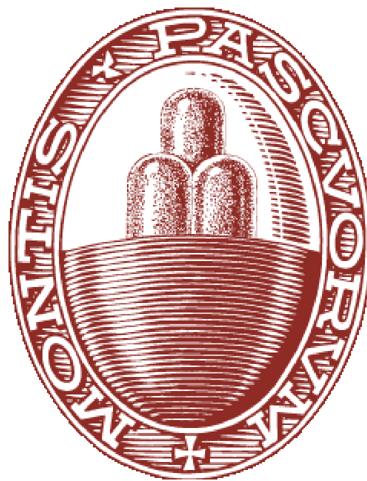
Pillar 3 Disclosure

31 December 2008

Pillar 3

MONTE
DEI PASCHI
DI SIENA
BANCA DAL 1472

Disclosure
Pillar 3



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Introduction

In order to strengthen market discipline, the Bank of Italy published Circular no. 263 on 27 December 2006, introducing disclosure obligations regarding capital adequacy, risk exposure and the general characteristics of the systems used to identify, measure and manage such risks.
The information, published according to the above-mentioned rules, is of a qualitative and quantitative nature and is subdivided into synoptic tables defined in Enclosure A, Section IV, Chapter 1 of the Circular no. 263. Table 11 may not be applied to the Montepaschi Group.
The Pillar 3 Disclosure (IPP3) provides a complete picture of the risks taken, of the characteristics of the relative management and control systems, and of the capital adequacy of the Banking Group.
The Montepaschi Banking Group publishes the Pillar 3 Disclosure (IPP3) and its subsequent updates on its following website: www.mps.it/Investor+Relations.

1. General information requirements

The regulation and the definition of roles and responsibilities in the management of risks within the Montepaschi Group have been further developed during 2008, also in view of the recognition by the Bank of Italy of the advanced internal models used on credit and operational risks for monitoring purposes.
The basic principles that distinguish the Risk Management process within the Montepaschi Group are based on a clear distinction of roles and responsibilities of the control units of first, second and third level.
The Board of Directors of the Parent Bank is in charge of defining the strategic guidance and management policies of risks at least on an annual basis and of expressing, also from a quantitative point of view in economic capital terms, the overall Group risk appetite. The Statutory Auditors and the Internal Control Committee are responsible for evaluating the level of efficiency and adequacy of the Internal Controls System, with particular reference to risk control.
The General Management is in charge of guaranteeing the compliance with risk policies and procedures. The Risks Committee prepares the Risk Management policies and verifies the overall compliance with the limits assigned to the various levels of operations. The Risks Committee of the Parent Bank evaluates, on a global level and within the single companies, the risk profile reached and thus, the use of capital – both capital for regulatory purposes and economic capital – as well as the trend of the risk-return performance indicators. The Finance Committee of the Parent Bank plans the funding of the Group, proposes the allocation of capital which is submitted for approval to the Board of Directors, establishes the measures to be adopted for a better risk-return profile of the Asset & Liability Management (ALM), manages liquidity risk and defines the actions carried out by Capital Management.
The Board of Directors is responsible for defining the rules relating to the internal controls system and verifying their actual application and compliance.
The Risk Management Area of the Parent Bank defines the integrated analysis methodologies to measure all the risks taken, to guarantee an accurate measurement and a constant monitoring of the same and quantifies the Economic Capital, therefore the minimum amount of capital to be held as cover for all the outstanding risks. This Area draws up the control reports and verifies the compliance with the operational limits set by the Board of Directors on the basis of internally developed models.
The Business Units carry out controls on the conformity of the transactions and represent the first check point of operations in the organization, the more general Internal Controls System.
Finally the Wealth Risk Management Unit, directly reporting to the Private Banking/Wealth Management Area has the responsibility for controlling, measuring and monitoring the risk of investment products offered to customers and held by them. In line with the New Basle Accord on Capital Adequacy (i.e. Basle 2) relating to the risks of Pillar 1, the Montepaschi Group completed

the internal models for credit and operational risks, during the first half of 2008. As per Circular Letter of the Bank of Italy no. 263/2006, on 12 June 2008 the Montepaschi Group was formally authorised to use advanced models for the measurement and the management of credit risks (AIRB - Advanced Internal Rating Based) and operational risks (AMA – Advanced Measurement Approach) starting from the first consolidated report as of 30/06/2008. The mentioned models are being completed and extended to the entities not included in the initial validation stages and activities are being carried out to improve the internal models for market and counterpart risks. In particular, during the second half of 2008, a Group Directive was released to improve the rules on Market Risk, redefining roles, responsibilities and processes of all parties involved.
Furthermore, the activities to comply with Pillar 2 went on. To this end, during the year a specific Capital Adequacy Unit was set up, within the Planning Area of the Parent Bank, to coordinate improvement and governance of all processes relating to the self-valuation of capital adequacy of the Group as per the Internal Capital Adequacy Assessment Process (ICAAP). This unit also collaborates with the Strategic Planning Unit to work out "risk appetite" proposals and defines the methodologies for capital allocation proposals. During the second half of 2008, a Group Directive was issued defining roles and responsibilities in the governance of the ICAAP process aimed at rationalising the entire Capital governance process.
With reference to Pillar 3 (compulsory "Pillar 3 Disclosure"), in order to ensure compliance with the *disclosure* obligations provided for by the rules, the Montepaschi Group started a specific project within the "Basle 2" activities with the objective of defining the structure and the contents of the document (Pillar 3 Disclosure), as well as the relative implementation processes. The work group, coordinated by the Risk Management Area, was supported by all main units of the Parent Bank.

The Montepaschi Group, during the ordinary course of its activities, takes various types of risks which may be schematically described as follows:

- Credit risk,
- Counterpart risk,
- Issuer risk,
- Concentration risk ,
- Market risk relative to the Trading Book,
- Interest risk of the Banking Book (Asset & Liability Management - ALM),
- Liquidity risk,
- Equity investments portfolio risk ,
- UCIT risks (alternative funds),
- Operational risks,
- Business risk,
- Reputational risk.

The Risk Management Area of the Parent Bank periodically takes steps to quantify the Economic Capital by type of risk, mainly on the basis of internal measurement models. These models have

been developed specifically for each risk factor and are based principally on Value-at-Risk (VaR) types of methodologies, aimed at determining the maximum loss in which the Group could incur, given a holding period and a pre-arranged level of probability (confidence interval). The risk measures allowing the quantification of the Economic Capital are determined on the basis of internal models developed by the Montepaschi Group: for some risk factors and on certain categories of portfolio these models have received a formal validation from the Supervisory Authorities for regulatory purposes (Credit Risk and Operational Risk). However the output in particular from both the internal market risks and the management models for counterpart risk represents a daily instrument to control and monitor risk exposure generated by these sectors, as well as to control operational limits and authorizations according to the guidelines set out and approved by the Parent Bank. Regarding credit risk, most of the input from the Credit Portfolio Model, which is also being continuously developed from a methodological point of view, is produced by internal models used for reporting, with further information and improvements, aimed at representing risk measurements mainly for operating purposes. As far as operational risk is concerned, the model output, obtained at Group level, is re-allocated on the basis of historical loss criteria, on the basis of estimates furnished by top management and on the basis of gross income information and is used for operating purposes. Furthermore, an integral part of Overall Economic Capital is also made up of the results in terms of sensitivity shifts of the economic value resulting from the internal Asset and Liability Management model, which during the year has undergone numerous and important improvements to better present and measure sight items and prepayment risk. Business risk is defined as loss risk from the reduction of interest margins and intermediation due to variations in the competitive environment and in the economic conditions of the company business. Equity risk results from the volatility of market valuations in relation to the equity investments held in portfolio not deducted from net equity. The liquidity risk, which was subject to important developments during the year to take account of specific monitoring functions, is not significant in terms of quantification of the Economic Capital. The MPS Group has implemented operational limits and introduced a formal policy for the management of liquidity risk in both normal situations and stressed market conditions. In particular, on the basis of predefined tolerance limits, specific procedures regarding contingency plans have been defined and finalized which became effective if necessary. Specific mitigation policies are being defined for other risks not measured with quantitative approaches (eg. Reputational risk).

Economic Capital on each single factor of risk results, therefore, from the corresponding metrical operating metrics of risks. Measurements of VaR on single risk factors actually maintain their "individual" value according to the current regulatory provisions and the international best practice and are determined for a holding period and confidence intervals which are generally differentiated. Overall Economic Capital (or Overall Internal Capital) is the amount of minimum capital resources necessary to cover any economic losses due to the occurrence of unexpected events generated simultaneously by the various kinds of risk.

The Overall Economic Capital stems from the combined measurement of single risk factors: these measures are standardized both as to the annual holding period and as to a chosen confidence interval, in line with the level of rating assigned to the Montepaschi Group by the official rating agencies, and are subject to "intra-risk" and "inter-risk" diversification processes. The final output shows Overall Economic Capital or Overall Internal Capital at Group level subdivided by the different types of risk, with the indication of the weight of "intra-risk" diversification with respect to the building block approach where quantification is not provided for.

All these macro-risk factors, which in particular directly impact on the Group's capital, are regularly measured by the Risk Management Area of the Parent Bank, which prepares the periodic documentation for the Risks Committee and for the Board of Directors.

The Planning Area takes care of distributing the above risk measures to each legal entity and Business Unit, in order to represent the performance adjusted by risk as well as the specific creation of risk-adjusted value, using metric measurements which are consistent with the income component and the absorbed economic capital component. The allocation of capital in final, prospective and periodical reporting terms, is also determined by the Planning Area, together with the company entities of each single legal company with the preparation of appropriate reporting adjusted to the specific business lines of the banks coming within consolidation and submitted for approval to the Finance and Liquidity Committee of the Parent Bank.

1.1. Organization of the Risk Management Area

The Risk Management Area is in charge of the functioning of the risk management system of the Group, and verifies the compliance and the adequacy of the mitigation measures. It carries out controls according to the Bank of Italy - Consob regulations regarding the organization of intermediaries and the prudential supervisory regulations of the Bank of Italy; it also develops and implements the measurement and risk control system to determine the economic and regulatory capital (with reference to validated internal models), by the different types of risk, and supplies information through appropriate reporting systems to the business units, the Board of Directors and the Top Management.

The following units directly report to the Risk Management Area:

- A **staff unit** with the function of:
  - compiling the notes to the quarterly, half-yearly and yearly report on operations of the Parent Bank and the Group as far as risk management and overall internal capital are concerned;
  - coordinating, for the Risk Management Area, the drawing up of the mandatory disclosures as defined by the Supervisory Authorities, sub Pillar 3;
  - preparing, as to the subjects of its competence, any documents for the meetings with the rating agencies and preparing the relative detailed reports for the Top Management and for the other Units of the Bank and of the Montepaschi Group;
  - periodically producing management reports supporting the business of the Parent Bank and the Affiliated Companies;

- An **operational risk control unit** with the function of :
  - defining, developing and updating the models for operational risk measurement, managing the internal model within the qualitative and quantitative limits established by the Supervisory Authorities;
  - coordinating the collection of the operational losses, the risk assessment process and the process for identifying the major operational critical areas on the basis of scenario analysis;
  - monitoring the measurements of internal capital used for operational risks for each business unit and globally for the Group (Operational VaR);
  - measuring the effects on absorbed economic capital of the mitigation operations of the operational risk of the Group;
  - measuring the scenario analyses and the stress tests on operational risks;
  - using effectively the measurement system within the decision-making processes and the daily management systems of the operational risks;
  - implementing a validation process and writing the final report on the Internal Model of Operational Risks to be submitted for approval to the Risks Committee;

- defining and developing methods and models of risk management related to the financial intermediation with customers;

- a **market risk management unit** with the function of :
  - validating/determining the pricing methodologies/criteria of the financial instruments used by the various entities of the Group;
  - defining the criteria and the parameters to use the Front Office and Market Risk Management application systems;
  - defining and updating the methodologies and measurement models for risk inherent in the market risk profile of the Group, in co-ordination with the units of risk control of the companies of the Group for the appropriate methodologies to be shared;
  - controlling and validate main market parameters, as to the financial portfolio;
  - monitoring market VaR measurements at level of each single business unit and at Group level;
  - steering and co-ordinating the control activities of market risk of the business control units, in compliance with the relative guidelines concerning financial controls within the Group;
  - monitoring the formalisation of market risk exposure limits assigned by the Board of Directors of the Parent Bank, verifying the methodological consistency of their overall structure;
  - monitoring the capacity levels of the limits established in relation to the related measures of VaR, of Stop Loss and of any other measurement metrics regarding market risk of the trade portfolio at level of each single business unit and y at Group level;
  - verifying the application of corrective measures taken due to exceeding of limits or other vulnerabilities noticed while monitoring risks;
  - validating P&L management data, on the basis of primary control activities and checking the correctness of the bookings made by the control sections of each single business unit;
  - defining, developing and updating the models of the counterpart risk measurement, monitoring the internal model as to qualitative and quantitative requirements provided for by the Supervisory Authorities, in collaboration with the risk control units of the companies of the Group for the appropriate methodology sharing;
  - monitoring the counterpart risk measurements at level of each single business unit and at Group level;
  - monitoring the formalisation of exposure limits of counterpart risks assigned by the Board of Directors of the Parent Bank, verifying the methodological consistency of their overall structure;

  - monitoring the capacity of the limits established with reference to the related measures of counterpart risk, at level of each single business unit and at Group level;
  - evaluating unlisted shares in the portfolio of customers;
  - evaluating unlisted shares relative to the activities of the custodian bank;
  - defining, developing and updating the models for measuring equity risk in the banking book;
  - monitoring equity investment risk of the Montepaschi Group;
  - quantifying the scenario analyses and the stress tests on market risks.

- A **credit risk management unit, comprising ALM and liquidity** with the function of :
  - defining, developing and updating models (PD, LGD, EAD) for the measurement of credit risk monitoring the internal models complying with qualitative and quantitative requirements provided for by the Supervisory Authorities;
  - monitoring credit VaR measurements at level of 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 units and proposing any corrective actions, also evaluating any effects on mitigation actions;
  - determining the internal capital used to calculate of risk-adjusted performance measures;
  - defining, developing and updating models for the measurement of risks inherent in 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 threshold limit value and activating the appropriate initiatives aimed at a global optimization, also on the basis of adequate scenario analyses;
  - measuring the scenario analyses and the stress tests on credit, ALM and liquidity risks;
  - developing and maintaining the methodologies used for identifying and mapping the risks of the Group, both by each business unit as well as by the legal entities;
  - defining, developing and updating estimation models and models for the evaluation of relevant and non-relevant corporate risks, as defined in the Supervisory Authorities' regulations;
  - quantifying the risks other than the Pillar 1;
  - defining, developing and updating models for integrating various risks, aimed at quantifying the global internal capital of the Montepaschi Group;
  - jointly developing, maintaining and implementing, from an operational point of view, the scenario methodologies and stress tests on all risk factors, supporting and co-ordinating methodologies for the ICAAP process estimates as well as developing scenario methodologies and stress tests for each single risk factor;

- supporting the calculation of management economic capital absorbed by legal entity, business unit and at Group level;
- co-ordinating the activities of the Risk Management Area in order to support the ICAAP process at Group level.

Below is a table summarizing main risk measurement methodologies:

Pillar 1 risks		
Type of risk	Current management	Present or future activities
Credit	• Internal model of credit VaR, inclusive of inter-risk correlation . • Measurement of expected loss and economic capital. • Usual Mitigations to reduce loss risks.	• "Loss based" integrated internal model based on Montecarlo simulations. • Active management of the credit portfolio
Market (Trading Book)	• Internal management model for generic risks based on historical simulation with full revaluation. • Internal management model for specific risks with VaR credit spread. • Counterpart risk: Current value method	• Counterpart risk: calculation of 'Actual Exposure, Total Exposure, Potential Exposure, Unexpected Loss with Montecarlo scenarios. • Development of specific internal risk model.
Operational	• Internal AMA model • Mitigation and insurance allocation of risk.	• Refinements

Pillar 2 risks

Type of risk	Current management	Present or future activities
Concentration	• VaR 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 entropic indices.	• Further refinements on clustering for the calculation of concentration
Market (ALM Banking Book)	• Internal model based on current profit approach, to determine the impact of the interest rate variation through sensitivity on interest margin . • Internal Model based on the Economic Value approach, to determine the impact of interest rate variation on the economic value of the bank (assets/liabilities). • Use of maturity gap to determine the impact. Shift of 25 bp, 100 bp e 200 bp. • The items at sight have been modellized and are included in the risk measures periodically presented. • Development and refinement of the model and in particular the modelling of the prepayment rate.	• Behavioural development models • Refinements
Equity investments	• VaR Model 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 activity of uncertain cash flows is almost completed.
Business	• Model based on internal estimates.	• Model development.
Reputation	• Control based on specific policies.	• Specific control/mitigation policies of reputational risk are being issued.

The following table shows the main characteristics of internal models adopted for the main types of risk and their management in view of risk integration..

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	Market volatility	Correlations based on historical loss evidence Correlations based on an internally developed additional model	
Equity investments	3 M e 1 Y VaR, 99%	Parametric VaR	Share price volatility for listed shares, comparable indices volatility for unlisted shares, appropriately bucketized by sector	Correlations between share prices Correlation between proxy indices	99.93%, normality hypothesis
Market (Banking Book)	1 Y, sensitivity shift to 25 bp	Maturity Gap	Bucketing on parallel and twist shift nodes Interest rate		1 Y, 99.93% , normality hypothesis
Market (Trading Book)	1 day VaR 99%	Full revaluation Historical Simulation	All market risk factors (IR, EQ, FX, CS,…)	Implicit in the full revaluation historical simulation	1 Y, 99.93% normality hypothesis
Operational	1 Y VaR, 99.9%	Quantitative: Loss Distribution Approach completely integrated by external data. Qualitative: Self-Assessment, integrated through the credibility theory	Frequency and severity by kind of event	Perfect correlation for conservative reasons	99.93%, normality hypothesis

At present the various risk factors are integrated by using a multi-varied model, even if numerous methodological developments are going on with regards to risk integration and improvement of the measurement of some types of risks to be refined.

During the meetings of the Risks Committee of the Parent Bank, a "**Risk Management Report**" is drawn up showing analysis and measurement of the overall risks at group level and for each single entity.

Periodically, the absorption of diversified and undiversified management economic capital of the Montepaschi Group is reported.

As far as credit risk is concerned, main analyses deal with:

- performing and non-performing portfolio risks by legal entities, client segments and industrial groups;
- risk dynamics of the performing loan Portfolio;
- risk quality distribution of the performing loan Portfolio;
- analysis by concentrations and industries.

As far as Asset & Liability Management is concerned, main analyses deal with :

- impact on economic value;
- impact on risk margin;
- impact on the interest risk margin, with and without viscosity on the items at sight.

As far as market risk is concerned, main analyses deal with:

- performance of the market risk profile of the Group's Trading Portfolio: management VaR;
- VaR break down by legal entity and risk factor;
- Diversified and undiversified VaR.

As far as operational risk is concerned, main analyses deal with:

- Data loss evidence (quantitative information);
- Losses with major impact during the quarter and analysis of the causes;
- VaR on the various regularoty event types.

Furthermore, information is provided on works in progress of the main projects under way in the bank as well as main subjects and points which are relevant from time to time are updated.

1.2. Credit Risk

The Budgeting, Planning, Capital and Risk Management processes of the Montepaschi Group are based on the "Risk Adjusted Performance Management" (RAPM) measurement logic. In the development of these management processes the definition of adequate credit policies, under the responsibility of the Credit Policies and Control Area, plays a relevant role which is operationally applied to implement strategies, in terms of credit portfolio quality objectives of the credit portfolio itself, to be applied to credit processes. The Montepaschi Group's strategies in risk management mainly aims at limiting the economic impacts of insolvency on the credit portfolio in particular using all potentialities offered by internal rating models and loss estimates in case of insolvency. Strategies are defined on a yearly basis, except for extraordinary changes due to exogenous conditions. It is possible to identify two definitions:

- Loan disbursement strategies (definition of quality targets for the access to credit);

- Credit monitoring strategies (definition of minimum quality targets to maintain the credit granted).

The definition of the customer acceptance policies, focused on the analysis of the customer's prospective solvency, plays a major role in the loan disbursement strategies. Only after having identified the customer with the required creditworthiness, other mitigation factors of credit risk (guarantees) are considered. The information on client quality and on risk characteristics of the transaction is essential to identify the authorising body competent to grant the loan.

The follow-up strategies consist of all the survey systems, on a monthly basis, of the customer's changing conditions. The identification of events likely to change the credit risk triggers a set of measures: the commercial network is assigned the key task of to keeping the communication channel with the customer open and of obtaining all useful information to verify the risk change. In case of confirmation, the client account manager is supported by personnel specialised in credit quality management and by legal staff to define the credit risk management procedures.

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

Risk mitigation policies are defined in the Credit Risk Mitigation (CRM) process, whereby the legal, operational and organizational conditions necessary to use supplementary guarantees to attenuate credit risk are defined and met. In the process three categories of guarantees complying with the mitigation requirements are defined: Personal Securities, Financial Collaterals and Mortgage Collaterals. Other types of credit protection guarantees do not produce any mitigation of credit risk. In particular for collaterals, a system has been introduced to monitor the asset value in guarantee based on the measurement of market value (daily for securities and annually for real estate). Within the credit granting process, the Montepaschi Group adopts a system to identify a risk adjusted authorizing body which is sensitive to the client's rating and to the presence of collaterals. Should the value of the asset in guarantee be subject to market or foreign exchange rate risks the safety margin is used, measured in percentage of the actual value of the guarantee offered, depending of the volatility of the security value. In the authorising stage, only the part of the financing covered by the value of the asset net of the safety margin is considered guaranteed. In the monitoring stages an adjustment of the guarantees the market value of which is lower than the authorised value net of the safety margin is required; the notification of this step is channelled into the implementation processes of the credit control strategies.

1.3. Operational Risk

The Montepaschi Group has adopted an operational risk management system in order to guarantee an effective action of prevention and mitigation of the risks. The management system is made up of a structured process for the identification, the valuation and the control of operational

risks and is defined in the Group's Directive on Governance and Management of Operational Risks. The management system adopted by the bank is divided into the following macro – processes: identification, measurement, monitoring, management and control, maintenance, internal validation and review. Each process is clearly documented and is subject to the responsibility of a specific corporate unit. The organizational units of the various companies controlled by the Group are also involved in the processes. Policies and procedures assign the operational risk control function to the Risk Management Area. To this end, the Operational Risk Unit is established within this Area and is responsible for:

- The definition, the development and the updating of the management and measurement systems of operational risks;
- The co-ordination of the data collection and storage systems;
- The reporting system;
- The valuation of operational risk profile and the measurement of the corresponding capital adequacy requirements.

The management and measurement model designed and implemented by the Montepaschi Group includes four components indicated below:

- Internal data of operational loss;
- External data of operational loss;
- Factors of the operational background and of the internal control 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 for example the process, the organizational unit, the geographical area etc. The bank has defined a Data Loss Collection process aimed at collecting and storing the data on operational risk which include both the information referred to the four components strictly provided for by the measurement system and other information considered important for management purposes.

The Data Loss Collection is such to ensure completeness, reliability and updating of the data and thus the effectiveness of the management and measurement systems using these data. The single application of the operational risk management and the relative data base are also subject to continuity plans and disaster recovery.

As far as the operational loss of external data is concerned, the Montepaschi Group has decided to use a strongly prudential approach. The external data derives from the Italian Operational Losses Database (IOLD) to which the Monte Paschi Group belongs since its establishment in 2003. Besides the complete utilisation of the external loss data, the IOLD initiative is also utilised for methodological purposes and for solving interpretative doubts.

The analysis of background and control factors identifies the operational difficulties of the bank. The breakdown of the analyses, which are carried out with the single process owners by means of annual tests of self assessment on operational risks, is a prospective component aiming at poiting

out the day by day operational difficulties. The Montepaschi Group finally conducts, on an yearly basis, scenario analyses for its own top management: the analyses are aimed at measuring , in terms of capital, every difficulty, in view of taking account (forward looking) of the developments of the organizational and business frameworks.

In order to ensure the correct application of this methodology and its compliance with the rules in force, the Risk Management Area is responsible for the process of internal validation. The quality of the operational risk management and measurement systems is assessed on a continuity basis, as well as their compliance with regulatory provisions, with corporate needs and with the reference market trends. In this regard, it is also particularly important not only to verify the reliability of the methodology for the calculation of capital adequacy, but also to ascertain the actual use of this measurement system in decision-making decisional processes as well as in the daily operational risk management system.

The Risk Management Area is also in charge of the reporting on the operational risk control and measurement system addressed both to the internal units and to the Supervisory Authorities. Each macro-process in which the system is structured provides for specific reports in the framework of the wider reporting. Through the definition of a set of contents, addressees and updating schedule this activity aims at ensuring timely horizontal and vertical communication of information on operational risks between the various corporate units involved.

Policies and procedures assigns the internal audit function to the Internal Controls Area, which is responsible for the periodic checks on the global functioning of the governance and operational risk management system of the Montepaschi Group in order to carry out an independent and organic adequacy valuation in terms of efficacy and efficiency. On an annual basis, the Internal Controls Area prepares a report to inform the company bodies on audit activities underlining any criticalities, proposals of corrective measures and the relative outcome.

1.4. Market risks

The Trading Portfolio of the Montepaschi Group – Trading Book - is made up of the Supervisory Trading Portfolios of the Parent Bank (MPS Bank), of MPS Capital Services (MPSCS) and residually of Biverbanca and of the Irish subsidiary, Monte Paschi Ireland. The recent joining the Group of Banca Antonveneta does not significantly weight on the perimeter, as the management approach adopted includes all market risks into MPS Bank and MPSCS. The portfolios of the other commercial subsidiaries are closed to market risks as they only contain own bonds held to service retail clients. Also the derivatives, traded on behalf of customers, are included and monitored by MPSCS.

The market risks of the Trading Portfolio is the potential financial loss that can take place on positions held by the Montepaschi Group following unfavourable variations of risk factors. The variations of the risk factors to which the trading book is subject are: interest rates, foreign exchange rates, share prices, indices and commodities, credit spreads, volatility in these factors.

The market risks of the trading portfolio are mainly monitored for management purposes in terms of Value-at-Risk (VaR), both for what concerns the Parent Bank and the other Group entities which are considered significant autonomous risk taking centres. The VaR is defined as the maximum potential loss a trading book can suffer at a determinate level of probability (confidence interval) and a pre-fixed holding period. The Montepaschi Group's VaR is calculated with a confidence interval of 99% and a holding period of one working day. The method used is that of the historical simulation with a full daily revaluation of all the elementary positions on a basis of 500 historical surveys of risk factors (roughly two working years) with a daily review. The VaR thus calculated in this manner permits the inclusion of all diversification effects between risk factors, trading books and types of instruments traded. It is unnecessary to take account beforehand of any functional form in the distribution of the yields of assets and the correlations between different financial instruments are implicitly captured by the VaR model on the basis of the combined historical performance of the risk factors.

Each bank operates individually on its own trading portfolio, managing, at the same time and in an integrated manner, positions on interest rates, on shares, on foreign exchange rates and on loans within the operational limits set by the Board of Directors. In particular, with reference to the trading portfolio of the Parent Bank the aggregate monitored with VaR integrated methodologies is wider than the aggregate for supervisory purposes as it includes also positions of the Banking Portfolio which, from a management point of view, are under the operational responsibility of the Business Areas which carry out trading activities. They are positions directly taken in compliance with provisions of the Board of Directors or positions managed by the Finance Area of the Parent Bank and they do not have the requirements necessary to be considered in the Supervisory Trading Book (eg. AFS shares and bonds).

Each business unit is subject to precise operational limits previously established by the Board of Directors and continuously subject to the monitoring of several independent control bodies. As a matter of fact, inside the Group there are Business Control Units which closely operate with front office personnel and monitor the correctness of the transactions, also with reference to the pricing of the official application systems of the Group and to the confirmations received from the counterparts. At head office level of the Parent Bank, there is a risk control unit (Risk Management Area) which mainly carries out operational control and integrated risk estimate activities, verifies the compliance with the operational limits established by the Board of Directors and the calculation of the economic capital absorbed by each business unit. The Internal Audit is in charge of the implementation, the control and maintenance of the whole Internal Control System of the Group and of the development/periodical revision of all the control processes.

The Trading Portfolio of the Montepaschi Group is subject to daily monitoring and reporting by the Risk Management Area on the basis of proprietary systems. The management VaR is autonomously calculated in respect of the operational units using the internal risk measurement model set up by the Risk Management Area itself, in line with main international best practices.

The operational limits of the trading activity are expressed, for each level of authorization, in VaR terms diversified among risk factors and portfolio and monthly and yearly stop loss. In particular, the credit risk of the trading book is included in the VaR reports and in the respective limits of the credit spread risk and is also subject to specific operational limits of issuer risk and bond concentration, providing notional maximum levels by macro-type counterpart and rating class. Periodically, the daily management reporting output of market risk is forwarded to the Risks Committee and to the Board of Directors of the Parent Bank in the Risk Management Report which is used to inform Management on the global risk profile of the Montepaschi Group.
The macro-types of risk factors taken into consideration in the Internal Market Risks Model are IR, EQ, FX, CS as follows:

- IR: interest rate on all the main curves and relative volatility;
- EQ: share prices, indices and relative volatility;
- FX: foreign exchange rates and relative volatility;
- CS: credit spread levels.

The VaR (or diversified VaR, or Net VaR, i.e. net of all diversification effects) however calculated as a unique and integral measure, is nonetheless disaggregated daily into three main analysis dimensions:

- Bank and Management Portfolios;
- Financial Instruments;
- Family risk.

The VaR for each combination of these dimensions can also be assessed to foster detailed analyses of the events affecting the portfolios.
With particular reference to the risk factors, Interest Rate VaR (IR VaR), Equity VaR (EQ VaR), Forex VaR(FX VaR) and Credit Spread VaR (CS VaR) are identified. The algebraic sum of these components makes up the so-called Gross VaR (or non-diversified VaR) which, if confronted with the VaR, allows to quantify the diversification benefits among risk factors resulting from holding portfolios allocated on asset classes and risk factors which are not perfectly correlated. This information can also be analysed along all the above-mentioned dimensions.
The development of the model used since the beginning of 2008 has permitted the production of diversified VaR metrics substantially for the whole Montepaschi Group, so that, in an integrated way, all diversification effects can be appreciated that can be produced in the various banks because of the specific positioning created by the various business units.
Finally, scenario analyses are regularly carried out on the various risk factors with differentiated levels of detailed analysis.

1.5. Interest and Liquidity Risk of the Banking Portfolio

With reference to the methodology developed for the interest rate risk of the ALM Banking Book), Table 14 has to be referred to.

With reference to liquidity risk, the Montepaschi Group structurally faces this subject with a formal management policy also in view of the compliance with the Basle 2 requirements of Pillar 2 .

The organizational and management framework provides that:

- a liquidity policy defining the perimeter and governance model of the Group's liquidity which is centralized in the Treasury and Capital Management Area, as well as an organizational model for the short and medium/long term, the composition of a net maturity ladder and limits for the short term and medium/long term;
- A stress test policy is also defined in the liquidity policy aimed at simulating the effects of stress conditions and at arranging the appropriate corrective measures;
- a contingency plan dealing with of liquidity management in anomalous conditions defining risk indicators and organizational processes necessary to deal with crisis situations.

The global structural liquidity profile is monitored on the basis of the mismatching quantification, of liquidity data and of cash flows that are due for maturity. The optional type items have representative models consistent with those utilised for interest rate risk.

Much attention has been given to estimate liquidity flows to optimise management of financial flows. To improve the liquidity management of the Group, some activities aimed at increasing the counterbalancing capacity (i.e. the assets which may be allocated to reserves) have been completed.

Special attention has been given the planning of funding policies at Group level (Funding Plan), co-ordinated and directed by the Treasury and Capital Management Area (in collaboration with the Planning Area) which :

- submits to the Finance and Liquidity Committee the plan of measures for the financial markets for approval to reach the targets established by the business plan and the requirements of capital management;
- coordinates the access to long and short term, national and international capital markets for all banks of the Group, as well as the access to refinancing operations with the European Central Bank and the centralised management of statutory reserves;
- develops projections on the future liquidity situation, simulating different market scenarios.

1.6. Equity investments Portfolio Risk

The methodology used for the measurement of the risk price of the equity investments portfolio of the Montepaschi Group is Value-at-Risk (VaR). The model used is however different to the one utilised for the Trading Portfolio and is of a parametric type, based on the traditional approach to variance-covariance. To estimate the volatility of prices, a historical series of market yields for listed companies and a historical series of sector indices for unlisted companies is used. The VaR of the

equity investment portfolio is calculated with a confidence interval of 99% and a holding period of one quarter.

The above-mentioned model, developed and maintained by the Risk Management Area, also allows the measurement of the marginal contribution to risk of each single equity investment as well as the disaggregation of the measurement effected for the Group on the investment shares held by the single legal entities.

2. Scope of Application

The contents of this Disclosure refer to the Monte dei Paschi di Siena Banking[*] Group. Within the Group there are no obstacles preventing the rapid transfer of capital resources or sums.

According to the provisions of the Supervisory authorities, the banks of the Group reduce their individual capital requirements by 25% since they do not show any capital shortages at consolidated level.

Within the Montepaschi Group, all non-consolidated subsidiaries do not show any capital shortages with respect to their own statutory capital requirements.

[*] According to the Supervisory Authorities definition

Table 2.1 – Consolidation area as of 31.12.2008

Name	Main office	Sector	Shareholding	Type of relationship (+)	Votes availaible % (**)	Treatment in the Balance Sheet	Treatment for Supervisory purposes	Type of Activity
BANCA MONTE DEI PASCHI DI SIENA S.P.A.	Siena	Banking				Full	Full	Banking
MPS ASSET MANAGEMENT SGR S.P.A.	Milan	Asset and Fund management	100.00	1	100.00	Full	Full	Financial
MPS CAPITAL SERVICE BANCA PER LE IMPRESE S.p.A.	Florence	Banking	99.92	1	99.92	Full	Full	Banking
BANCA TOSCANA S.P.A.	Florence	Banking	100.00	1	100.00	Full	Full	Banking
MPS VENTURE SGR S.P.A.	Florence	Private equity fund management	70.00	1	100.00	Full	Full	Banking
MPS BANCA PERSONALE S.p.A.	Lecce	Savings promotion	100.00	1	100.00	Full	Full	Banking
MPS GESTIONE CREDITI S.p.A.	Siena	Credit recovery management	100.00	1	100.00	Full	Full	Banking
MPS LEASING E FACTORING S.p.A.	Siena	Leasing and factoring	100.00	1	100.00	Full	Full	Banking
MPS COMMERCIALE LEASING SPA	Siena	Leasing and factoring distribution through non-banking channels	100.00	1	100.00	Full	Full	Banking
AGRISVILUPPO S.p.A.	Mantua	Agricultural development finance company	99.07	1	99.07	Full	Full	Financial
MAGAZZINI GENERALI FIDUCIARI DI MANTOVA	Mantua	Deposit and custody warehouses (for third parties)	100.00	1	100.00	Full	Full	Non-financial
MPS ALTERNATIVE INVESTMENTS SGR S.P.A.	Milan	Speculative fund management	100.00	1	100.00	Full	Full	Financial
MPS ASSET MANAGEMENT IRELAND LTD	Dublin	Asset management	100.00	1	100.00	Full	Full	Financial
MONTE PASCHI IRELAND LTD	Dublin	Financial activity	100.00	1	100.00	Full	Full	Financial
MONTE PASCHI FIDUCIARIA S.P.A.	Siena	Trust company	100.00	1	100.00	Full	Full	Financial
ULISSE S.p.A.	Milan	Credit Securitization vehicle	60.00	1	60.00	Full	Full	Financial
ULISSE 2 S.p.A.	Milan	Credit Securitization vehicle	60.00	1	60.00	Full	Full	Financial
CONSUM.IT S.P.A.	Siena	Consumer credit	100.00	1	100.00	Full	Full	Financial
MPS TENIMENTI FONTANAFREDDA e CHIGI SARACINI S.p.a.	Siena	Wine industry	100.00	1	100.00	Full	Full	Non-financial
MPS IMMOBILIARE S.p.A.	Siena	Real estate	100.00	1	100.00	Full	Full	Instrumental
G.IMM.ASTOR Srl	Lecce	Real estate renting	52.00	1	52.00	Full	Full	Non-financial
PASCHI GESTIONI IMMOBILIARI S.p.A.	Siena	Real estate management	100.00	1	100.00	Full	Full	Instrumental
CONSORZIO OPERATIVO GRUPPO MPS	Siena	IT and Information services	100.00	1	100.00	Full	Full	Instrumental
BANCA MONTE PASCHI BELGIO S.A.	Brussels	Banking	100.00	1	100.00	Full	Full	Banking
MPS PREFERRED CAPITAL I LLC	Delaware	Financial vehicle	100.00	1	100.00	Full	Full	Financial
MPS PREFERRED CAPITAL II LLC	Delaware	Financial vehicle	100.00	1	100.00	Full	Full	Financial
MONTE PASCHI BANQUE S.A.	Paris	Banking	100.00	1	100.00	Full	Full	Banking
MONTE PASCHI CONSEIL FRANCE	Paris	Financial intermediary	100.00	1	100.00	Full	Full	Financial
MONTE PASCHI INVEST FRANCE S.A.	Paris	Financial intermediary	100.00	1	100.00	Full	Full	Financial
IMMOBILIARE VICTOR HUGO	Paris	Real estate	100.00	1	100.00	Full	Full	Non-financial
MONTE PASCHI MONACO S.A.M.	Montecarlo	Banking	100.00	1	100.00	Full	Full	Banking
MONTEPASCHI LUXEMBOURG S.A.	Brussels	Financial vehicle	100.00	1	100.00	Full	Full	Financial
MPS INVESTMENTS S.P.A.	Siena	Equity investments management	100.00	1	100.00	Full	Full	Financial
SANTORINI INVESTMENTS LTD	Edimburgh	Financial vehicle	100.00	1	100.00	Full	Full	Financial
CIRENE FINANCE Srl	Conegliano	Credit securitization vehicle	60.00	1	60.00	Full	Full	Financial
SIENA MORTGAGES 00-01 S.P.A.	Milan	Credit securitization vehicle	100.00	1	100.00	Full	Full	Financial
BIVERBANCA CASSA RISP. BIELLA E VERCELLI S.P.A.	Biella	Banking	59.00	1	59.00	Full	Full	Banking
MPS SIM S.P.A.	Milan	Securities intermediation	100.00	1	100.00	Full	Full	Financial
BANCA ANTONVENETA S.P.A.	Padua	Banking	100,00	1	100,00	Full	Full	Banking

Table 2.1 – Consolidation area as of 31.12.2008

Name	Main office	Sector	Shareholding	Type of relationship (+)	Votes availaible % (**)	Treatment in the Balance Sheet	Treatment for Supervisory purposes	Type of Activity
ANTENORE FINANCE S.P.A.	Padua	Credit securitization vehicle	98.00	1	98.00	Full	Full	Financial
ABN AMRO ASSET MANAGEMENT ITALY SGR S.P.A.	Milan	Asset management	100.00	1	100.00	Full	Full	Financial
ANTONVENETA CAPITAL LLC I	Delaware	Financial vehicle	100.00	1	100.00	Full	Full	Financial
ANTONVENETA CAPITAL LLC II	Delaware	Financial vehicle	100.00	1	100.00	Full	Full	Financial
ANTONVENETA CAPITAL TRUST I	Delaware	Financial vehicle	100.00	1	100.00	Full	Full	Financial
ANTONVENETA CAPITAL TRUST II	Delaware	Financial vehicle	100.00	1	100.00	Full	Full	Financial
ANTONVENETA IMMOBILIARE S.P.A.	Padua	Real estate	100.00	1	100.00	Full	Full	Instrumental
GIOTTO FINANCE S.P.A.	Padua	Credit securitization vehicle	98.00	1	98.00	Full	Full	Financial
GIOTTO FINANCE 2 S.P.A.	Padua	Credit securitization vehicle	98.00	1	98.00	Full	Full	Financial
SALVEMINI S.R.L.	Padua	Real estate	100.00	1	100.00	Full	Full	Instrumental
THEANO FINANCE S.P.A.	Padua	Credit securitization vehicle	98.00	1	98.00	Full	Full	Financial
ANTONVENETA ABN AMRO INVESTMENT FUNDS LTD	Dublin	Investment funds	100.00	1	100.00	Full	Full	Financial
Seashell II Srl	Milan	Credit securitization vehicle	100.00	1	100.00	Full	Full	Financial
INTEGRA SPA	Florence	Consumer credit	50.00	7	50.00	Proportional	Proportional	Financial
BANCA POPOLARE DI SPOLETO S.P.A.	Spoleto	Banking	25.93	7	25.93	Proportional	Proportional	Banking
MARINELLA S.p.A.	La Spezia	Purchase and sale of own real estate	100.00	1	100.00	Full	Excl. from Cons.	Non-financial
LA CITTADELLA S.P.A.	Padua	Real estate	100.00	1	100.00	Full	Excl. from Cons.	Non-financial
M.P. ASSURANCE S.A.	Paris	Insurance	99.40	1	99.40	Full	Excl. from Cons.	Insurance
AGRICOLA POGGIO BONELLI	Siena	Wine industry	100.00	1	100.00	Full	Excl.from Cons.	Non-financial

(+) Type of relationship:
1 majority of voting rights in an ordinary shareholders' meeting
2 dominant influence in an ordinary shareholders' meeting
3 agreements with other partners
4 other forms of control
5 unitary vote as per art. 26. comma 1. of Leg. Decree 87/92
6 unitary vote as per art. 26. comma 2. of Leg. Decree 87/92
7 joint control
(**) Votes available in an ordinary shareholders' meeting distinguishing between actual votes and potential votes

3. Composition of Regulatory Capital

Capital management concerns the set of policies and strategies necessary to define the size of capital as well as the optimal combination of the various alternative capitalization instruments to ensure that capital and the ratios of the Group are in line with the adopted risk profile and comply with supervisory requirements. From this point of view, the capital management at consolidated level has become more and more relevant important and strategic. Quality and size of capital resources of each single Group company are subsequently defined in the framework of more general aims of the Group.

The regulatory capital and capital ratios are calculated on the basis of capital values and P&L results by applying the IAS/IFRS international accounting principles and taking account of the Supervisory Authorities' instructions issued by the Bank of Italy in the twelfth updating document to Circular no. 155/91 "Reporting instructions on regulatory capital and prudential ratios". Capital for regulatory purposes is calculated as the sum of the positive and negative items, on the basis of their capital quality. Positive items must be fully available to the bank in order to be able to use them in the calculation of the absorption of capital.

As from 2008, the Group calculates the prudential requirements according to the Basle II Accord; furthermore, by a letter received in June 2008, the Parent Bank has been authorised to use internal models to calculate the capital requirements, both individual and of the Group, for credit and operational risks.

The application of internal models is allowed in compliance with some qualitative and quantitative limits required by supervisory rules. In particular limits (so-called 'floors') are established for which any capital savings resulting from internal models is subject to ceilings which are to be tailored against the requirements calculated on the basis of the previous rules (Basle I). It is expected that this limitation to benefits can be removed in future financial years in view of further refinement and consolidation of the internal models adopted.

The capital for regulatory purposes is made up of Tier I and Tier II capital net of some deductions; in particular:

- Tier 1 capital includes paid-in capital, share premium, profit and capital reserves, innovative and non-innovative capital instruments and the profit for the period net of own shares in portfolio, intangible assets including goodwill as well as possible losses of previous years and the current year, and other minor corrections;
- Tier II capital includes valuation reserves, hybrid capital instruments, second-level subordinated liabilities net of estimated doubtful outcomes on country risk and other negative items.

The provisions in the above mentioned Circular aim to harmonise the criteria used to calculate the capital for regulatory purposes and the capital ratios with international accounting standards.

In particular, these rules contemplate the so-called "prudential filters", indicated by the Basle Committee, which are used to regulate the criteria which national supervisory authorities have to abide by to harmonise the supervisory rules with the new financial statements criteria.
Prudential filters, aimed at safeguarding the quality of supervisory capital and reduce its potential volatility caused by the application of the new principles, consist mainly in correcting the accounting data before their use for regulatory purposes.
In particular, with regard to the aspects which are more important for the Group, the regulations provide that:

- For financial assets held for trading purposes, unrealized capital gains and losses registered in the profit and loss account are fully applicable;
- For the available-for-sale financial assets, the unrealised capital gains and losses are posted for, after compensation, to a specific net equity reserve : the balance of this reserve, if negative, reduces the Tier 1 capital, if positive, contributes for 50% to Tier 2 capital;
    - For hedging transactions, the unrealised capital gains and losses on cash flow hedges, posted to the appropriate net equity reserve, are sterilised whilst no prudential filter is applied on the fair value hedging;
- For liabilities valued at fair value (fair value option) of natural hedges both unrealized capital gains and losses posted to the profit and loss account are fully applicable except for the element due to variations of own creditworthiness;
- The investment in the capital of the Bank of Italy is not considered in the calculation of the net equity and therefore the relative capital gain from the fair value valuation is not taken into consideration in the reserves of AFS instruments;
- The calculation of net tax benefit in the 2008 profit and loss statement, due to the accounting treatment of substitute tax for the tax redemption of goodwill, is cut down by 50%; therefore 50% of the net benefit is deducted from the Tier 1 by means of a negative filter; starting from 2009 this filter will be progressively reduced by 1/8 each year.

The mentioned update of Circular no. 155 has introduced, inter alia, a number of innovations into the treatment of items to be deducted which are indicated below.
Equity investments and other items (innovative capital instruments, hybrid capitalization instruments and subordinated assets) issued by banks and financial companies which are not wholly or proportionally consolidated are deducted by 50% from Tier 1 capital and by 50% from Tier 2 capital. The regulations previously in force provided for the deduction of this aggregate from the sum of Tier 1 and Tier 2.
The use of internal models to determine capital requirements to cover credit risks means having to report in the regulatory capital the difference between expected loss and net value adjustments; if the expected loss is higher than the net adjusted values, the difference is deducted by 50% from Tier 1 capital and by 50% from Tier 2 capital; if the expected loss is lower than the net value adjustments, the difference is calculated in Tier 2 capital by 0.6 % of the weighted credit risk assets.

Equity investments held in insurance companies and the subordinated liabilities issued by them are deducted by 50% from Tier 1 capital and for 50% from Tier 2 capital if they were acquired after 20.07.2006. If they were bought before this date, they continue to be deducted from Tier 1 and Tier 2 capital until 31.12.2012.

Moreover banks must comply with capital requirements for risks generated from operations on the markets regarding financial instruments, currencies and commodities. These market risks are calculated on the whole supervisory trading portfolio divided by different risk type, position risk on debt and equity securities, settlement risk and concentration risk. With reference to the whole financial statements the foreign exchange risk and the position risk on commodities must also be calculated. Finally in the new regulatory framework capital requirements regarding operational risks have been introduced which represent loss risks deriving from inadequacy or malfunction of procedures, human resources and internal systems, or external events.

In compliance with the Supervisory instructions, the Group capital must represent at least 8% of the total risk weighted assets (total capital ratio) with regards to the credit risk profile evaluated on the basis of the debtor counterpart, of duration, of country risk and guarantees received.

Following tables illustrate main contractual characteristics of the innovative instruments which, together with capital and reserves, are included in the calculation of Tier 1 capital whereas the hybrid capitalization instruments and subordinated liabilities contribute to the formation of Tier 2 capital. Tier 3 capital subordinated loans are not calculated in Tier 2 capital but are deducted from capital requirements on market risks.

Tier 1 capital

Main characteristics of the instruments that are calculated in Tier 1 capital and in particular innovative capital instruments issued by the Montepaschi Group are reported below.

As of 31.12.2008

Characteristics of subordinated instruments

	Interest rate	Step Up	Issue date	Maturity	Prepayment starting from	Curr.	Original amount in currency units	Contrib. to RegulatoryCapital (thousands of euro)
F.R.E.S.H. (Floating Rate Exchangeable Subordinated Hybrid) – subordinated deposit	Euribor 3m + 0.88%	NO	31/12/2003	N.A.	(a)	EUR	700,000,000	531,925
Preferred Capital Securities part 1	Euribor 3m + 3.75%	YES	21/12/2000	N.A.	(b)	EUR	80,000,000	80,000
Preferred Capital Securities part 2	Euribor 3m + 3.10%	YES	27/06/2001	N.A.	(b)	EUR	220,000,000	220,000
Preferred Capital I LLC	7.59 Sub	YES	07/02/2001	07/02/2031	(c)	EUR	350,000,000	350,000
Total Preference shares and capital instruments (Tier I)								**1,181,925**

a) The Fresh instruments, amounting to a nominal value of EUR 700 million, are perpetual and there are neither repayment nor step up clauses, however they are convertible into shares. In September of each year from 2004 to 2009 included and however, at any time, starting from 1 September 2010 the instruments are convertible upon request of the investor. Furthermore, there is an automatic conversion clause if, after the seventh year from the issue date, the reference price of the ordinary shares exceeds an established amount.
The return is noncumulative, with an option not to pay the return if during the previous year the Bank had not registered distributable profit and/or had not paid dividends to the shareholders. The unpaid return is completely lost.
The rights of the instrument holders are guaranteed on a subordinated basis. In case of liquidation of the Bank, the rights of the investors will be subordinated to all BMPS creditors which are not equally subordinated including security holders which come under the Tier 2 capital and will have more rights than the BMPS shareholders. Given these characteristics the 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 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 2008 a partial conversion took place for a nominal value of EUR 139.3 million.

b) The 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) The preference shares (CPS) amounting to a nominal value of EUR 350 million 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 authorization of the Bank of Italy. EUR 300 million with a 10-year life and belonging to the newly acquired Antonveneta Group are to be added. Interest is paid annually on the basis of a fixed rate of 7.59% until 2010; at issuance, a step-up clause was included which is activated 10 years after issue date.

Tier 2 capital

The following table contains main characteristics of the instruments that are included in the calculation of Tier 2 capital and therefore in particular of the hybrid capital instruments and subordinated liabilities.

As of 31.12.2008

Characteristics of subordinated instruments

	Interest rate	Step Up	Date of issue	Maturity	Pre-payment starting from	Curr.	Original amount in currency units	Contrib. To Regulatory Capital (thousands of euro)
Subordinated bond loan	4.875% fixed	NO	31/05/2006	31/05/2016	(*)	EUR	750,000,000	743,285
Subordinated bond loan	5.750% fixed	NO	31/05/2006	30/09/2016	(*)	GBP	200,000,000	293,958
Subordinated bond loan	Euribor 6m+ 2.50%	NO	15/05/2008	15/05/2018	(*)	EUR	2,160,558,000	2,108,960
Convertibile subordinated bond loan	1% Fixed	NO	01/07/1999	01/07/2009	(*)	ITL	1,770,705,000,000	44,352
Total Hybrid Instruments (Upper Tier II)								**3,190,555**
Subordinated bond loan	5% fixed	NO	12/03/1999	12/03/2009	(*)	EUR	417,915,000	65,208
Subordinated bond loan	CMS Convexity Notes	NO	07/07/2000	07/07/2015	(*)	EUR	30,000,000	30,000
Subordinated bond loan	CMS Volatility Notes	NO	20/07/2000	20/07/2015	(*)	EUR	25,000,000	25,000
Subordinated bond loan	4.50% fiixed until 24/09/2010. then Euribor 3m+1.20%	YES	24/09/2003	24/09/2015	24/09/2010	EUR	600,000,000	581,905
Subordinated bond loan	Euribor 3m + 0.45% until 01/06/2014. then Euribor 3m+1.05%	YESI	01/06/2004	01/06/2014	01/06/2009	EUR	250,000,000	244,751
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	350,000,000	347,513
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	500,000,000	494,401
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	150,000,000	149,032
Subordinated bond loan	7.44% fixed	NO	30/06/2008	30/12/2016	(*)	EUR	250,000,000	247,468
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	75,000,000	59,008
Subordinated bond loan	Euribor 6m+1.10% until 29/06/2012. then Euribor 6m+0.93%	YES	14/12/2007	14/12/2017	14/12/2012	EUR	50,000,000	4
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	450,000,000	28
Subordinated debt	Euribor 3m + 2.8%	NO	10/10/2006	10/10/2016	10/10/2011	EUR	400,000,000	400,000
Subordinated bond loan	6.4% until31/10/2013. then Euribor 3m + 3%	YES	31/10/2008	31/10/2017	31/10/2013	EUR	100,000,000	95,383
Bond loan	variable	NO	30/09/2003	30/09/2013	30/09/2008	EUR	73,000,000	1,117
Bond loan	variable	NO	30/09/2003	30/09/2013	30/09/2008	EUR	7,000,000	7,100
Bond loan	variable	NO	22/12/2003	22/12/2013	22/12/2008	EUR	50,000,000	52
Bond loan	3.11%	NO	30/12/2002	30/12/2009	Not foreseen	EUR	60,000,000	8,807
Bond loan	Euribor 6m+1%	NO	28/06/2002	28/06/2009	Not foreseen	EUR	7,784,900	7,632
Bond loan	Euribor 6m+0.75%	NO	30/12/2004	30/12/2009	Not foreseen	EUR	3,892,950	779
Bond loan	Euribor 6m+0.60%	NO	07/12/2005	07/12/2015	Not foreseen	EUR	7,785,900	7,796
Bond loan	Euribor 6m+0.60%	YES	15/04/2008	15/04/2018	15/04/2013	EUR	2,134,894	2,162
Bond loan	Euribor 6m+0.60%	YES	18/04/2008	18/04/2018	18/04/2013	EUR	2,823,686	2,857
Total Calculable Subordinates (Lower Tier II)								**2,778,003**
Total (Tier II)								**5,968,558**

(*) No pre-payment clauses are provide for

Table 3.1 – Composition of regulatory capital *	
Positive items of Tier 1 capital	
Capital	4,538,145
Issue premium	4,094,592
Reserves	5,016,794
Non-innovative capital instruments	531,925
Innovative capital instruments	650,000
Profit for the period	832,520
Prudential filters: increases in Tier 1 capital	54
Total positive items of Tier 1 capital	**15,664,030**
Negative items of Tier 1 capital	
Shares or own shares	36,963
Goodwill	6,824,699
Other intangible assets	796,836
Loss for the period	-
Other negative items	-
Prudential filters: decreases in Tier 1 capital	679,707
Total negative items of Tier 1 capital	**8,338,205**
Tier 1 capital including items to be deducted	**7,325,825**
Decreases in Tier 1 capital	
Shareholdings in banks and financial entities equal to or higher than 20% of the capital of the affiliated company	49,081
Shareholdings in banks and financial entities equal to or higher than 10% but lower than 20% of the capital of the affiliated company	31,215
Shareholdings in banks or financial entities equal to or lower than 10% of the capital of the affiliated company	-
Investments in insurance companies	68,655
Expected losses surplus with respect to aggregate value adjustments	378,488
Deductions due to securitizations	-
Deductions due to settlement risk on non-DVP transactions	-
Total items to be deducted	**527,439**
TOTAL TIER 1 CAPITAL	**6,798,386**
Positive items of Tier 2 capital	
Valuation reserve	94,845
Non-innovative capital instruments not accounted for in Tier 1 capital	-
Hybrid capitalization instruments	3,190,555
Subordinated liabilities	2,778,003
Total positive items on Tier 2 capital	**6,063,403**
Negative items on Tier 2 capital	
Other negative items	4,708
Prudential filters: deductions from Tier 2 capital	6,069
Total negative items of Tier 2 capital	**10,777**
Tier 2 capital including items to be deducted	**6,052,626**
Shareholdings in banks and financial entities equal to or higher than 20% of the capital of the affiliated company	49,081
Shareholdings in banks and financial entities higher than 10% but lower than 20% of the capital of the affiliated company	31,215
Investments in insurance companies	68,655
Of which excess of expected losses with respect to aggregate value adjustments	378,488
Total items to be deducted	**527,439**
TOTAL TIER 2 CAPITAL	**5,525,187**
ITEMS TO BE DEDUCTED FROM TIER 1 AND TIER 2 CAPITALS	**327,583**
TOTAL REGULATORY CAPITAL	**11,995,990**
TOTAL TIER 3 CAPITAL	**344,395**
TOTAL REGULATORY AND TIER 3 CAPITAL	**12,340,385**

*on 10 April, 2008 the Board of Directors issued a resolution to increase the capital following the authorization received from the Shareholders' meeting of BMPS on 6 March, 2008 by issuing, on a payment basis and with a premium, no. 295,236,070 ordinary shares, at a nominal value of 0.67 euro each, to be underwritten by JPMorgan for a price of EUR 3.218 per share – and therefore for a total of EUR 950,069,673.26 – for the purposes of issuance, by JPMorgan, or possibly by a company that does not belong to the JPMorgan Group, of financial instruments convertible in ordinary BMPS shares. On 15 April, 2008, BMPS stipulated, with J.P. Morgan Securities Ltd, a contract according to which the latter underwrote all newly issued ordinary shares at the price fixed by the Board of Directors. This transaction has brought about the increase of the share capital item by EUR 197.8 million, equal to the nominal counter-value of the shares and an increase of the share premium item by EUR 752.3 million. On 16 April 2008, MPS Bank acquired, from J.P. Morgan Securities Ltd, a beneficial interest right on the mentioned shares, according to art. 2352 of the Italian Civil Code for thirty years but which can be paid off in advance, inter alia, in case of conversion of the convertible instruments. As consideration for of the beneficial right, BMPS undertook to pay, to J.P. Morgan Securities Ltd, an annual fee, the payment of which is subject to the presence of distributable profits, to the payment of dividends in cash against distributable profits and for an amount not exceeding the difference between distributable profit and paid dividends paid. The voting right of the shares, belonging to the holder of the beneficial right, is suspended until this right in favour of MPS Bank remains valid. Alongside the contract of beneficial right, a swap was signed providing for payments to be effected by MPS Bank against a fixed premium of roughly EUR 50 million to be received at the time of the conversion of the mentioned convertible instruments.

4. Capital Adequacy

4.1. Methodology used by Banca Monte dei Paschi di Siena, the Parent Bank , to evaluate the capital adequacy of internal capital supporting of current and prospective operations

Internal capital adequacy is constantly monitored by the Parent Bank both while reporting management trends (budget monitoring as well as yearly, half-yearly and quarterly accounting documents) and in the Planning process which is carried out with the approval of the annual Budget and the three-year Business Plan. The control/accounting activity is strictly connected to planning since, obviously, budget drafting cannot exclude the measurement of risk-weighted assets (RWA), of market and operational risks and capital items. According to the organizational structure of the Parent Bank, the CFO and, in particular, the Tax and Financial Statements Unit is officially responsible for calculating and monitoring the Supervisory ratios although this task is carried out co-ordinating several offices that oversee the adoption and measurement of the single components necessary for the calculation of the ratios and in particular:

- The Risk Management Area which develops and updates the calculation models of the risk parameters (Default Probability, Loss Given Default, Operational Risks) feeding the calculation formulae of the advanced approaches used by the MPS Group and authorised by the Supervisory authorities;
- The ALM and Treasury Area which controls the transformation of the components of Tier 1 and Tier 2 capital;
- The Planning Area which estimate the trends of the Group's activities and – through the Capital Adequacy Office – manages the internal assessment process of capital adequacy (ICAAP process) and, with the Operational Planning unit, formulates the proposals for "risk appetite" and defines capital allocation methodologies.

This interaction between the different units is the basis of the correct process of half-yearly and yearly reporting but also of the prospective monitoring of capital adequacy.

With regards to the assessment of internal capital adequacy, the adequacy of currents assets must be distinguished from prospective assets. In the first case, the internal global capital measurements resulting from the internal risk measurements of the Montepaschi Group are periodically calculated together with capital absorption generating the same exposures, the regulatory capital and the capital actually available to cover all risks. The analysis is submitted, in the case of global internal capital, to the Risk and Finance Committees of the Parent Bank and to the single legal entities; further remarks are submitted to the Top Management by means of specific communications. Comparing the above mentioned quantities, it is possible to verify not only the performance of management capital in relation to the risks actually assumed but also to the regulatory capital absorptions generated in compliance with the Basel 2 regulations. Both the

measurements are then compared with regulatory capital which is also appropriately calculated and/or estimated simultaneously to risks measurement and is compared with available capital.
The prospective control of capital adequacy has some "key" points such as the yearly budget, the Business Plan (usually a three-year plan) as well as possible interventions connected to extraordinary transactions (acquisitions, asset sales, securitizations). This control is usually supervised by the Planning Area, which is in charge for the measurements of the profit and loss account and balance sheet items from a prospective point of view or for extraordinary transactions. Obviously, because of the above-mentioned grounds, also the prospective capital measurement process implies a co-ordination between the above units under the supervision of the Top Management.
The information provided to the Top Management on the prospective scenarios relative to capital ratios and on the planned measures to adequately monitor capital adequacy is provided by official documents prepared by the Planning Area itself with the collaboration of the above units.
Specifically, the Montepaschi Group, using simulative instruments that include parameters with the same calculation method of the internal models of measuring risks and using regulatory calculation models carries out specific global internal capital and regulatory absorption estimates and is capable of evaluating the impact on regulatory capital relative to the development plans indicated in the Business Plan or included in other transactions of a business or strategic nature also provided by the other units of the bank. This method enables to calculate the absolute values and connected capital target ratios as well as to proceed with the analysis of the shifts which could temporarily take place with respect to the final data, thus allowing the activation of appropriate correction policies of the on-going dynamics.

As of 31.12.2008
In thousands of euro

Table 4.1 – Capital adequacy

	Capital requirements
CREDIT RISK ACTIVITY	
Standard methodology	**7,207,957**
Exposures to governments and central banks	632
Exposures to local authorities	57,999
Exposures to non-profit organisations and public entities	100,386
Exposures to multilateral development banks	9
Exposures to International organisations	-
Exposures to controlled intermediaries	364,317
Exposures towards corporates	4,675,308
Retail exposure	912,971
Exposures guaranteed by real estate	324,878
Past due exposures	372,404
Exposures towards high risk categories for regulatory purposes purposes	79,414
Exposures in the form of guaranteed bank bonds	-
Short term exposures to corporates	-
Exposures to units in collective investment undertakings (UCI's)	16,032
Other exposures	278,235
Exposures to securitization	25,372
Advanced Internal Rating Based methodology	**3,102,761**
Exposures to corporates	**2,809,475**
Retail exposures	**293,020**
Guaranteed by real estate	239,641
Qualifying revolving retail exposures	1
Individuals	53,378
Other assets	**265**
TOTAL CREDIT RISK	**10,310,718**
MARKET RISK ACTIVITY	
Standardized methodology	**482,292**
General risk	262,122
Specific risk	174,856
Position risk of units in collective investment undertakings (UCI's)	1,966
Options	3,107
Exchange risk	40,242
Position risk in commodities	-
Internal models	
VAR	
Other requirements	
Settlement risk for DVP transactions	
Required capital for fin. instruments exposed to risk factors not foreseen in	
Concentration risk	**54**
TOTAL MARKET RISK	**482,346**
Adjustment to capital requirements for intra-group transactions	**-1,470,298**
OPERATIONAL RISK ACTIVITY	
Operational risk	
Base method	59,076
Standardized method	216,481
Advanced methods	480,640
TOTAL OPERATIONAL RISK	**756,197**
Floor integration	**513,705**
Other requirements	
AGGREGATE CAPITAL REQUIREMENTS	**10,592,668**
Tier 1 capital ratio	**5.13%**
Total capital ratio	**9.32%**

The above Tier I Ratio calculated applying the floor integration of 90% is **5.4**%.

5. Credit Risk: General information regarding all banks

To classify impaired loans in the various categories of risk (non-performing, watchlist loans, restructured and past due exposures), the Group refers to the regulations issued by the Bank of Italy, integrated by internal provisions which establish automatic criteria and rules for fixing the credits in the different risk categories.

For impaired loans, in line with supervisory definitions, the following apply:

- For loans defined as past due since more than 180 days;
- Restructured loans or under ongoing restructuring;
- Watchlist credits;
- Non-performing loans

The classification is carried out autonomously by the business units except for past due loans and/or exposed loans since more than 180 days and for the watchlist credits for the actually past due and/or exposed loans since more than 270 days, automatically reported. For the other loans, the Montepaschi Group has drawn up a punctual classification and valuation process of the value adjustments based on the expert approach of the manager and on the support provided by expert units specialised in the management of impaired loans. When classifying the loans as watchlist credits or non-performing loans, the manager establishes, on the basis of the relevant elements available, an estimated time measurement of failed recovery, which is different for the part of the exposure related to the loan and for the part related to interest and other expenses. Subsequently, the head office departments specialised in the management of loans showing criticalities periodically control and review said positions and the relative estimated failed recoveries, inserting changes, if any, in estimated loss. These estimates are the calculation basis for the analytical valuation and the subsequent calculation of the balance sheet value adjustments.

Regarding the provisions made for the guarantees issued and the obligations with third parties, if these are classified as default loans, the above- mentioned methodology is used.

For the other classification categories, the calculation for provisions made on guarantees issued and obligations with third parties follows the same rules as for the provisions made on cash positions of the performing loan book, which uses a framework similar to the calculation of expected loss according to Basle 2, with input factors such as Default Probability and the Loss Given Default, both resulting from the internal rating systems and from EAD which, in the case of the Montepaschi Group, is based on credit conversion factors provided for by the standardized method, since this parameter is not validated and included in the roll-out plan submitted to the Supervisory Authorities. Main differences respect to the other performing loans concern the calculation of the amount on which the loss is calculated. In this regard, the part of the guarantees and obligations for which the customers have asked for the appropriate cover is identified and on that amount – for the overall amount, except for signatures on commercial loans where the conversion factor applied is 50% - the PD and LGD factors provided for by the specific technical forms are applied.

In order to calculate the adjustments to make to the book-values, an analytical and collective valuation is carried out on the basis of the various levels of impairment as indicated hereunder.
The **non-performing**, the **watchlist credits** and the **restructured** loans are analytically evaluated whist the **past due** and/or **exposed** loans since more than 180 days, the **country risk** positions and the **performing** loans are collectively evaluated. For the past due and/or exposed loans since more than 180 days, the following tables indicate instead the analytical valuation in compliance with the recent update issued by the Bank of Italy of their Circular no. 262/2005.
For loans subject to analytical valuation the amount of each credit adjustment is equal to the difference between the book value at the time of valuation (amortized cost) and the current value of the estimated future cash flows, calculated applying the actual original interest rate.
The estimated cash flows take into account the expected recovery schedule, the likely salvage value of the guarantees, if any, as well as the likely costs of the recovery of the credit exposure.
The value adjustment is registered to the profit and loss account under account130 net impairment value adjustments/recoveries. The adjustment component which may referred to the updating of the financial flows is issued on an accrual basis according to the interest rate mechanism and registered under the value recoveries.
Should the impaired credit quality improve considerably to such a point that a quick recovery of principal and interest is likely, the original value of the loans is recovered in the following financial years as much as the causes of the adjustment disappear if this valuation is objectively related to an event that occurred after the adjustment. The recovery is registered in the profit and loss account and may never exceed the amortized cost that the loan would have had in the absence of previous adjustments.

Loans, which have not registered objective losses, are collectively evaluated as to loss value. This valuation, developed on the basis of a Risk Management Model, takes place by homogenous credit categories of credit risk and the relative loss percentages are estimated on the basis of historical series, based on elements noticeable at the date of valuation which permit the valuation of latent loss value of each risk category.
The model, for this type of valuation, provides following steps:

- Segmentation of the loans book by:
    - Client segments (turnover);
    - Economic activity sectors;
    - Geographical location;
- Determination of the loss rate of the single segment of the loan book, using as reference the historical experience of the Group.

Value adjustments collectively determined are registered in the profit and loss account. At every year end or for quarterly or half-yearly reports, value adjustments or recoveries, if any, are differently classified with respect to the whole loan book at the same date.

As of 31.12.2008
In thousands of euro

Table 5.1 – Distribution of financial assets according to relative portfolio and to credit quality

Portfolio/Quality	Banking Group						Total	Period average*
	Non-performing	watchlist credits	Restructured exposures	Pat due exposures	Country risk	Other assets		
1, Financial assets held for trading	9,367	137	-	-	-	21,788,192	21,797,696	23,113,168
2, Available-for- sale financial assets	5,977	-	-	-	-	4,990,044	4,996,021	4,922,446
3, Held-to-maturity financial assets	-	-	-	-	-	3	3	3
4, Due from banks	13,535	16,940	-	1,652	57,346	17,526,243	17,615,716	15,314,476
5, due from customers	3,613,093	2,578,480	196,909	953,870	21,395	137,989,443	145,353,190	127,527,911
6, Financial assets valued at fair value	-	-	-	-	-	180,038	180,038	190,133
7, Financial assets on sale	-	-	-	-	-	64,214	64,214	651,939
8, Hedging derivatives	-	-	-	-	-	99,160	99,160	57,382
Total 31/12/2008	**3,641,972**	**2,595,557**	**196,909**	**955,522**	**78,741**	**182,637,337**	**190,106,038**	
Total 31/12/2007	**2,006,279**	**1,202,744**	**130,528**	**581,027**	**586,715**	**147,825,092**	**152,332,385**	
Period average values*	2,814,741	1,840,070	178,797	834,299	493,042	165,633,051	172,449,269	

The table shows financial assets by each accounting portfolio and credit quality. The values indicated are used in the financial statements and refer to positions of both the banking portfolio and the trading portfolio for supervisory purposes.
* The average values are calculated taking into consideration the joining of the Montepaschi Group of Banca Antonveneta in June 2008. Most differences of the values registered at 31/12/2007 and at 31/12/2008 are due to this event.

As of 31.12.2008
In thousands of euro

Table 5.2 – Geographical distribution of cash - and off- balance sheet exposures to customers

Exposure/Geographical areas	ITALY			OTHER EUROPEAN COUNTRIES			AMERICA			ASIA			REST OF THE WORLD		
	Gross exposure	Net exposures	Adjustments	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments
A. Cash exposures exposures															
A.1 Non- performing	8,271,938	3,581,662	4,690,276	94,567	36,062	58,505	9,308	6,220	3,088	2,836	82	2,754	1,589	308	1,281
A.2 Watchlist credits	3,150,025	2,482,155	667,870	131,157	94,200	36,957	6,636	2,013	4,623	593	108	485	7	5	2
A.3 Restructured exposures	208,280	196,909	11,371	-	-	-			-			-			-
A.4 Past due exposures	1,015,688	949,989	65,699	3,655	3,510	145	340	333	7	5	4	1	36	33	3
A.5 Other exposures	143,480,317	142,408,806	1,071,511	5,027,532	5,021,321	6,211	1,067,296	1,065,370	1,926	242,443	241,581	862	642,832	642,517	315
Total A	**156,126,248**	**149,619,521**	**6,506,727**	**5,256,911**	**5,155,093**	**101,818**	**1,083,580**	**1,073,936**	**9,644**	**245,877**	**241,775**	**4,102**	**644,464**	**642,863**	**1,601**
B. Off-bal.sheet exposures															
B.1 Non-performing	108,932	87,193	21,739			-	777	621	156			-			-
B.2 watchlist credits	22,880	21,272	1,608	-	-	-			-			-			-
B.3 Other impaired assets	12,511	11,628	883	326	326	-			-			-			-
B.4 Other exposures	18,700,121	18,679,217	20,904	5,243,139	5,243,139	-	1,117,557	1,117,342	215	48,975	48,975	-	35,763	35,763	-
Total B	**18,844,444**	**18,799,310**	**45,134**	**5,243,465**	**5,243,465**	-	**1,118,334**	**1,117,963**	**371**	**48,975**	**48,975**	**-**	**35,763**	**35,673**	**-**
Total (A+B) 31/12/2008	**174,970,692**	**168,418,831**	**6,551,861**	**10,500,376**	**10,398,558**	**101,818**	**2,201,914**	**2,191,899**	**10,015**	**294,852**	**290,750**	**4,102**	**680,227**	**678,626**	**1,601**

The table shows the geographical distribution of cash exposures and off-balance sheet loans to customers. The values indicated are used In the financial statements and refer to both the banking book and trading portfolio for supervisory purposes.

As of 31.12.2008
In thousands of euro

Table 5.3 – Geographical distribution of cash and off- balance sheet exposures to banks

Exposures/Geographical areas	ITALY			OTHER EUROPEAN COUNTRIES			AMERICA			ASIA			REST OF THE WORLD		
	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments	Gross exposure	Net exposure	Adjustments
A. Cash exposures exposures															
A.1 Non-performing	2,145	299	1,846	38,482	14,795	23,687	26,452	2,453	23,999			-	232	94	138
A.2 Watchlist credits			-	37,220	16,940	20,280			-			-			-
A.3 Restructured exposures			-			-			-			-			-
A.4 Past due exposures	1,739	1,652	87			-			-			-			-
A.5 Other exposures	14,290,493	14,206,717	83,776	7,689,955	7,686,461	3,494	448,850	448,744	106	316,440	316,060	380	127,299	127,246	53
Total A	**14,294,377**	**14,208,668**	**85,709**	**7,765,657**	**7,718,196**	**47,461**	**475,302**	**451,197**	**24,105**	**316,440**	**316,060**	**380**	**127,531**	**127,340**	**191**
B. Off bal.sheet exposures															
B.1 Non-performing exposures	1,428	1,143	285			-			-			-			-
B.2 Watchlist credits			-			-			-			-			-
B.3 Other impaired assets	1,697	1,612	85			-			-			-			-
B.4 Other exposures	1,438,845	1,437,882	963	4,254,720	4,254,698	22	413,827	413,826	1	165,774	165,711	63	111,736	111,638	98
Total B	**1,441,970**	**1,440,637**	**1,333**	**4,254,720**	**4,254,698**	**22**	**413,827**	**413,826**	**1**	**165,774**	**165,711**	**63**	**111,736**	**111,638**	**98**
Total (A+B) 31/12/2008	**15,736,347**	**15,649,305**	**87,042**	**12,020,377**	**11,972,894**	**47,483**	**889,129**	**865,023**	**24,106**	**482,214**	**481,771**	**443**	**239,267**	**238,978**	**289**

The table shows the geographical distribution of cash and off-balance sheet exposures to banks. The values indicated are those used In the financial statements and refer to both the banking book and trading portfolio for supervisory purposes.

As of 31.12.2008
In thousands of euro

Table 5.4 – Distribution by sector of cash and off-balance sheet exposures to customers

Exposures/Counterparts	Governments and Central Banks				Other public entities				Financial companies				Insurance companies				Non-financial companies				others			
	Gross exposure	Specific value adjustments	Loan book adjustments	Net exposure	Gross exposure	Specific value adjustments	Loan book adjustments	Net exposure	Gross exposure	Specific value adjustments	Loan book adjustments	Net exposure	Gross exposure	Specific value adjustments	Loan book adjustments	Net exposure	Gross exposure	Specific value adjustments	Loan book adjustments	Net exposure	Gross exposure	Specific value adjustments	Loan book adjustments	Net exposure
A.- Cash xposures																								
A.1 Non-performing	25	25		-	538	264		274	95,913	56,239		39,674	1,098	783		315	6,928,215	3,947,70	9,316	2,971,199	1,354,44	597,273	144,3	612,873
A.2 Watchlist credits	3	2		1	8,990	4,464		4,526	223,011	67,914		155,097	595	119		476	2,380,484	493,123	599	1,886,762	675,336	120,957	22,76	531,619
A.3 Restructured									-	-		-					202,552	10,800	-	191,752	5,728	571	-	5,157
A.4 Past due	-			-	39	2		37	13,202	90	-	13,112	300	11		289	610,437	31,455	924	578,058	395,746	20,612	12,76	362,373
A.5 Other exposures	4,681,1		371	4,680,79	3,662,5		1,543	3,660,96	9,828,062		53,803	9,774,259	213,242		44	213,198	90,737,617		918,286	89,819,33	41,337,8		106,7	41,231,0
Total A	**4,681,1**	**27**	**371**	**4,680,79**	**3,672,0**	**4,730**	**1,543**	**3,665,80**	**10,160,18**	**124,243**	**53,803**	**9,982,142**	**215,235**	**913**	**44**	**214,278**	**100,859,30**	**4,483,07**	**929,12**	**95,447,10**	**43,769,0**	**739,413**	**286,6**	**42,743,0**
B. Off-bal. sheet																								
B.1Non-perrforming									996	199		797					108,053	12,427	9,133	86,493	660	135		525
B.2 Watchlist credits									26	-		26					21,768	1,391	149	20,228	1,086	68		1,018
B.3 Other impaired									9			9					10,012	619	-	9,393	2,817	264		2,553
B.4 other exposures	2,145,4		1,144	2,144,26	467,438		388	467,050	5,779,160		6,587	5,772,573	496,594		207	496,387	14,455,546		10,177	14,445,36	1,801,41		2,616	1,798,79
Total B	**2,145,4**	**-**	**1,144**	**2,144,26**	**467,438**	**-**	**388**	**467,050**	**5,780,191**	**199**	**6,587**	**5,773,405**	**496,594**	**-**	**207**	**496,387**	**14,595,379**	**14,437**	**19,459**	**14,561,48**	**1,805,97**	**467**	**2,616**	**1,802,89**
Totale (A+B)	**6,826,5**	**27**	**1,515**	**6,825,05**	**4,139,5**	**4,730**	**1,931**	**4,132,85**	**15,940,37**	**124,442**	**60,390**	**15,755,54**	**711,829**	**913**	**251**	**710,665**	**115,454,68**	**4,497,51**	**948,58**	**110,008,5**	**45,575,0**	**739,880**	**289,2**	**44,545,9**

The table shows the distribution by sector of cash and off- balance sheet exposures to customers. The values indicated are those used in the financial statements and refer to both the banking book and trading portfolio for supervisory purposes.

As of 31.12.2008
In thousands of euro

Table 5.5 – Time distribution by residual contractual life of financial assets

Items/time brackets	At sight	From more than 1 to 7 days	From more than 7 to 15 days	From more than 15 days to 1 month	From more than 1 month to 3 months	From more than 3 months to 6 months	From more than 6 months to 1 year	From more than 1 year to 5 years	More than 5 years	Undetermined	Total
Cash assets	**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**	**176,850,160**
Government securities	3		970		343,232	666,008	1,080,921	1,023,695	2,619,378		5,734,207
Listed debt securities	146	338	1,674	86,119	610,389	297,756	245,757	1,427,986	427,495		3,097,660
Other debt securities	126,334	-	-	7,842	60,523	74,883	245,003	2,734,730	2,579,672	-	5,828,987
UCIT shares	806,526		-					477	-	5,397	812,400
Loans	33,267,981	3,420,249	3,880,630	4,947,223	8,374,946	9,917,998	8,949,572	29,740,867	44,203,187	14,674,253	161,376,906
- to banks	5,535,296	856,945	876,439	543,405	1,438,967	366,672	422,168	745,109	126,575	6,987,937	17,899,513
- to customers	27,732,685	2,563,304	3,004,191	4,403,818	6,935,979	9,551,326	8,527,404	28,995,758	44,076,612	7,686,316	143,477,393
Off-balance sheet transactions	**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**	**103,722,325**
Financial derivatives with exchange of principal	2,486,238	7,995,068	5,040,463	8,860,116	15,696,072	11,253,598	13,926,892	4,423,960	1,360,413	13,370	71,056,190
- Long positions	1,113,686	3,567,236	2,473,828	4,784,957	7,944,392	6,056,926	6,922,996	2,296,887	634,337	6,685	35,801,930
- Short positions	1,372,552	4,427,832	2,566,635	4,075,159	7,751,680	5,196,672	7,003,896	2,127,073	726,076	6,685	35,254,260
Receivable deposits and loans	1,191,826	535,466	1,044,921	733,179	88,374	117,457	291	-	-	-	3,711,514
- Long positions	1,191,826	267,733	347,077	1,382	176	47,417	145		-		1,855,756
- Short positions		267,733	697,844	731,797	88,198	70,040	146	-	-		1,855,758
Irrevocable commitments to grant loans	9,113,240	155,876	736	725,743	106,351	343,546	1,747,449	6,789,603	8,499,431	1,472,646	28,954,621
- Long positions	1,430,813	103,299	736	725,743	96,185	212,438	899,205	3,672,865	6,599,576	737,685	14,478,545
- Short positions	7,682,427	52,577	-	-	10,166	131,108	848,244	3,116,738	1,899,855	734,961	14,476,076

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

As of 31.12.2008
In thousands of euro

Table 5.6 – Cash exposures to banks: dynamics of total adjustment values

Reasons/ Categories	Non-perf. exposures	Watchlist credits	Restructured exposures	Past due exposures	Country risk exposures	Total
A. Total initial adjustments		**-**	**-**	**-**	**3,591**	**7,941**
- of which: : sold financial assets not derecognized						
B. Increases	**45,943**	**20,281**	**-**	**87**	**404**	**66,715**
B.1 value adjustments	**4,350**	20,281		87	347	22,073
B.2 transfers from other categories of impaired exposures						-
B.3 other increases	44,585	-			57	44,642
C. Reductions	**618**	**-**	**-**	**-**	**3,289**	**3,907**
C.1 writeback of adjustments	618				3,234	3,852
C.2 writeback on collection	-					-
C.3 derecognized assets	-					-
C.4 transfers to other categories of impaired exposures						-
C.5 other reductions	-	-			55	55
D. Final total adjustments	**49,675**	**20,281**	**-**	**87**	**706**	**70,749**
- of which: : sold financial assets not derecognized						-

As of 31.12.2008
In thousands of euro

Table 5.7 – Cash exposures to customers : dynamics of total adjustment values

Reasons/ Categories	Non-performing exposures	Watchlist credits	Restructured exposures	Past due exposures	County risk exposures	Total
A. Total initial adjustments	**2,138,743**	**367,743**	**7,246**	**44,094**	**1,830**	**2,559,656**
- of which: : sold financial assets not derecognized	803,516			78		803,594
B. Increases	**3,487,455**	**704,115**	**25,711**	**75,457**	**185**	**4,292,923**
B.1 value adjustments	1,186,679	466,743	5,369	45,604	171	1,704,566
B.2 transfers from other categories of impaired exposures	137,068	9,462	186	-		146,716
B.3 other increases	2,163,708	227,910	20,156	29,853	14	2,441,641
C. Decreases	**870,294**	**361,920**	**21,586**	**53,696**	**1,706**	**1,309,202**
C.1 writebacks of adjustments	180,165	99,463	13,337	38,249	1,698	332,912
C.2 writeback on collection	260,388	54,453	1,946	2,580	2	319,369
C.3 derecognized assets	251,140	39,981	-	1,797		292,918
C.4 transfers to other categories of impaired exposures	698	131,354	5,718	8,946	-	146,716
C.5 other decreases	177,903	36,669	585	2,124	6	217,287
D. Final total adjustments	**4,755,904**	**709,938**	**11,371**	**65,855**	**309**	**5,543,377**
- of which : sold financial assets not derecognized	760,411	757	-	1,288	-	762,456

The significant increase in "other increases" within the non-performing category is due to the acquisition of Banca Antonveneta.

6. Credit Risk: Information on the Portfolios subject to the Standardised Method and Specialised Credit Exposures and Capital Instruments using IRB Methods

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

- Standard & Poor's;
- Moody's Investor Service;
- Fitch Rating,

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

Portfolios and official ratings

Portfolios	ECA/ECAI	Rating characteristics (*)
Exposures to governments and central banks	Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited/Unsolicited
Exposures to International organisations	Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited
Exposures to multi-lateral development banks	Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited/Unsolicited
Exposures to companies and other entities	Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited
Exposures to undertakings for collective investments in transferable securities (UCIT)	Standard & Poor's Moody's Investor Service Fitch Ratings	Solicited
Positions in securitizations with a short term rating	Standard & Poor's Moody's Investor Service Fitch Ratings	NA
Positions in securitizations other than those with a short term rating	Standard & Poor's Moody's Investor Service Fitch Ratings	NA

(*) Solicited/Unsolicited

As of 31.12.2008
In thousands of euro

Table 6.1 – Portfolios subject to the standardized method

Standard portfolios	Creditworthiness category							Total	Deductions from statutory capital
	01	02	03	04	05	06	Without creditworthiness category		
Governments and Central Banks	12,360,434	448	4,558	22,734	2	233	668,980	13,057,388	-
Supervised intermediaries	19,548,947	125,978	197,321	211,425	9,175	1,855	3,593,024	23,687,724	160,590
Local entities	2,841,596	-	-	-	-	0	858,179	3,699,776	-
Non-profit and Public Entities	1,768,369	13,341	5,430	0	0	0	225,325	2,012,465	-
Multi-lateral development banks	246,601	24,641	-	-	-	-	5,194	276,436	-
International Organizations	-	-	-	-	-	-	-	-	-
Companies and other entities	19,685	1,039,506	849,217	80,935	926,277	-	39,355,498	42,271,117	-
Retail exposures	-	-	-	-	-	-	15,714,951	15,714,951	-
Short term exposure to companies	-	-	-	-	-	-	-	-	-
Exposures to undertakings for collective investments in transferable securities (UCIT)	-	200,129	275	-	-	-	0	200,404	-
Exposures guaranteed by real estate	-	-	-	-	-	-	10,666,224	10,666,224	-
Past due exposures	-	-	-	-	-	-	3,825,525	3,825,525	-
High risk exposures	-	-	-	-	-	-	713,603	713,603	-
Securitizations	117,493	61,193	15,693	9,271	-	7,040	10,153	220,842	-
Other exposures	-	-	-	-	-	-	7,623,599	7,623,599	464,891
Total	**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 exposures of the banking group subject to credit risk – standardized method; the exposures are reported by creditworthiness category (rating ECA/ECAI) and by statutory category. The exposures are calculated according to prudential supervisory regulations and take into consideration the risk mitigation techniques (compensations, guarantees etc.).
Category 1 contains the positions with the lowest risk weighting ratios which correspond to the best ratings (eg. Aaa for Moody's, AAA per Fitch and AAA for Standard & Poor's); as the creditworthiness category increases, also the risk weighting measures increase reaching category 6 which contains the worse ratings (eg. Caa1 and lower for Moody's, CCC+ and lower for Fitch and CCC+ and lower for Standard & Poor's).
The last column, "Deductions from supervisory capital", shows the exposures which were not considered for the purposes of assets weighting as they are directly deducted from the statutory capital.

7. Credit Risk: Information on the Portfolios subject to the IRB Approach

7.1. AIRB Authorization

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

- The internal estimates of the Probability of Default (PD), for the corporate loan book and for the retail exposures;
- The internal estimates of Loss Given Default (LGD), for the corporate loan book and for retail exposures.

For all other not above-mentioned portfolios the standardized approach will be used and applied according to the roll-out plan submitted to the Supervisory Authorities.

The application framework of the authorized approach for legal entities is the following:

- AIRB: Banca Monte dei Paschi di Siena, Banca Toscana, MPS Capital Services;
- the remaining legal entities of the Montepaschi Group will use the standardized approach.

7.2. Internal rating systems structure

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

The rating system has thus become, over time, one of the main elements of valuation for all the units involved in the credit industry, both at head office level (Risk Management, Chief Financial Officer, Head office management, Risk Committee, Board of Directors) and at branch level (credit management area, loan lab units and account managers).

Thanks to the experience made, the Montepaschi Group has decided to further invest in internal rating systems, starting, at the beginning of 2006, a project called Basel II Project with the aim of improving and adjusting the existing internal procedures to the new prudential supervisory regulations on Banks which came into force on January 1, 2007 with Legislative Decree n. 297 dated 27 December 2006. This project ended in 2008 with the authorization of the Bank of Italy to use advanced internal rating systems (AIRB) for PD and LGD to calculate capital requirements of "non-financial companies" and "retail exposure" portfolios for the above-mentioned banks.

To estimate the PD and LGD models in line with credit granting and recovery, meetings were held, during the development process, with the persons in charge of the credit process and of the recovery process management to share the choice of variables and the consistency of the results.
To develop the internal rating systems, strict statistical and advanced methodologies were adopted in compliance with the requirements of the regulations; at the same time, models were selected so that the results obtained were in line with the historical experience of the bank in credit management.
Lastly, in order to optimize the correct use of the new instruments, the model ratings were shared top-down – from Risk Management down to each single account manager by means of an strong training activity.
In the estimate model of the loss rate, internal data relative to capital flows, recoveries and expenses actually registered on the non-performing positions were used.
The results obtained using the model were then compared with the data noted 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 which is now in a well-established for all the business units of the Group.

Main characteristics of the advanced rating systems are the following:

- the rating, for all the regulatory portfolios subject to validation, is calculated according to a counterpart approach, in line with the accepted management procedure providing for the valuation of credit risk, both in the granting and in the monitoring phases, at the level of each borrower;
- the rating is based on a Group logic: a unique rating is attributed at banking group level for each single counterpart based on the information set relative to all the lending banks of the AIRB perimeter, whereas the LGD is different for each legal entity, as the recovery processes recorded over time are different for the various banks of the Group;
- The LGD rate is relative to the recorded economic loss and not only to the accounting loss; for this reason, during the estimate phase, the costs incurred for the recovery process and the time process are also included;
- The rating model segmentation is defined in such a way to make the single model clusters consistent with commercial logic, with credit process logic and with the statutiry portfolios provided for by the regulations;
- The loss rate in case of default is different for the various types of loans and is assigned at level of each single transaction;
- The customer segmentation for the estimate and assignment of LGD uses the rating model logic; to attribute value to the single clusters the segments were grouped together under "Retail" for the retail exposures and "Corporate" for the non-financial corporate exposures;

- The loss rate estimate on default positions others than the non-performing loans is carried out according to the Cure Rate logic. For counterparties under Watchlist Credits, Restructured and Past Due, the percentage to return to performing loans is calculated and used to rectify the LGD rate for the unimpaired positions;
- The calculation of the final rating is different for each counterpart category. The credit process provides a close investigation level according to the risk associated to the counterparty: the valuation of loans granted shows a complex and articulate structure for medium- large counterparties (SME segments and Large Corporates – LC), with higher exposure and concentration risks and a simplified structure for Small Business and Retail sectors;
- In line with this process, the final rating for the SME and the LC is considered as an integration of more factors: statistical rating, qualitative rating, override possibility and valuation of the economic group; for the SB and Retails counterparties the rating is calculated only on the statistical factor;
- The rating has a 12-month internal validity period and is usually reviewed each year, except for the rating reviews with well-structured and codified rules or are anticipated on the account manager's request or following a serious worsening of the counterpart situation.

The Montepaschi Group has adopted a unique Master Scale for all types of exposures, so that all tunits involved in credit management are able to immediately compare the risk level associated to counterparties or different loan books; furthermore, the default probabilities of the internal rating classes were mapped according to the external rating scale of Standard&Poor's to make the internal risk measurements comparable to those available on the financial market.

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

The development and monitoring activities of the rating systems are structurally assigned to the Risk Management Area. The estimate procedure is carried out according to such an internal development protocol that the valuation activities are transparent and visible for the Internal Controls Department and for the Supervisory Body.
The Risk Management Area periodically carries out the monitoring/backtesting analyses of the internal models to verify the performance stability over time; should a significant critical state emerge from the analyses, fine-tuning or revaluation procedures of the model are activated.
The Montepaschi Group presently uses 13 rating models and one LGD model (differentiated by legal entity, kind of loan, kind of guarantee, kind of cover of the guarantee and default exposure) for the measurement of the validated regulatory risk portfolio; the extension to all Business Units of the Group (including Banca Antonveneta) and the other supervisory portfolios is expected in the next few years in the internal roll-out plan.

7.3. Use of Internal Models

Prior to the authorization of the Bank of Italy which enabled the Montepaschi Group to calculate capital absorptions according to the rules contemplated 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 provided for the use of the input factors established by Basle 2 in line with the operating requirements as much as possible even though, for obvious reasons resulting from the natural difference required by operational practice and reporting practice, with some methodological fine-tuning and improvements required by internal purposes and the calculation systems. In particular, "common" parameters used for both the "reporting" and "operational" practice are in relation to the default probabilities (DP) resulting from the internal rating systems and the loss rates on the "impaired" portfolio(LGD), which are the basis of calculation for different systems of measurement and monitoring, and specifically:

- **Measurement of the economic capital for credit risk.** The operations of the credit loan model and the related output in terms of VaR incorporate the variables of DP and LGD used also for regulatory purposes. It is clear that some adjustments were

necessary as in the case of the default probabilities "not subject" to validation for portfolios other than "Corporate" and "Retail" portfolios resulting from internal rating systems not subject to approval, from empirical average default probabilities of business sector or segmentation of the affinity model, from official ratings mapped on internal ratings. In addition, on the basis of specific analyses with respect to positions with maturities of less than one year, it was possible to assign intra-annual default probabilities to take account of the actual maturity rather than the simple annual maturity. With respect to the impaired loan portfolio, the maximum default probability assigned is 45%. On the front of LGD, the Group uses parameters estimated on the basis of portfolios being validated according to what approved by the regulatory authorities except for the down turn effect contemplated only for regulatory purposes. Non-validated portfolios use parameters estimated on the basis of analyses on medium-long term collection rates, if existing, or minimum LGD rates in line with the provisions of the internal regulations for the FIRB method, if not worse. In relation to particular exposure segments (Countries, Governments, Public Administrations, Non-banking Financial Institutions), LGD rates used are in line with those resulting from domestic and international analyses conducted on the subject or resulting from qualitative analyses, also in view of the fact that the Montepaschi Group – with reference to these types of counterparts – has no considerable long-term historical series in relation to any possible recoveries registered in case of defaults of such positions which can be considered as statistically significant. Specific emphasis must be placed on the economic capital measurements for legal entities outside the area of validation. In light of the principle of univocal ratings, wherever possible, in relation to the customers of these legal entities, the Group uses the final rating assigned to the customers "shared" with the entities subject to validation (given that sharing rates are very high between validated and non-validated legal entities), since the determination of the rating of the shared customer, based on financial performance and qualitative data, is in any case based on quantitative and qualitative data resulting from the consolidated exposures at Group level subject to the AIRB perimeter or on the qualitative analysis implemented by the account managers, taking account of all exposures. With reference to the remaining part of the loan portfolio, the above rules were applied to the portfolios not included in the AIRB area of the approved legal entities. As regards the LGD parameter applied to non-validated legal entities, the Group assigns the loss rates resulting from the specific business carried out by the legal entity subject to measurement (in the case of MPS Leasing and Factoring, medium-long term loss rates were estimated in relation to the typical forms of business of this legal entity. The same principle was applied to Consum.it). In relation to the remaining types of

exposures, the Group used loss rates determined as the average of the rates of the 4 legal entities subject to validation, since NPLs are centrally managed at the Montepaschi Group by MP Gestione Crediti for all the legal entities and therefore their management is based on the operational, qualitative and performance metrics of the banks subject to validation. Although EAD for regulatory purposes follows the standardized methodology as it is not subject to validation, it is calculated as the sum of the utilization plus the available margin (Disbursements – Utilizations) multiplied by a conversion co-efficient (CCF) which is different by type of exposure and deteriorates as the default probability assigned increases.

- The Group follows the logic of calculation used for the loan portfolio model, both for the legal entities subject to validation and the entities excluded from the area of validation, also for the calculation process of the **risk-adjusted performance and measurement of value creation.** Furthermore, whenever new estimates or readjustments of the internal rating system subject to validation are made, the related results are also adopted by the VBM procedures and therefore the output data are aligned with the latest updates at any time.
- The parameters which feed the calculation model of the **risk-adjusted pricing process** are the parameters of 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 the input not only of annual default probability but also the marginal, forward and multi-period default probabilities. For these reasons, the Montepaschi Group has developed specific calculation methodologies of these default probabilities, all in compliance with the annual default probability resulting from the validated rating systems. The LGD adopts the criteria set for the above-mentioned Loan Portfolio Model, always excluding the down turn effect.
- In particular, in relation to the **loan process control** (trend management, systemic supervision, operational authorities,…):
  - **Loan disbursement** processes concerning customers included in the scope of application of the advanced IRB method have been completely re-engineered in the Electronic Credit File (ECF) application. The counterpart rating of the Montepaschi Group is the result of a process which evaluates - in a transparent, structured and homogenous manner - all the economic-financial, performance and qualitative information relative to customers with pending credit risk, according to the definition of the models, the use of information sources and methodological and information sources diversified by homogenous groups of parties involved. The official rating thus determined has an ordinary validity up to the twelfth following month and shall be reviewed no later than the end of that month. It is subject to a monitoring

process which can anticipate the review during the period of validity if steady, huge statistical PD variations – exceeding specific cut-offs - are captured on a monthly basis. The loan disbursement system is based on several paths, according to the type of customer and the transaction requested, which incorporate the opportunity of executing the process of rating assignment for each counterpart and do not contemplate any exercise of the power of authorization failing a valid rating.

- The current algorithm of automatic measurement of the positions under **Systematic Supervision** is based on the use of new rules which envisage the adoption of two metrics: a) an "Official" Rating or a rating calculated with internal models on which stabilization rules are applied; b) the synthetic index of anomaly (SIA) in the customer's credit behaviour, calculated in view of at least one reported critical event, which takes an increasing value on the basis of the risk level, as made available in the Operational Management. The process of Systematic Supervision is fuelled by the critical portfolio, identified in accordance with the mix of the two metrics based on a total score given to each position equalling the simple sum of the rating-related scores and the SIA of reference. Default positions and E£-rated positions are automatically classified as "impaired (in disimpegno)".
- The **Simplified Renewal** process of the loan is based on the control of the trend of the rating over a period of time and the prompt review of the loan file when the rating deteriorates. This is applied to all borrowers with credit lines subject to review which expired or will be expiring in the month under exam, or were subject to an early review of the rating, in accordance with the principle stating that the maturity of a loan with a rating which is confirmed or early improved or deteriorated marginally, is automatically extended to the new maturity of the rating. With reference to the positions with process rating, where the monitoring system has captured an improvement in the statistical DP, the business units involved (as conveniently informed) shall be in charge of conducting a Rating review or not.
- The principle underlying **authorization levels** contemplates that the levels of authority are based on the rating assigned to each counterpart (risk-based authorizations), the amount of the exposure, the intensity of risk represented by the characteristics of the transactions and the type of borrower. The system is based on the transformation of the nominal amount into a risk-weighted amount. The decision-making bodies have fixed discretionary powers of authorization, which make reference to a combination of risk factors (anchor points corresponding to an internal rating) which equal the nominal amount to the risk- weighted amount. The weighted system developed contemplates an

increase in the nominal amounts to be authorized when the rating improves and a reduction if the ratings deteriorate. Exceptions to this rule are made in the case of the levels of authority assigned to collective decision-making bodies (i.e. Credit Committee, Executive Committee and Board of Directors).

- In relation to the calculation process of **collective impairment**, for a long time the Montepaschi Group has indexed the PD and LGD parameters used in the previous measurements to such output. However, significant adjustments are made during this stage of calculation, as the IAS principles incorporate estimates showing the Incurred Loss instead of the Expected Loss.

The policies of recognition of the guarantees with a credit risk mitigation effect are implemented through a dedicated IT process which is applied for reporting purposes and does not overlap the rules of management of the guarantees within the loan disbursement process. The application manages all rules of admission of the guarantees. The process is based on a first step of anagraphical record of the guarantees, which outlines the Group operational framework. Later, the data of each guarantee are assessed through the analysis of the specific characteristics. In particular, following are the general requirements analysed:

- Legal certainty
- Guarantee third party opposability
- Prompt collection
- Compliance with organizational requirements

The importance of the internal ratings for operating purposes required to set up a unit for the control and validation of the rating systems within the Montepaschi Group, which is independent from the organization viewpoint and plays the role of management point of reference for the unit established for the development, maintenance and review of the systems. This unit meets the requirements of "Credit Risk Control Unit" of the regulatory regulations for the conduct of validation controls.

7.3.1. Management Models

An advanced internal rating system, according to the 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, or controls regulated by specific operational practice (e.g. hierarchical controls), within the business units involved in process of rating assignment. These controls have the

objective of reviewing the proper implementation of the activities preliminary to rating assignment (i.e. the selection of the model suitable for the assessment of the customers or the transactions, the identification of the economic or legal relations between the customers, compliance with the internal procedures oriented to obtaining the information necessary for the assignment and updating of the rating). The Model Validation and Credit Systems Staff (responsible for validation controls, hereinafter referred to as "Staff") within the Operational and Credit Governance 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 Validation Report of the Internal Rating System (hereinafter VIRS Report) of the Montepaschi Group expressing an opinion on the regular operations, the prediction power and the overall performance of the IRB system adopted. The Risk Committee expresses its opinion on the annual validation of the VIRS Report, on the basis of the opinion of the validation unit.
The Internal Controls Area (hereinafter ICA) is responsible for the valuation of the functionality of the overall controls on the rating system (responsible for review controls).
The methods adopted by the above business units in relation to the operational procedure of validation and review controls are briefly illustrated below.

Validation Process of the Internal Rating System

The Parent Bank Risk Committee is responsible for the validation of the IRS. The Risk Committee is supported by the Validation Model and Credit Systems Staff (hereinafter called Staff) for the operational activities in relation to the validation process. 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 mentioned in Circular no. 263 of the Bank of Italy.
The results of these controls are evidenced and reported periodically to the Top Management, the first level units and the ICA. Once a year these results are included in the "Annual Validation Report of the Internal Rating System" which expresses an overall opinion on the position of the IRS with respect to the regulatory 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 which finally validates the Rating System consists of the following formal validations:

- The **validation of the process of rating attribution**: checks compliance of the internal rating assignment process with the minimum organizational requirements of Circular no. 263 of the Bank of Italy, with specific focus on the analysis of

compliance of the rating models attributable to human action with the guidelines given to the units involved in the assignment of ratings;

- The 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 organizational and quantative requirements provided for by the rules; and in particular the process controls:
    - **performance**: valuation of the prediction power of the model and therefore its power to separate highly solvent customers from potentially risk customers;
    - **grading**: check whether the risk preliminarily assigned to each class of rating matches the observed historical risk;
    - **stability:** valuation of the stability of the assigned ratings in the course of time;
    - **stress testing**: review of the stress test activities on the models, carried out by the model development unit.
- The validation of the **IT systems**: reviews compliance with the minimum requirements imposed by the regulations in relation to the quality of the data used by the IRS;
- The validation of the **use of the IRS in corporate processes**: reviews the actual use of the rating system in corporate management, 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, with the objective of checking compliance of each aspect of the IRS with the regulatory requirements. The detailed positions on each requirement are assembled in a global 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 Regulatory Authorities but especially to each business 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.

Process of internal review of the internal rating system

In line with the ruling regulations (see Supervisory Instructions – Title IV, Chapter 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 oriented to controlling, also through on the spot controls, the regular operations and the trend of the risks and to evaluating the functionality and compliance of the Internal Control Systems in order to improve the efficacy and efficiency of the organization.
The introduction of advanced systems of measurement and risk management (in particular, with reference to credit risk, see Circular no. 263 of 27 December 2006 "New prudential regulatory rules for banks" – Title II, Chapter 1, Second part, Section III) extended the activities of the Internal Audit unit and its responsibilities. The role assigned to the unit represents a specialised activity which traditionally falls within the competence of the ICA and can be usefully supported by a systematic approach used which has been applied for some time.
The overall definition of review is focused on the objective of achieving an organic valuation of adequacy, in terms of efficacy and efficiency, of the control systems of the process of governance and management of credit risk based on the rating system.
In particular the responsibilities given to the internal audit unit by the above-mentioned Circular, with reference to the review of the advanced models for the valuation and management of credit risk can be summarized in accordance with the three following points:

1. Valuation of the overall functionality of the control system of the AIRB approach;
2. Valuation of the functionality and regularity of the internal validation process;
3. Review of the compliance of the system with the eligible requirements for the regulated 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 should be considered as a component of a larger analysis and valuation of the whole loan management process. The objective is to ensure the materialization of important synergies from the point of view of the actual cost of implementation and, above all, the overall and organic 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 the valuation of the above-mentioned points are in relation to the following kinds of activities:

- Functionality checks, i.e. control activities for identifying any existing adequate rules (process regulations, circulars, system of the limits and authorization powers etc.) instruments, IT systems and coded processes, which ensure the mitigation of risk and the efficacy and efficiency of the activities, or the adequacy of the global organizational solutions with respect to the objectives to be achieved.

- Compliance 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 official operational/regulatory references, compliance checks also ensures the review of normally adopted practices. Thus, as a result of the material control of the significant aspects by the units/ activities subject to control, it is possible to concentrate any comments and remarks on failure to anticipate these aspects.

As a result of the different kinds of controls, the internal audit unit performs its responsibilities which consist of the review of 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 purpose of calculation of capital absorption for credit risks, the Montepaschi Group adopts the **standardized method** for the following regulatory classes:

- Central governments and central banks
- regulated intermediaries
- Capital instruments

Internal rating systems are used for the following types of exposure:

- Corporates
- Retail exposures

7.4.1. Internal Rating Model for Corporates

DP models

The Montepaschi Group adopted a default based method for the development of DP models. Logistic regression characterised by an optimal trade/off between statistical solidity and the interpretation of results was selected among the technical statistics for the estimate of models with a bad/good dichotomy target variable. The "non financial companies" portfolio includes all cash exposures and endorsement credits with respect to corporates with registered office in Italy and in relation to the 4 banks in the validation area.

The Montepaschi Group operates almost exclusively in the domestic market and therefore given the modest importance of international operations, decided to exclude all the exposures to foreign corporates from the application of the advanced systems.

The period of exam of the data source for DP estimates is 5 years (2002-2006) in line with the regulatory regulations of the Bank of Italy.

Model segmentation

Corporate customers were preliminarily segmented in order to obtain homogenous clusters by risk profile. To this end, a size logic (based on the legal status of a company and its turnover) which is apparently consistent from the statistical and operational point of view was used.

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 DP models, the following definition of default is used: default counterparts are a sub-group of customers with an exposure (credit line granted or drawn) which, in an ordinary situation in a specific month of the year, show at least one deterioration anomaly within the following twelve months.

The definition of default includes, among the impairments, non-performing loans, watchlist credits, restructured loans; past due loans for a period exceeding 180 days have been included since 2006, or since the reporting of these positions has become mandatory.

Furthermore, in 2006 it was decided to use an internal "technical" definition of past due loans to identify non-representative cases of an actual state of financial difficulty which might generate an economic loss (power given to the banks by the regulations), in line with the operational expectations of the account managers in relation to such event.

As a result of these rules, a sub-group of reports with critical aspects similar to the other states of anomaly (in particular watchlist credits) were identified. The principle adopted is the integration of default positions with positions which show no temporary anomaly but are characterized by the aspects featuring the other anomalous states.

The definition of technical past due loans is used consistently with the DP and LGD estimates.

Default positions are determined at the MPS Banking Group level.

Development stages of the rating model

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

Score model estimate

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

The information sources used for corporate models are the following:

- Balance sheet reports,
- Internal trend data,
- Industry data (Bank of Italy Centrale Rischi and Centrale Rischi of economic associations).

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

With reference to the trend components, the variables normally used by the account managers for risk valuation were restated (i.e. procedures for the use of the kind of loans, account movements, number of anomalies 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.

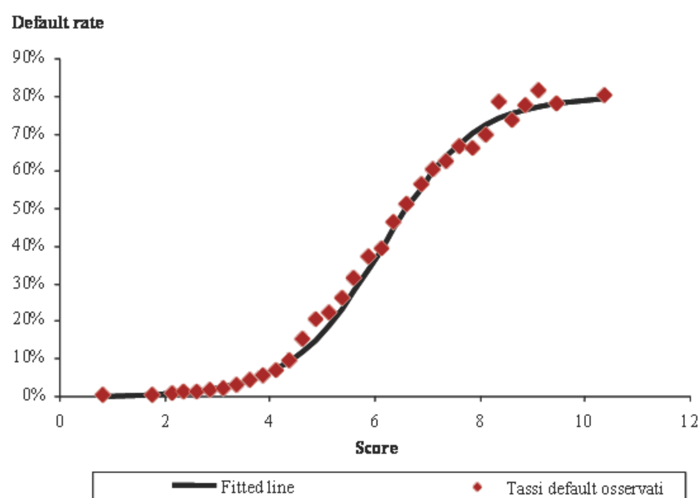
As per the internal practice, the stage of development follows all procedures contemplated by a statistical inquiry (i.e. determination of a development sample (70%) and a test sample (30%), preliminary analyses and preliminary data management, univariate analyses, correlation analyses and short list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

Grading

Grading is a process for the assessment of the function which transforms the score models output into default probability, i.e. the probability that a counterpart 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 grading 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.

Example of a grading function



The anchor point represents the level of risk traditionally associated with the specific segment which the model is graded on. It is calculated on the basis of the long term default rate and qualitative considerations the analyst deems it important to introduce.

In particular, for the purpose of compliance with the Basle 2 definition and the achievement of appropriate prudential metrics, it was decided to reweigh the default rates taking account of the past due (only non-technical) effect, also in the first four years of the historical series. The model anchor point is 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 final DP which is subsequently mapped on the Montepaschi Group Master Scale. Each counterpart is assigned a PD level corresponding to the rating class.

LGD Model

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

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

The database used for assessing the indicator includes all cash exposures and endorsement credits in relation to the 4 banks in the area of validation, which were classified as NPLs from January 1985 to June 2007, which are still active but have a nil balance or the process of collection was completed. The relevant clusters for the estimates include the kind of customers, loans, exposures classified under default positions, guarantees and their percentage of coverage.

Model segmentation

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

Default definition

The definition of default used during the stage of development of the LGD model matches the definition of the rating model, namely default counterparts are the sub-group of customers with an exposure (credit line granted or drawn) which, in an ordinary situation in a specific month of the year, show at least one deterioration 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 by the historical records of each single legal entity in relation to the non-performing customers, (ii) the calculation of the LGD downturn, i.e. an indicatorparameter which takes account of the adverse phases of the economic cycle; (iii) the calculation of the LGD for all loan status other than non-performing loans.

Loss Rate for Non-Performing Positions

Realized collections minus the costs incurred with respect to default exposures are compared to calculate the LGD rate actually observed on non-performing positions. With reference to the registered economic loss, and not only the accounting loss, indirect costs are also included and the movements are updated as of the date the loan is classified as non-performing.

The interest rate used for the updating 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 ascertained a negative relation between the two series, a regression model is clearly expressed between collection rates and macroeconomic variables. Once determined the collection rates of expansionary and recession cycles After calculating the recovery rates for the expansion phase and those for recession, the

LGD downturn is calculated as the long-term default-weighted average, suitable for the recessive phases of the economic cycle.

Global LGD

The estimated loss rates on default positions other than non-performing loans starts from the estimated cure rate, i.e. the percentage of Watchlist Credits, Restructured Loans, or Past Due Loans returning to performing loans status. All corporate performing loans as of January 2002 showing an anomaly from February 2002 to January 2007 were selected to determine this.

A weighted average of the LGD downturn was calculated, using the cure rates multiplied by the default probabilities 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 population of the rating models.

7.4.2. Internal Rating Model for Retail Exposures

PD Models

Default-based methods were adopted also in relation to retail exposures. The portfolio includes all cash exposures and endorsement credits in relation to loans granted by the 4 banks in the area of validation to retail customers (individuals or jointly liable individuals). The period of exam of the data sources for the DP estimate is 2 years (2005-2006).

The Montepaschi Group, in view of the operational pricing practice currently applied, prudently decided to assign the Retail customers with the best credit standing an observed probability default rate not lower than the B1 rating class.

Model segmentation

The Retail portfolio was segmented including jointly liable individuals and individuals. In turn, individuals 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.

Default definition

The Group used the definition of default adopted for the corporate models also in relation to the DP 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. The approach chosen for the retail models incorporates the classification of the variables into categories, i.e. the transformation of the continuous variables into discrete variables. This method is included in the most internationally widespread Credit Scoring Development techniques and has some statistical benefits for the Retail segment, as the management of the variables of a different nature and the variables with a high percentage of missing values can be optimized.

The major developments in relation to the Retail segment concern the information with reference to the loans granted by the Group (current account advances, mortgage loans and personal loans) and the customers' personal data.

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.

As of 31.12.2008
In thousands of euro

Table7.1 – Exposures to corporates, advanced IRB method

DP Class	Exposure	Unused Margin*	Credit equivalent	Weighted average EAD for exposures	Weighted average LGD of the exposure (LGD%)	Average weight factor of the weighted risk for exposure (RW%)
First class of DP	5,288,427	304,748	271,556	8,277	39%	18%
Second class of DP	13,288,844	767,366	718,322	57,217	37%	40%
Third class of DP	27,308,096	2,111,138	2,057,083	151,576	34%	62%
Fourth class of DP	9,729,663	538,006	527,120	70,769	34%	102%
Fifth class of DP	1,399,102	38,993	38,011	4,550	32%	146%
Sixth class of DP	6,013,421	34,976	34,659	12,953	46%	NA
Total	**63,027,553**	**3,795,226**	**3,646,752**			

As of 31.12.2008
In thousands of euro

Table 7.2 – Retail exposure – Secured by real estate, advanced IRB Method

DP Class	Exposure	Unused Margin*	Credit equivalent	Weighted average EAD for exposures	Weighted average LGD of the exposure (LGD%)	Average weight factor of the weighted risk for exposure (RW%)
First class of DP	1,695	1,016	508	255	14%	2%
Second class of DP	14,518,233	67,056	47,737	28,977	13%	11%
Third class of DP	4,076,769	64,524	41,727	6,761	14%	19%
Fourth class of DP	1,126,325	14,239	9,135	2,096	14%	56%
Fifth class of DP	54,856	2,048	1,267	493	13%	81%
Sixth class of DP	437,975	1,687	1,043	496	14%	NA
Total	**20,215,853**	**150,570**	**101,417**			

* Only the irrevocable commitments were taken into account in the Unused Margins and the related credit equivalents, for the purpose of this table.

As of 31.12.2008
In thousands of euro

Table 7.3 – Retail exposure – Qualifying revolving credit, advanced IRB method

DP class	Exposure	Unused Margin*	Credit equivalent	Weighted average EAD for exposures	Weighted average LGD of the exposure (LGD%)	Average weight factor of the weighted risk for exposure (RW%)
First class of DP						
Second class of DP	147				26%	6%
Third class of DP	32				26%	10%
Fourth class of DP	0				0%	0%
Fifth class of DP	0				0%	0%
Sixth class of DP	0				16%	NA
Total	**179**					

As of 31.12.2008
In thousands of euro

Table 7.4 – Other retail exposure , advanced IRB method

DP class	Exposure	Unused margin*	Credit equivalent	Weighted average EAD for exposures	Weighted average LGD of the exposure (LGD%)	Average weight factor of the weighted risk for exposure (RW%)
First class of DP	5,603	66,1	65,8	63,97	30%	3%
Second class of DP	1,564,041	9,775	8,940	1,677	31%	14%
Third class of DP	859,068	4,687	4,493	502	29%	23%
Fourth class of DP	504,450	1,100	1,051	221	30%	40%
Fifth class of DP	79,472	1,055	795	343	30%	63%
Sixth class of DP	777,722	103,4	102,8	98,7	49%	NA
Total	**3,790,354**	**16,786**	**15,447**			

* Only the irrevocable commitments were taken into account in the Unused Margins and the related credit equivalents, for the purpose of this table.

7.5. Expected Loss/Actual Loss Comparison

An analysis carried out at the international level and co-ordinated by the "European Banking Federation" (EBF)[1] showed a few limits of the above-mentioned comparison which might automatically result into the partial interpretation of issued data.
The comparison between expected losses and actual losses was not indicated since it is not significant and not consistently homogenous. The Expected Loss shows the average expected loss within 12 months following its calculation, but it is based on risk parameters, in particular the Loss Given Default, which is estimated on the basis of medium/long term historical loss data, with reference to the principle of "economic", and not merely accounting, loss and including other prudential elements such as the LGD downturn. As a result of this methodological approach - which is required to be applied in compliance with the qualitative-quantitative regulations of Basle 2 – the comparison with the actual loss flow, which is computed in compliance with the accounting rules, is not homogenous and fully consistent. The comparison between expected loss and actual loss can clearly become of importance in the medium term, and therefore, it is presently partly applicable since the MontePaschi Group obtained the validation to use the AIRB approach only in June 2008 in relation to some portfolios/legal entities for which validation was requested

[1] European Banking Federation, *Paper Alignment of Pillar 3 Disclosure*, 24 September 2008.

8. Risk mitigation techniques

8.1. Netting policies

With reference to the commercial loan portfolio, the Montepaschi Group does not apply any netting processes of 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 for derivatives and repurchase agreements.

8.2. The Management of Collaterals

The Montepaschi Group implemented the requirements contemplated by the New Prudential Regulatory Regulations for the purpose of recognition of the effects of risk mitigation produced by any existing collaterals securing the loan.

The disbursement of loans secured by collaterals is subject to specific control measures, which change according to the type of guarantee, and are applied during the phase of disbursement and monitoring. Two kinds of main guarantees, subject to different regulations, can be identified by volume of the loans and numerousness of the customers, namely Mortgages and Pledges (Cash and Securities).

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

- The presence of an IT system in support of the phases of the life cycle of the guarantees (acquisition, valuation, management, re-valuation and enforcement);
- Regulated management policies for the guarantees (principles, methods, processes), available to the users;
- The presence of regulated management procedures of the guarantees (principles, methods, processes), supported by evidence and available to the users;
- The 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 should be flanked by 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 the pledged goods. In the case of redemption of the pledge, the repayment should be made at the Bank (collection).

The Montepaschi Group identified a string of technical forms (by purpose of the loan/kind of customer) providing for the presence of mortgage guarantees.
Within the IT system, the proposal of financing one of these loans triggers a request of detailed information on the characteristics of the real estate subject to guarantee (valuation) and, after the authorization, the acquisition steps will become compulsory.
In the 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 the necessary information for the proper management of real estate guarantees.
The Montepaschi Group has developed one process for the acquisition of collaterals which is at the same time a working instrument and materializes the Group management policies. The instrument can activate different paths on the basis of the type of guarantee.
The management of guarantees starts after the authorization of loan disbursement. The process consists of various steps:

- acquisition (also multiple acquisition); the controls of (formal and amount) consistency with the guarantees proposed during the authorization step are implemented;
- adjustment/change/amendment; useful to amend the characteristics of a guarantee without stopping the protection of the loan;
- query; gives information about the present data and the historical trend of the guarantees received;
- Repayment/Cancellation.

A monitoring system of the value of the collaterals on the basis of market values is working. Pledge transactions are monitored daily (in particular, for listed securities deposited with the bank). The value of real estate is currently reviewed once a year in relation to mortgages (the assets are accurately estimated in the case of loans with exposures higher than EUR 3 million and revaluations are made on the basis of average market indices for loans in a lower amount).

It is useful to emphasize the importance of the valuation of the assets securing the transaction during the stage of authorization of a mortgage loan. In the case of retail mortgage loans, a dedicated disbursement process binds the preliminary query process to the presentation of the technical expert's report on the assets, thus ensuring the execution of this step and compliance with the obligations of the landed property in acquiring the guarantee.

If the value of the property given as a guarantee is subject to market or foreign exchange risks, the Montepaschi Group uses the concept of guarantee differential, as a percentage of the value of the guarantee offered, calculated according to the volatility of the value of the assets. The only portion of the loan covered by the value of the assets net of the differential is considered as guaranteed during the authorization step. The monitoring step requires the adjustment of the guarantees with a market value lower than the value of authorization, net of the differential. This is notified by the Operating Management, an automatic process of daily credit monitoring which reports events which could modify the risk perception, to the Network.

The presence of collaterals does not alter the valuation of the insolvency risk of the customer. However, it has an impact on the authorization 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 presence of authorization levels dedicated only to Land Credit 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 UCIT's deposited with the Bank;
- Mortgages on 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 of today, the first three categories (which account for more than 98% of the nominal amount of the collaterals received) ensure the presence of the

regulatory/legal/organizational requirements contemplated by the New Regulatory Regulations for the application of the rules on credit risk mitigation.
All the types which can be acquired by the Montepaschi Group are included in the structured management process of the collaterals, which shares all the steps it consists of.
If the measures of monitoring of the collaterals show operational irregularities during the step of acquisition or any inadequacies/losses of the values received as a pledge, this implies events falling within the scope of the credit control policies which determine operational measures of credit risk valuations.

8.4. Reports on Concentrations

The main concentration of collaterals is linked with retail mortgage loans. However, it is not a question of risk concentration due to the principle of risk splitting which is implicit in this kind 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 are provided, on an annual basis, by specialised industry players (extraordinary updates may be generated by significant variations in the very short period).

As of 31.12.2008
In thousands of euro

Table 8.1 – Exposures secured by guarantees

Portfolio	Financial collaterals	Personal guarantees	Total
Central Governments and Central banks	4,867,707	41,775	4,909,482
Regulated intermediaries	8,103,711	71,771	8,175,482
Geographical entities	1,403	64	1,467
Non-profit and public entities	518,296	2,300	520,596
Multi- lateral development banks	547	-	547
International organisations	-	-	-
Corporates and other subjects	5,629,003	4,416	5,633,419
Retail exposures	5,769,380	-	5,769,380
Short term exposure to corporates	-	-	-
Exposure to units in collective investment undertakings (UCITs)	-	-	-
Exposures secured by real estate	2,392	-	2,392
Exposure in the form of guaranteed bank bonds	-	-	-
Past due exposures	32,938	-	32,938
High risk exposures	-	-	-
Other exposures	271,747	-	271,747
Total	**25,197,122**	**120,326**	**25,317,448**

The table provides, by 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.

9. Counterparty risk

The Montepaschi Group is committed to monitoring the counterparty risk , as the risk the counterparty in a transaction involving specific financial instruments (over the counter derivatives, securities financing transactions and forward transactions) is in default before the settlement of the transaction.
According to the regulatory requirements, the Montepachi Group bases its measurement method on the current value method. This method consists of the calculation of the current and potential exposure with the standard regulatory method, using the market value as the current exposure of the instrument and the regulatory add-on to represent, in a simplified manner, the potential future exposure.
From an operational point of view, the operations of importance for the purpose of counterparty risk consist of two macro-segments on the basis of the characteristics of the counterparty (ordinary customers and institutional counterparties) and the operational and control modes implemented by the Group.
With reference to typical finance operations with financial institutions, the counterparty risk exposure is monitored on a daily basis by the Control Unit of the Business units, by monitoring the credit lines of each counterparty. Furthermore, the general use of credit risk mitigation measures – i.e. collateral, netting agreements, break clauses etc. – substantially limits the risks taken.
Briefly, the daily process incorporates:

- Credit lines granted to the counterparties on the basis of the requests received from the staff of the Business Units, with a periodical review of the limits set;
- Limits included in the management systems;
- Inclusion of the ISDA and ISMA standards and the Credit Support Annexes (CSA) in the systems for the proper valuation of the guarantees subject to exchange with the counterparties (Collateral Management);
- Daily review of the drawings and the limits exceeded in real time.

The process in relation to derivative operations with ordinary customers is based on the distinction of roles and responsibilities in the Group companies. Derivative transactions with customers contemplate the centralisation of the product factory and the control of market risk at MPS Capital Services, with the allocation, management and control of counterparty risk with respect to the customers in the branch network.

In this sense, the commercial banks shall:

- Authorise the credit limits to be granted to customers;
- Manage each transaction in their books;

- Take care of the related documents and regulatory requirements;
- Review the drawings with respect to the credit lines granted.

As far as the products offered to the customers are concerned, in general a string of common characteristics characterizes most of the operations. In particular the traded products:

- Do not have a speculative nature;
- Are associated with an underlying position, even if they are separate from a contractual and administrative point of view;
- Although in the presence of not completely plain vanilla transactions (structured transcations), show limited elements of complexity;
- Are not characterized by financial leverage

As of 31.12.2008
In thousands of euro

Table 9.1 – Counterparty risk: derivatives

	Gross Positive Fair value (book values)	Nettings	Net offset Fair value	Effect of guarantee agreements	Exposure
Derivatives	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 fair value transactions. The "net offset fair value" indicates the positive fair value amount remaining after the compensations.
The "Exposure" is a value calculated according to the prudential regulatory rules; in the method of the current value used by the MPS Group, it is based on the positive fair value net of set-off; 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.

The overall exposure with reference to the Long Settlement Transactions and Securities Financing Transactions amounts to about 3.35 billion euro.

As of 31.12.2008
In thousands of euro

Table 9.2 – Distribution of positive fair value according to the underlying type

	Interest rates	Currencies and gold	Equities	Credits	Other	Total
Derivatives	7,231,302	2,005,524	338,791	509,106	18,177	10,102,900

The table illustrates the breakdown of the positive gross fair value of OTC derivative contracts by kind of underlying assets.

As of 31.12.2008
In thousands of euro

Table 9.3 – Notional values of credit derivative contracts

Group of products	Banking Portfolio		Trading Portfolio for regulatory purposes	
	Protection purchases	Protection sales	Protection purchases	Protection sales
Credit default swap	44,264	-	6,247,705	5,913,251
Total Return Swap	-	-	23,980	-
Total	**44,264**	**-**	**6,271,685**	**5,913,251**

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

10. Securitization

The securitization transactions carried out by the Group prior to the enforcement of the international accounting principles are posted in the balance sheet in accordance with methods which differ from the method adopted in relation to the transactions conducted afterwards.
The loans underlying "pre-IAS" transactions were written off from the balance sheet of the assignor which indicated only any forms of credit enhancement entered into by the assignor.
Any consolidation of the Special Purpose Entities (SPE) in relation to these transactions concerned only their working capital. The loans sold, posted under off-balance sheet data of the SPEs, were not subject to consolidation in the Group balance sheet.
Upon the first application of the international accounting principles, the Group decided not to post the assets underlying the transactions carried out before January 1, 2004, written off on the basis of previous domestic principles. Therefore, these assets are never reported in the consolidated balance sheet.
In the transactions carried out after the introduction of the IAS, all the notes issued by the SPEs have been underwritten by the originator (the Parent Company), which substantially maintained the risks and benefits of the portfolio sold.
Therefore, these securitizations do not meet the requirements of IAS 39 for the de-recognition. The underlying assets were not written off from the originator's balance sheet and consequently are still included in the consolidated assets under assets sold but not written off. The assignment transactions had no economic impact on the originator's balance sheet and, for the purpose of the calculation of capital absorption, the loans remained in the weighted assets of the Group as if they had never been transferred.
For the purpose of greater information transparency, the business model will be described separating the transactions carried out before 1st January 2004 and the transactions carried out after such date.

10.1. Securitizations originated before 1 January 2004

The securitization transactions belonging to this category were structured with the objective of achieving economic benefits concerning the optimization of the loan portfolio management, the diversification of the financing sources and the reduction of their cost.
Following are the main securitizations of the Group before 1 January 2004:
Securitizations of *performing loans* :

- Siena Mortgages 02 – 3 Srl

    - Siena Mortgages 03 - 4 Srl
    - MPS Asset Securitization SpA
    - Mantegna Finance Srl
    - Mantegna Finance II Srl
    - Spoleto Mortgages Srl
    - Giotto Finance SpA (originated by Banca Antonveneta)
    - Giotto Finance 2 SpA (originated by Banca Antonveneta)
- Securitizations of *non-performing* loans:
    - Ulisse 2 SpA
    - Ulisse 4
- Securitizations of other assets:
    - Gonzaga Finance Srl
    - Vintage Capital Srl

The trend of the securitizations is regular. This opinion is shared by the rating agencies which did not review the ratings originally assigned to the classes of notes issued.
On 27 October 2008 the group repurchased the Seashell II Srl securitization of performing landed mortgage loans, secured by first class mortgages.
The portfolio in relation to the Ulisse Spa non-performing securitization was repurchased in December by Banca Monte dei Paschi di Siena.
The assets securitized by MPS Asset Securitization SpA are represented by loans secured by pledges on financial instruments with maturities ranging from 15 to 30 years, originated by the Parent Company and the other commercial banks of the Group.
The portfolio securitized through Siena Mortgags 02-3 and 03-3 consists of mortgage loans originated by the Parent Company and the other banks of the Group.
Following are the securitizations of residential mortgage loans:

- Mantegna Finance Srl and Mantenga Finance II Srl in relation to the assets originated by Banca Agricola Mantovana SpA;
- Spoleto Mortgages Srl in relation to the residential mortgage loans originated by Banca Popolare di Spoleto SpA.

As far as the securitizations of non-performing asset are concerned, the Ulisse 2 SpA portfolio consists of short-term unsecured loans originated by the Parent Company. So far the trend of this securitization was more than satisfactory, with a higher-than expected excess of actual collections.

10.2. Securitizations originated after 1 January 2004

This category incorporates two transactions carried out by the Parent Company in December 2007 and March 2008 concerning performing loans in a total amount of about € 8.5 billion.

These transactions have the objective of diversifying and consolidating available funding instruments, by transforming the loans sold into refinanceable securities. The Parent Company underwrote all the notes issued by the vehicle for both transactions, as part of a more general policy of consolidation of the Group liquidity position. AAA notes are assignable stock and therefore contribute to maintaining the Group counterbalancing capacity.

The first of the above-mentioned transactions, carried out by the Parent Company in December 2007, had an underlying portfolio of over 57 thousand performing residential mortgage loans in a global amount of € 5,162.4 million, with a residual expected life of about 20 years. From the geographical viewpoint, 46% of the mortgage loans are concentrated in central Italy, with northern and southern Italy accounting for 27% respectively.

The vehicle company (Siena Mortgages 07-5 SpA) issued RMBS notes (Residential Mortgage Backed Floating Rate Notes) to finance the acquisition, in the following tranches:

class A1 securities	(rating Aaa e AAA)	in a global countervalue of	€/million	4,765.90
class B securities	(rating A2 e A9)	in a global countervalue of	€/million	157.45
class C securities	(rating Ba3 e BBB)	in a global countervalue of	€/million	239.00

Furthermore a cash reserve of € 123.90 million corresponding to class D Junior Securities was set up. The capital of the joint stock company is held by a stichting (93%) and by Banca Monte dei Paschi di Siena Spa (7%).

On 20 March 2008 the Siena Mortgages 07-5 Spa vehicle resolved to start another securitization transaction with the purchase of a performing loans portfolio wholly transferred without recourse by the Parent Company in the amount of € 3,416.00 million. The purchase was executed on 31 March 2008.

Siena Mortgages 07-5 SpA was used again as a SPV for this securitization. The SPV financed the acquisition through the issue of RMBS notes (*Residential Mortgage Backed Floating Rate Notes*) in the following tranches:

class A securities	(Fitch rating AAA)	in a global countervalue of €/million	3,129.40
class B securities	(Fitch rating A)	in a global countervalue of €/million	108.30
class C securities	(Fitch rating BBB)	in a global countervalue of €/million	178.30

Furthermore a cash reserve of € 82.07 million was established corresponding to class D Junior securities was set up.
The Parent Company wholly underwrote the notes issued by the vehicle.
This transaction, with technical characteristics similar to the previous securitization, is part of the more general policy of consolidation of the Group liquidity position. On 28 December 2007 the Parent Company executed another securitization of non-performing loans as part of the general project of enhancement of the quality of the non-performing portfolio contemplated by the Business Plan.
The whole NPL portfolio, consisting of over 25 thousand NPL files, in a total book value of € 738.90 million was sold at the end of 2007.

From the geographical viewpoint, 44.25% of the loans are concentrated in central Italy, with northern Italy and southern Italy and the islands accounting for 25.33% and 30.42%, respectively.
Siena Mortgages 00-1 SpA is the vehicle which was used again for this securitization, with loans prepaid on 7 August 2007. As of 31 December 2008 the capital of the joint stock company was wholly held by Banca Monte dei Paschi di Siena SpA.
In this case, the notes issued by the vehicle were wholly underwritten by the originator, Banca Monte dei Paschi di Siena SpA, and the loans sold were not written off from the balance sheet.

10.3. Internal Measurement and Risk Control Systems

The trend of the transactions is steadily controlled through periodical (quarterly and monthly) reports of (i) the flows of collection of the residual capital, (ii) default payments and (iii) bad loans positions ((ii) and (iii) in the case of performing securitizations).

10.4. Organization Structure and Reporting System to the Top Management

The Montepaschi Group set up a specific unit in the Credit Policies and Control Area of the Parent Company, with the task of coordinating performing securitizations. The follow up of non-performing securitizations is ensured by a specific unit within MPS Gestione Crediti Spa (a subsidiary of BMPS).
A specific Group Directive also provides for a six-monthly report to the Top Management covering the trend of the transactions implemented by the Banking Group.

The above-mentioned companies are securitization vehicles with the Group playing the role of originator. As of today, the Montepaschi Group was the sponsor of no securitization.

The Finance Area participates in securitization operations, only in relation to third party securitizations, playing the role of investor. Investment operations in these instruments are attributable to the diversification of the risk profile of the portfolio under management and to the optimization of the risk/return objective.

Rating agencies for securitizations

Type*	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)	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 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)	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)	Internal operation- Not Rated
ULISSE 2 SPA (MPS GCBANCA)	Fitch Rating Ltd Moody's Investors Service Ltd
ULISSE 4 (BP SPOLETO)	Moody's Investors Service Ltd

* The originator company is indicated in brackets.

As of 31.12.2008
In thousands of euro

Table 10.1 – Exposures underlying securitized assets

Type of asset/ Vehicle company	Net exposure	impaired exposure	Losses for the period
Non-performing loans			
ULISSE II (MPSGCB)			
ULISSE 4 (MPSCGB)			
SIENA MORTGAGES 00 1 (MPSGCB)			
Total non-performing loans	**884,797.71**	**884,797.71**	**- 19,530.50**
Mortgage loans			
SIENA MORTGAGES 03 4 (GMPS)*			
SIENA MORTGAGES 02 3 (GMPS)			
MANTEGNA FINANCE (BAM)*			
MANTEGNA FINANCE II (BAM)			
GIOTTO FINANCE (BAV)			
GIOTTO FINANCE II (BAV)			
SIENA MORTGAGES 07 5 (BMPS)			
SIENA MORTGAGES 07 5 BIS (BMPS)			
SPOLETO 03 4 (BANCA POP SPOLETO)			
Total Mortgage loans	**9,698,624.00**		
Bonds and credit derivatives			
VINTAGE CAPITAL (BMPS)*			
GONZAGA FINANCE (BAM)			
Total Bonds and credit derivatives	**176,267.00**		
Other performing loans			
MPS ASSET SECURITIZATION (GMPS)			
Total other performing loans	**548,490.13**		
Total	**11,308,178.84**		

*The capital requirements for credit risk are calculated in relation to the exposure with respect to the securitization. The requirement in relation to the remaining transactions the is calculated on the basis of securitised exposures.

As of 31.12.2008
In thousands of euro

Table 10.2 – Type of exposure by weighting category

Roles / Underlying assets	Weighting						Total
	20%	50%	100%	350%	1250%	1250% - no Rating	
Own securitizations							
Residential mortgage loans					7,040	10,153	17,193
Total Own securitizations					**7,040**	**10,153**	**17,193**
Third party securitizations							
Bonds		1,340	3,758				5,097
Non-performing loans		51,004					51,004
Residential mortgage loans	18,531	1,272	3,294				23,097
Loans	25,879	5,360	7,159	6,222			44,621
Commercial mortgage loans	17,538	2,218	996	1,676			22,428
Consumer Loans			486	1,373			1,858
Leasing	5,545						5,545
Re-securitization	50,000						50,000
Total Third party securitiz.	**117,493**	**61,193**	**15,693**	**9,271**			**203,649**
Total	**117,493**	**61,193**	**15,693**	**9,271**	**7,040**	**10,153**	**220,842**

The table shows the exposures with respect to the securitizations by weighting category and type of transaction. The amounts indicated, in line with the regulatory requirements, are in relation to the exposures with respect to own and third party securitizations included in the banking portfolio. Therefore, the exposures with respect to the securitizations included in the regulatory portfolio for trading purposes are not included in the table. Furthermore, as far as own securitizations are concerned, according to the regulatory regulations, the exposures with respect to securitizations which a) are in relation to operations not recognised as securitizations - according to the prudential regulations – e.g. since credit risk is not actually transferred or b) because the risk-weighted value of all positions with respect to one securitization is higher than the weighted value of the securitised assets, calculated as if they had not been securitised (cap test).

The capital requirements of both a) and b) are calculated with reference to the securitised assets and not to the corresponding exposures with respect to the securitizations. Moreover, in these cases the securitised assets are classified under the regulatory classes of origin (exposures secured by real estate etc.) and are therefore excluded from the "securitizations" class. With reference to "Third party securitizations", the growth with respect to June 2008 is mainly attributable to the accounting reclassification of some positions under L&R, previously included in trading operations and not in new investments.

12. Operational Risk

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 the valuation of the risk exposure and the effects of mitigation by business area. The Montepaschi Group was authorised by the Bank of Italy on 12 June 2008 to use the advanced internal model (AMA) for the calculation of capital requirements for operational risks. The advanced model officially started operating on 1 January 2008. The first consolidated regulatory report on the basis of the model was prepared in relation to the results as of 30 June 2008.

The Bank of Italy granted the authorization after checking compliance with the requirements indicated by Circular 263. The controls involved all the aspects of risk measurement, management and mitigation, with the participation of the Top Management of the Group.

All the domestic banking and financial components are incorporated in the advanced approach area (AMA). Pending the developments of the Business Plan, the base methods were adopted for the foreign companies.

During the year of 2008, the Montepaschi Group purchased Cassa di Risparmio di Biella e Vercelli (Biverbanca) and Banca Antonveneta. The addition of these two banks to the Montepaschi Group gave the opportunity of extending the application of the same AMA model to them, according to a roll-out plan. During this first step, the capital requirements for operational risk of the two banks were calculated in accordance with the base method and the standardised method, respectively.

The advanced approach adopted by the Montepaschi Group is designed so as to homogeneously combine all the main qualitative and quantitative information sources (information or data) (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 (DIPO). The model includes the calculation in relation to the 7 categories of events established by Basle 2 used as risk class, with the adoption of Extreme Value Theory techniques. The estimated frequency of occurrence is based only on internal data.

The qualitative component is focused on the valuation of the risk profile of each unit and is based on the identification of the relevant scenarios. The Companies are involved during the step of identification of the processes and risks to be evaluated, the valuation of the risk processes by the officers in charge, the identification of the possible mitigation plans, the sharing of common scenarios of the priority and technical-economic feasibility of mitigation actions with the Head Office.

The AMA model, which has been in parallel running for two years prior approval, ensured a more conscious management of operational risk and a gradual reduction of risk within the Group.
The extension of the advanced model to the new entities is considered necessary, especially at this stage, for a close monitoring of all the operational risk components resulting from the sensitive processes of integration and re-organization which involved the Group in 2008-2009.
The Montepaschi Group adopts operational risk transfer techniques by insurance coverage. The Montepaschi Group has currently decided, in a conservative logic, not to use these insurance policies for the purpose of reducing the capital requirements.
However, in future the Group intends to assess the use of transfer techniques of operational risk, which are properly supported by documentary evidence and in line with the provisions of Circular 263, for the purpose of reducing capital requirements.

13. Equities exposure: Information on the Positions included in the Banking Portfolio

The equity investments in the portfolio are held for strategic purposes (group investments, affiliated companies and industrial joint ventures), institutional purposes (investments in industry associations, local entities and institutions), as operational instruments for the bank's business and the development of commercial business, for financial investment purposes (limited to the investments associated with the merchant banking business of MPS Capital Services). There are also other investments, which are no longer considered as strategic and are being sold, as well as investments in companies into liquidation.
The methods of fair value valuation of the investments are established on a case by case basis according to 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. i.e. recent transactions, market multiples, valuation methods based on the updating of expected cash flows (Discounted Cash Flow), 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.

13.1. Available-for-sale financial assets

Recognition criteria
Financial assets are initially posted as of the date of settlement in the case of bonds or equities and as of the date of disbursement in the case of loans.
Upon the initial recognition the assets are recorded at their fair value which normally corresponds to the amount paid including costs or transaction income directly attributable to the instruments. If the assets are posted following a re-classification from assets held upon maturity, the value posted is represented by the fair value as of the transfer. In the case of bonds, any difference between the initial value and the value of repayment is spread over the life of the bond with the amortized cost method.

Classification criteria
This category includes non-derivative financial assets which are not classified as loans, financial assets at the fair value posted to the profit and loss statement or financial assets held upon maturity.

In particular, this item incorporates equity investments (also strategic investments), which are not managed for trading purposes and not qualified for control, connection and joint control and bonds not subject to trading.
These investments can be subject to sale for any reason, such as liquidity reasons or changes in interest rates, foreign exchange rates or equities prices.

Valuation criteria
After the initial measurement, available-for-sale assets are still valued at the fair value, by (i) posting the portion of interest, as resulting from the application of the amortized cost and the related foreign exchange effect, to the profit and loss statement and (ii) posting the profits/losses resulting from the fair value change to a specific net equity reserve, net of the associated tax effect, except for the losses due to value reduction.
The foreign exchange variations in relation to equities are posted to the specific net equity reserve. The equities with a fair value which cannot be determined in a reliable manner are maintained at cost, which is adjusted in the case of ascertained losses due to value reduction.
Any existing objective evidences of value reduction are checked at the closing of the financial statements or as of the date of the interim reports. Following are the indicators of a possible reduction of value: e.g. significant financial difficulties of the issuer, defaults or non-payments of capital or interest, any bankruptcy statement by the beneficiary or other bankruptcy proceedings with respect to the beneficiary, the termination of an active market.
In addition, a significant or extended decrease in the fair value of equities below their cost is considered as an objective evidence of loss of value. In particular, with reference to the equities listed in active markets, any existing market price as of the date of the financial statements which is lower than the original purchase cost by at least 30% or any existing market value lower than the cost for more than 12 months is considered as an objective evidence of loss of value. Should additional decreases occur in the following financial years, they shall be posted to the profit and loss statement directly. Any write-down amount measured as a result of an impairment test is posted to the profit and loss statement as a loss for the financial year. Should the reasons for the loss of value be removed as a result of an event occurred after the measurement of the reduction of value, write-backs are made in net equity in relation to equities and in the profit and loss statement in the case of bonds.

Derecognition criteria
Financial assets are written off when the contractual rights on the financial flows resulting from the assets expire or when the financial assets are sold with the transfer of all the

relevant risks and benefits. Securities received under a transaction contractually contemplating an agreement to sell and securities delivered under a transaction contractually contemplating an agreement to repurchase are not posted to or written off from the balance-sheet, respectively. Accordingly, in the case of securities purchased under an agreement to resell the amount paid is posted to the balance sheet as due from customers or due from banks. In the case of securities sold under agreement to repurchase, the liabilities are recorded under due to banks, or due to customers or other liabilities.

Profit and Loss recognition criteria

Upon the disposal, the exchange with other financial instruments or in view of a loss of value following an impairment test, the results of the valuations included in the reserve in relation to available-for-sale assets are posted again to the profit and loss statement:

- under account "100 – Profit (Loss) from the purchase/sale of: b) "financial assets available for sale", in the case of a disposal;
- under account "130 – Net value adjustments/recoveries on impairment of b) "financial assets available for sale", in the case of a loss of value.

Write-backs are made if the reasons for the loss of value are removed as a result of an event occurred after the measurement of the reduction of value.

Such write backs are posted to the profit and loss statement in case of loans or bonds, and to net equity in the case of equities.

13.2. Equity investments

Recognition criteria

The item includes the equity investments:

- Subject to considerable influence, valued with the net equity method;
- Any investments held in subsidiaries where consolidation from the capital and profitability viewpoints has not been considered significant with respect to the consolidated financial statements;
- The item does not include the net equity valuation of jointly-controlled subsidiaries as they are consolidated with the proportional method.

Classification criteria

For the purpose of classification under this item, the companies where the Group holds 20% or a higher share of the voting rights and the companies which should be considered as subject to considerable influence due to specific legal connections (i.e. participation in shareholders' pacts) are considered as associated companies. These classifications do not

take account of the company's legal status and the potential voting rights which can currently be exercised are also considered in the calculation of the voting rights.
This item includes the subsidiaries, where consolidation from the capital and profitability viewpoints is not significant with respect to the consolidated financial statements and where the Group has the power of deciding the financial and operating policies for the purpose of obtaining benefits from their business.
This occurs when the Group directly and/or indirectly more than the half of the voting rights or in view of other de facto controlling conditions such as the appointment of the majority of the directors.
The companies with ruling contractual agreements, shareholders' pacts or other contracts for the joint management of business and the appointment of the directors are considered as jointly-controlled companies.

Principles of income valuation and measurement

In consideration of the above, this item basically includes the valuation of equity investments with the net equity method. The net equity method provides for the initial posting of the investment at cost and its subsequent adjustment on the basis of the share in the net equity of the investment itself.
The profits and losses from the investment are recorded on a pro-quota basis under account "240 – Profits (Losses) from equity investments" in the consolidated profit and loss statement.

Derecognition criteria

Equity investments are written off when the contractual rights to the financial flows resulting from the assets expire or when the equity investment is sold, with the transfer of all the risks and benefits associated with the asset.

Dati al 31.12.2008
Valori in migliaia di euro

Tabella 13.1 - Esposizioni in Strumenti di Capitale - Portafoglio Bancario

	Valore di Bilancio	Fair Value	Market Value	Esposizione	Utili/perdite realizzati nel periodo	Plusvalenze/minusvalenze sospese a patrimonio netto	Plusvalenze/minusvalenze sospese a patrimonio netto: di cui computate nel patrimonio di base/supplementare
Titoli disponibili per la vendita	**374.361**	**374.361**		**374.361**	**65.119**	**- 66.335**	**- 66.335**
di cui quotati	87.701	87.701	87.701	87.701	10.393	- 21.951	- 21.951
di cui non quotati	286.661	286.661		286.661	54.726	- 44.384	- 44.384
Partecipazioni	**98.216**			**79.377**	**183.377**	**-**	**-**
di cui quotati						-	-
di cui non quotati	98.216			79.377	183.377	-	-
Totale	**472.577**	**374.361**		**453.738**	**248.496**	**- 66.335**	**- 66.335**
di cui quotati	87.701	87.701	87.701	87.701	10.393	- 21.951	- 21.951
di cui non quotati	384.876	286.661		366.037	238.103	- 44.384	- 44.384

Nella tabella sono evidenziate le partecipazioni del portafoglio bancario, non dedotte dal patrimonio di vigilanza, per portafoglio contabile di riferimento.
L'"Esposizione" viene determinata secondo le regole di vigilanza prudenziale; ad esempio per le partecipazioni di influenza notevole l'esposizione differisce dal "Valore di Bilancio" per l'avviamento implicito.
Le "Plusvalenze/minusvalenze sospese a patrimonio netto: di cui computate nel patrimonio di base/supplementare" sono imputate a rettifica negativa del Patrimonio di Base.

14. Interest rate risk on the positions included in the Banking Book

In accordance with international best practice, the Banking Book identifies the whole of the Bank's commercial operations associated with the transformation of the assets and liabilities of the balance sheet, the Treasury, the overseas branches and hedging derivatives of reference. The Banking Book area (in line with the banking book for regulatory purposes) and the centralization process of the ALM are defined in the Board of Directors' resolution of the Parent Company covering the "Centralization of the Asset and Liability Management and operational limits with respect to the interest rate and liquidity risks of the Group's Banking Book" approved by the Parent Company's Board of Directors in September 2007.

The risk profile is measured and monitored at a centralized level by the Risk Management Area of the Parent Company on a monthly basis. The operational startegies of the Banking Book, adopted by the Finance and Liquidity Committee and monitored by the Risk Committee of the Parent Company, are based on the measurement of interest rate risk in a logic of "total return" and are oriented to minimizing the volatility of the expected interest margin in the current financial year (12 months) or minimizing the volatility of the overall economic value when the interest rate structure changes.
The changes in interest margin at risk and the variation of the economic value of the assets and liabilities of the Banking Book are analyzed by applying deterministic shifts of 25 bp, 100 bp and 200 bp. The 200 bp shift is applied pursuant to the provisions of the "second pillar" of Basle 2 , expressed as a percentage of Tier 1 capital and the consolidated capital for regulatory purposes.
The risk measurements of the commercial banks of the MPS Group are calculated by using a valuation model of sight items or "core deposits", with characteristics of stability and partial insensitivity to the changes of the interest rates being outlined in the systems with a statistical/predictive model (replicating portfolio) which takes account of a significant historical series of past customers' behaviours.
The duration of sight assets, where the "replicating portfolio" is modelled, and liabilities is currently about one and a half months and about eight and a half months, respectively, at the Parent Bank.
In addition, in the last quarter of 2008, the MPS Group introduced a behaviour model which takes account of the prepayment of mortgage loans (the so-called prepayment risk) in the measurements of interest rate risk. The prepayment rate of loans and in particular of residential mortgage loans became potentially more instable due to a string of concurrent factors such as the higher volatility of the interest rate curve attributable to the recent crisis.

The MPS Group sensitivity at the end of 2008 showed a risk exposure profile with respect to increasing interest rates. The amount of the economic value at risk is in any case fully consistent with the amount of Tier 1 capital and the Capital for regulatory purposes, and well below the level considered as a critical threshold (20% in the case of an interest rate shock of 200 bp) according to the New Accord on Capital (Basle 2)

As of 31.12.2008

Table 14.1 – Risk indices by shift

Shift (+/-)	Effect on interest margin	Effect on the Capital for regulatory purposes
Eur +200bp	1.18%	8.37%
Usd +200bp	0.07%	0.06%
Other +200bp	0.27%	0.09%
Total +200 bp	**0.84%**	**8.52%**
Eur -200bp	1.08%	12.77%
Usd -200bp	0.07%	0.06%
Other -200bp	0.27%	0.10%
Total -200 bp	**0.74%**	**12.94%**

Ratios expressed as absolute values. The values are in relation to the sensitivity of the interest margin with respect to the final interest margin and the sensitivity of the economic value with respect to the capital for regulatory purposes.

Statement of the Officer in charge of preparing corporate accounting documents

The Officer in charge of preparing corporate accounting documents, Daniele Pirondini, declares that, pursuant to paragraph 2 of article 154 bis of the Act on Financial Intermediation, the accounting information contained in this document match the records, books and accounting entries.

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