

GRUPPO SANPAOLO IMI

THE TRANSITION TO IFRS/IAS IN 2005

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Milan-London 19-20th October 2004

- **The regulatory framework**
 - Principal changing to financial reporting
 - IAS transition rules
 - Application of IAS to Sanpaolo IMI Group
 - Conclusions

EU SCENARIO

- **The EU has adopted 32 IAS and IFRS 1 (*First Time Adoption*). Further improvements to these IAS, as well as IFRS from 2 to 5, are expected to be endorsed without any particular problem by the end of October.**
- **During the ARC (*) meeting, held on the 1st of October, a new version of IAS 39 was agreed with two major amendments to the original text. The compromise takes into consideration the FBE (Fédération Bancaire Européenne) concerns on one hand and on the other concerns raised by the ECB and domestic banking authorities. The vote was passed by a majority with Denmark, Sweden, Hungary and the Czech Republic voting against and the UK, Ireland and Malta abstaining.**

(*) The Accounting Regulatory Committee has a regulatory function and provides opinions on Commission proposals to endorse IAS. It is chaired by a representative of the European Commission and is composed of technical representatives from EU member states.

EU SCENARIO

IAS 39 Carved out

From an operating point of view IAS 39 Carved out:

- does not authorize the Fair Value option for financial liabilities;
- enables, on an optional basis, to apply macro hedge accounting to core deposits for which maturity and interest rate profiles have been set by internal models;

After these amendments IAS 32 and IAS 39 should now be endorsed in a short time

DOMESTIC SCENARIO

- The Parliament has delegated the Government to broaden extensively the scope for the application of IAS, in order to include separate and consolidated financial statements of “listed” and “unlisted” companies (except for the financial statements of small entities and the separate financial statements of insurance companies).
- In the absence of coordination between civil-code and tax provisions with IAS rules, the new standards will not be applied to separate financial statements. Thus, it seems that IAS will be applied only to the consolidated financial statements of listed companies (as per EU Regulation) and to consolidated financial statements of unlisted Banks and Insurance firms, at national level.

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PRINCIPAL CHANGES TO FINANCIAL REPORTING

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Fair-value-oriented accounting principles

Mandatory	<p>Fair value accounting for a broad range of financial instruments:</p> <ul style="list-style-type: none"> ▪ derivatives (included in the trading book, with hedging relationship or embedded in complex financial instruments) ▪ hedged financial instruments (complying with IAS hedging requirements); ▪ Shareholdings (representing strategic investments other than affiliates); ▪ securities not recorded as held to maturity (included in the trading or available for sale book);
Optional	Fair value accounting for all investment property
Mandatory	Use of actuarial valuation methods for personnel liabilities (pension plans, employee severance fund, other long-term commitments)
Mandatory	First time recognition at fair value of any asset and/or liability, particularly in case of company acquisitions (business combination), regardless of the legal form utilized
Mandatory	Recognition at fair value of intangible assets (purchased from third parties). Indefinite-life intangible assets will no longer be amortized on a straight-line basis but will be tested for impairment

Implication of IAS accounting on Regulatory Capital

Accounting records represent the basis for calculating Regulatory capital and capital adequacy ratios:

- **The new rules introduced by IAS affect greatly the amount, the quality and volatility of bank's capital;**
- **Regulators aim not to amend substantially the present definition of Regulatory Capital;**
- **Prudential filters are currently being studied to offset the IAS impact of changes to shareholder's equity**
- **Some guidelines have already been set and disclosed in the Basel committee press releases of 8 June and 20 July.**

PRINCIPAL CHANGES TO FINANCIAL REPORTING

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Implication of IAS accounting on Regulatory Capital

Disclosed guidelines

To be posted to Regulatory Capital:

fair value related to the trading portfolio as per IAS definition.

To be taken out or deducted from Regulatory Capital:

- intangible assets both with a definite or indefinite life (brands, royalties, customer list, goodwill);
- profit and loss booked in the Cash Flow Hedge equity reserve;
- changes in own rating as result of IAS 39 carved;
- equity component of bifurcated financial liability.

Capital related filters currently being considered for:

Unrealized gains and losses related to:

- financial instruments included in the Available For Sale portfolio;
- fixed assets measured at Fair Value;
- loans given and received under Fair Value Hedge accounting;
- financial assets under Fair Value option.

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- A specific standard (IFRS 1) sets out the rules on “first time adoption”, in terms of both contents and comparability criteria.
- From an operating point of view, accounting balances under Italian GAAP are restated under IAS as at transition date. All the adjustments will be recognized directly in equity.
- The general transition rule provide that accounting balances need to be restated as if IAS had always been applied (retrospective application), with some specific exceptions.



Main exceptions to retrospective application:

- Business combinations: transactions occurred prior to 1.1.2004 may continue to reflect the carrying amount recognized under *local GAAP*.
- Investment property: recognition at market value as of 1.1.2004 is allowed.

FIRST TIME ADOPTION: APPLICATION OF IAS TO SANPAOLO IMI GROUP




Possible impacts of *First Time Adoption* (assuming prudential capital filters adopted)

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	Equity	Tier 1	Tier 2	P/L	Impact summary	Probable impact on SANPAOLO IMI
NPV Problem Loans	↓	↓	=	↑	A	
Reopening of Business Combination under the purchase method:						
▪ purchase Price Allocation (other than intangibles)	↑	=	↑	↓	B	
▪ goodwill and other intangibles	↑	=	=	=	D	
Fixed asset revaluation (at amortized cost)	↑	=	↑	↓	B	
De-recognition of provisions (also for NPV calculation)	↑	↑	=	↓	B	
Fair value related to the classification as available for sale (AFS)* of securities other than held to maturity (HTM)	↑	=	↑	=	D	
Fair value related to the classification as AFS of HTM securities	↑↓	↓	↑	=	C/D	
Equity shares representing strategic investments at AFS	↑↓	↓	↑	=	C/D	
Cash flow hedge accounting	↑↓	=	=	=	C/D	
Fair value hedge accounting	=	=	=	=	-	
Loan portfolio securitization as per L. 130/99	=	=	=	↑	-	N.A.

* Only if stated at the lower of cost and market value

- A. Assets' devaluation with decrease in net equity and positive effects on future earnings;
- B. Assets' revaluation with increase or decrease in net equity and negative effects on future earnings;
- C. Assets' devaluation with decrease in net equity but without (positive) effects on future earnings;
- D. Assets' revaluation with increase in net equity but without (negative) effects on future earnings.

Legend:		Low impact
		Significant negative impact
		Significant positive impact

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Up to now it has not been possible to give reliable indications about future impacts for the following reasons:

- Only in the first week of October were important IAS rules defined (IAS 39) and interpretation studies on accounting principles application are still ongoing both at Italian banking association level (ABI) and internally;
- Important accounting issues, which will influence IAS optional choices (e.g. goodwill and other intangibles, unrealized gains on fixed assets and AFS reserve) and necessary to calculate Regulatory Capital, are not yet officially disclosed;
- Consob is still to set rules/guidelines for publication of financial statements prior to 2005

Key dates:

- October 19-20th 2004, IFRS seminars in Milan and London
- February 2005, disclosure of 2004 results under Italian Gaap
- May 2005, Q1 2005 results probably (*) under Italian Gaap, with some details according to IAS principles
- September 2005 or April 2006, first complete report under IAS/IFRS (*)

(*) subject to Consob decision

APPLICATION OF IAS TO SANPAOLO IMI GROUP

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Sanpaolo IMI assumed reporting framework: BALANCE SHEET

<i>Assets</i>	2005	2004	<i>Liabilities</i>	2005	2004
Cash and deposits at central banks	IAS	It G			
Loans to banks	IAS	It G	Payables due to banks	IAS	It G
Loans to customers:	IAS	It G	Payables due to customers	IAS	It G
a) sight	IAS	It G	a) sight	IAS	It G
b) others	IAS	It G	b) others	IAS	It G
Financial assets for sale	IAS	It G	Payables on securities issued	IAS	It G
Value variation of assets subject to macrohedging (+/-)	IAS	It G	Value variation of liabilities subject to macrohedging (+/-)	IAS	It G
Positive value of hedging derivatives	IAS	It G	Negative value of hedging derivatives	IAS	It G
Financial assets held to maturity	IAS	It G			
Stakeholdings	IAS	It G			
Financial trading assets	IAS	It G	Financial trading liabilities	IAS	It G
Investments benefitting insured customers of risk-bearing life business deriving from pension fund management	IAS	It G			
Financial assets marked at "fair value"	IAS	It G	Financial liabilities marked at "fair value"	IAS	It G
Fixed assets	IAS	IAS	Committed funds	IAS	IAS
Goodwill	IAS	IAS	Fiscal liabilities	IAS	IAS
Other intangible assets	IAS	IAS	a) current	IAS	IAS
Technical reserves charged to re-insurers	IAS	IAS	b) deferred	IAS	IAS
Fiscal assets	IAS	IAS	Technical reserves	IAS	IAS
a) current	IAS	IAS	Technical reserves where the risk is borne by the insured customers and reserves deriving from pension funds management	IAS	IAS
b) deferred	IAS	IAS			
Other ASSETS	IAS	IAS	Other liabilities	IAS	It G
			Total Liabilities	IAS	IAS
			Net equity and minority interest	IAS	IAS
			Reserves from evaluation	IAS	It G
			Additional paid in capital at the time of sub	IAS	It G
			Reserves	IAS	It G
			Other net equity instruments	IAS	It G
			Share capital	IAS	It G
			Income for the period	IAS	It G
			Minority interests	IAS	It G
Total assets	IAS	---	Total Liabilities	IAS	---

APPLICATION OF IAS TO SANPAOLO IMI GROUP

Sanpaolo IMI assumed reporting framework: P&L

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	2005	2004	<i>continues</i>	2005	2004
Interest income	IAS	It G	Net administrative costs	IAS	IAS
Interest expense	IAS	It G	a) personnel	IAS	IAS
			b) other administrative costs	IAS	IAS
Net interest income	IAS	It G	Adjustments to tangible and intangible fixed assets	IAS	IAS
Commission income	IAS	It G			
Commission expense	IAS	It G	Operating costs	IAS	IAS
Net commissions	IAS	It G	Adjustments to goodwill	IAS	IAS
			Net provisions to committed funds	IAS	IAS
Dividends	IAS	It G			
Income from trading	IAS	It G	Operating income	IAS	IAS
Income from hedging	IAS	It G			
Income from the disposal of non financial trading assets	IAS	It G	Profits (losses) from investments	IAS	---
Premia for the period net of disposals in re-insurance	IAS	It G	Income before taxes	IAS	IAS
Charges for claims net of disposals in re-insurance	IAS	It G	Income taxes for the period	IAS	IAS
Net interest and other banking income	IAS	---	Profit (loss) for the period	IAS	IAS
			Income attributable to minority interests	IAS	IAS
Net variation in the value of those financial assets marked at "fair value"	IAS	It G	Net income	IAS	IAS
Net variation in the value of those financial liabilities marked at "fair value"	IAS	It G			
Net variation in the value of shareholdings	IAS	It G			
Net provisions for deterioration of other financial assets	IAS	It G			
Other net revenues	IAS	It G			
Profits (losses) from companies carried at equity	IAS	It G			
Income from financial management and services	IAS	It G			

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IAS	Area	Notes	Mandatory	Already compliant	Probable impact on Sanpaolo IMI P&L
27	Scope of consolidation	Insurance subsidiaries consolidated line-by-line	YES	NO	
		Consolidation line-by-line of SPE, VIE, Variable Interest Entity	YES	NO	
22	Business combination	End of goodwill amortization	YES	NO	
40	Fixed asset (building and land)	Cost or fair value	NO (option)	YES (cost)	
39	Securities other than HTM: classified in Trading portfolio	Fair value through P & L	YES	YES	
39	Securities other than HTM: classified in F.V.O. portfolio	Fair value through P & L	YES	YES (substantially)	
39	Securities other than HTM: classified in AFS portfolio	Fair value through Equity	YES	NO	

Legend:

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IAS	Area	Notes	Mandatory	Already compliant	Probable impact on SANPAOLO IMI P&L
39	Securities HTM: classified in HTM portfolio	Amortizing Cost	YES	YES	
39	Securities HTM: classified in AFS portfolio	Fair value through Equity	YES	NO	
39	Securities HTM: classified in F.V.O. portfolio	Fair value through P & L	YES	NO	
39	Loans classified in L&R portfolio	Amortizing Cost	YES	YES (substantially)	
39	Derivatives and hedge	Fair value	YES	NO	
39	Equity investments classified in AFS	Fair value through Equity	YES	NO	
37	Provisions	Actuarial calculation	YES	NO	
39	Fees and commissions	Amortizing cost	YES	YES (substantially)	
12	Taxes		YES	YES	

Legend:

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SANPAOLO IMI IAS GROUP PROJECT

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<i>Start</i>	December 2002
<i>Objective</i>	To plan and manage the Group's successful transition to IFRS
<i>Organization</i>	Project participants include: Steering Committee, Project Representatives from main Subsidiaries; Project Manager, Program Manager, Lead Group and working Groups. These are responsible for providing suitable decision-making levels and technical skills to carry out the activities. Around 120 specialists (90 from the Parent and 30 from the subsidiaries) have been involved with the working Groups.
<i>Activities</i>	<p>A three-stage procedure has been adopted:</p> <ul style="list-style-type: none"> ▪ <u>inquiry process</u>: includes mainly analytical activities (accounting, operations and management). The Parent Company is responsible for the implementation, in cooperation with the subsidiaries and the professional assistance of PricewaterhouseCoopers; ▪ <u>implementation process</u>: includes the most important organizational and IT-related activities of the project. Implementation is centralized by the MOI (IT dept.) for the commercial bank and it is decentralized for the other Group companies; ▪ <u>guidance activity</u>: designed by the Parent Company to provide guidance for the decentralized implementation effort.
<i>Completion status</i>	Implementation activities under way
<i>Costs</i>	Total additional external expenses are estimated at 21 million €

- **The IFRS are now mainly agreed although there remain outstanding issues, particularly as regards application to regulatory capital and reporting timetable**
- **Against this background the Group IAS project has ensured and will ensure that Sanpaolo IMI is well prepared for the IFRS transition**
- **The adoption of the new reporting standards will not change either group strategy or business practices**