THE ITALIAN BANKING INDUSTRY:
KEY FIGURES, TRENDS, STATE OF HEALTH

June 2013
Agenda

1. The Italian banking industry at a glance
2. Macroeconomic scenario & country strenghts
3. Italian banks: characteristics and strengths
4. Hot issues:
   - Lending
   - Asset quality
   - Profitability
   - Capitalization
   - Funding and liquidity
   - Rules & supervision practices
5. Key final remarks
The Italian banking industry at a glance* (1/2)

- **1,031** ABI’s members
- **159** independent banks and banking groups listed
- **24** independent banks and banking groups
- **320,000** employees
- **35 million** current accounts
- **17.3 million** current accounts online
- **79.7 million** payment cards
- **36 million** credit cards
- **33.3 million** debit cards
- **33,500** branches
- **2 million** customers at branches daily
- **47,000** ATMs
- **4 million** customers at ATMs daily
- **3.500 billion €** total banks’ assets
- **225%** total banks’ assets/GDP

* 2011 figures
The Italian banking industry at a glance* (1/2)

- **2.200 billion €** of total funding (deposits, bonds)
- **1.971 billion €** of total loans to the economy
- **995 billion €** of total loans to enterprises
- **..of which 52%** granted to SMEs (%)
- **+3,6%** annual loans growth rate in Italy
- **+1,3%** annual loans growth rate in the Euro Area
- **+3,1%** annual corporate loans growth rate in Italy
- **+1,1%** annual corporate loans growth rate in the Euro Area
- **+4,3%** annual households loans growth rate in Italy
- **+1,5%** annual households loans growth rate in the Euro Area
- **0 €** of State aid to the banking sector during the crisis
- **15 billion €** of additional liquidity to 260,000 SMEs thanks to the “Avviso Comune”
- **7.200 €** of additional liquidity to 55,000 households thanks to the “Household plan”

* 2011 figures
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Macroeconomic scenario: Key remarks (1/2)

- **Public finances have substantially improved** - General government net borrowing decreased in 2012 for the third consecutive year, falling to 3.0% of GDP and thus foreshadowing the closure of the excessive deficit procedure opened against Italy in 2009. According to the Government's recent estimates, which factor in the effect (estimated at 0.5 percentage points) of the payment of part of general government bodies' commercial debts to firms, net borrowing will amount to 2.9% of GDP this year. Net of interest expenditure, there was a budget surplus of 2.5% of GDP in 2012. The further increase in the **primary surplus expected for 2014 will permit the stabilization of the ratio of debt to GDP even if the latter's growth is modest**

- **Growth is the priority of Italy's new government.** There are several structural factors which explain the Italian limited economic growth: **fixing the productivity problem is a critical one**

- Although the low economic growth, Italy has what it takes to be a strong and committed member of the EU and to be part of a global solution:

  a) **good deficit control** (we will achieve a structural adjusted balance budget in 2013 and the primary surplus is about 3% of GDP 2012) that will lead to a decline of debt ratios, once the economy stabilizes;

  b) **low leverage in the private sector**;

  c) **high households’ net wealth** to disposable income ratio;
Macroeconomic scenario: Key remarks (1/2)

d) a **strong industrial sector** with positive export performance and a positive transformation under way;

e) a **solid banking system**

- Italian banks' **capital structure remains solid and is sufficient to withstand the poor cyclical conditions**, as the IMF's Financial Sector Assessment Program recently confirmed

- Thanks to their resiliency, Italian banks can play a leading role in supporting the country's economic recovery

- **Italian banks distinctive features**, which reflect the adoption of the traditional commercial banking model, **have helped to withstand the crisis** while ensuring maximum protection for savers

- **Italian banks** can rely on a number of strengths that, even in the current difficulties, make them **stronger than many major European competitors** (January 2013 OECD Economic Outlook estimates that if the euro area’s banks were to move to a 5% capital/assets ratio standard - identified as a benchmark for well-capitalised banks by OECD, even if it is more demanding than the minimum Basel III leverage ratio that will apply from 2018-, Italian banks show a capital shortage of only 0.15% of GDP to be compared with a EA average of 4.2% of GDP
Italy weaknesses are well known ...

- Poor GDP growth
- High public debt
- An inefficient judicial system
- A burdensome bureaucracy

- Small size of firms
- Loss of competitiveness since the introduction of the EURO
- High cost of funding for the economy (public & private sectors)
...while Italian strengths are often overlooked

Where does Italy differ from its peers?

1. Public finances under control (deficit/GDP<3% high primary surplus)
2. A very healthy private sector
3. High financial wealth
4. Quality of economic growth (no bubbles)
5. Strong defense of export market share
6. A solid banking system (IMF assessment)
1. Public finances under control

- **A long experience of high debt management**

- **Low deficit:** deficit consistently below 3% of GDP, in line with the level needed to achieve the structural fiscal balance (structural deficit in balance from 2013)

- **High primary surplus**, steadily growing

- **Debt / GDP ratio down from 2014**; in 2015 in line, to respect the 'rule of debt' of the Six Pack (taking into account the effects of the cycle and the expected evolution in the two subsequent years)

- **A sustainable pension system**

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### Public finance: Outcomes and Medium Term Objectives

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</thead>
<tbody>
<tr>
<td><strong>Real GDP growth</strong></td>
<td>+0.4%</td>
<td>-2.4%</td>
<td>-1.3%</td>
<td>+1.3%</td>
<td>+1.5%</td>
</tr>
<tr>
<td><strong>Nominal GDP growth</strong></td>
<td>+1.7%</td>
<td>-0.8%</td>
<td>+0.5%</td>
<td>+3.2%</td>
<td>+3.3%</td>
</tr>
<tr>
<td><strong>Deficit / GDP</strong></td>
<td>-3.8%</td>
<td>-3.0%</td>
<td>-2.9%</td>
<td>-1.8%</td>
<td>-1.5%</td>
</tr>
<tr>
<td><em><em>Structural Deficit</em> / GDP</em>*</td>
<td>-3.5%</td>
<td>-1.2%</td>
<td><strong>0.0%</strong></td>
<td>+0.4%</td>
<td>-0.0%</td>
</tr>
<tr>
<td><strong>Primary balance / GDP</strong></td>
<td>1.2%</td>
<td>2.5%</td>
<td>2.4%</td>
<td>3.8%</td>
<td>4.3%</td>
</tr>
<tr>
<td><strong>Public debt / GDP</strong></td>
<td>120.8%</td>
<td>127.0%</td>
<td><strong>130.4%</strong></td>
<td>129.0%</td>
<td>125.5%</td>
</tr>
</tbody>
</table>

(*) Updated policy framework, (2) under the assumption of the continuation of the real estate property taxation system established by Decree 201 of 2011; effect of payments of trade payables to firms included (0.5 pp), (3) net of one-off and cyclical components
1. Public finances: 2012
Eu countries comparison

- In 2012 only Germany registered a government surplus (+0.2%)  

- Italy is among the eleven Member States which had deficits lower than 3% of GDP, in line with the European request  

- PIGS countries positioned at the bottom of the rank  

- France stands at -4.8%, UK at -6.3%
2). Very healthy private sector

- A country of prudent savers

- Italian private debt on GDP ratio is among the lowest in Europe: non financial firms debt is 80% vs 100% EA average; households debt is 54% vs 66% EA average

- As a consequence the Italian aggregate debt is in line with the EA average (261% vs 257%)
3. High financial wealth

- A country characterized by a very high level of financial wealth:
  - High households financial asset as a % of disposable income (344% vs 316% EA)
  - High ratio of per capita net wealth to per capita GDP (UK= 4.1x; France=3.7x; Italy=3.7x; USA=2.9x; Germany=2.5x; Spain 1.8x)

Source: ABI on Bank of Italy data
4. Good quality of growth

- Economic growth, even if poor, is not “bubble driven”, as it has been in other European countries (such as Spain and Ireland) …

- … where the economic miracles ended with the burst of the housing bubble in 2007/2008
5. Strong defence of export market share

- Italy is Europe’s second-largest manufacturing and industrial country, after Germany (‘s)

- A country of excellence in different niches with a long history of industrial districts

- One of the biggest export-oriented economies in the euro zone (1° exporting country in a number of goods)

<table>
<thead>
<tr>
<th></th>
<th>1° exporting Country</th>
<th>2° exporting Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clothing and fashion</td>
<td>Italy</td>
<td>China</td>
</tr>
<tr>
<td>Leather goods &amp; footwear</td>
<td>Italy</td>
<td>China</td>
</tr>
<tr>
<td>Textile</td>
<td>Italy</td>
<td>Germany</td>
</tr>
<tr>
<td>Non-electronic mechanical</td>
<td>Germany</td>
<td>Italy</td>
</tr>
<tr>
<td>Basic manufactures</td>
<td>Germany</td>
<td>Italy</td>
</tr>
<tr>
<td>Electrical appliances</td>
<td>Germany</td>
<td>Italy</td>
</tr>
</tbody>
</table>

Export of goods % GDP; 2012

- Germany: 44.0%
- Italy: 24.9%
- France: 21.4%
- UK: 19.5%
- USA: 9.9%
6. A solid banking system

- A business model focused on loans intermediation and other retail services and very limited exposure to market risk

- This traditional banking approach has helped the banks in:
  
  - supporting domestic growth ...
  
  - ... while ensuring maximum protection for savers...
  
  - ... with very limited public aids throughout the crisis

- However the banking industry is now challenged by the economic crisis and by difficult operating conditions

"Banking assets on GDP" ratio in Europe %; January 2013

Source: Abi on ECB and Eurostat figures (GDP as at dec. 2012; Assets referred to Monetary Financial Institutions)
Addressing the Italian growth issue means fixing the productivity problem

Many factors contribute to the poor economic growth....

Source: Intesa Sanpaolo research
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5. Key final remarks
In Europe different banking business models coexist.

The financial crisis has not hit Italian banks, due to their traditional business model.

The crisis has mainly hit Italian banks through the real side of the economy (fall in demand for loans, increase in default rates...).

The economic recovery remains a key factor for the Italian banks’ profitability.

Where does Italy differ: 6) solid banking system
key positive factors for Italian banks (1/2)

1. Business mix: loans to private customers

<table>
<thead>
<tr>
<th>LOANS/ASSETS (aggregated data; 2012)</th>
<th>FINANCIAL ASSETS/ASSETS (aggregated data; 2012)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT 61% ES 57% UK 38% DE 28% FR 26%</td>
<td>IT 53% ES 51% UK 43% DE 25% FR 23%</td>
</tr>
</tbody>
</table>

2. Low level of financial/illiquid assets

<table>
<thead>
<tr>
<th>Level 3 financial instruments/TIER1 capital (aggregated data; 2010)</th>
</tr>
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<tbody>
<tr>
<td>DE 69,0%</td>
</tr>
</tbody>
</table>

3. Low level of financial leverage

<table>
<thead>
<tr>
<th>Assets/equity; aggregated data 2012</th>
</tr>
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<tbody>
<tr>
<td>DE 32</td>
</tr>
</tbody>
</table>

4. High percentage of retail funding

<table>
<thead>
<tr>
<th>Direct Funding*/Total Liabilities (largest 28 Eubanking groups; aggregated data; 2012)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ES 62%</td>
</tr>
</tbody>
</table>
5. Low banking exposure to GIPS countries (bln $)

Banks' foreign exposure (September 2012; bln $)

<table>
<thead>
<tr>
<th></th>
<th>Total foreign claims</th>
<th>European Banks</th>
<th>Italy</th>
<th>France</th>
<th>Germany</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>All countries</td>
<td>25,478</td>
<td>16,861</td>
<td>856</td>
<td>2,560</td>
<td>2,755</td>
<td>4,063</td>
</tr>
<tr>
<td>Greece</td>
<td>63</td>
<td>59</td>
<td>1</td>
<td>32</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Ireland</td>
<td>387</td>
<td>306</td>
<td>11</td>
<td>28</td>
<td>84</td>
<td>119</td>
</tr>
<tr>
<td>Portugal</td>
<td>147</td>
<td>140</td>
<td>2</td>
<td>17</td>
<td>23</td>
<td>18</td>
</tr>
<tr>
<td>Spain</td>
<td>519</td>
<td>443</td>
<td>22</td>
<td>103</td>
<td>123</td>
<td>78</td>
</tr>
<tr>
<td>Total 4 countries</td>
<td>1,115</td>
<td>948</td>
<td>35</td>
<td>180</td>
<td>236</td>
<td>220</td>
</tr>
</tbody>
</table>

6. Absence of State aids

State bailouts on banking sector % GDP (as June 2012)

Source: Ignazio Visco Speech (Bank of Italy Governor) - Assiom Forex 2013

7. High quality of capital: relatively small capital and business model impact from the new regulations

Preliminary evaluations on the major impacts of Basel 3 by country

<table>
<thead>
<tr>
<th></th>
<th>Quality of capital</th>
<th>Deductions</th>
<th>Counterparty risk</th>
<th>Leverage ratio</th>
<th>Liquidity Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

8. High stability of performance (low risk), though structurally linked to the domestic business cycle

Return on Equity for a sample of European Banking Group (aggregated figures; 2004 – 2010)

Perfoms stability over time ( implicit risk; standard dev. ROE; 2004 – 2010 Q4)

Key positive factors for Italian banks (2/2)
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Lending

Ø Loan dynamics is affected by low domestic economic development.

Ø A suitable comparison of the loans dynamics between European countries should be conducted taking into account the relation between loans and GDP evolution: in terms of loans per GDP unit variation Italian figures show a better performance than those of all other majors EU peers (Germany included).

Ø Moreover, even looking only at the loans annual growth rate, latest data shows that the resilience of credit facilities in Italy is higher than in countries subjected to similar stress.

Ø Bank loans’ slowdown to Italian residents in the last year was mainly due to two factors: 1) difficulties in the Italian banks’ ability to access the market; 2) a contraction in the quality and amount of the demand, especially by firms. The decrease in credit demand stems from a sharp contraction in business investment, while the demand for debt restructuring increases. Latest figures show some early signs of improvement in the quality of the demand.

Ø The easing of market tensions, driven by the decisive action taken by the Italian Government coupled by the steps taken at European level, is also likely to re-open the access to Italian banks to the international capital markets (see data on recent issues by Italian banks).
Loans dynamic is driven by the GDP trend in all the EU countries: in Italy more loans than elsewhere relative to the cycle

‘Credit per GDP unit’ trend
(Loans to GDP ratio; var % a/a)

Sources: ABI
Loans to non-financial corporations and main driver of credit demand in Italy*  
(March 2000=100)

GDP components, disposable income and bank loans in Italy  
(2008-2012; figures at constant prices, %)

(*) Fixed investments at nominal value  
Source: Istat, Bank of Italy, Intesa Sanpaolo

(*) Consumer households  
Source: Istat, Bank of Italy, Intesa Sanpaolo
Loans’ slowdown was mainly due to the reduced ability of the Italian banks to access the international capital market and to a contraction in the quality and amount of the demand.
The resilience of credit facilities in Italy is higher than in countries subjected to similar stress.

**LOANS TO PRIVATE CUSTOMERS**

**Loans to households in Europe**
(YoY growth rates; Jan 2010 – Mar 2013; %)

**Loans to non financial corporations in Europe**
(YoY growth rates; Jan 2010 – Mar 2013; %)

Sources: ABI on ECB
Bank endogenous and exogenous factors behind the credit standards tightening: comparing cycles

Factors contributing to tightening credit standards
(Endogenous and exogenous components)

Endogenous factors contributing to tightening credit standards

Sources: ABI on ECB
The decrease in credit demand stems from a sharp contraction in business investment, while the demand for debt restructuring increases.

**Trends in demand for credit by Italian firms**

(diffusion index)

Factors affecting demand for loans and credit lines to enterprises

(diffusion index)

Sources: ABI on ECB
Changes in terms and conditions for approving loans to Italian firms: the second quarter of 2012 marks a sharp reversal of stress

**LOANS TO ITALIAN FIRMS: SUPPLY SIDE**

Changes in credit standards applied to the approval of loans to Italian firms

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**ECB bank lending survey open to banks**

(“diffusion index”*: index varies between 1 and -1; bank lending survey ECB)

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(*) The bank lending survey is addressed to senior loan officers of a representative sample of euro area banks. The diffusion index is the weighted difference between the share of banks reporting that credit standards have been tightened and the share of banks reporting that they have been eased.

Sources: ABI on ECB
Asset quality

Ø The assessment of the credit quality of Italian banks is often carried out in comparison with banks of other countries. This type of analysis has often fuelled doubts on the solidity of Italian banks (e.g. IMF figures). In this respect, we believe that one should be aware of some unreliaibility in cross-country comparisons (mainly on the ‘impaired loans on total loans’ ratio and on the impaired loans coverage ratio) which may generate some false beliefs on the solidity of the Italian banks (see also the statements released by PWC and EBA on this topic in the following slides).

Ø Moreover in order to evaluate the asset quality of a bank (or the goodness of the impaired loans coverage) one should also considered:

✔ the level of the “loan to value ratio”: very low in Italy if compared to European peers

✔ the quality of the collateral: very high in Italy thanks to the absence of a real estate bubble, which is reflected in the stability of house prices (or in the value of collateral)

Ø Some peculiarities in the tax regime for loan loss provisions and deficiencies in legal procedures, which slow down the outflow from the balance sheets, also play a role in the amount of impaired loans.

Ø After the progress of previous quarters, from the third quarter of 2011 there were signs of deterioration in credit quality. The new recession has interrupted the process of slow improvement. However, we remain confident in the ability of Italian banks to control the risk as they proved they were capable during the 2008-2009 crisis: structural improvement in the client screening processes is a strength of Italian banks which helps to contain the growth of impaired loans and their management.
Starting from the third quarter of 2011 the economic framework worsened: recession interrupts the process of slow improvement.

**CREDIT RISK AT ITALIAN BANKS**

**New non-performing Loans/Loans**
(by number of individuals; quarterly annualised; Q1 2007 – Q4 2012)

<table>
<thead>
<tr>
<th>Year</th>
<th>Consumer housekolds</th>
<th>Corporates</th>
<th>Producer households</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>1,2%</td>
<td>1,6%</td>
<td>2,5%</td>
<td>3,3%</td>
</tr>
<tr>
<td>2008</td>
<td>1,6%</td>
<td>1,9%</td>
<td>2,5%</td>
<td>3,3%</td>
</tr>
<tr>
<td>2009</td>
<td>1,9%</td>
<td>2,2%</td>
<td>2,5%</td>
<td>3,3%</td>
</tr>
<tr>
<td>2010</td>
<td>2,2%</td>
<td>2,7%</td>
<td>3,3%</td>
<td>3,3%</td>
</tr>
<tr>
<td>2011</td>
<td>2,5%</td>
<td>3,3%</td>
<td>3,3%</td>
<td>3,3%</td>
</tr>
</tbody>
</table>

(*: Historical average: 1990-2011

Sources: Bank of Italy
Impaired loans are growing due to the slowdown of the economy

**Italy: the dynamics of impaired loans**
(March 2010 - December 2012, € billion)

**Italy: the dynamics of impaired loans as % of loans to private sector resident**
(March 2010 - December 2012; %)

Sources: Bank of Italy
How Italian banks compare: the official data outline a framework that is particularly bleak for Italian banks ...

IMF data (‘Financial Soundness Indicators’)

... are these figures really comparable between countries?
• in most countries, with the notable exception of Italy, accounting and regulatory frameworks for impaired loan classification differ;

• definitions of impaired loans are often not fully harmonized in banks within the same country, as banks implement the general accounting principles using their internal credit risk policies. In particular:
  ➢ there seems to be no commonly accepted definition of impaired loans;
  ➢ there are divergences in practice with regards to the classification of restructured loans, hence in some cases management judgment seems often to be a key driver of loan appraisals and “time to cure”;
  ➢ there are divergences in practice with regards to the classification of past due loans (“past due but not impaired”)

• any comparison based on unadjusted accounting data has to be taken with a degree of caution. In order to be fully meaningful, numbers should be compared on the basis of fully harmonized definitions

• Italy seems to experience the greatest consistency between the accounting and the regulatory framework for impaired loan classification and also the most prescriptive and comprehensive set of minimum disclosure requirements as defined in Circular 262 from the Bank of Italy.

• This framework is enforced by the Bank of Italy in its regular activity of supervision.

• «While many supervisors have stepped up efforts to monitor asset quality, a range of different national approaches makes it difficult to obtain a clear picture of the extent of asset quality problems across the EU in a transparent way.

• Differing practices across jurisdictions to address not only asset quality concerns, but also debt forbearance, create uncertainties about the actual level of credit risk in banks’ balance sheets and the valuation of bank assets.

• For example, there are differences in loan classifications (performing loans, non-performing loans, ‘doubtful’ loans, ‘watchlist’) and how forbearance is defined, assessed, classified and reported.

• Uncertainties also arise through accounting practices for loans in arrears, uncertainties of the status of restructured loans, and through different practices of reclassifying performing loans which can distort information on reported NPLs.

• Further supervisory actions to reduce uncertainties surrounding asset values would be beneficial to restore market confidence about the reliability of reported asset values and of the status of banks.»
In Italy the aggregate of impaired loans includes: non performing, doubtful, restructured and past due loans. At December 2012, the aggregate amounted to about € 237 billion ...

**Italy: breakdown of impaired loans by class of risk**
(December 2012, € billion)

- **Non performing**: 125 (53%)
- **Doubtful**: 76 (32%)
- **Restructured**: 15 (6%)
- **Past due**: 21 (9%)
- **Total impaired**: 237 (100%)

In Italy the impaired loans are classified into the following categories:

- **Non-performing loans** - exposure to insolvent borrowers, even if the insolvency has not been recognized in a court of law, or borrowers in a similar situation. Measurement is generally on a loan-by-loan basis or, for loans singularly not significant, on a portfolio basis for homogeneous categories of loans;

- **Doubtful loans** - exposure to borrowers experiencing temporary difficulties, which the Group believes may be overcome within a reasonable period of time. Doubtful loans also include loans not classified as non-performing granted to borrowers other than government entities where the following conditions are met:
  - they have fallen due and remained unpaid for more than 270 days (or for more than 150 or 180 days for consumer credit exposure with an original term of less than 36 months, or 36 months or over, respectively);
  - the amount of the above exposure to the same borrower and other defaulted payments that are less than 270 days overdue, is at least 10% of the total exposure to that borrower. Doubtful loans are valued analytically when special elements make this advisable or by applying analytically flat percentages on a historical or stochastic basis in the remaining cases;

- **Restructured loans** - exposure to borrowers with whom a rescheduling agreement has been entered into including renegotiated pricing at interest rates below market, the conversion of part of a loan into shares and/or reduction of principal; measurement is on a loan-by-loan basis, including discounted cost due to renegotiation of the interest rate at a rate lower than the original contractual rate;

- **Past-due loans** - total exposure to any borrower not included in the other categories, which at the balance-sheet date has expired facilities or unauthorised overdrafts that are more than 90 days past due and meet the requirements set out by supervisory regulations (ref. Bank of Italy's Circular No. 263 of December 27, 2006 “New regulations for the prudential supervision of banks”) for their classification under the “past due exposures” category (TSA banks) or under the “defaulted exposures” category (IRB banks).
As already shown by the September 2012 stress test report on Spanish banks (Oliver Wyman) December 2012 pillar 3 data confirm the uncertainty of the international comparison: higher amount of impaired loans and lower impaired loans coverage for Spanish banks in comparison with the Italian

**Credit quality: Italy vs Spain (December 2012 *)**

**Impaired loans/loans to residents: balance sheet data vs. ‘effective’ data**

- **In Spain**, the amount of impaired loans as a % of total loans to residents is equal to 10,9% on the basis of official data. This figure is, however, more than 19% including restructured loans, not included in the impaired loans according to balance sheets of Spanish banks. The Spanish 19,1% is comparable with the Italian 13,3% (which sum non-performing, doubtful, restructured and past due loans).

**Coverage of impaired loans: Italy vs. Spain (December 2012*)**

- **In Spain**, the coverage of impaired loans amounted to 67% on the basis of official data. This figure is, however, less than 40% including the restructured loans in the denominator of the ratio. The Spanish 38% is comparable with the Italian 41% (where the denominator sum non-performing, doubtful, restructured and past due loans).

Source: Abi on annual report figures; spanish banks include: Santander, BBVA, Bankia, Banco Popular Espanol, Banco Sabadell, La Caixa. Only domestic business considered.
An effective assessment of the level of impaired loans coverage should take into account the amount of guarantees other than the value of the loan loss provisions (coverage from 44% to 125% for top 3 Italian groups; Dec. 2012)

**Cash coverage**
(2012; top 3 Italian groups)

<table>
<thead>
<tr>
<th>Gross impaired loans (a)</th>
<th>Loan loss provisions (b)</th>
<th>Net impaired loans (a-b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>152</td>
<td>67</td>
<td>85</td>
</tr>
</tbody>
</table>

**Coverage by guarantees**
(2012; top 3 Italian groups)

<table>
<thead>
<tr>
<th>Real guarantees (c)</th>
<th>Personal guarantees (d)</th>
<th>Total guarantees (c+d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>101</td>
<td>21</td>
<td>123</td>
</tr>
</tbody>
</table>

**Total coverage**
(2012; top 3 Italian groups)

- Cash coverage: \( \frac{67}{152} = 44\% \)
- Coverage by guarantees: \( \frac{123}{152} = 81\% \)

(* The actual value of the guarantees is underestimated since if its fair value is difficult to be determined, the amount shown in the balance refers to its contractual value, stated - as required by the regulations - up to the net exposure value.

Source: Abi on bank annual reports; top 3 Italian banking groups
The degree of collateralization of deteriorated exposures is very high for Italian banks: in Europe lacks a good disclosure on this issue.

Coverage of impaired loans for some European banks including collateral and guarantees (provisions/impaired loans; December 2011)

Total coverage in Europe

Total coverage in Italy

Cash coverage ratio is obviously lower for banks that have a larger share of non-performing exposures backed by collateral (and thus higher expected recovery rates)

Source: ABI on Mediobanca securities data (‘Harmonising EU banks’ asset quality report; 15 October 2012’)
In order to evaluate the goodness of the level of the impaired loans coverage one should be also considered the level of the loan to value ratio, very low in Italy ...

**Typical loan to value (LTV) ratio for a first time house buyer (2007; %)**

![Bar chart showing typical LTV ratios for different countries.](chart.png)

*(*) 2011 figure for Italy = 63%

Source: ECB (Occasional Paper No 101, March 2009)
... and the quality of collateral, very high in Italy thanks to the absence of a real estate bubble, which is reflected in the stability of house prices (or value of collateral).

**House prices in Europe (1)**

**House prices in Europe (1) (current prices; indices, 2000=100)**

**House prices in Europe (1) (last 1, 2, 5 years; variation; %)**

Sources: Abi on bank of Italy based on national sources and ECB data. (1) Quarterly data (for the euro area, semi-annual).
On the amount of impaired loans also play a role some peculiarities in the tax regime for loan loss provisions and deficiencies in legal procedures that slow down the outflow from the financial statements.

As far as the corporation tax (IRES) is concerned:

Loan write-downs (specific and generic provisions, as resulting from IAS individual accounts) are tax deductible only within a limit of 0,30% of outstanding loans to customers. The basis for the 0,30 percentage does not include the loans to other banks, since they are not considered as “customers”, nor write-downs of loans granted to other banks are tax deductible (in this case only realized losses can be deducted).

The write-downs’ amount in excess of 0,30% is deductible on a straight-line basis over the (too long) period of 18 years. This issue implies an additional concern where this deferral timing causes questions on the recognition of a deferred tax asset (length of the recoverability period).

Loan write-offs are deductible only to the extent that the corporate taxpayer can provide “sure and precise” evidence that the credit can no longer be recovered. In many cases, such evidence is difficult to be brought, giving rise to the risk of litigation with the tax authorities. On the other hand the tax authorities, on the basis of some Supreme Court’s decisions, require such evidence for the deduction of losses realized through the assignment of credits as well. Since 2012 IAS adopters can always deduct loan write-offs in case of derecognition.

When a bankruptcy proceeding is pending the tax law provides for an exception to the requirement to bring “sure and precise” evidence of the loss: in this cases write-offs are always deductible. This regime should be made more efficient, enlarging the area of the proceedings allowing the deduction.

### Write-downs tax treatment in the last years

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Write-downs tax deduction within the current year (% of total credit exposure)</td>
<td>0,5</td>
<td>0,6</td>
<td>0,4</td>
<td>0,3</td>
</tr>
<tr>
<td>Excess split timeframe</td>
<td>7</td>
<td>9</td>
<td>9</td>
<td>18</td>
</tr>
</tbody>
</table>

- **Art. 82, comma 12, D.L. 25 June 2008 n. 112.**

Transitional arrangement allows banks to split the amount of write-downs (ninths) - not completely deducted at the date of the last legislative modification (2008) - until the eighteenth tax period following the one in which they originally formed.
The impact of difference between tax and accounting regimes

In addition, it has to be stressed that loan losses (write-downs as well as write off) cannot be deducted for the purposes of the IRAP (Italian regional tax on production) (exceptions: losses on the assignments of credits). This tax is a local tax levied on the value of production generated by businesses.

This represents a relevant competitive distortion vis-à-vis other major European countries because in France, Germany and the United Kingdom, impairment calculated for accounting purposes is tax-deductible on a loan-by-loan basis; in France and Germany, on pooled basis too.

Such penalisation is pro-cyclical because the burden is greater during cyclical downturns, when loan losses increase; it might result in reduction of banks’ ability to financing real economy.

Please note that:

• Italy requires the adoption of IAS/IFRS in the individual financial accounts of all banks, both listed and not listed;

• as from 1 January 2008 IAS/IFRS compliant companies apply for income tax purposes the qualification, recognition and classification criteria envisaged in international accounting standards.
The impact of difference between tax and accounting regimes

<table>
<thead>
<tr>
<th>Year</th>
<th>ANTE IAS</th>
<th>IAS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004</td>
<td>2006</td>
</tr>
<tr>
<td>Threshold for deduction (tax regime)</td>
<td>0,60%</td>
<td>0,40%</td>
</tr>
<tr>
<td>Write-downs/credit exposure [accounting regime]</td>
<td>0,66%</td>
<td>1,01%</td>
</tr>
<tr>
<td>Write-downs/credit exposure [tax regime]</td>
<td>0,55%</td>
<td>0,39%</td>
</tr>
</tbody>
</table>

Source: Tax Analysis Forum ABI Analysis, elaboration on ABI data (2004; 2011)
**Write-downs index trend (2004-2011)**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Threshold for deduction (tax regime)</td>
<td>0,60%</td>
<td>0,40%</td>
<td>0,40%</td>
<td>0,30%</td>
<td>0,30%</td>
<td>0,30%</td>
<td>0,30%</td>
<td></td>
</tr>
<tr>
<td>Total yearly write-downs (tax regime)/Total yearly write-downs (accounting regime)</td>
<td>83,06%</td>
<td>38,70%</td>
<td>72%</td>
<td>75%</td>
<td>42%</td>
<td>34%</td>
<td>37%</td>
<td>34%</td>
</tr>
</tbody>
</table>

In the last three years (2009-2011) Italian banks deducted only **35%** (average) of total credit write-downs.

The remainder will have a tax recognition over the next 13 years (weighted average lifetime) with a strong negative impact in term of interest margin.

The opportunity cost of this non-interest bearing amount can be estimated in the order of 200 million € per year (risk-free rate): this value is expected to greatly increase when the financial scenario will stabilized and the rates will return to higher values.

*Source: Tax Analysis Forum ABI Analysis, elaboration on ABI data (2004; 2011)*
Financial sector: addressing the challenges ahead

... consideration could also be given to relaxing the current tax rules on the deductibility of loan write-downs, which are stricter than in other major European countries, also in light of the possible new capital regulation on deferred tax credits. Italian banks should begin to adapt their capital strategies to the tougher regulatory framework in prospect.
Profitability

Ø Economic recovery remains a key factor in the profitability of Italian banks, as a result of our bank business model, which implies a strong correlation between Italian bank performance and domestic economic growth.

Ø The economic performance of the Italian banking sector is constrained by the slow recovery of the economy: loans’ growth is slowing while net spreads are under pressure because of low policy interest rates and the cost of funding level, which, although slowly decreasing, still remains dependent on high sovereign spreads.

Ø Whilst an important revenue contribution can come from the exploitation of the substantial and still untapped growth potential in many financial products and services (eg. current accounts, credit cards, asset management, life & non-life insurance products, pension funds, mortgages), in the short & medium term profitability recovery is expected to be achieved mainly by effective cost cutting measures and by a reduction in the average cost of funding.

Ø However, a substantial improvement of the return on equity will be the major challenge for Italian banks. Our forecasts are for an average of...at..
Economic recovery remains a key factor in the profitability of Italian banks, as a result of our bank business model.

Return On Equity of Italian banks and domestic GDP Growth

Source: ABI on Istat and Bank of Italy

*2010 ROE net of goodwill amortization (balance sheet stated Roe -6.2%)
**Italian banks: P&L accounts (YoY; var. %; 2013 – 2014)**

<table>
<thead>
<tr>
<th></th>
<th>April 2013</th>
<th>December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013F 2014F</td>
<td>2013F 2014F</td>
</tr>
<tr>
<td>Net interest income</td>
<td>-1,2 3,2</td>
<td>-0,8 2,7</td>
</tr>
<tr>
<td>Other income</td>
<td>2,2 4,0</td>
<td>3,3 5,6</td>
</tr>
<tr>
<td>Operating income</td>
<td>0,4 3,6</td>
<td>1,1 4,1</td>
</tr>
<tr>
<td>Operating costs</td>
<td>-1,9 -1,7</td>
<td>-1,8 -1,8</td>
</tr>
<tr>
<td><strong>show staff costs</strong></td>
<td>-1,2 -1,0</td>
<td>-1,2 -0,9</td>
</tr>
<tr>
<td>Gross operating income</td>
<td>5,1 13,5</td>
<td>7,0 15,0</td>
</tr>
<tr>
<td>Loan loss provisions</td>
<td>-2,2 -9,3</td>
<td>2,2 -9,3</td>
</tr>
<tr>
<td>Net income (bln €)</td>
<td>3,098 7,871</td>
<td>4,811 8,906</td>
</tr>
<tr>
<td>ROE (end year; %)</td>
<td>0,8 2,0</td>
<td>1,2 2,2</td>
</tr>
</tbody>
</table>

**Fonte: Previsioni Abi (Afo); aggiornamento Aprile 2013**
How to restore profitability: short & medium terms priorities for Italian banks CEO

**Main priorities:**

- increase in cross-selling
- increase in employee productivity
- development of existing products & services
- reengineering of products / services even towards distribution of not traditionally retail banking products and services;
- Costs containment: labour and administrative
- diversification of delivery channels (technologies)

---

**ABI survey open to 27 Italian banks CEOs (January 2013)**

What should be the priorities for Italian banks in the short-medium terms?

<table>
<thead>
<tr>
<th>Priority</th>
<th>4 = very high</th>
<th>3 = high</th>
<th>2 = low</th>
<th>1 = very low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-selling</td>
<td>3.6</td>
<td>3.5</td>
<td>3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Improve employees productivity</td>
<td>3.2</td>
<td>3.2</td>
<td>3.1</td>
<td>3.0</td>
</tr>
<tr>
<td>Development of existing products &amp; services</td>
<td>3.2</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Reengineering of products / services</td>
<td>2.2</td>
<td>2.2</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Assets re-pricing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cut labour costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cut other administrative costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribution channel diversification (eg. mobile, internet banking)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dispose of non-core assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Further consolidate domestically</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change business model towards asset gathering</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expand outside Italy</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Not only relevant actions on costs but also on the amount and composition of revenues

*Source: ABI survey on banking group annual reports*
How to restore profitability: 1. by leveraging on cost containment...

Dynamics of the operating costs for the largest Italian and EU banking groups (December 1997 vs December 2012, aggregated data)

Italian banking groups¹: 1997 vs 2012

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>2012*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating costs**/assets</td>
<td>2,23%</td>
<td></td>
</tr>
<tr>
<td>labour cost/assets</td>
<td>1,56%</td>
<td>1,48%</td>
</tr>
<tr>
<td>other operating expenses/assets</td>
<td>0,93%</td>
<td>0,75%</td>
</tr>
</tbody>
</table>

Italian¹ vs. European banking groups² 2012

<table>
<thead>
<tr>
<th></th>
<th>Italy</th>
<th>EU²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating costs**/assets</td>
<td>1,56%</td>
<td>1,28%</td>
</tr>
<tr>
<td>labour cost/assets</td>
<td>0,93%</td>
<td>0,67%</td>
</tr>
<tr>
<td>other operating expenses/assets</td>
<td>0,51%</td>
<td>0,52%</td>
</tr>
</tbody>
</table>

Source: ABI - on banking group annual reports

(¹) Italian banking groups
(²) EU banking groups

(** labour costs + other administrative expenses
(1) top 8 banking groups
(2) top 20 EU groups

Source: ABI - on banking group annual reports
In late 2009, the number of branches dropped in Italy for the first time... through various strategies including the reorganisation of distribution models.

Bank branches per 100,000 inhabitants (December 2011)

Bank branches per 100,000 inhabitants (Trend, 1999 - 2011)

Source: ABI - on ECB

(*) 2010 figure for UK
.... 2. by leveraging on revenues upside potential (in Italy there is plenty of room for growth in a number of markets)

Degree of development of some financial products: Italy vs. Europe

**Current accounts**
- Current accounts/inhabitants (#)
- Italy: 0.71
- EU: 1.2
- Italy: -76%
- EU: 

**Credit cards**
- Credit cards/ inhabitants (#)
- Italy: 0.5
- EU: 1
- Italy: -103%
- EU: 

**Asset under management**
- Stock/GDP (%)
- Italy: 16.9
- EU: 23.9
- Italy: -7pp
- EU: 

**Life insurance**
- Technical reserves/GDP (%)
- Italy: 26.1
- EU: 45.4
- Italy: -19pp
- EU: 

**Pension funds**
- Stock/GDP (%)
- Italy: 2.4
- EU: 26.5
- Italy: -24pp
- EU: 

**Mortgages**
- Stock/GDP (%)
- Italy: 19.2
- EU: 52.3
- Italy: -33pp
- EU: 

Notes: 2009 Figures; Credit card figures as at 2008; (1) France, Germany, Spain and UK; (2) Mutual funds

Source: Intesa Sanpaolo on central banks, RBR Payment cards in Europe, business associations
... 3. by supporting a radical transformation of Italian non financial firms to increase their competitiveness ...

Firms must diversify their sources of funding:

1. **bank loans** represent a larger share of firms’ total financial debt than in other industrial countries (66% vs 47%).

2. **loans with original maturity of less than 1 year** are around 34% of firms’ banks debt, compared to 29% in the Euro Area.

3. the contribution of **equity** as a source of funds is significantly lower than in the Euro Area (especially in the component of listed shares)

Source: ABI on national accounts and Bach data, 2011
Banks can provide business solutions in the fields of:

1. **M&A advisory**

In Italy large firms (more than 250 workers) employ only 22% of total jobs, against 47% in France and 53% in Germany.

2. **Internationalization process support**

In Italy outward direct investment amount to only 578 bln $, against 1,720 in France and 1,378 in Germany.

3. **Debt capital market**

Only 28 Italian non financial firms have outstanding bonds on the euro-market.

4. **Restructuring of liabilities**

The share of short-term debt on total debt is still very high in Italy (34%).

5. ...

Source: ABI based on Intesa San Paolo data
Capitalization

Ø The capitalization gap with European peers has been closed: the Core Tier 1 ratio of the five largest Italian banking groups has reached an average of 10.9% (as at December 2012), compared with 5.7% at the end of 2007, in line with the European average.

Ø It should also be pointed out that the value of the capital ratio depends on the RWAs amount (which means on RWAs calculation methods) in addition to the capital amount.

Ø The current huge dispersion between countries in the RWAs calculation reflects “unjustified” divergences in national supervisory approaches (e.g., differences in the internal models approved by the national supervisors) in addition to justified diverse external macroeconomic factors. The expected standardization between European countries in methods for calculating the RWAs is likely to play a major role in the capitalization of European banks.

Ø Indeed the harmonization of practices on the European average standards would favour Italian banks more than their competitors. The adoption at European level of criteria similar to those currently followed in Italy, would make the Italian banks more capitalized than the European competitors, which structurally have lower risk weights and higher proportion of internally measured the RWAs.
The gap in capitalisation with Italian banks' EU peers has been closed. Remaining differences are at least partially due to a lack of harmonisation between countries in the methods for calculating RWAs for IRB banks.

Core Tier 1 Ratio
(balance sheet figures)

Core Tier 1 Ratio in Italy
(2010 – 2012; %)

Core Tier 1 Ratio in Europe
(aggregated data by country*; December 2012)

( *) Figure refers to the 25 largest European banking groups – 8 for Italy – Basel 2,5 rules for 12 Banks and Basel 2 rules for 13 banks

Sources: ABI on banks annual report (B2 for Spanish bank)
Impact of diverse RWAs calculation methodologies on capital adequacy: the case of residential mortgage portfolios

| Risk weights of EU banks adopting the IRB models (residential mortgage portfolios; aggregated figures by country; top 2 banks by country*; 2012) |
|---|---|---|---|---|---|---|
| Italy | Spain | Ireland | Germany | UK | France | Sweden |
| 16.9% | 16.8% | 15.7% | 15.3% | 12.7% | 11.4% | 7.9% |

| Impact of diverse Risk Weights calculation methodologies (residential mortgage portfolios; Italy vs EU average; 2012) |
|---|---|---|---|
| Italy | EU average |
| The same loans volume, what amount of capital is needed to achieve the same capital ratio? (EU average = 100) |
| Italy: 127 | EU average: 100 |
| +27% |

| The same amount of capital available, what level of capital ratio is achieved? (EU average = 100) |
|---|---|---|
| Italy: 73 | EU average: 100 |
| -27% |

*Italy: ISP, UCG; France: Societe Generale, BNP; Ireland: Bank of Ireland; Germany: Deutsche, Commerzbank; Sweden: Swedbank, SEB; Spain: SCH, BBVA; UK: HSBC* (only domestic business), Lloyds.

Sources: ABI on IRB banks annual report
The EBA interim report published last 26th February 2013 recognizes there are differences in the calculation of RWA among European banks.

**Differences between European IRB banks in Global Charge* and types of factors explaining the differences**

- **A-type differences** include those referring to the type of method in use (SA or IRB) and to the portfolio composition: roll-out effect, standard risk weight effect, IRB portfolio mix effect and the IRB share of defaulted assets. The differences can be attributed to these specific drivers relating to structure of the balance-sheet and the reliance to different regulatory approaches. They might be reasonable, as they do not depend on risk parameters estimated under the IRB approach but they also reflect different business and supervisory practices that might require further investigations and possibly measures to achieve greater convergence.

- Differences which are not taken accounted for the work are termed **B-type differences** and these will be the subject of further supervisory analysis. They include differences stemming from the IRB risk parameters applied which are caused by idiosyncratic variations in the riskiness of exposures and credit risk mitigation, and the use of foundation versus advanced IRB.

(*) The indicator used by EBA to assess the materiality of differences is the overall RWA and EL outcome or ‘global charge’, which takes into account both unexpected losses and expected losses. Global charge = (RWA + 12.5* EL)/ EAD

Source: Interim results of the EBA review of the consistency of risk-weighted assets; February 2013 - Based on data referred to 89 banks from 16 countries
The review of the consistency of risk weighted assets across European countries and banks is on-going.

The EBA interim report published last 26th February 2013 recognizes there are differences in the calculation of RWA among European banks.

In its study on IRB models in Europe, the EBF notes that at least part of divergences in the calculation of Risk Weights reflect different supervisory practices between countries which act on the determination of PD and LGD.
**Largest European banking groups capitalization:**
**Basel 3 rules impact on banks’ capital ratio levels**

<table>
<thead>
<tr>
<th>Core tier 1 capital ratio: current ratio* vs B3 ratio</th>
<th>CT1 capital ratio: reduction due to the adoption of B3 rules</th>
<th>CT1 ratio: current* vs B3 ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 2012; simple average by country</td>
<td>Dec. 2012; simple average by country; basis points</td>
<td>Italian vs European banking groups</td>
</tr>
<tr>
<td>Current CT1 ratio (2012)</td>
<td>Current CT1 ratio under B3 rules</td>
<td>(December 2012; simple average by country; bp)</td>
</tr>
<tr>
<td>Current CT1 ratio under B3 rules</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NL</td>
<td>IT</td>
<td>EU 4 average</td>
</tr>
<tr>
<td>12,0%</td>
<td>11,0%</td>
<td>11,6%</td>
</tr>
<tr>
<td>10,2%</td>
<td>9,9%</td>
<td>8,9%</td>
</tr>
<tr>
<td>11,3%</td>
<td>11,6%</td>
<td>11,6%</td>
</tr>
<tr>
<td>11,7%</td>
<td>9,2%</td>
<td>7,7%</td>
</tr>
<tr>
<td>11,6%</td>
<td></td>
<td>8,9%</td>
</tr>
<tr>
<td>EU 4 average</td>
<td></td>
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<td></td>
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</tr>
</tbody>
</table>

Impact on Eu more than double

(†) Current CT1 capital ratio under Basel 2,5 rules
Source: Abi on banks annual report figures; top 2 banks by country
Liquidity/funding: Key final remarks

Ø The funding shows some signs of recovery, especially in the deposit component (+7.7% YoY, on April 2013) (substitution of bonds by time deposits). Clearly, future prospects are linked to the sovereign risk trend.

Ø The “Outright Monetary Transactions” scheme launched last September by the ECB restored market confidence and Italy's ability to meet its debt obligations, thus breaking the negative feedback loop between banks and sovereign risk.

Ø Pressures are mitigated by some specific features of Italian banks, namely the composition of external debt, which relies mainly on deposits and bonds offered to domestic retail investors and this could prove an advantage given the strong pressure on wholesale markets.

Ø In the second half of 2012 some major Italian banks were able to issue unsecured bonds although still at a very high spread (around 350 basis points on average). January 8th 2013 one bank placed 3.5 billion dollar on the U.S. market with the launch of a 3-year and 5-year dual-tranche bond issue (spread down to 230 bp).

Ø Moreover, eventual (unexpected) liquidity strains can be dealt with by further recourse to the ECB funding, given the banks’ substantial holdings of free eligible assets (248 bln €).
The dynamics of the spread between BTP and Bunds take benefits from the approval of the “EU antispread plan” (6 September 2012) and the progress towards a true European Union.
- Decrease of foreign funding (mainly wholesale) driven by sovereign risk increase
- Recently signs of recovery (substitution of bonds by time deposits)
- Future prospects are linked to the sovereign risk trend

Source: ABI on Bank of Italy
### Funding flows mainly from the ECB: recomposition towards short term funding (lack of medium & long term funds)

#### Stable funding vs loans to resident customer (stock)

<table>
<thead>
<tr>
<th></th>
<th>March 2013</th>
<th>December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>bln €</td>
<td>y/y</td>
</tr>
<tr>
<td>Stable funding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(private sector &amp; PA)</td>
<td>1.765</td>
<td>+1,5%</td>
</tr>
<tr>
<td>- deposits</td>
<td>1.213</td>
<td>+6,6%</td>
</tr>
<tr>
<td>- bonds</td>
<td>552</td>
<td>-8,2%</td>
</tr>
<tr>
<td>Loans to customer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(private sector &amp; PA)</td>
<td>1.910</td>
<td>-2,0%</td>
</tr>
<tr>
<td>- Households &amp; firms</td>
<td>1.465</td>
<td>-2,3%</td>
</tr>
<tr>
<td>- m/l terms</td>
<td>1.078</td>
<td>-2,6%</td>
</tr>
</tbody>
</table>

#### Funding composition in Italy (flows)

**Annual flows**

- ECB funds
- Funding from residents
- Foreign funding
- Capital and other
Funding mainly relies on deposits and bonds placed with domestic retail investors (a plus point given the pressure on wholesale markets)

**Direct Funding***/Total Liabilities
(largest 28 EU banking groups; aggregated data; 2012)

<table>
<thead>
<tr>
<th>Country</th>
<th>Direct Funding/Total Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>NL</td>
<td>63.3%</td>
</tr>
<tr>
<td>ES</td>
<td>62.3%</td>
</tr>
<tr>
<td>IT</td>
<td>61.4%</td>
</tr>
<tr>
<td>UK</td>
<td>47.7%</td>
</tr>
<tr>
<td>DE</td>
<td>44.5%</td>
</tr>
<tr>
<td>FR</td>
<td>34.7%</td>
</tr>
<tr>
<td>EU5*</td>
<td>47.1%</td>
</tr>
</tbody>
</table>

(*) deposits, interbank deposits excluded, and bonds (**) simple average between DE, ED, FR, UK

Source: ABI - on banking group annual report
Moreover, eventual (unexpected) liquidity strains can be dealt with by further recourse to the central bank, given the banks’ substantial holdings of unencumbered eligible assets.

At the end of February 2013 banks would have been able, if necessary, to draw an additional €302 billion on the credit granted by the Eurosystem.
The absence of public aids during the crisis is an clear evidence of the soundness and resiliency of Italian banks.

This good performance of the Italian banking industry is also the result of **effective and efficient supervision of the Bank of Italy**.

Differently from many other regulators, the **Bank of Italy implemented in a very prudent manner European directives and regulations.**

A full "harmonization of rules and supervisory practices" in Europe is urgently needed to avoid competitive disadvantages stemming from an unlevelled playing field. In this respect the Italian banks welcome the proposal for a Banking Union and are fully supportive of a swift implementation.

ABI considers the Banking Union as a milestone in the process of integrating the European financial market.
Some examples of practices adopted by the Italian supervisor which are stricter than those of the majority of their European peers:

1. **Definition of impaired loans** (see page 34 and followings)

2. **Calculation of RWAs** for IRB banks (internal models validation) (see page 56)

3. **Transitional floors capital requirements** (EBA recapitalisation exercise of 2011) (see page 67)

4. **Eligibility criteria for credit claims** (as collateral for the Eurosytem credit operations) (see page 68)

5. ....
Transitional floors capital requirements

• Currently, different methodologies are used for calculating the transitional floors. In particular, in some jurisdictions the floor is based on minimum own funds (capital requirements; Italian case), while in others the focus is on total own funds.

• On 8th December 2011, the European Banking Authority (EBA) completed the 2011 EU Capital Exercise and published the final figures of the banks’ recapitalisation needs in Europe. EBA asked national authorities to choose one of two of the most widely used approaches, which are outlined below, and direct all banks in their jurisdiction to adopt that approach:

  ➢ **Approach 1**: Transitional floor capital requirement = Max \[(80\%*(Capital Requirement B1) – (Total Minimum Own Funds)),0\],

  ➢ **Approach 2**: Transitional floor capital requirement = Max \[(80\%*Capreq B1) – Total Own Funds, 0\]

• The likelihood that the floor generates a restrictive effect on the regulatory ratio reported and disclosed by institutions is much lower under the latter approach.

(*) For non IRB/AMA banks the transitional floor is "not applicable"
The ECB Governing Council has decided on December 8th 2011 to allow national central banks, as a temporary solution, to accept performing bank loans as collateral under requirements that are less strict than those normally used by the Eurosystem.

Specifically, the maximum probability of default has been raised by ECB from 0.4 to 1.5%.

Following this decision, the Bank of Italy has established that, as of February 2012, the collateral pool may include loans granted by Italian banks with a probability of default of not more than 1%

In contrast, in other countries, such as in Portugal, national supervisors have established the collateral pool may include loans up to a 1,5% probability of default.
1. The Italian banking industry at a glance
2. Macroeconomic scenario & country strengths
3. Italian banks characteristics and strengths
4. Hot issues:
   - liquidity/funding
   - loans & revenues
   - operating costs
   - cost of risks (asset quality)
   - capital adequacy (Basel III & other)
   - performance
5. Key final remarks
The closure of the EU procedure for excessive deficit (at the end of May 2013) is a good news which confirms the European Union recognized the efforts made by Italy to put public finances under control, the basis to revive growth.

The expected further increase in the primary surplus will permit the stabilization of the ratio of debt to GDP even if economic growth will be modest.

Fostering growth is the priority of Italian government. The recent approval of the repayment of public-administration debts to the private sector is a meaningful and strong measure that should injects into the economy some billion euros over the next years.

This should contribute to stimulate internal demand (household consumption and corporate investment), which is the real drag on economic activity. Addressing the Italian growth issue also means fixing the productivity problem.

Structural reforms in progress show the road taken by the country is the right one.
... and the banks

Statement at the End of the IMF Financial Sector Assessment Program (FSAP) Mission to Italy - March 26, 2013

- The Italian financial system has shown remarkable resilience in the face of a severe and prolonged recession at home and a major crisis in Europe.

- At present, the Italian banking system as a whole appears well capitalized. The substantial capital buffers over regulatory minima built in recent years would offset most of the losses generated by an adverse macroeconomic scenario, even taking into account the phase-in of Basel III requirements.

- Preliminary stress test results suggest that the Italian banking system as a whole should be able to withstand both a scenario of concentrated shocks and one of protracted slow growth, thanks to the banks’ strong capital position and ECB liquidity support.

- The strong financial sector oversight in Italy is a critical pillar of financial stability

- Italy has an effective framework for crisis management and bank resolution.

- the Italian financial system is not immune from risks: continuing weakness in the real economy and the link between the financial sector and the sovereign remain key risks