446	-
Securitization positions	20,284	413,057	70,468	14,965	-	5,671	5,393	529,839	-
Other exposures	-	-	-	-	-	-	9,133,229	9,133,229	534,482
Total 31/12/2009	**46,246,656**	**1,977,976**	**976,116**	**267,818**	**35,967**	**11,971**	**73,649,607**	**123,166,112**	**695,794**
Total 31/12/2008	**36,903,126**	**1,465,237**	**1,072,497**	**324,368**	**935,459**	**9,133**	**83,260,256**	**123,970,055**	**625,481**

The Table shows the Banking Group's exposures subject to the standardised approach to credit risk; the exposures are reported by classes of creditworthiness (ECA/ECAI rating) and by regulatory exposure classes. The exposures are determined according to prudential supervisory regulations and take account of risk mitigation techniques (netting agreements, guarantees etc.).
Class 1 contains positions with the lowest risk weighting ratios which correspond to the best ratings (eg. Aaa for Moody's, AAA for Fitch and AAA for Standard & Poor's); the higher the creditworthiness class, the higher the risk weighting becomes, with class 6 defining the worse ratings (e.g.Caa1 and lower for Moody's, CCC+ and lower for Fitch and CCC+ and lower for Standard & Poor's).
The external ratings used in this table reflect the relevant treatment set out for prudential supervision purposes.
The last column, "Deductions from regulatory capital"shows exposures not considered for weighting purposes as they are directly deducted from regulatory capital.

Table 7 - Credit risk: disclosures for portfolios treated under IRB approaches

Qualitative disclosure

7.1 AIRB Authorisation

With decree no. 647555 of 12 June 2008, the Bank of Italy authorized the Montepaschi Group to use advanced internal rating based (AIRB) systems to calculate the capital requirements for credit and operational risk. In particular, whereas the Montepaschi Group will use the standardised approach ratios for Exposure at Default (EAD), the Group is by contrast 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:

- the AIRB approach will be used by Banca Monte dei Paschi di Siena and MPS Capital Services;
- the standardised approach will be used for all remaining legal entities of the Montepaschi Group and portfolios acquired from Banca Antonveneta.

7.2 Internal rating system structure

The Montepaschi Group began using internal rating systems for the measurement of credit risk in 2002. The first Probability of Default (PD) models were developed for the small and medium-sized enterprises (SMEs) and Small Businesses (SB) portfolios which still remain the "core business" of the Group; subsequently, rating models were also estimated for other types of exposure and a Loss Given Default (LGD) estimation model was implemented.

The rating system has thus become, over

time, one of the main elements of assessment for all units involved in the credit industry, both at Head Office level (Risk Management, Chief Financial Officer, General Management, Risk Committee, Board of Directors) and at branch level (Credit Management Area, Loan Lab units and Relationship Managers).

Thanks to the experience accumulated, the Montepaschi Group has decided to further invest in internal rating systems, starting, at the beginning of 2006, with the Basel II Project aimed at improving the existing internal procedures by adjusting them to the new prudential supervisory regulations for Banks which came into force on January 1, 2007 with Legislative Decree no. 297 dated 27 December 2006. This project ended in 2008 with the authorisation from the Bank of Italy to use advanced internal rating systems (AIRB) for PD and LGD with a view to calculating capital requirements for portfolios of "non-financial companies" and "retail exposures" for the above-mentioned banks.
In line with an internal overall 'advancement plan', the MPS Group continued the process of refinement/revision of its rating models for corporate and retail clients in the course of 2009, both with a view to maintaining and upgrading the rating systems and for the purpose of extending the rating models to 'Banca Antoveneta', the newly acquired entity of the Group which was taken over in 2008.
For the estimation of PD and LGD models in line with lending and credit collection activities, meetings were held, during the development phase, with the persons in charge of the credit granting and credit collection management processes for a shared selection of variables and consistency of results.
The development of the internal rating systems involved the adoption of strict and advanced statistical methodologies in compliance with the requirements set out in the regulations; at the same time, models were selected in such a way as to make results consistent with the historical experience of the bank in credit management.
Lastly, in order to optimise the proper use of these new instruments, the rating models were shared with a top-down approach - from Risk Management down to individual client managers by means of intense training.
Estimation of the LGD model was based on internal data relative to capital flows, recoveries and expenses actually incurred on positions transferred to the non-performing portfolio.
Results obtained from model application were then compared with data recorded by MPS Gestione Crediti Banca, a company of the Group dedicated to the management and

recovery of non-performing loans.

The introduction of advanced rating systems in the credit process was an important cultural step forward which is now becoming a well-established practice for all business units of the Group.

The main characteristics of the advanced rating systems are as follows:

- for all regulatory portfolios subject to validation, the rating is calculated with a counterparty-based approach for each individual borrower, in line with the accepted management practice which provides for the assessment of credit risk, both in the disbursement and monitoring phases;
- ratings are based upon a Group logic: each individual counterparty is assigned a single rating at banking Group level, based on the set of information pertaining to all lending banks within the AIRB scope; there is one LGD reference definition for retail banks while there are different reference definitions for product companies;
- LGD reflects the economic (and not only the accounting) loss incurred; for this reason, LGD estimates must also include the costs incurred for the recovery process and a time factor;
- the rating model segmentation is defined in such a way as to make the individual model clusters consistent with commercial objectives, credit process logics and regulatory portfolios set out in the regulations;
- loss given default is differentiated by type of loans and an LGD value is assigned at the level of each individual transaction;
- customer segmentation for LGD estimation and assignment follows the same logics as with the rating models; for clusters to acquire significance, segments were aggregated together under "Retail" for retail exposures and "Corporate" for exposures to non-financial corporates;
- the loss rate is differentiated by geographical area since historical and current recovery rates are different among Northern Italy, Central Italyand Southern Italy and Islands;
- loss on defaulted positions other than non-performing loans is estimated with a Cure Rate approach. With regard to counterparties whose exposures are administratively classified as Watchlist, Restructured and Past Due, the percentage of exposures reverting back to a performing status was calculated and used to adjust LGD for positions other than NPLs.
- the calculation of the final rating is differentiated by type of counterparty. The credit process envisages a level of in-depth analysis proportional to counterparty

risk: the assessment of loan disbursements is based on a complex multi-level structure for medium-large corporate counterparties (SME and Large Corporate (LC) segments), whose exposure and concentration risks are higher, and a simplified structure for Small Business and Retail clients;

- in line with this process, the final rating for SMEs and LC is the result of a number of different factors: statistical rating, qualitative rating, overrides and valuation of the 'economic group' which businesses belong to; for SB and Retail counterparties the rating is calculated only on the basis of statistical factors;
- the rating has a 12-month internal validity period and is usually reviewed on a yearly basis, except for rating reviews following well-structured codified practices or that are brought forward on client managers' request or following serious counterparty deterioration.

The Montepaschi Group has adopted one Master Scale for all types of exposures, which enables all units involved in credit management to immediately compare the risk level associated with different counterparties or portfolios; furthermore, the probabilities of default of internal rating classes were mapped against Standard&Poor's external rating scale so as to make internal risk measurements comparable to those available on the financial market.

The rating system development and monitoring activities are functionally assigned to the Risk Management Area. The estimation procedure is carried out according to an internal development protocol to make sure that estimation activities are transparent and visible for the Internal Controls and Auditing departments.

Overall master scale of the MPS Group

PD Class	PD up to
1	0.13%
2	0.46%
3	2.42%
4	16.03%
5	45.00%
6	Default

Risk Management periodically carries out monitoring/backtesting analyses on the internal models to verify their performance stability over time. Should significant vulnerabilities emerge from the analyses, model fine-tuning or 're-estimation' procedures are put in place.

The Montepaschi Group currently has 14 rating models and one LGD model (differentiated by geographical area, type of loan, type of guarantee, guarantee coverage ratio

and exposure at default) for the measurement of risk in validated regulatory portfolios. The internal roll-out plan over the next few years includes extending the models to all Group Business Units and to the other regulatory portfolios.

7.3 Use of Internal Models

Prior to authorisationa from the Bank of Italy enabling the Montepaschi Group to calculate capital absorptions according to the rules set out for the advanced internal rating systems, the Group used the parameters underlying the calculation of Risk Weighted Assets also for other operational and internal management purposes. The basic principle called for the use of Basel 2 input factors -as much in line with operating requirements as possible- even though, for obvious reasons, operational practices naturally diverge from supervisory standards, with some methodological fine-tunings and adjustments required for internal purposes and calculation systems. In particular, common "across-the board" parameters used for both "supervisory reporting" and "operational" practices are in relation to the Probabilities of Default (PD) resulting from internal rating systems and the loss rates on the "impaired" portfolio (LGD). The latter provide the basis of calculation for different systems of measurement and monitoring, and specifically for:

- **Measurement of economic capital for credit risk.** Among the inputs used for the credit model and related VaR output to be operational, the same PD and LGD variables are applied as those that are also used for regulatory purposes. It is clear that certain adjustments have been necessary, such as the use of probabilities of default "not subject" to validation for portfolios other than "Corporate" and "Retail", resulting from internal rating systems not yet subject to validation or from main rating agencies, appropriately mapped to the internal master scale. With regard to LGD, the Group uses parameters estimated on the basis of portfolios subject to validation according to provisions set out by supervisory authorities, although excluding the economic downturn effect that is contemplated only for regulatory purposes. Out-of-validation portfolios use parameters estimated on the basis of medium-long term recovery rates, if any, or LGD rates in line with

those set out by internal provisions under the FIRB approach.

Specific emphasis must be placed on economic capital measurements for legal entities outside the scope of validation. In light of the principle of univocal ratings, wherever possible, the Group uses, for customers of these legal entities, the final rating assigned to borrowers "shared" with the entities subject to validation (given that "customer sharing" is very high between validated and non-validated legal entities), since the determination of shared customers' ratings, based on financial, 'behavioural' and qualitative data, is in any case grounded in quantitative and qualitative data arising from exposures consolidated at Group level subject to AIRB treatment or in qualitative assessments made by the client managers, against the overall exposure background. With reference to the remaining part of the loan portfolio, the same rules as those described above were applied to portfolios not included in the AIRB scope, pertaining to the approved legal entities. As far as the LGD parameter is concerned, non-validated legal entities are assigned loss rates arising from the specific business sector in which the legal entity subject to measurement is involved (in the case of MPS Leasing and Factoring, for example, medium-long term loss rates were estimated in relation to the typical forms of business of this legal entity whereas,in relation to the remaining types of exposures, the Group has used loss rates determined on the basis of the clients pertaining to the legal entities subject to validation, it being understood that NPLs in the Montepaschi Group are centrally managed for all legal entities by MP Gestione Crediti and are therefore based on the operational, qualitative and implementation metrics used by the banks subject to validation. Although EAD for supervisory purposes follows the standardized approach as it is not subject to validation, it is calculated as the sum of drawn amounts plus undrawn balance (Committed Amount - Drawn Amount) multiplied by a Credit Conversion Factor (CCF) which differs by type of exposure and worsens as the default probability assigned increases.

- For the calculation of **risk-adjusted performance and measurement of value creation,** the Group follows the same calculation logic as used in the loan portfolio model both for legal entities subject to validation and for those that are excluded from the scope. Furthermore, whenever new estimates or readjustments are made to the internal rating system subject to validation, adjustment results are incor-

porated in the VBM procedures which ensure continuous output alignment with the latest updates.

- The parameters which feed the calculation model for the **risk-adjusted pricing process** are the same as those used for the loan portfolio model, even though with some extensions implicit in the pricing model. The pricing model which price-marks different types of loans with different maturities, requires input not only from the annual Probability of Default but also from marginal, forward and multi-period PDs. For these reasons, the Montepaschi Group has developed specific calculation methodologies for these default probabilities, all in compliance with the annual PD resulting from the validated rating systems. Similarly, LGD calculation is based on the same criteria as those used and mentioned above for the Loan Portfolio Model, though not taking account of economic down turns.
- In relation to **credit process monitoring** (loan trend management, systematic surveillance, operating powers,…):
  - processes of loan disbursement to customers included in the AIRB scope of application have been completely 're-engineered' with the Electronic Credit Facility Record software. The Montepaschi Group's counterparty rating is the result of a process which evaluates - in a transparent, structured and consistent manner - all the economic-financial, 'behavioural' and qualitative information relative to customers with whom the bank has credit risk exposures, based on model definitions, the use of information sources and methodological / operational solutions diversified by homogenous groups of counterparties. The official rating thus determined has ordinary validity up to the twelfth following month and shall be reviewed by the end of that month. However, the rating review in the monitoring process may be prompted at an earlier date during the validity period if ongoing, major monthly statistical PD variations - exceeding specific cut-offs - are intercepted. The loan disbursement system is organised into several 'paths', depending on the type of customer and transaction requested, which envisage the possibility of executing the process of assigning a rating to each counterparty and do not allow for any decision-making powers to be exercised in the absence of a valid rating.

- The current algorithm for automatic detection of positions under **Systematic Surveillance** is based on the use of new rules which make use of two metrics: a) an "Official" Rating, i.e. the rating calculated by the internal models on which the stabilisation rules are applied; b) the synthetic anomaly index (it. ISA) in relation to the customer's credit behaviour, calculated in the presence of at least one reported critical event, which increases in grade based on the risk level, as made available in the Operating Credit Management system. The Systematic Surveillance process is fed with data relating to the 'critical portfolio', identified as a result of a combination of the two metrics with a total score being assigned to each position, which is equal to the simple sum of the scores relating to the Official rating and the Synthetic Anomaly Index of reference. Defaulting and E3-rated positions are automatically classified as "disengagements (it. *in disimpegno*)".
- The Simplified Renewal process for the electronic credit facility record is based upon the monitoring of ratings over time and a timely revision of the credit facility record when the level of impairment is such that there is an increased perception of risk resulting from either the credit facility being intercepted by the Systematic Surveillance software or serious ISA (Synthetic Anomaly Index) events being reported. This process is applied to all counterparties with credit facilities subject to revision, which have matured or will mature in the month of reference.
- The principle underlying decision making powers provides for levels of approval to be assigned on the basis of individual counterparty ratings (risk-based decision-making powers), exposure amounts, risk 'intensity' depending onthe type of borrower and characteristics of the transactions. The system is based on translation of the nominal amount into a risk-weighted amount. A fixed discretionary power of approval is assigned to the decision-making bodies, making reference to a so-called 'anchor point' (corresponding to a certain internal rating) resulting from a combination of risk factors which make the nominal amount equal

to the risk- weighted amount. The weighting system developed makes it possible to increase the nominal amounts falling within the scope of approval when the ratings improve and to reduce them if the ratings deteriorate. Exceptions to this rule are made for levels of approval assigned to corporate decision-making bodies (i.e. Credit Committee, Executive Committee and Board of Directors).

The policies for recognition of credit risk mitigation guarantees are implemented through a dedicated IT process which is applied for reporting purposes and does not overlap the rules for managing guarantees and collaterals applicable to the loan disbursement process. The IT application manages all rules for the admissibility of guarantees. The process is based on a first step registry of all guarantees, which outlines the Group operational framework. At a later stage, the data of each individual guarantee is assessed through an analysis of its specific characteristics. In particular, the following general requirements are verified:

- legal certainty;
- enforceability of Guarantee against third parties:
- timely liquidation;
- compliance with organisational requirements.

The importance of the internal ratings for operating purposes made it necessary to set up a rating system control and validation unit within the Montepaschi Group, which is organisationally independent from - and acts as a point of reference and guidance for- the unit established for the systems' development, maintenance and review. This unit meets the "Credit Risk Control Unit" requirements of statutory regulations for validation controls to be fulfilled.

7.3.1. Management Models

An advanced internal rating system, according to current regulations in force (see Circular no. 263 BI - Title II, Chapter 1 - Section III), should provide for appropriate forms of review and inspection at all levels of control activities.

The AIRB system used by the Montepaschi Group provides for the execution of automatic controls, i.e. controls regulated by specific operational protocols (e.g. hierarchical controls), within the operating units involved in the process of rating assignment. These controls are aimed at making sure that activities preliminary to rating assignment are properly performed (i.e. selection

of a model suitable for customer or transaction assessment, identification of economic or legal relations between customers, compliance with internal procedures oriented to obtaining the information necessary for the assignment and updating of the rating). The Model and Credit Systems Validation Staff (responsible for validation controls, hereinafter referred to as "Staff") within the Credit Credit Management Area, shall be responsible for the following levels of review contemplated by the regulations. The Staff steadily evaluates whether the estimates of all important risk components are accurate and produces the annual Internal Rating System Validation Report (hereinafter IRSV Report) of the Montepaschi Group expressing an opinion on the regular operations, prediction power and overall performance of the IRB system adopted. The Risk Committee expresses its opinion on the annual validation of the IRSV Report, on the basis of the opinion of the validation unit.

The Internal Controls Area (hereinafter ICA) is responsible for the valuation of the functional efficiency of the overall controls on the rating system (reviews).

The methods adopted by the above operating units in relation to the operational procedures of validation and review are briefly illustrated below.

7.3.2 Internal Rating System Validation Process

The responsibility for IRS validation has been allocated to the Risk Committee of the Parent Company. The Risk Committee is supported by the Staff unit in carrying out operational activities that are functional to validation. The Staff unit was established in 2006 with the specific task of reviewing the proper operations of the IRS and checking compliance with the regulatory requirements set out in Circular no. 263 of the Bank of Italy.

The results of these controls are pointed out and reported periodically to the Top Management, the first level units and the ICA. Once a year these results are included in the "Annual Internal Rating System Validation Report" which expresses an overall opinion on the position of the IRS with respect to the supervisory requirements. The Risk Committee validates the IRS on an annual basis, in accordance with such opinion.

The validation process, within which the above-mentioned controls are carried out with a view to finally validating the Rating System, consists of the following formal validations:

- **validation of the rating assignment process:** checks compliance of the internal rating assignment process with the

minimum organisational requirements of Circular no. 263 of the Bank of Italy, with a specific focus on the analysis of consistency of modifications to the rating models attributable to human action with the guidelines given to the units involved in rating assignment;

- validation of **models:** checks that the statistical models for the production of the risk parameters used by banks maintain specific performance levels and comply with the minimum organisational and quantitative requirements provided for by the rules; and in particular the following is verified:
  - **performance:** assessment of the prediction power of the model and therefore its power to separate highly solvent customers from potentially hazardous customers;
  - **calibration:** check whether the risk preliminarily assigned to each class of rating matches the observed historical risk;
  - **stability:** assessment of the stability of the assigned ratings over time;
  - **stress testing:** review of stress testing activities carried out on the models by the model development unit.
- validation of the IT systems: reviews compliance with the minimum requirements set out by the regulations in relation to the quality of data used by the IRS;
- validation of the use of the IRS in corporate processes: reviews the actual use of the rating system in the business, by identifying the players and processes involved with particular reference to the loan disbursement and renewal processes.

The process of validation involves the preparation of questionnaires for each scope of action identified, with the objective of checking compliance of each aspect of the IRS with regulatory requirements. The detailed positions on each requirement are collated in an overarching opinion of validation through a system of scoring of the replies and weighting of the questions.

The methods chosen meet the requirement of making the process of validation transparent and objective, not only with respect to the Supervisory Authorities but especially to each operating unit which develops the IRS and is informed of any faults in the system, for correction. This ensures easier action on the gaps and consequently a better control of the proper operations of the IRS by the Staff.

7.3.3 Process of internal review of the internal rating system

In line with the existing regulations (see Su-

pervisory Instructions - Title IV, hapter 11, Section II), the Internal Controls Area of the Montepaschi Group adopts the professional Standards and guidelines of the main domestic and international entities, through an independent and objective activity of assurance and advice aimed at controlling, also through on site inspections, the regular operations and risk trend and assessing the functional efficiency and compliance of the Internal Control Systems in order to improve the effectiveness and efficiency of the organisation.

The introduction of advanced systems of risk measurement and management (in particular, with reference to credit risk, see Circular no. 263 of 27 December 2006 "New regulations for the prudential supervision of banks" - Title II, Chapter 1, Second part, Section III) determined an extension of activities mandated to the Internal Audit unit and related responsibilities. The role assigned to the unit represents a further specialisation of traditionally falling within the sphere of competence of the ICA, which can be usefully supported by a well-established systemised approach that has been in use for some time now.

The overall review approach focuses on the objective of providing a coherent assessment of adequacy, in terms of both effectiveness and efficiency, of the control systems of the rating-based process of governance and management of credit risk.

In particular, the responsibilities assigned to the internal audit unit by the above-mentioned Circular, with reference to the review of the advanced models for credit risk assessment and management can be summarised in three following points:

1. Assessment of the overall functional efficiency of the control system of the AIRB approach;
2. Assessment of the functional efficiency and regularity of the internal validation process;
3. Review of system compliance with the requirements for regulatory use of risk estimates.

However, the main operating components attributable to the adoption of an internal rating system require that the review of that process be considered as part of a larger analysis and assessmentof the whole loan management process. The objective is to ensure the materialisation of important synergies from the point of view of the actual cost of implementation and, above all, the overall and coherent observation of the events analysed which share different audit findings on the rating process stemming from the reviews carried out in the distribution network and Group companies.

The audit controls to be carried out for an assessment of the above-mentioned aspects are in relation to the following kinds of activities:

- Functional efficiency checks, i.e. control activities for identifying any existing adequate rules (process regulations, circulars, system of the limits and authorisation powers etc.) instruments, IT systems and formalised processes, which ensure the mitigation of risk and the efficacy and effectiveness of the activities, i.e. the adequacy of the overall organisational solutions with respect to the objectives to be achieved.
- Conformity checks i.e. control activities, normally on a sample basis, for reviewing the regularity in terms of application and compliance with the internal rules and identified best practices
- Failing any internal formalised operational/regulatory references, conformity checks also ensure the review of normally adopted practices. Thus, having ascertained the material control of the significant aspects by the units/ activities assessed, it is possible to concentrate any comments and remarks on failure to anticipate these aspects.

As a result of the different kinds of control, the internal audit unit performs its responsibilities which consist in reviewing the validity of the whole IRS and the validation process as well as compliance of the system with the regulatory requirements.

7.4. Description of the Internal Rating Systems

For the calculation of capital absorption against credit risk, the Montepaschi Group uses **internal rating** systems for the following regulatory classes:

- Corporates,
- Retail exposures.

7.4.1. Internal Rating Model for Corporates

PD models

In 2009, PD and LGD models were re-estiIn 2009, PD and LGD models were re-estimated. The methodological decisions taken were essentially in line with previous models and the developments introduced were continuously compared and contrasted among all relevant functions.

For the re-estimation of PD models, the Montepaschi Group adopted a default-based methodology. Among the statistical techniques used in the estimation of models with dichotomous bad/good target variables, a logistic regression was selected, characterised by the optimal trade-off between statistical soundness and interpretability of results

The "non-financial businesses" portfolio includes all balance-sheet and unsecured exposures to companies with registered offices in Italy and relating to the banks, Monte dei Paschi, Antonveneta and Capital Services.

The Montepaschi Group operates almost entirely in the domestic market and therefore, due to the low significance of foreign operations, it took the decision to exclude all exposures to foreign Corporates from the application of advanced systems. The data source observation period for the estimation of PD is 7 years (2002-2008), in compliance with Bank of Italy regulatory instructions.

- **Model segmentation**

  Corporate customers were segmented beforehand in order to obtain consistent clusters by risk profile. To this end, a size logic was used (based on the legal form of a company and its turnover) which appears to

  be consistent from both the statistical and operational point of view.

  Any information on turnover is obtained from the company balance sheet prepared in accordance with the Fourth EEC Directive in relation to the last available annual report. The segment of Small Businesses (one-man businesses and partnerships) consists of companies which are not subject to the obligation of preparing balance sheets for legal purposes. Tax data are not currently used in the segmentation.

- **Default definition**

  During the stage of development of the PD models, the following definition of default is used: defaulting counterparties are a sub-group of customers with an exposure (credit line granted or drawn) which, in an ordinary condition in a specific month of the year, show at least one impairment anomaly within the following twelve months.

  The anomalies contained in the definition of default include non-performing loans, watchlist loans, restructured loans. Past-due positions for a period in excess of 180 days are included as of 2006, the year from which the reporting of such positions became mandatory. Furthermore, the decision was taken to use an internal definition of past due, so called "technical", to identify instances not representative of a state of financial difficulty that is liable to generate an economic loss (option granted to banks by the regulations at issue), in line with relationship managers' actual business-based expectations of economic loss.

  The rules applied, and subjected to review in the course of last year, allowed a sub-set of alerts to be identified, involving vulnerabilities similar to other impairment states (particularly watchlist); the rationale adopted was aimed at integrating defaulting positions with positions which show no temporary anomaly but are characterized by aspects featuring in other states of impairment..

  The definition of 'technical past due loans' was used consistently for PD and LGD estimates.

  Defaulting positions are identified at MPS Banking Group level.

- **Development stages of the rating models**

  Two main stages of development are envisaged for each rating model: score model estimate and calibration.

- **Score model estimate**

  All information sources available are taken into account for the estimate of each rating model. A modular approach was adopted to maximize the prediction power of each information source, i.e. a (financial, internal trend, industry trend) standard module was estimated for each information source with the following determination of the final model as a combination of all modules.

  The information sources used for corporate models are the following:

  - balance sheet reports,
  - internal trend data,
  - industry data (Central Credit Regis-

ters of the Bank of Italy and of trade associations).

As far as the balance sheet is concerned, a set of indicators covering all areas of inquiry contemplated by corporate financial analysis was determined, including debt coverage, financial structure, liquidity, profitability, productivity, development.

With reference to lending trend components, the variables normally used by the account managers for risk valuation were restated (i.e. types of use of loan forms, account movements, number of irregularitie found). The variables are calculated for each type of loan (callable, self-liquidating, upon maturity etc.) and are determined at the Group level over a time horizon of 12 months.

As per the internal practice, the stage of development follows all procedures contemplated by a statistical inquiry (i.e. determination of a development sample (70%) and a test sample (30%), fact-finding analyses and preliminary data treatment, univariate analyses, correlation analyses and short list determination, multivariate analyses, model selection and review of out of sample performances.

- **Calibration**

Claibration is a process for estimating the function which transforms the score models output into default probability, i.e. the probability that a counterparty is in default within one year.

The internal method envisages the estimate of a function which shows the best fitting level with bad rates (default rates observed) associated with the bucket scores included in the calibration sample. From a technical viewpoint, this is done through the linear regression between the bad rate logarithm and an appropriate conversion of the average bucket score (normally exponential functions are used) linked to the model anchor point. The anchor point represents the level of risk traditionally associated with the specific segment which the model is calibrated on. It is calculated on the basis of the long term default rate and qualitative considerations the analyst deems appropriate to introduce.

In particular, for the purpose of being in line with the 'Basel 2 compliant' definition and achieving appropriate prudential metrics, it was decided to reweigh the default rates taking account of the past due (only technical) effect, also in the first four years of the historical series. The model anchor point was therefore determined by introducing the specific weight of the past due loans examined in 2006 (net of the so-called technical past due loans) in the

other estimate periods.

The estimated grading function is used to calculate the point-in-time PD which is subsequently mapped on the Montepaschi Group Master Scale. Each counterparty is assigned a PD level corresponding to its rating class.

LGD Model

The estimated loss rate, as provided for by the "New regulations for the prudential supervision of banks", is the long term average of realised losses, weighted by the number of counterparties and not by exposure.

The Group uses a work-out model based on historical evidence of sets of defaulting transactions with similar characteristics.

The database used to estimate the parameter includes all balance-sheet and unsecured exposures relating to the banks within the scope of validation, that were classed as "non-performing" from January 1987 to June 2009, for which either the recovery process has terminated or, if still active, whose balance is zero or seniority exceed 15 years.

The relevant clusters for the estimates include the geographic area, type of customers, loans, exposures transitioning to a default state, guarantees and their percentage of coverage.

- **Model segmentation**

  The corporate segment includes all counterparties which have been segmented according to the rating model logics and can be defined as large corporates, SMEs, small businesses or small economic players.

- **Definition of Default**

  The definition of default used during the stage of development of the LGD model matches the definition of the rating models, namely defaulting counterparties are the sub-group of customers with an exposure (credit line granted or drawn) which, in an ordinary condition in a specific month of the year, show at least one impairment anomaly within the following twelve months.

- **Development stages of the LGD model**

  The LGD estimate includes three main stages: (i) the measurement of the loss rate actually registered in the history of each individual legal entity in relation to the non-performing customers, (ii) the calculation of the LGD downturn, i.e. an indicator which takes account of the adverse phases of the economic cycle; (iii) the calculation of the LGD for all loan statuses other than non-performing loans.

- **Loss Rate for Non-Performing Positions**

  Realised collections minus the costs incurred with respect to defaulting exposures are compared to calculate the LGD rate actually observed on non-performing positions. Considering that reference is made to the registered economic loss, and not only to the accounting loss, all movements are discounted as of the date the loan is classified as non-performing.

  The interest rate used for discounting is the risk free rate plus a spread which remunerates the opportunity cost of each bank resulting from the non-use of the capital not repaid by the customer.

  As provided for by the regulations, a lower limit of 0% is set since the average LGD cannot be negative.

- **LGD Downturn**

The relation between collection rates and default rates was analysed to determine the adjustment to be made to the LGD estimates in

case of a possible downturn of the economic cycle. Once a negative relation between the two series was ascertained, a regression model was clearly formulated between collection rates and macroeconomic variables. Once the collection rates of expansionary and recessive cycles are determined, the LGD downturn is calculated as long-term default-weighted average, suitable for the recessive phases of the economic cycle.

- **Overall LGD**

  The estimated loss rates on defaulting positions other than non-performing loans starts from the estimated cure rate, i.e. the percentage of Watchlist Loans, Restructured Loans, or Past Due Loans reverting to performing loan status. All corporate performing loans as of January 2002 showing one irregularity from February 2002 to January 2009 were selected to determine this.

  A weighted average of the LGD downturn was calculated, using the cure rates multiplied by the probabilities of default as weights, to determine the LGD rates for the different default positions. The LGD to be applied to all loan transactions of performing customers was determined by using the grading clusters of the rating models.

7.4.2. Internal Rating Model for Retail Exposures

PD Models

A default-based methodology has also been adopted for “Retail exposures”. The portfolio includes all balance-sheet and unsecured

exposures relating to loans granted by the banks, Monte dei Paschi, Antonveneta and Capital Services to Retail customers (natural persons or joint coobligations of natural persons). The data source observation period for the estimation of PD is 4 years (2005-2008).

The Montepaschi Group, in view of the operational pricing practice currently applied, prudently decided to assign Retail customers with the best credit standing an observed probability of default rate not lower than an A1 rating.

- **Model segmentation**

  The Retail portfolio was segmented drawing a distinction beween jointly liable individuals and individual natural persons. In turn, the latter were classified on the basis of their holding an instalment product (mortgage loans or personal loans) or not. The criteria were selected on the basis of the risk profile associated to the cluster and internal historical records.

- **Definition of Default**

  The Group used the definition of default adopted for the corporate models also in relation to the PD models applied to the portfolio of retail exposures.

- **Development stages of the rating models**

  Following are the specific aspects concerning the Retail models, which were developed and graded in accordance with the principles adopted for the corporate models. For the Retail segment, the main sets of information regarding developments are those relating to loans granted by the Group (overdraft facilities, mortgages and small loans) and to the personal data available for the Client and connected parties.

LGD Model

The LGD model for retail exposures includes the stages contemplated for the corporate model. The comments on the estimate data base are only in relation to the Retail segment.

Quantitative disclosure

Following are the quantitative tables for the advanced IRB approach for each regulatory class of activity. In particular, for 2009 the segment "Exposure to Corporates" was divided into "SMEs" and "Other Corporates", as opposed to 2008 when findings were reported in a single table.

Table 7.1 - Exposures to corporates - SMEs

	dec-09						dec-08
PD Class	Exposure	Unused Amount [(a)]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	1,600,409	2,860,288	281,713	9.85%	35.06%	19.14%	2,571,201
Class 2	4,496,051	3,945,339	508,382	12.89%	33.87%	39.11%	7,894,969
Class 3	11,349,674	5,099,613	752,972	14.77%	32.09%	62.04%	21,745,047
Class 4	5,573,452	1,611,978	226,804	14.07%	32.14%	101.61%	8,623,719
Class 5	1,109,703	340,630	42,203	12.39%	32.82%	157.55%	1,318,734
Class 6	4,678,554	316,684	51,562	16.28%	36.40%	-	4,994,449
Total	**28,807,843**	**14,174,533**	**1,863,637**				**47,148,117**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Table 7.2 - Exposures to corporates - Other companies

	dec-09						dec-08
PD Class	Exposure	Unused Amount [(a)]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	2,708,617	4,506,323	674,986	14.98%	41.49%	16.80%	2,717,227
Class 2	5,137,242	8,020,655	1,276,501	15.92%	42.63%	52.07%	5,393,876
Class 3	5,789,050	5,997,114	1,082,019	18.04%	40.99%	85.32%	5,563,049
Class 4	1,088,786	454,319	50,949	11.21%	38.12%	139.79%	1,105,944
Class 5	526,988	281,963	76,601	27.17%	41.27%	232.24%	80,368
Class 6	963,112	178,677	48,384	27.08%	44.13%	-	1,018,972
Total	**16,213,795**	**19,439,050**	**3,209,440**				**15,879,436**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Following are the quantitative tables for the advanced IRB approach for each regulatory class of activity. In particular, for 2009 the segment "Retail exposure secured by real estate" was divided into "SMEs" and "Individuals", as opposed to 2008 when findings were reported in a single table.

Table 7.3 - Retail exposures - Secured by real estate - SMEs

	dec-09						dec-08
PD Class	Exposure	Unused Amount [a]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	28,825	1,194	597	50.00%	20.32%	4.92%	-
Class 2	244,768	8,502	3,844	45.21%	21.32%	14.14%	-
Class 3	724,584	26,174	12,049	46.03%	22.16%	35.79%	-
Class 4	263,023	9,459	3,733	39.47%	22.54%	94.46%	-
Class 5	73,857	1,089	286	26.24%	23.18%	138.80%	-
Class 6	102,018	692	159	22.97%	21.17%	-	-
Total	**1,437,074**	**47,110**	**20,668**				**-**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Table 7.4 - Retail exposures - Secured by real estate - Individuals

	dec-09						dec-08
PD Class	Exposure	Unused Amount [a]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	5,822,648	59,908	24,949	41.65%	13.90%	4.28%	1,695
Class 2	9,702,946	73,564	23,801	32.35%	14.54%	10.03%	14,518,233
Class 3	5,444,487	128,774	56,486	43.86%	15.27%	22.53%	4,076,769
Class 4	931,269	19,521	5,698	29.19%	15.42%	64.83%	1,126,325
Class 5	224,594	2,805	541	19.28%	15.60%	94.26%	54,856
Class 6	496,174	5,249	577	11.00%	15.08%	-	437,975
Total	**22,622,119**	**289,820**	**112,052**				**20,215,853**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Table 7.5 - Retail exposures - Qualifying revolving

	dec-09						dec-08
PD Class	Exposure	Unused Amount [a]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	129	6,858	-	-	33.92%	2.69%	-
Class 2	535	2,732	-	-	35.24%	7.47%	147
Class 3	926	1,838	-	-	37.50%	19.91%	32
Class 4	260	198	-	-	41.29%	66.38%	-
Class 5	46	15	-	-	40.66%	123.98%	-
Class 6	32	98	-	-	57.24%	-	-
Total	**1,928**	**11,738**	**-**				**179**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Following are the quantitative tables for the advanced IRB approach for each regulatory class of activity. In particular, for 2009 the segment "Other Retail exposures" was divided into "SMEs" and "Individuals", as opposed to 2008 when findings were reported in a single table.

Table 7.6 - Other retail exposure - SMEs

	dec-09						dec-08
PD Class	Exposure	Unused Amount [a]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	364,339	661,988	47,948	7.24%	32.62%	8.67%	-
Class 2	1,885,178	1,694,601	182,120	10.75%	31.62%	20.20%	-
Class 3	6,557,696	3,503,598	482,332	13.77%	33.29%	39.35%	-
Class 4	2,947,850	842,201	124,147	14.74%	34.42%	58.73%	-
Class 5	521,565	131,713	12,480	9.48%	33.92%	88.68%	-
Class 6	2,776,378	171,110	27,149	15.87%	47.46%	-	-
Total	**15,053,007**	**7,005,211**	**876,176**				**-**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Table 7.7 - Other retail exposures - Individuals

	dec-09						dec-08
PD Class	Exposure	Unused Amount [a]	Credit equivalent	Average Credit Conversion Factor (average CCF)	Average weighted LGD (LGD%)	Average Risk Weighting factor (RW%)	Exposure
Class 1	982,587	963,773	55,391	5.75%	17.20%	6.06%	5,603
Class 2	901,793	344,596	16,957	4.92%	20.35%	13.49%	1,564,041
Class 3	832,294	342,131	25,278	7.39%	23.39%	27.66%	859,068
Class 4	229,112	46,753	10,742	22.98%	23.62%	39.51%	504,450
Class 5	36,993	5,600	1,939	34.63%	23.02%	61.02%	79,472
Class 6	935,627	17,520	681	3.89%	40.16%	-	777,722
Total	**3,918,406**	**1,720,373**	**110,988**				**3,790,354**

(a) For reporting purposes, Unused Margins and respective Credit Equivalents refer to issued guarantees and revocable and irrevocable commitments to disburse funds

Table 8 - Risk mitigation techniques

Qualitative disclosure

8.1. Netting policies

With reference to the retail and corporate loan portfolio, the Montepaschi Group does not apply any netting processes to the credit risk exposures with on- or off-balance sheet items with opposite sign.
The Montepaschi Group adopts policies reducing the counterparty risk with institutional counterparties, by entering into netting agreements and collateral agreements both in relation to derivatives and repos (repurchase agreements).

8.2. The Management of Collaterals

The Montepaschi Group has fulfilled the obligations set out by the New Regulations for Prudential Supervision for the purpose of recognition of risk mitigation effects produced by any existing collaterals securing the loan.

The disbursement of loans secured by collaterals is subject to specific control measures, differentiated by type of guarantee pledged, which are applied during the phase of disbursement and monitoring. Two main types of guarantees, subject to different regulations, can be identified by volumes of loans granted and number of customers, namely Mortgages and Pledges (Cash and Securities).

With reference to compliance with the main organisation requirements for the mitigation of risk, the Group ensured:

- the presence of an IT system in support of the life cycle phases of the guarantees (acquisition, valuation, management, re-valuation and enforcement);
- regulated policies for the management of guarantees (principles, practices, processes), available to the users;
- the presence of regulated, documented procedures for the management of guarantees (principles, practices, processes), available to the users;
- independence of the customers' insolvency risk (Internal rating) from any existing Collaterals.

For the purpose of limiting residual risks

(termination or non-existence of the value of protection), the Montepaschi Group requires that:

- in the case of a mortgage guarantee, the acquisition of the right be flanked by the underwriting of insurance policies (catastrophic events) in relation to the assets covered by the guarantee, and a report prepared by reliable experts;
- in the case of a pledge, the original value should be reinstated (ensuring the continuity of the guarantee through papers amending the original guarantee) in view of the depreciation of goods pledged. In the case of redemption of the pledge, the repayment should be made at the Bank (collection).

The Montepaschi Group identified a set of technical forms (by purpose of the loan/type of customer) providing for the admissibility of mortgage guarantees.

Within the IT system, the proposal of financing one of these types of loans triggers a request for detailed information on the characteristics of the real estate subject to guarantee (valuation) which, after loan approval, will make the acquisition steps compulsory.

In the specific case of mortgage loans to retail customers, the loan is disbursed according to specific disbursement processes, characterized by a standardised valuation/inquiry process, which gather all information necessary for the proper management of real estate guarantees.

The Montepaschi Group has developed one single process for the acquisition of collaterals which is at the same time a working instrument and the expression of the Group's management policies. The instrument can activate different paths on the basis of the type of guarantee. The management of guarantees starts after loan disbursement approval. The process consists of various steps:

- acquisition (also multiple acquisition); the controls of (formal and amount) consistency with the guarantees proposed during the authorisation phase are performed in this stage;
- adjustment/change/amendment; useful to amend the characteristics of a guarantee without interrupting loan protection;
- query; gives information about the present data and the historical trend of guarantees received;
- repayment/cancellation.

A system to monitor the value of the collaterals on the basis of market values is in place. Monitoring of pledge transactions is carried out on a daily basis for listed securities deposited with the bank, while for mortgages, real estate value is currently verified once a year for non-residentials (where real estate

is subject to point-in-time appraisals every three years for loans with exposures in excess of three million euro) and once every three years for residentials, using a market indices revaluation.

In this respect, it is appropriate to underline that an assessment is made on the assets pledged as collateral during the mortgage loan approval phase. In the specific case of retail mortgage loans, a dedicated disbursement process subordinates disbursement to the submission of a technical survey on the asset pledged, thus ensuring the fulfilment of obligations and compliance with relevant validity requirements upon acquisition of the guarantee.

If the value of the property pledged as a guarantee is subject to market or foreign exchange risks, the Montepaschi Group uses the concept of guarantee differential, which is understood as a percentage of the value of the guarantee offered, determined as a function of asset value volatility. The only portion of the loan covered by the value of the assets net of the differential is considered as guaranteed during the approval phase. The monitoring phase requires the adjustment of the guarantees with a market value lower than the value approved, net of the differential. This is notified by the Operating Management units, through an automated process of daily credit monitoring which alerts the Network with events which may modify risk perception.

The availability of collaterals does not alter the valuation of the insolvency risk of customer. However, it has an impact on the approval process since loan disbursements with mitigated risk are subject to different discretionary powers (this difference at Banca MPS is even more marked due to the introduction of authorization levels dedicated only to Land and Building Credit).

8.3. The Collaterals accepted by the Montepaschi Group

The Montepaschi Group accepts different instruments to protect loans which can be summarised in the following categories:

- Pledge of sums deposited with the Bank;
- pledge of securities and mutual funds deposited with the Bank;
- mortgages on immovables (real estate);
- mortgages on movables;
- pledge of sums deposited with other

banks;

- pledge of securities deposited with other banks ;
- pledge on other rights (insurance policies and Portfolios under Management);
- pledge on loans;
- pledge on commodities;
- other forms of collaterals (Insurance, Guarantee funds).

As at today, the first three categories (accounting for more than 98% of the nominal amount of the collaterals received) are compliant with regulatory/legal/organisational requirements set out by the New Supervisory Regulations for the enforcement of credit risk mitigation standards.

All types that may be received by the Montepaschi Group are entered into a structured collateral management process, under which all sub-steps are operationally shared.

If the measures of monitoring of the collaterals show operational irregularities during the acquisition phase or any inadequacies/losses of the values received as a pledge, events falling within the scope of credit monitoring policies are put in place, which trigger operational obligations of credit risk assessment.

8.4. Reports on Concentrations

The main concentration of collaterals is linked with retail mortgage loans. However, it cannot be referred to as risk concentration by virtue of the principle of risk fragmentation which is implicit in this type of customers. Specific rules are in force in relation to retail mortgage loans in an amount higher than EUR 3 million. When the loan exceeds this ceiling, the value of the guarantee is kept updated with periodical appraisal reports on the property.

The value of real estate in relation to transactions below the threshold of relevance is updated through the measurement of the average values of the real estate market. by reviewing the average values of the real estate market. Any information on the evaluations is provided, on an annual basis, by specialised industry operators (extraordinary updates may be generated by significant variations in the very short period).

Quantitative disclosure

Table 8.1 - Exposures secured by guarantees

Regulatory portfolio	Financial collaterals		Personal guarantees		Total	
	dec-09	dec-08	dec-09	dec-08	dec-09	dec-08
Central Governments and Central banks	7,346,281	4,867,707	24,797	41,775	7,371,078	4,909,482
Supervised institutions	25,668,192	8,103,711	133,024	71,771	25,801,216	8,175,482
Regional governments and local authorities	10,010	1,403	79,704	64	89,714	1,467
Non-commercial and public sector entities	294,847	518,296	3,445	2,300	298,292	520,596
Multilateral development banks	702	547	-	-	702	547
International organisations	-	-	102	-	102	-
Corporates and other persons	11,502,566	5,629,003	99,407	4,416	11,601,973	5,633,419
Retail exposures	1,991,459	5,769,380	-	-	1,991,459	5,769,380
Short-term exposures to corporates	-	-	-	-	-	-
Exposures to UCITs	-	-	-	-	-	-
Exposures secured by real estate	8,731	2,392	-	-	8,731	2,392
Exposures in the form of covered bonds	-	-	-	-	-	-
Past due exposures	82,242	32,938	-	-	82,242	32,938
High risk exposures	-	-	-	-	-	-
Other exposures	25,007	271,747	-	-	25,007	271,747
Total	**46,930,037**	**25,197,122**	**340,479**	**120,326**	**47,270,516**	**25,317,448**

The table provides, by regulatory asset class, the exposures of the banking group considered for credit risk purposes - standardized method secured by financial collaterals and by personal guarantees. The exposures taken into consideration are determined according to prudential regulatory rules, net of any compensation agreements. Therefore, the table does not include all kinds of guarantees; for example, the exposures guaranteed by real estate are not included, since they are not recognized for the purpose of risk mitigation and are directly represented in the same class, as shown in table 6.1. There are no exposures hedged with credit derivatives, which are valid for the purpose of the risk mitigation techniques.

Table 9 - Counterparty risk

Qualitative disclosure

The Montepaschi Group is committed to monitoring counterparty risk, understood as the risk that the counterparty in a transaction involving specific financial instruments (i.e. OTC derivatives, securities financing transactions and long settlement transactions) is in default before the settlement of the transaction.

In conformity with regulatory requirements, the Montepaschi Group uses the "current value" method to calculate the value of exposures for OTC derivatives and long settlement transactions. This method consists in calculating current and potential exposure using the market value as the current exposure and the regulatory add-on to represent, in a simplified manner, the potential future exposure.

For SFTs (securities financing transactions), the comprehensive method with supervisory volatility adjustments is used.

The Group has adopted credit risk mitigation measures such as netting agreements, collaterals, break clauses, etc. to substantially limit the risk assumed.

From an operational point of view, activities relevant for the purpose of counterparty risk may be broken down into two macro-segments on the basis of both counterparty characteristics (ordinary clients and institutional counterparties) and the operational and monitoring methods put in place by the Group.

With regard to business with financial institutions, counterparty risk exposure on individual credit lines is monitored on a daily basis by the control units of the various Business Units.

In short, the daily process involves:

- granting credit lines to counterparties on the basis of requests from Business Unit staff, with a periodical review of the limits set;
- inserting the limits in the management systems;
- inserting the ISDA and ISMA standards and the Credit Support Annexes (CSA) in the systems for the proper valuation of guarantees subject to exchange with counterparties (Collateral Management);
- reviewing the drawn and overdrawn amounts daily, in real time as well.

The process for derivative transactions with ordinary clients is based on the distinction of roles and responsibilities among the

different entities within the Group. Derivative transactions with customers - with the exception of those with Biverbanca - entails the centralisation of the product factory and monitoring of market risk in MPS Capital Services with the allocation, management and control of counterparty risk with respect to the customers in the Branch Network.

To this end, Retail banks:

- authorise the credit facilities granted to customers;
- manage each transaction in their books;
- take care of the related documents and regulatory requirements;
- review the amounts drawn with respect to the credit facilities granted.

With regard to products offered to customers, from a general point of view, a series of common elements are typical of most operations. In particular, traded products:

- are not of a speculative nature;
- are for the exclusive purpose of covering risk;
- are associated with an underlying position, even if they are contractually and administratively separate from it;
- show limited elements of complexity;
- on the overall position covered, they hold no financial leverage.

Quantitative disclosure

Table 9.1 - Counterparty risk: derivatives

	Gross Positive Fair value (book values)	Effect of netting agreements	Netted Fair value	Effect of collateral arrangements	Net Credit Exposure
Derivatives as at 31/12/2009	9,801,392	7,902,089	1,899,304	497,313	4,102,662
Derivatives as at 31/12/2008	10,102,900	7,001,386	3,101,514	428,879	4,899,150

The table represents the exposure of the Banking Group to counterparty risk for derivative instruments. All the financial and credit derivatives traded over the counter (OTC) with any counterparty (institutional, corporate, retail counterparties etc.) are included in the table irrespective of the regulatory (trading and banking) portfolio they belong to. In particular, the "gross positive fair value" corresponds to the book value of the above-mentioned contracts and therefore is inclusive of the netting agreements. The "Nettings" represent the gross positive fair value amount, which as a result of the agreements executed with the counterparties, is offset with negative value transactions. The net "netted fair value" indicates the positive fair value amount remaining after the nettings. The "Exposure" is a value calculated according to prudential supervisory requirements. In the Current Value method adopted by the Montepaschi Group, it is based on the positive fair value net of nettings; this value is increased by the future credit exposure (add-on) and reduced by the effects of the guarantee agreements. The future credit exposure takes account of the probability that in future the current value of the contract, if positive, may increase or, if negative, may become a credit position. This probability is linked with the volatility of the underlying market factors and the residual maturity of the contract. In other terms, it is calculated on the basis of the notional amount of all the derivatives taken into consideration, both with a positive and negative fair value. With regard to LSTs (Long Settlement Transactions) and SFTs (Securities Financing Transactions), the overall exposure recorded comes to approximately Euro 6.66 billion.

Table 9.2 - Derivatives: breakdown of positive fair value by type of underlying

	Interest rates	Foreign currencies and gold	Equity securities	Credits	Other	Total
Derivatives as at 31/12/2009	8,583,605	533,152	257,560	402,335	24,740	9,801,392
Derivatives as at 31/12/2008	7,231,302	2,005,524	338,791	509,106	18,177	10,102,900

The table illustrates the break down of the positive gross fair value of OTC derivative contracts by type of underlying assets.

Table 9.3 - Credit Derivatives: notional amounts

Group of Products	Banking Book		Regulatory Trading Book	
	Protection purchases	Protection sales	Protection purchases	Protection sales
Credit default swaps	347,610	-	13,497,945	13,183,675
Total as at 31/12/2009	**347,610**	**-**	**13,497,945**	**13,183,675**
Total as at 31/12/2008	**44,264**	**-**	**6,247,705**	**5,913,251**

The table shows the notional values of credit derivative contracts, by portfolio (banking and trading book) and the role played by the Montepaschi Group (buyer/seller of protection).

Table 10 - Securitisation transactions

Qualitative disclosure

10.1 Securitisation activity: Bank objectives and roles

The Group operates in the securitisation market both as an *originator,* through the issue of notes from originated securitisations, and as an investor through subscription of securities from third-party securitisations.

Self securitisations include:

- securitisations structured with a view to achieving economic benefits from the optimisation of the loan portfolio, the diversification of funding sources and the reduction of their cost. They coincide mainly with securitisations originated before 1 January 2004 (originated securitisations);

- securitisations aimed at strengthening the available funding sources, through the conversion of the loans sold into securities that can be refinanced (securitisations of assets sold but not derecognised). This category includes all securitisations originated by the Group after 1 January 2004.

Originated securities

In general this type of transactions involve the spin-off of a package of assets (generally loans) recognised in the balance sheet of Group banks and its subsequent transfer to a Special Purpose Entity. The SPE, in turn, finances the purchase through the issue and placement of securities. Resources raised in this way are returned to the seller (the Montepaschi Group), whereas the commitments to the subscribers are met using the cash flows generated by the loans sold.

Following is an outline of the Group's main securitisation transactions, broken down into securitisation of performing loans, securitisation of non-performing loans and securitisation of other assets:

- securitisation of performing loans:
  - Siena Mortgages 02 - 3 Srl
  - Siena Mortgages 03 -4 Srl
  - MPS Asset Securitization SpA (repurchased on 5/11/2009)
  - Mantegna Finance Srl
  - Mantegna Finance II Srl
  - Spoleto Mortgages Srl
  - Giotto Finance SpA (repurchased on 14/04/2009)
  - Giotto Finance 2 SpA
- securitisation of non-performing loans:
  - Ulisse 2 SpA

- securitisation of other assets:
  - Vintage Capital Srl
  - Gonzaga Finance Srl

Securitisations remained stable, an opinion also shared by the rating agencies who did not readjust the ratings originally assigned to the classes of notes issued.

The portfolio securitised through the Siena Mortgages vehicles comprises real estate-backed loans issued by both the Parent Company and by other banks within the Group, while Mantegna Finance S.r.l. and Mantegna Finance II S.r.l. were originated from Banca Agricola Mantovana S.p.A. and Spoleto Mortgages S.r.l. from Banca Popolare di Spoleto S.p.A.. Subsequent to the merger by absorption of Banca Antonveneta in December 2008, the Parent Company took over from Banca Antonveneta as the Servicer of 2 securitisations, namely Giotto and Giotto 2 S.p.A.. Giotto Finance S.p.A. was repurchased in April 2009.

With regard to the securitisation of non-performing assets, the Ulisse 2 S.p.A. portfolio consists of short-term unsecured loans from the Parent Company. The securitisation has shown a more than satisfactory trend with total collections exceeding the original estimates set out in the Cumulative Business Plan.

Securitisations of assets sold and not derecognised

These transactions involve the transfer of a package of assets (generally loans), originated by Group banks, to a Special Purpose Entity which, in turn, finances the purchase through the issue of Residential Mortgage-Backed Floating Rate Notes (also known as Residential Mortgage-Backed Securities or RMBSs). All RMBSs issued are subscribed by the Parent Company, as a way to enhance the Group's portfolio of ECB eligible assets which, acting as a significant 'security buffer', improve the MPS Group's liquidity position. As these securities are issued within the more general framework of the Group's liquidity strengthening policy, they can be used as security for ECB funds.

In this logic, as of 2007 four performing residential mortgage loan transactions have been carried out.

The category includes the two performing loans transactions effected in December 2007 and March 2008 for a total amount of approx. € 8.5 bln through the vehicle company, Siena Mortgages 07-5 S.p.A.

Two further transactions were carried out in 2009 through the vehicle company,

Siena Mortgages 09-6, for the nominal amount of € 8.5 bln. These transactions released "eligible" assets, that create a significant safety margin and improve BMPS's liquidity position.

On 20 February 2009 the first of the two securitisation transactions for the year was carried out with a portfolio containing 45,781 performing, real-estate backed loans of BMPS (considering the former branches of Banca Agricola Mantovana, Banca Antonveneta and Banca Toscana that have been merged into BMPS) in the land and construction area, regularly paid as at the date of valuation of the disposed portfolio (broken down as follows: 1,657 modular rate, 20,791 floating rate and 23,333 fixed rate mortgages) for a residual debt of € 4,436 mln. On 20 February 2009 the first of the two securitisation transactions for the year was carried out with a portfolio containing 45,781 performing, real-estate backed loans of BMPS (considering the former branches of Banca Agricola Mantovana, Banca Antonveneta and Banca Toscana that have been merged into BMPS) in the land and construction area, regularly paid as the date of valuation of the disposed portfolio (broken down as follows: 1,657 modular rates, 20,791 floating rate and 23,333 fixed rate mortgages) for a residual debt of € 4,436 mln.

In order to finance the acquisition, the vehicle company (Siena Mortgages 09 - 6 S.r.l.) issued Residential Mortgages Backed Floating Rate Notes as follows:

Securities	Type of rating	Total consideration
class A	Fitch AAA	3,851.30
class B	Fitch A	403.70
class C	Fitch BBB	181.45

Furthermore, the Group set up a cash reserve of EUR 106.70 mln corresponding to class D junior securities 93% of the vehicle company Siena Mortgages 09 - 6 is held by Stichting Giglio, a Foundation governed by Dutch law, while the remaining 7% is held by Banca Monte dei Paschi di Siena. This structure guarantees the vehicle company's independence.

On 26 June 2009 an additional securitisation transaction for € 4.1 bln was finalized, involving 44,148 performing loans in the name of natural persons. Siena Mortgages 09 - 6 S.r.l. was used again as the transferee of the transaction assets and issuer of RMBS notes.

The mortgage loan transaction structure was the same as with the afore-mentioned transactions (Siena Mortgages 07/5 1st and

2nd portion and Siena Mortgages 09/6), in order to finance the acquisition, the vehicle company Siena Mortgages 09 - 6 S.r.l.) issued Residential mortgage backed Floating Rate Notes as follows:

Securities	Type of rating	Total consideration
class A1	Aaa e AAA	3,466.00
class B	Baa3/A	447.10
class C	B3/ -	188.65

The AAA rated portion accounts for approx. 85% of total assets sold and is structured so as to be included by the ECB in the list of "eligible" instruments.
Furthermore, the Group set up a cash reserve of EUR 103.50 mln corresponding to class D junior securities

The exposures underlying this type of securitisation account for approx. 6% of consolidated assets.

Third-party securitisations

The Montepaschi Group plays a role in the securitisation market also as an investor. For this reason, a portion of the Group's capital is allocated to stock market investments, even though Banking and Trading Book investment volumes account for 0.83% ofthe consolidated assets. The overall book value of long positions in structured credit products amounts to EUR 1,875.59 mln.

In this area the Group pursues a multitude of objectives. In particular, the Group aims to:

- attain a risk-adjusted return that is significantly higher than the cost of allocated capital so as to create value for the shareholders;
- achieve diversification with respect to other risks that are typical of its business;
- maintain in-depth and up-to-date knowldege of financial market trends which additionally and inevitably condition the domestic markets in which the Group mainly operates.

In pursuing the above objectives, the Group set up a specifically dedicated unit within the Finance Area of the Parent Company. The scope of operations within the financial markets tends to be as broad as possible so as to draw the maximum benefit from risk diversification and reduced exposure to specific sectors of the stock market. For this purpose, in addition to typical investment acitivities in government bonds, securities and forex markets, 2002 also saw the launch of targeted activity on the market of corporate bonds and credit derivatives.

The specifically dedicated unit followed market pattern developments over time, making investments in structured bonds as well. These investments are compliant with the above-mentioned process of diversification. Financial technology has actually made it possible over time to take positions on specific credit risk components such as correlation and recovery through structured bonds.

The investment process, for this area too, starts with the specific analyses and evaluations made by the traders in a bottom-up logic. The process is included in the overall monitoring of portfolio risks. In other terms, positions are taken following an analysis by traders and within the maximum risk profile of the portfolios.

All operations in securities markets are subject to risk limits set by the Board of Directors that are monitored daily by the Parent Bank's Central Risk Management Unit. These are stop-loss and risk limits, which also include, in particular, nominal limits for maximum exposure for major issuer categories broken down by rating.

Securitisations: methods for calculating risk weighted exposures

The MPS Group applies the standardised approach for calculation of the capital requirement for credit risk relating to securitised exposures.

Accounting policies

The accounting of securitisation transactions effected by the Group before the International accounting standards came into force differs from the accounting of transactions effected thereafter.

The loans underlying pre-IAS transactions were derecognised from the transferor's financial statements which only include credit enhancements, if any, executed by the transferor. Any consolidation of the Special Purpose Entities (SPEs) relating to these transactions only takes their working capital into account; transferred loans, posted "under the line" in the SPE's financial statements, were not consolidated in the Group's financial statements. Upon the first-time application of the International accounting standards, the Group availed itself of the option not to post the assets underlying transactions effected prior to 1 January 2004, which were derecognized on the basis of the previous national standards. The assets, therefore, have never been included in the consolidated financial statements.

All notes issued by the SPEs were fully underwritten by the originator (the Parent bank), with substantial retention of the risks and benefits of the portfolio sold. As a result, these securitisations are not compliant with IAS 39 requirements for derecognition. Thus, the underlying loans were not derecognised from the originator's balance sheet and are retained in the Group's consolidated assets under assets sold but not derecognised.

These sale transactions had no economic impact on the originator's financial statements and thus, for the purposes of calculating capital absorption, the loans were maintained in the Group's weighted assets as if they had never been sold.

10.2 Control and Management Reporting systems

The trend of the transactions is steadily monitored through the periodical (quarterly and half-yearly) recording of remaining principal repayment flows, default and bad debt positions (in relation to performing securitisations). The Montepaschi Group set up a specific unit within the Parent Company's Credit Policies and Control area, responsible for coordinating performing securitisations. non-performing securitisations are managed by a separate unit of the subsidiary, MPS Gestione Crediti S.p.A.

Furthermore, a specific Group Directive requires a half-yearly report to be submitted to the Top Management showing the performance of transactions executed by the Banking Group over time. The above-cited companies are securitisation vehicles with the Group in the role of originator. As at today, the Montepaschi Group has not acted as a sponsor of any securitisation transactions.

The Finance Area participates in securitisation activities as an investor, only in relation to third-party securitisations. Investment in this area relates to the diversification of the risk profile of the managed portfolio and the maximisation of the risk-return targets.

Rating agencies for securitizations

Type[(a)]	Rating agencies
MULTIORIGINATOR	
SIENA MORTGAGES 02-3 (BMPS EX B121 BT BAM)	Fitch Rating Ltd Moody's Investors Service Ltd Standard & Poor's Rating Services
SIENA MORTGAGES 03-4 (BMPS BT BAM)	Fitch Rating Ltd Moody's Investors Service Ltd Standard & Poor's Rating Services
MAS (BMPS BT BAM EX B121) repurchased on 05.11.2009	Moody's Investors Service Ltd Standard & Poor's Rating Services
ORIGINATOR	
SIENA MORTGAGES 07-5 (BMPS)	Fitch Rating Ltd Moody's Investors Service Ltd
SIENA MORTGAGES 07-5/BIS (BMPS)	Fitch Rating Ltd
SIENA MORTGAGES 09-6 (BMPS)	Fitch Rating Ltd
SIENA MORTGAGES 09-6/BIS (BMPS)	Fitch Rating Ltd Moody's Investors Service Ltd
VINTAGE CAPITAL (BMPS)	Fitch Rating Ltd Moody's Investors Service Ltd
GONZAGA FINANCE (BAM)	Moody's Investors Service Ltd Standard & Poor's Rating Services
MANTEGNA FINANCE (BAM)	Moody's Investors Service Ltd Standard & Poor's Rating Services
MANTEGNA FINANCE II (BAM)	Moody's Investors Service Ltd Standard & Poor's Rating Services
GIOTTO FINANCE SPA (BAV) repurchased on 20.04.2009	Fitch Rating Ltd Moody's Investors Service Ltd
GIOTTO FINANCE 2 SPA (BAV)	Moody's Investors Service Ltd Standard & Poor's Rating Services
SPOLETO MORTGAGES 03 4 (BPSPOLETO)	Moody's Investors Service Ltd Standard & Poor's Rating Services
NON PERFORMING	
SIENA MORTGAGES 00 1 (MPS GCBANCA) repurchased on 30.09.2009	n.r
ULISSE 2 SPA (MPS GCBANCA)	Fitch Rating Ltd Moody's Investors Service Ltd
ULISSE 4 (BP SPOLETO)	Moody's Investors Service Ltd

(a) Originator in brackets.

Quantitative disclosure

Table 10.1 - Underlying securitisation exposures

Type of securitised asset	Exposure		Losses for the period
	net	of which impaired	
Non-performing loans	189,743	189,743	-
Mortgage loans	14,908,920	-	-
Bonds and credit derivatives	66	-	-
Other performing loans	-	-	-
Total as at 31/12/2009	**15,098,729**	**189,743**	**-**
Total as at 31/12/2008	**11,308,179**	**884,798**	**-19,531**

In the course of 2009 the securitisation of assets sold and not derecognised, Siena Mortgages 00-1 S.p.a., was extinguished earlier than due. It had been originated in 2007 following the disposal of a portfolio of non- performing loans from Banca Monte dei Paschi di Siena S.p.a. to Banca Toscana S.p.a. and Banca Agricola Mantovana S.p.a. With regard to losses for the period, the repurchase transaction did not have any effects on the consolidated financial statements.

Table 10.2 - Type of exposure by risk weight bands

Exposures / Underlying assets	Risk weight band						Total
	20%	50%	100%	350%	1250%	1250% no Rating	
Originated securitisations	**-**	**-**	**-**	**-**	**941**	**5,393**	**6,334**
Residential mortgage loans	-	-	-	-	941	5,393	6,334
Third party securitisations	**20,284**	**413,057**	**70,468**	**14,965**	**4,730**	**-**	**523,504**
Bonds	-	-	-	-	-	-	-
Non-performing loans	-	49,795	-	-	-	-	49,795
Residential mortgage loans	5,210	3,213	3,313	-	-	-	11,735
Loans	7,519	356,871	64,214	13,358	3,370	-	445,332
Commercial mortgage loans	5,509	-	2,942	1,607	-	-	10,058
Consumer Loans	-	-	-	-	1,360	-	1,360
Leasing	2,046	-	-	-	-	-	2,046
Re-securitisations	-	3,178	-	-	-	-	3,178
Total 31/12/2009	**20,284**	**413,057**	**70,468**	**14,965**	**5,671**	**5,393**	**529,839**
Total 31/12/2008	**117,493**	**61,193**	**15,693**	**9,271**	**7,040**	**10,153**	**220,842**

The table above details the exposures to securitisations by risk weight bands and type of transaction. The amounts shown, in line with prudential regulations, relate to the 'self' and 'third-party' securitised exposures included in the banking book and, therefore, do not include the exposures to securitisations included in the regulatory trading book. It is noted that, in compliance with supervisory regulations, self securitisations do not include securitised assets:
a) that refer to transactions that are not recognised as securitisations for prudential supervisory purposes, since they do not entail the actual transfer of credit risk,
b) whose overall risk-weighted value of exposure to the same securitisation exceeds the risk-weighted value of underlying securitised assets, calculated as if they had not been securitised (cap test).
Both in the case of a) and b), capital requirements are calculated in relation to securitised assets and not to the corresponding securitisation exposures. Additionally, securitised assets are classified in their original regulatory classes (exposures secured by real estate, etc.) and are therefore excluded fromc "securitisations". With regard to "Third-party securitisations", the growth with respect to December 2008 is mainly due to the accounting reclassification of some L&R positions from trading to new investments.

Table 12 - Operational risk

Qualitative disclosure

The Montepaschi Group implemented an integrated risk management system on the basis of a governance model which involves all the companies of the Montepaschi Group included in the scope of application. The approach defines the standards, methods and instruments which ensure an assessment of risk exposure and of the effects of mitigation by business area. The Montepaschi Group was authorised by the Bank of Italy on 12 June 2008 to use the internal advanced measurement approach (AMA) for the calculation of capital requirements for operational risks. The advanced model officially started operating on 1 January 2008. The first consolidated regulatory reporting on the basis of the model was prepared in relation to the results as at 30 June 2008.

The Bank of Italy granted the authorisation after verifying compliance with the requirements set out in Circular 263. Verification involved all aspects of risk measurement, management and mitigation, with strong engagement from the Group's Top Management.

All the domestic banking and financial components are incorporated in the scope of advanced measurement approach (AMA). Pending the developments of the Business Plan, the foundation approaches were adopted for foreign companies.

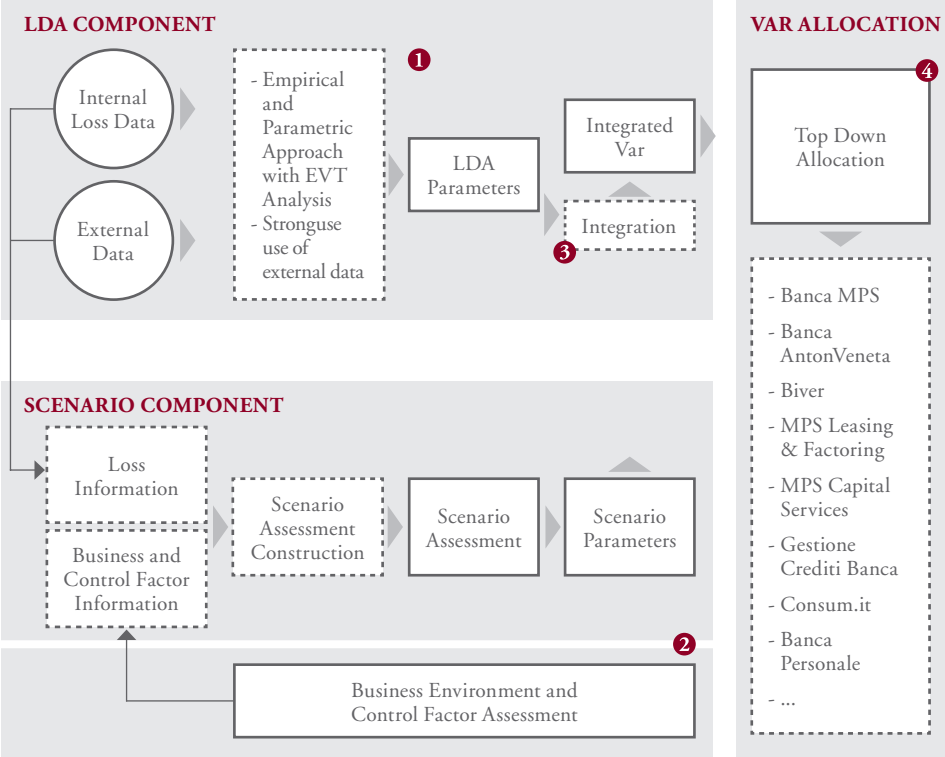
Among the new aspects compared to the previous financial year, it should be noted that all activities regarding roll-out of the advanced approach to Banca Antonveneta have been completed. These activities were stepped up by the Parent Company so as to more effectively identify and monitor the risks associated with extending processes and systems to a new company, permitting a better understanding of this new component within the Montepaschi Group's risk profile.

Roll-out activities involved extending the qualitative and quantitative components of the advanced model to the 623 branches acquired by Banca Monte dei Paschi and to the new Banca Antonveneta, which, as of 1 January 2009, has a network made up of the remaining 403 branches.

The advanced approach adopted by the Montepaschi Group is designed so as to ho-

mogeneously combine all the main qualitative and quantitative information (or data) sources (Mixed LDA-Scenario Model).

The quantitative Loss Distribution Approach component is based on the statistical collection, analysis and modelling of internal and external historical loss data (Italian Database of Operational Losses, DIPO). The model includes calculation in relation to the 7 categories of events established by Basel 2 used as risk classes, with the adoption of Extreme Value Theory techniques.



The estimated frequency of occurrence is based exclusively on internal data.

The qualitative component is focused on the assessment of the risk profile of each unit and is based on the identification of relevant scenarios. The Companies are involved during the phases of: identification of the processes and risks to be assessed; assessmente of risks by process managers in charge; identification of possible mitigation plans; sharing of priorities and technical-economic feasibility of mitigation actions during scenario discussions with Head Office functions.

The AMA model, which had been run-

ning in parallel for two years prior to final approval, ensured a more conscious management of operational risk and a gradual reduction of risk within the Group.

Furthermore, in 2009 the Group completed an important project to rationalise the insurance plans

inherited from the various extraordinary transactions carried out in recent years.

Consequently, the policies were redefined to ensure greater coverage both in terms of events and of widening the scope of application. The deductibles and maximum limits were therefore adjusted to make the transfer of operational risk more effective. At present, pending revision of the regulations of reference, the Montepaschi Group has taken the decision not to use such policies to any extent in order to reduce capital requirements.

However, in the future the Group intends to consider the use of operational risk transfer techniques, properly documented and in line with the provisions of Circular 263, for the purpose of reducing capital requirements.

Finally, the percentage breakdown of operational losses recorded in 2009 is reported, divided into the following risk classes:

- internal fraud: losses arising from unauthorised activities, fraud, embezzlement or violation of laws, regulations or corporate directives that involve at least one internal resource of the Group;
- external fraud: losses due to fraud, embezzlement or violation of laws by subjects external to the Group;
- employment relationships and Occupational Safety: Losses arising from actions in breach of employment, occupational health and safety laws and agreements, payment of compensation for personal injury or episodes of discrimination or failure to apply equal treatment;
- customers, products and operating practices: losses deriving from non-fulfilment of professional obligations towards customers or from the nature and characteristics of the product or service provided;
- property damage: losses arising from external events, including natural disasters, acts of terrorism or vandalism:
- business disruptions and system failures: losses due to business disruption or system failures or interruption;

- process management, execution and delivery: losses arising from operational and process management shortfalls, as well as losses arising from transactions with commercial counterparties, vendors and suppliers.

With respect to 2008, a decrease was recorded for operational risk events, confirming the positive trend already observed in previous years.

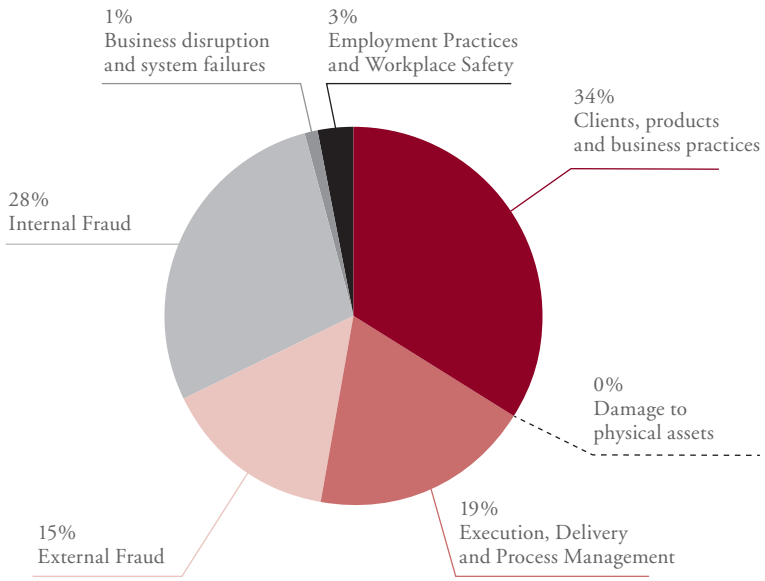


Table 13 - Equity exposures: disclosures for banking book positions

Qualitative disclosure

13.1 Purpose of exposures

The equity investments in the portfolio are held for strategic purposes (group investments, affiliated companies and joint ventures), institutional purposes (investments in trade associations, local entities and institutions), purposes functional to the bank's business and the development of commercial business, financial investment purposes (limited to the investments associated with the merchant banking business of MPS Capital Services). Other investments exist, which include investments no longer considered as strategic and that are being sold, as well as investments in companies in liquidation. The methods of fair value valuation of the investments are determined on a case by case basis depending on the specific characteristics of each investment. The valuation methods include the use of market prices for listed companies. The following methods are used in the case of unlisted companies: recent transactions, market multiples, valuation methods based on the discounting of expected cash flows, any existing options and/or sale agreements setting the price of future sale.

Equities exposures are mainly but not exclusively classified for balance sheet purposes under available-for-sale financial assets and equity investments.

13.2 Measurement and accounting criteria

13.2.1 Assets available for sale

Recognition criteria

Initial recognition of the financial asset occurs at settlement date for debt securities and equities and on the date of disbursement for loans.

On initial recognition, assets are recorded at fair value which usually corresponds to the amount paid inclusive of transaction costs or revenues directly

attributable to the instrument. If recognition occurs following the reclassification from assets held to maturity, the recognition value is the fair value as at the time of transfer. In the case of debt instruments, any difference between the initial value and the value of repayment is spread out over the life of the debt instrument in accordance with the method of amortised cost

Classification criteria

This category includes non-derivative financial assets which are not classified as loans, financial assets designated at fair value through profit and loss or held to maturity investments.

In particular, this category also comprises strategic equity investments which are not managed for trading purposes and cannot be defined as controlling interest, connection and joint control, and bonds which are not subject to trading.

Such investments may be transferred for any reason, such as liquidity requirements or variations in interest rates, exchange rates, or stock price.

Measurement criteria

After initial recognition, financial assets available for sale are measured at fair value, with interest being recognised in the income statement as resulting from the application of the amortized cost and related foreign exchange effect, and with appropriation to a specific net equity reserve of the gains or losses arising from changes in fair value net of the related tax effect, except losses due to impairment.

Foreign exchange fluctuations in relation to equities are posted to the specific net equity reserve. Equities, for which it is not possible to determine a reliable fair value, are maintained at cost, adjusted for any impairment losses.

Financial assets available for sale are reviewed for objective evidence of impairment at each balance sheet and interim reporting date. Indicators of a likely impairment are, for instance, remarkable financial difficulties of the issuer, non-fulfilment or defaults in payments of interest or principal, the possibility that the borrower is declared bankrupt or submitted to other forms of insolvency proceedings, the disappearance of an active market for the assets. In particular, as far as equities listed on active markets are concerned, a

market price as at the date of the financial statements lower than the original purchasing cost of at least 30% or a market value lower than the cost lasting more than 12 months are considered an objective evidence of value reduction. If further reductions occur in the following financial years they are directly posted to profit and loss.

The amount of any value adjustment shown following the impairment test is recorded in the profit and loss statement as an expense for the year. If the reasons for impairment cease to exist, following an event which occurred after registration of impairment, value recoveries are posted through net equity in the case of equities, and through profit and loss in the case of debt securities.

Derecognition criteria

Financial assets are derecognised upon maturity of the contractual rights on the financial flows arising from the financial assets or when the financial assets are sold and all related risks and benefits are transferred. Securities received within the scope of a transaction that contractually provides for subsequent sale are not recognised in the financial statements, and securities delivered within the scope of a transaction that contractually provides for subsequent buyback are not derecognised from the financial statements. Consequently, in the case of securities acquired with an agreement for resale, the amount paid is recognised in the financial statements as loans and advances to customers or banks, while in the case of securities transferred with an agreement for repurchase, the liability is shown under deposits from customers or deposits from banks or under other liabilities

Revenue recognition criteria

Upon disposal, exchange with other financial instruments or measurement of a loss of value following impairment testing, the fair value results accrued to the reserve for assets available for sale are reversed to profit and loss under:

- account "100 - Gains/Losses on purchase/disposal of: b) financial assets available for sale", in case of a disposal;
- account "130 - Net losses/recoveries on impairment of: b) financial assets available for sale", in case of measurement of an impairment loss.

If the reasons for impairment cease to

exist, following an event which occurred after the impairment was recognised, value recoveries are posted through profit and loss in the case of loans or debt securities, and through net equity in the case of equities.

13.2.2. Equity investments

Recognition criteria

The item includes equity investments:

- subject to significant influence, valued using the net equity method;
- held in subsidiaries for which the consolidation of the balance sheet and profit and loss statement was not deemed significant with respect to the consolidated financial statements;
- the item does not include net equity-method valuation of equity investments under joint control since they are consolidated using the proportional method.

Classification criteria

For classification purposes in this item, subsidiaries are considered as companies where the Bank has the power of determining financial and operational policies for the purpose of obtaining benefits therefrom. This occurs when more than half of the voting rights are held directly and/or indirectly or in the presence of other conditions of de facto control, such as the appointment of the majority of the directors.

Companies with contractual agreements, shareholders' pacts or agreements of a different nature for the joint management of business and the appointment of the directors are considered as jointly controlled entities.

Associates include (i) companies where a share of 20% or higher of voting rights is held, and (ii) companies which - owing to specific legal ties such as the participation in shareholders' pacts - have to be considered as subject to significant influence.

These classifications are made irrespective of legal status. Any potential voting rights which can be currently exercised are considered in the calculation of voting rights.

Income component recognition and measurement criteria

In consideration of the above, this item broadly contains the valuation of equity investments using the net equity method.

This method contemplates the initial posting of the investment at cost and its subsequent adjustment on the basis of the stake held in the shareholders' equity of the partially owned company.

The pro-rata amount of the profit/loss for the year of the partially owned company is posted to item 240 "Profits/losses from equity investments" in the consolidated profit and loss statement.

Derecognition criteria

Financial assets are derecognised upon maturity of the contractual rights on the financial flows resulting from the assets or when the financial assets are sold and all related risks/benefits are transferred.

Quantitative disclosure

Table 13.1 - Equity exposures: disclosures for banking book positions

Type	Book Value	Fair Value	Market Value	Exposure	Realised gains/ losses	Unrealised gains/losses	
						Total	of which included in Tier 1 and Tier 2 capital
Available For Sale securities (A)	**597,609**	**597,609**	**x**	**597,609**	**43,853**	**108,754**	**54,377**
quoted	248,977	248,977	248,977	248,977	27,403	52,608	26,304
unquoted	348,632	348,632	x	348,632	16,450	56,146	28,073
Investments (B)	**61,517**	**x**	**x**	**149,575**	**201,372**	**-**	**-**
quoted	-	x	x	-	-	-	-
unquoted	61,517	x	x	149,575	201,372	-	-
Total 31.12.2009 (A+B)	**659,126**	**597,609**		**747,184**	**245,225**	**108,754**	**54,377**
quoted	248,977	248,977	248,977	248,977	27,403	52,608	26,304
unquoted	410,149	348,632	x	498,207	217,822	56,146	28,073
Total 31.12.2008 (A+B)	**472,578**	**374,362**		**453,739**	**248,496**	**-66,335**	**-66,335**

x = value not attributable

Note: The table illustrates exposures in capital instruments broken down by the respective accounting portfolio. Values refer to the exposures included in the Banking Book and do not include exposures in capital instruments which are deducted for the calculation of Regulatory Capital. In the column "Exposure" the related value is calculated according to the rules of Prudential Supervision and thus differs from the Book value. The value of the Exposure also includes the value of the shareholding in MPS Tenimenti which, for prudential purposes, is calculated with the net equity method while for Financial Statements the comprehensive method is applied.

Table 14 - Interest rate risk on positions in the banking book

Qualitative disclosure

In accordance with international best practices, the Banking Book refers to all of the commercial operations of the Parent Bank in relation to the transformation of maturities with respect to balance-sheet assets and liabilities, Treasury, foreign branches, and hedging derivatives of reference. The definition of the scope of the Banking Book (in alignment with that for the regulatory book) and the process of centralising the management of ALM are contained in a resolution by the Board of Directors of the Parent Company, aimed at centralising Asset & Liability Management and the operational limits in view of the interest rate risk of the Group Banking Book as approved in September 2007 and updated last October to adjust the overall framework to the changed ownership structure, as well as to develop the approach in keeping with the set-up outlined in the regulatory provisions (Bank of Italy Circ. 263).

The Banking Book also includes active bonds held for investment purposes, classified as either AFS or L&R. The same ALM rate risk metrics of measurement used for other accounts were also applied to this aggregate.

The operational and strategic choices for the Banking

Book, adopted by the Finance Committee and monitored by the Risk Committee of the Parent Company, are based first on exposure to interest rate risk by a variation in the economic value of the assets and liabilities of the Banking Book by applying a parallel shift of 25bp, 100bp and 200bp, the latter in accordance with what is required in the "second pillar" of Basel 2.

The risk measurements of the retail banks of the Montepaschi Group are calculated by using, among other things, a model for the valuation of demand items or core deposits, whose characteristics of stability and partial insensitivity to variations in interest rates are described in systems with a statistical/predictive model (replicating portfolio), which takes into consideration a significant historical series of customer behaviours in the past.

In addition, the Montepaschi Group's ALM model includes within rate risk measurements, a behavioural model which takes into account the aspect of mortgage advance repayment (prepayment risk).

Loan prerepayment rates and, in particular, home mortgage prepayment rates have become potentially more unstable due to a series of concomitant factors, such as, for example, the greater volatility of the rate curve due to the recent crisis.

The Group adopts a system of rate risk governance and management which, in accordance with the provisions of the Supervisory Authority, avails itself of:

- a quantitative model, on the basis of which the exposure to interest rate risk of the Group and the individual companies/structures thereof is calculated, in terms of risk indicators;
- risk monitoring processes, aimed at ongoing verification of compliance with the operational limits assigned to the Group overall and to the individual business units;
- risk control and management processes, geared toward bringing about adequate initiatives for optimising the risk profile and activating any necessary corrective measures.

Within the above system, the Parent Company has opted for a centralisation of the responsibility for defining the policies aimed at managing the Group Banking Book and controlling its related interest rate risk.

Quantitative disclosure

The sensitivity of the Montepaschi Group, at the end of 2009 , suggests a profile of exposure to rate hike risk. Based on a +200 bp shift, sensitivity was up as compared to the end of 2008, standing at -1,251.74 €/ mln.

Table 14.1 - Interest Rate Risk in the Banking Book (IRRBB)

Shift (+/-)	Effect on Economic Capital (EUR/mln)	
	dec-09	dec-08
Eur +200bp	-1,239.23	-1,003.78
Usd +200bp	5.16	-6.87
Other +200bp	-17.66	-11.05
Total +200bp	**-1,251.74**	**-1,021.70**
Eur -200bp	1,634.74	1,532.45
Usd -200bp	1.75	7.53
Other -200bp	13.94	12.43
Total -200bp	**1,650.44**	**1,552.41**

The amount of the economic value at risk is, in any case, fully consistent with the amount of Tier I capital and Regulatory Capital and is well below the level considered as a critical threshold (set at 20% for a rate shock of 200bp) by the New Capital Accord (Basel II).

Declaration of the Financial Reporting Officer

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

Siena, 22 April 2010

Daniele Bigi

Financial Reporting Officer

Glossary of the main terms used

ABS: *see* Asset Backed Securities

Advanced Internal Rating Based (AIRB): advanced internal models used to calculate capital requirements for credit and counterparty risk within the Basel 2 international framework. They differ from the FIRB models since with the AIRB approach, the banks uses its own internal estimates for all inputs. See also PD, LGD, EAD.

Advanced Measurement Approach (AMA): advanced internal models used to calculate capital requirements for operational risk within the "Basel 2" international framework . The approach involves the measurement of capital requirements by the bank through calculation models based on operational loss data and other valuation elements the bank collects and processes.

AFS: *see* Available For Sale

AIRB: *see* Advanced Internal Rating Based

ALM: *see* Asset & Liability Management

AMA: *see* Advanced Measurement Approach

Asset & Liability Management (ALM): the set of risk management models and techniques applied to the Banking Book for the purpose of measuring interest rate risk and liquidity risk. See also Banking Book, Interest Rate Sensitivity, Shift Sensitivity, Economic Value Approach.

Asset Backed Securities (ABS): Financial Securities whose coupon yield and redemption are guaranteed by a pool of assets (collateral) of the issuer (usually a Special Purpose Vehicle), exclusively intended to ensure satisfaction of the rights attached to said financial securities. Typically, they are broken down into RMBS and CMBS.

Available For Sale (AFS): IAS category used to classify the assets available for sale.

Banking Book: in accordance with International best practices, the term "banking book" refers to all of the non-trading operations of the Bank in relation to the transformation of maturities with respect to balance-sheet assets and liabilities, Treasury, foreign branches and hedging derivatives. The interest rate, liquidity and forex risk of the Banking Book are typically measured trough Asset & Liability Management (ALM) models. *See* Regulatory Banking Book.

Basel 1: the regulations relating to the application of Minimum Capital Requirements issued by the Basel Committee in 1988.

Basel 2: the regulations relating to the application of the New Capital Accord issued by the Basel Committee in 2006.

BCU: *see* Business Control Unit.

bp (basis point): one hundredth of a percentage point, ie. 1bp = 0.01% = 0.0001.

BU: Business Units.

Business Control Unit (BCU): Local, first-level risk management functions, located within the areas / business units (BUs).

Cap test: the test undergone by all securitisation transactions recognised for prudential purposes, according to which the risk-RWAs of securitisation positions are compared with those of securitised exposures (calculated as though the latter were not securitised). If the RWAs of the former are greater than those of the latter (*cap*) then the latter are taken into consideration.

Capital position: the difference between Regulatory Capital, including Tier 3 capital and Overall Capital Requirements. The difference may be positive (surplus), or negative (deficient), according to whether the Regulatory Capital is higher or lower than the Overall Capital Requirement.

Capital Requirements Directive (CRD): EU directive no. 2006/48 and 2006/49, transposed by the Bank of Italy into Circular Letter no. 263/2006 of 27 December 2006 and subsequent updates

Capital Requirements: the sum of capital, calculated according to supervisory regulations, destined to cover the single risks of the First Pillar in compliance with the supervisory framework.

CCF: Credit Conversion Factor

CDO: *see* Collateralised Debt Obligation

CDS: *see* Credit Default Swap.

CMBS: *see* Commercial Mortage Backed Securities

Collateralised Debt Obligation (CDO):

Securities issued based on differentiated risk classes with various tranches following the securitisation of a portfolio of debt instruments incorporating the credit risk. Typically characterised by the presence of a financial lever.

Commercial Mortgage Backed Securities (CMBS): ABS with underlying commercial mortgages.

Confidence level: level of probability linked to VaR measurements.

Consolidated Law on Banking (it. *Testo Unico Bancario*, T.U.B): Legislative decree no. 385 of 1 September 1993, as amended and supplemented.

Core Capital (Tier 1): defined by the Supervisory framework as the sum of the following components: (+) general banking risk fund (+) capital (+) share premium reserve (+) reserves (+) innovative capital instruments (-) retained losses (-) capital subscribed and not paid in (-) treasury shares (-) other intangible assets (-) goodwill.

Core Tier 1 ratio: the ratio between Tier 1 capital, net of preference shares, and total risk-weighted assets. The Tier 1 ratio is the same ratio inclusive of the preference shares in the numerator.

Corporate clients: Customer segment consisting of medium- and large-sized companies (mid-corporate, large corporate).

Counterparty risk: counterparty risk is the risk that the counterparty in a specific financial transaction is in default prior to settlement. Counterparty risk is associated with certain, specifically-identified types of transactions, which: 1) generate an exposure that is equal to their positive fair value; 2) have a market value which evolves over time depending on underlying market variables; 3) generate an exchange of payments or an exchange of financial instruments or goods against payment. The categories of transactions subject to counterparty risk are:

- credit and financial derivative instruments traded *Over the Counter* (OTC);
- Securities Financing Transactions (SFTs);
- Long Settlement Transactions (LST).

Covered bond: Special bank bond that, in addition to the guarantee of the issuing bank, is also backed by a portfolio of mortgage loans or other high-quality loans sold to a special purpose vehicle.

CRD: *see* Capital Requirements Directive.

Credit Default Swap (CDS): Contract under which one party transfers to another the credit risk of a loan or security contingent on occurrence of a default.

Credit derivatives: Derivative contracts for the transfer of credit risks. These products allow investors to perform arbitrage and/or hedging on the credit market, , to acquire credit exposures of varying maturities and intensities, to modify the risk profile of a portfolio and to separate credit risks from other market risks.

Credit Risk Mitigation (CRM): set of credit risk mitigation techniques recognised for supervisory purposes (e.g., compensation of accounts in balance sheet, personal guarantees, credit derivatives, financial collaterals), for which the following eligibility requirements apply - legal, economic and organisational - for the purpose of reducing risk.

Credit risk: the risk that a debtor may default on his obligations, either at maturity or subsequently. Credit risk is associated with an unexpected change in creditworthiness of a responsible party - towards whom there is an exposure - which generates a corresponding unexpected change in the value of the credit position.

CRM: *see* Credit Risk Mitigation.

Current Value method: Supervisory method used to determine counterparty risk in derivatives and the capital requirement to cover it. The current value is calculated adding the replacement cost (or intrinsic value, determined on the basis of the "mark-to-market" value of the derivative, if positive) to the future credit exposure (approximating the *time value* of the derivative, i.e. the probability that, in the future, the intrinsic value will increase, if positive, or convert into a credit exposure if negative); the future credit exposure is determined for all contracts, independently of the positive value of the replacement cost, multiplying the nominal value of each derivative contract by coefficients differentiated by residual maturity and type of contract.

Default, credit exposures in: these include non-performing loans, watchlist loans, restructured loans and past-due.

Default, the state of: state of insolvency or delinquency of a debtor. Declared inability to honour one's debt and/or make the relevant interest payments.

Delta EL: see Surplus of expected loss value over the value of net provisions.

DIPO (*Database Italiano Perdite Operative*): The Italian Database of Operational Losses. Database used for operational risk.

Diversification: benefit arising from the simultaneous holding of financial instruments which depend upon risk factors not perfectly matched. In the case of VaR, this corresponds to the correlation effect among risk factors on the overall VaR value.

Duration Gap: the difference between the duration of assets and liabilities of a given portfolio in relation to the total amount of assets.

Duration: also defined as average financial duration, this is a synthetic index which represents the weighted arithmetic mean of time upon expiry of the individual components of a cashflow (principal + interest), since the weights are determined as current values of the individual components, calculated on the basis of the term structure of the interest rates. It is typically used as a measurement of bond price sensitivity to interest rate fluctuations.

EAD: *see* Exposure-at-Default.

ECA: Export Credit Agency.

ECAI: External Credit Assessment Institution.

Economic Capital: the capital needed to deal with any loss in value generated by unexpected changes in conditions, internal or external, as a consequence of risk. It is calculated on the basis of risk measurement models developed by the Risk Management area. In general, it is obtained on the basis of a consistent transformation in terms of holding period and confidence interval of VaR measurements calculated for individual risk factors and appropriately diversified. The confidence interval is a function of the bank's objective rating. The Economic Capital is the internal estimation of capital needed to deal with risk that is the necessary operational equivalent of Capital Requirements (Regulatory Capital).

Economic Value approach: measure of the changes in the Banking Book overall net current value (defined as the difference between the current value of assets, the current value of liabilities and the value of hedging derivatives) in the presence of different alternative interest rate scenarios. The focus is placed on the changes in the net current economic value of the Bank and takes account of all maturities of assets, liabilities and off-balance-sheet items existing at the time of each valuation. It is typically measured with shift sensitivity assumptions. *See* also ALM, Banking Book, Interest Rate Sensitivity, Shift Sensitivity.

Equity Tranche: the portion of the portfolio that is at greater risk, also known as "first loss"; it is subordinate to all other tranches; it is therefore the first to be impacted by the losses that may arise during the recovery of underlying assets.

Expected Loss: the total amount of net losses which, on average, the bank can expect (estimate) to incur in the 12 month period following the date of reference on the total amount of performing loans in the portfolio upon measurement. Since it is an estimate, it does not represent the actual risk of the credit exposure. Estimated ex-ante as the "cost of doing business", it ought to be directly included, in terms of spread, in the pricing conditions applied to the customer and covered using an appropriate accounting provision policy. It is defined as the product of the probability of default (PD), loss given default (LGD) and exposure at default (EAD):

- PA = PD x LGD x EAD.

Exposure at Default (EAD): estimated future value of an exposure upon default of a client. Defined as:

- EAD = Drawn Amount + k (Committed amount - Drawn Amount) where k ($0 \leq k \leq 1$) represents the expected "drawn" percentage of the unused amount before default.

The EAD essentially depends on the technical form of the loan and is faced up to through loan trend management.

Value required in the advanced model for credit risk measurement (AIRB - "Advanced Internal Rating Based Approach") as set out by Basel 2. For regulatory purposes, a credit conversion factor (CCF) is applied to the EAD.

Fair Value (FV): the amount at which an asset could be bought or sold or a liability incurred or settled, in an arm's length transaction between willing, independent parties.

FIRB: *see* Foundation Internal Rating Based.

Floor: The lower limit set for Overall Capital Requirement by the Bank of Italy in the event that the bank and the banking groups calculate Capital Requirements for Credit Risk or for Operational Risk through internal models; the basis of reference for the calculation of the Floor up to 2009 was provided by Basel 1; as of 2010, the basis of reference is represented by standard Basel 2 (i.e. the standardised approach for Credit Risk and the foundation approach for operational risk).

Foundation Internal Rating Based (FIRB): the internal models used to calculate capital requirements for credit and counterparty risk within the international Basel 2 Accord. It differs from the AIRB approaches because, in this case, only the PD parameters are estimated by the bank.

Held For Trading (HFT): IAS category used to classify trading assets and liabilities.

HFT: *see* Held for Trading.

Holding period (hp): *forward-looking* length of time for which a position is held.

IAS/IFRS: the International Accounting Standards are issued by the International Accounting Standards Board (IASB). The standards issued after July 2002 are called IFRS (International Financial Reporting Standards).

ICAAP: *see* Internal Capital Adequacy Assessment Process.

Internal Capital Adequacy Assessment Process (ICAAP): Under the "Second Pillar" (Chapter III of the Bank of Italy's Circular Letter no. 263/2006) banks are required to adopt processes and instruments for determining the level of internal capital needed to cover any type of risk, including risks different from those covered by the total capital requirement ("First Pillar"), when assessing current and future exposure, taking into account business strategies and developments in the economic and business environment.

IMA: *see* Internal Models Approach.

Impairment: when referred to a financial asset, a situation of impairment is identified when the book value of an asset exceeds its estimated recoverable amount.

Interest Rate Sensitivity: measurement of the impact an unexpected shift (parallel or not) in the yield curves by maturity generates on the bank's economic value. It is typically used to measure the interest rate risk of the Banking Book within the Asset & Liability Management (ALM) systems. The value is obtained from calculating the variation in the current value of the real and notional cashflows of sheet assets, liabilities and off-balance items existing at a certain date when there is a variation in the yield curve (eg. +25 bp) with respect to the values of the baseline. Measurement of risk as potential loss which emerges following an adverse movement in the structure of yield curves, schematically defined as:

- $\Delta VA = VA' - VA$

where:

- ΔVA = variation in current value, ie. Sensitivity measurement;
- VA = current value of cash flows calculated on the basis of the yield curve at the recognition date;
- VA' = current value of the same cash flows calculated on the basis of the yield curve assumed (e.g. parallel upward shift of +25 bp").

If, for example, a +25bp shift in the yield curve results in $\Delta VA > 0$ (positive sensitivity), this means that the bank is "liability sensitive", ie. it has more liabilities coming to maturity/being repriced than assets, and therefore its economic value is at risk in the event of a decrease in market interest rates. If, on the other hand, a +25bp shift in the yield curve results in $\Delta VA < 0$ (negative sensitivity), this means that the bank is "asset sensitive", ie. with more assets coming to maturity/being repriced than liabilities, thus having an economic value that is at risk in the event of an increase in market interest rates.

Internal Models Approach (IMA): method of VaR internal models for the calculation of capital requirements for market risk.

Investment grade: issuers or issues with a rating between AAA and BBB-.

Issuer risk: connected to the issuer's official rating, this is the risk of decreasing portfolio value due to the unfavourable change in the issuer's credit standing up to the extreme case of default, in the buying and selling of plain vanilla or credit structured bonds, ie. purchase/selling of protection through credit derivatives.

Junior tranche: in a securitisation transaction it is the lowest-ranking tranche of the securities issued (Equity tranche), being the first to bear losses that may occur in the course of the recovery of the underlying assets.

L&R (Loans & Receivables): IAS category used to classify credit.

LDA: *see* Loss Distribution Approach.

LGD: *see* Loss Given Default.

Liquidity Risk: the risk that a company will be unable to meet its 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 rapidly converting financial assets into cash without

negatively and significantly affecting their price due to inadequate market depth or temporary market disruptions (*market liquidity risk*).

Long Settlement Transactions (LSTs): long settlement transactions (in which a counterparty commits to delivering (receiving) a security, commodity or foreign currency against receipt (delivery) of cash payment, other financial instruments or goods with settlement upon a pre-established contractual date, later than the one determined by market practice for these types of transaction, namely five days from the transaction stipulation date.

Loss Distribution Approach (LDA): model used to assess exposure to operational risk. It makes it possible to estimate the amount of expected and unexpected loss for any event/loss combination and any business line.

Loss-Given-Default (LGD): is the discounted net loss measured over the years on positions classified as defaulting. LGD is estimated in the form of a coefficient ranging from 0 to 1 based on the following *drivers*: type of borrower, type of guarantee pledged, technical form of lending. This value is required within the framework of the Advanced Internal Ratings-Based Approach for credit risk under Basel 2. When conditioned on adverse macro-economic scenarios (or downturns), the LGD parameter is defined as "downturn LGD".

Lower Tier 2: it designates subordinated liabilities that meet the eligibility criteria for inclusion in supplementary (Tier 2) capital.

LST: *see* Long Settlement Transactions.

M (Maturity): the residual life of an exposure, calculated according to prudential requirements for credit risk. For banks authorised to use internal ratings, it is explicitly considered if the advanced approach is adopted, while it is pre-determined by legislation if the FIRB approach is adopted.

Market Risk: the risk of value loss on a financial instrument or a portfolio of financial instruments, resulting from an unfavourable and unexpected change in market risk factors (interest rates, share prices, exchange rates, price of goods, indices,…). A typical risk of the trading book.

Mark-to-market. valuation of a position at market value, usually from the trading book. For instruments officially traded on organised markets, it corresponds daily to the market closure price. For unlisted instruments, it results from the development and the application of specifically-developed pricing functions which determine the valuation starting from the market parameters relating to the respective risk factors. It is at the basis of the calculation of P&L in the trading book.

Mezzanine tranche: in a securitisation transaction, it is the tranche ranking between junior and senior tranche. As a rule, the *mezzanine tranche* is broken down into 2-4 tranches with different levels of risk, subordinated one to the other. They are typically characterised by an investment grade rating.

Monoline insurer: insurance companies specialised in guaranteeing payment of interest and notional amount of bonds upon default of the issuer. They are so called because, in general, they guarantee a service that is limited to a single industrial sector.

Non performing: term generally referring to loans for which payments are overdue.

Operational risk: the risk of incurring losses due to inadequacy or failure of processes, human resources or internal systems, or as a result of external events. These include, among others, loss deriving from fraud, human error, business disruption, system failure, breach of contract, natural disasters. Operational Risk includes legal risk while it does not include strategic or reputational risk (included in Pillar II of Basel 2).

OTC derivatives: financial and credit derivatives traded *over the counter* (eg: swaps, forward rate agreements).

OTC: *see* OTC derivatives.

Overall Capital Requirement (or Regulatory Capital): the sum of capital requirements relating to the individual type of risk, as well as those provisioned for real estate and equity investments assumed for credit recovery ("building block"). With regard to credit risk, the capital requirement is equal to 8% of risk-weighted assets.

P&L: *see* Profit & Loss.

Past due: *see* Default.

PD: *see* Probability of Default

Performing: term generally referring to loans characterised by regular performance.

Preference shares: innovative capital instruments, usually issued by foreign subsidiaries, and included in tier 1 capital if their characteristics ensure the

banks' asset stability. *See* also Core Tier 1 Ratio.
Private equity: activity aimed at the acquisition of equity investments and their subsequent sale to specific counterparties, without public offerings.

Probability of Default (PD): the probability that a customer/counterparty will default within the space of 1 year. Each PD derives from an internal ratings system and thus falls within a specific range of values corresponding to those used by the official rating agencies (*masterscale*) so as to obtain standardised data processing between internal and external rating systems. The PD strongly depends upon the definition of default: from the stricter sense of default limited exclusively to non-performing loans, the meaning has been broadened by the Basel 2 framework to include watchlist loans, restructured loans, loans under restructuring and past and overdue loans for over 180 days (timeframe set out by Basel 2). A value that is required by the advanced model for credit risk measurement (AIRB - "Advanced Internal Rating Based Approach") as provided for by Basel 2.

Profit & Loss (P&L): operational profit or loss indicator of the Trading book which expresses the difference in value of an instrument or a portfolio in a given timeframe, calculated on the basis of market values and directly validated/listed ("mark-to-market") or determined on the basis of internally-adopted pricing models ("mark-to-model").

Prudential ratios: there are two particularly significant ones:
- the ratio between Regulatory Capital including Tier 3 Capital and the result from overall capital requirements multiplied by 12.5 (*Total Capital Ratio*);
- the ratio between Tier 1 Capital and the result from overall capital requirements multiplied by 12.5 (*Tier 1 ratio*).

RAPM: cfr. Risk Adjusted Performance Measurement.

Rating: the degree of risk of non-compliance regarding a specific debtor (counterparty or issuer rating) or a single loan (issuance rating). It is typically expressed through a qualitative assessment belonging to a grading scale. If determined by a rating agency it becomes an "official" rating. If it is based upon internally-developed models it is called an "internal" rating.
It expresses the likelihood of default or insolvency.

Regulatory Banking Book: comprises all positions that are not assigned to the Regulatory Trading Book; its definition is therefore 'residual' in nature, even though most of a retail bank's exposures are assigned to this portfolio; in general, the rules for determining the capital requirements for Credit Risk are applied to the Regulatory Banking Book. *See* also Banking Book.

Regulatory capital: defined on the basis of Supervisory banking regulations, it is the numerator of the prudential ratio; it is calculated by starting from net equity and then carrying out adjustments, integrations, applying filters and making deductions; it is made up of Tier 1, Tier 2, net of deductions. Banks are required to constantly hold a total of Capital for regulatory purposes (including tier 3 capital) not lower than the Overall Capital Requirements, which is equal to the sum of Capital Requirements prescribed against Credit and Counterparty Risk, Market and Operational Risk, and those estimated for real estate and equity investments assumed for credit recovery.

Retail Clients: customer segment mainly including households, professionals, retailers and artisans.

Risk Adjusted Indicators: see Risk Adjusted Performance Measurement.

Risk Adjusted Performance Measurement (RAPM): measurement of performance adjusted by risk. Method of measurement of profitability, which is defined as "risk adjusted" in that - on the one hand - it includes a new P&L negative component under Profit for the Year, that rises as the expected risk component increases (Expected Loss), and - on the other - replaces the "book value" capital used in the transaction with the Economic Capital.

Risk factor: the driver/variable which determines the variation in value of a financial instrument.

Risk Weighted Assets (RWA): a definition that applies to Credit and Counterparty risk; in particular, with regard to exposures subject to standard methods, it results from the application of certain risk weights to exposures as determined by supervisory regulations.

Risk: can be defined as an unexpected potential economic loss. Risk is an economic loss in the sense that, against the commercial initiatives undertaken, if risk emerges it always results in a loss of value in the books of the Bank. Risk is an unexpected loss and implies the need to set aside a corresponding sum of capital in order to guarantee the bank's stability and solvency over a long period. Risk is a potential loss in the sense

that there may or may not be a certain confidence level (probability) in the future (forward looking) estimate and it is therefore an estimate, not a known value. Since risk is potential, it is always prospective or *forward-looking*. It is not the measurement of an economic effect that has already materialised. Risk is covered by the bank's capital, both in the form of Regulatory Capital and that of Economic Capital.

RMBS: *see* Residential Mortgage Backed Securities.

RWA: *see* Risk Weighted Assets.

Scoring: a company's customer analysis system which consists in an indicator resulting from both an analysis of book data and an assessment of the performance forecast for the sector, on the basis of statistic-based methodologies.

Security Financing Transactions (SFT): repos and reverse repos on securities or commodities, securities or commodities lending or borrowing transactions and margin lending transactions.

Senior/SuperSenior tranche: the tranche with the highest degree of *credit enhancement,* ie. the highest level of privilege in terms of remuneration and reimbursement priorities. It is higher in rating than the *mezzanine tranche*.

Seniority: Level of subordination regarding the repayment of notes, generally broken down (in decreasing order) into SuperSenior, Senior, Mezzanine, Junior.

Servicer: in securitisation transactions it is the subject that - on the basis of a specific servicing contract - continues to manage the securitised loans or assets after they have been transferred to the special purpose vehicle responsible for issuing the securities.

Settlement Risk: the risk that arises in transactions on securities when, after expiry of a contract, the counterparty is in default with regard to delivery of securities or payment of amounts due.

SFT: *see* Security Financing Transactions.

Shift Sensitivity: measurement of the impact of an unexpected and parallel shift in the yield curve upon the bank's economic value. See ALM, Banking Book, Interest Rate Sensitivity, Economic Value Approach.

SMEs: Small and Medium Enterprises.

SPE/SPV: *see* Special Purpose Entities or Special Purpose Vehicles.

Special Purpose Entities or Special Purpose Vehicles (SPE/SPV): established in pursuit of specific objectives, mainly to isolate financial risk. The assets consist in a portfolio, the proceeds of which are used for the servicing of bond loans issued. Typically used in asset securitisation transactions.

SREP: *see* Supervisory Review and Evaluation Process.

Stress test: a set of quantitative and qualitative techniques used by banks to assess their vulnerability to exceptional, though plausible, events.

Supervisory Review and Evaluation Process (SREP): a process put in place by the Supervisory Authorities with the objective of analysing the ICAAP process developed by the banks, verifying the congruence of results, providing an overall assessment of the banks and implementing, where necessary, the appropriate corrective measures, both organisational and financial.

Supplementary Capital (Tier 2): defined by the Supervisory framework as: (+) valuation reserves (+) Tier 2 subordinated liabilities (+) non-committed credit risk fund (+) hybrid capital instruments not included in Tier 1 capital (-) net capital losses on held to maturity investments (-) loan losses in the course of the year (+/-) net gain/losses on listed non-banking/financial equity investments.

Surplus expected losses on net provisions ("Delta PA"): the difference between expected losses and overall net value adjustments, limited to the exposures subject to internal models for credit risk; it is a component of the Regulatory Capital.

Syndicated lending: loans arranged and secured by a pool of banks and other financial institutions.

Tertiary Capital (Tier 3): defined by the Supervisory framework, it is used to cover up to a maximum of 71.4% of capital requirements against market risk.

Tier 1 Ratio: ratio of a bank's core capital to its total risk-weighted assets. It is a measure of capital adequacy defined in the Supervisory Regulations (stemming from the 1998 Basel Capital Accord known as Basel 1) as a solvency ratio for banks. No mandatory minimum level is required for this ratio by the Bank of Italy.

Tier 1: *see* Core Capital.

Tier 2: *see* Supplementary Capital.

Tier 3: *see* Tertiary Capital.

Total Capital Ratio: ratio of a bank's total regulatory capital to its total risk-weighted assets. It is a measure of capital adequacy defined in the Supervisory Regulations (stemming from the 1998 Basel Capital Accord known as Basel 1) as a solvency ratio for banks. This ratio must be no lower than 8%.

Trading Book: positions intentionally held for trading purposes and destined to be disposed of in the short term and/or assumed with the aim of benefitting, in the short term, from the differences between purchase and sale price, or other price or interest rate variations. It consists in a set of positions in financial instruments and commodities held for trading or to cover risk inherent in other constituent of the same portfolio. For eligibility to be included under the trading book prudential treatment, the financial instruments must be exempt from any clause which would limit their tradeability or, in alternative, fully covered. Furthermore, the positions must be frequently and accurately assessed. The trading book must be actively managed.

UCITS: Undertakings for collective investments in transferable securities (UCITS).

Upper Tier 2: identifies hybrid capital instruments (e.g. perpetual loans) that make up the highest quality constituents of Tier 2 capital.

Value-at-Risk (VaR): probability measure of a portfolio's market risk. It is defined as the maximum potential loss in value of an asset or portfolio over a defined period (*holding period*) for a given *confidence interval* (with the *confidence level* expressing probability). As an example, with regard to the trading book, the VaR model estimates the maximum decrease (loss) that a portfolio is expected to incur with a specified probability (for ex. 99%), over a defined time horizon (for ex. 1 day). In this example, a 1 day VaR with a 99% confidence implies that there is only a 1% chance of the Bank losing more than the VaR amount in one single working day.

Volatility risk: measure of the exposure to fluctuations in the historical or implied volatility of market risk factors. It is connected with the amplitude of price, rate, and foreign exchange fluctuations over a set period of time and is an integral part of market risk.

List of Tables

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