BANCA
MEDIOLANUM S.p.A.

2012
PILLAR III

BANCA
MEDIOLANUM
MEDIOLANUM BANKING GROUP

Table of Contents

3 PREAMBLE
4 INTRODUCTION
4 1. Purpose
4 2. Structure
6 1. RISK MANAGEMENT – GENERAL INFORMATION
6 1.1. Risk Management and Internal Control System
7 1.2. Compliance & Risk Control Function
8 1.2.1. Risk Control Unit
9 1.2.2. Risk Assessment & Mitigation Unit
9 1.2.3. Compliance Unit
9 1.3. Internal Audit Function
9 1.4. Key Risks
9 1.4.1. First Pillar risks
10 1.4.2. Second Pillar risks
10 1.5. Credit Risk
13 1.5.1. Control Process
14 1.5.2. Reporting System
15 1.6. Market Risk
15 1.6.1. Control Process
15 1.6.2. Reporting System
16 1.7. Operational Risk
17 1.7.1. Reporting System
17 1.8. Risk Management and Mitigation
19 2. SCOPE OF APPLICATION
21 3. COMPOSITION OF REGULATORY CAPITAL
24 4. CAPITAL ADEQUACY
28 5. CREDIT RISK – GENERAL INFORMATION (ALL BANKS)
28 5.1. Definition of Default
29 5.2. Method used to Calculate Impairment
36 6. CREDIT RISK - EXPOSURES MEASURED UNDER THE STANDARDISED APPROACH
38 8. RISK MITIGATION TECHNIQUES
40 9. COUNTERPARTY RISK
41 12. OPERATIONAL RISK
44 13. EQUITY EXPOSURES
45 14. INTEREST RATE RISK IN THE BANKING BOOK
47 15. COMPENSATION POLICIES AND PRACTICES INCLUDING INCENTIVE PLANS
47 15.1. Decision-making process
48 15.2. Link between Compensation and Performance
49 15.3. Key features of the compensation system
49 15.3.1. Incentive component
50 15.4. Performance Indicators
50 15.4.1. Incentive Component – Financial Performance Parameters
51 15.4.2. Incentive Component – Non-financial Performance Parameters
51 15.4.3. Parameters applied to the Sales Network's compensation system
52 15.5. Rationale of the compensation systems
56 GLOSSARY

The chapter of this document correspond to the Synoptic Tables of Circular 263/06. Chapters 7, 10 and 11 relative to tables 7, 10 and 11 of Circular 263/06 are not applicable to the Mediolanum Banking Group.

Mediolanum Banking Group

Disclosures pursuant to Title IV Chapter 1 of Bank of Italy's Circular 263/06

Information at December 31 2012

BANCA MEDIOLANUM
MEDIOLANUM BANKING GROUP

Preamble

The June 2006 EU Capital Requirements Directive adopting the New Basel Capital Accord ('Basel II') marked the beginning of sweeping changes in banking regulations.

The new regulatory framework introduced key novelties in capital measurements and triggered a comprehensive, in-depth review of risk measurement and management systems especially within Banking Groups.

After public consultation, on December 27, 2006, the Bank of Italy adopted the Capital Requirements Directive for credit institutions and investment firms (i.e. Directives 2006/48/EC and 2006/49/EC of the European Parliament and of the Council) by issuing Circular 263 that set forth new regulations governing capital requirements for banks.

The Supervisory Regulations in effect from January 1, 2008 are based on 'three pillars':

1. The first pillar relates to capital requirements for risks that are typical of banking and finance, i.e. credit risk, counterparty risk, market risk and operational risk. Banks have alternative options for the calculation of capital requirements in accordance with the degree of complexity of their operations.
2. The second pillar requires banks to have a process for assessing their overall capital adequacy and a strategy for maintaining adequate capital levels (Internal Capital Adequacy Assessment Process or 'ICAAP'). Supervisory authorities are required to review and evaluate the effectiveness and reliability of the internal capital adequacy assessment process of banks, and, if not satisfied with the results, take appropriate supervisory action (also 'Supervisory Review Process' or 'SREP').
3. The third pillar requires banks to disclose information about their capital adequacy, risk exposures and the general features of their internal control system and risk management framework.

Introduction

1. Purpose

The purpose of this document is to disclose information about the capital adequacy and risk exposures of the Mediolanum Banking Group as well as the methods it uses to identify, measure and manage risks.

2. Structure

This document contains both qualitative and quantitative information. Apart from the preamble and the introduction, this document is organised into chapters that mirror the disclosure requirements Tables in Annex A, Title IV, Chapter 1 of Bank of Italy's Circular 263/06. These chapters are:

Chapter 1: Risk Management – General Information

This chapter sets out information about risk management policies and goals by type of risk.

Chapter 2: Scope of application

This chapter sets out information about the entities within the Banking Group to which disclosure requirements apply.

Chapter 3: Composition of Regulatory Capital

This chapter sets out regulatory capital components and related quantitative information.

Chapter 4: Capital Adequacy

This chapter sets out information about the methods used to measure capital adequacy and calculate capital charges for current and future operations.

Chapter 5: Credit risk – general information (all banks)

This chapter sets out the definitions of the various categories of impaired loans as well as the method used to calculate impairment.

Chapter 6: Credit risk – exposures measured under the standardised approach

This chapter sets out information on external credit assessment institutions (ECAI) and credit ratings.

Chapter 8: Risk mitigation techniques

This chapter sets out information about credit risk mitigation policies and practices.

Chapter 9: Counterparty Risk

This chapter sets out information about the method used to monitor counterparty risk.

Chapter 12: Operational Risk

This chapter sets out information about the method used to calculate operational risk capital charges.

Chapter 13: Equity exposures

This chapter sets out information about the purpose of holding equity instruments, the methods used to measure and recognise them and information about gains/losses realised upon their sale or liquidation.

Chapter 14: Interest Rate Risk in the Banking Book

This chapter sets out information about interest rate risk and how it is measured.

Chapter 15: Compensation Policies and Practices including Incentive Plans

This chapter provides disclosures on the decision-making process applied when defining compensation policies including incentive plans.

The chapters of this document correspond to the Synoptic Tables of Annex A, Title IV, Chapter 1 of Circular 263/06. Chapters 7, 10 and 11 relative to tables 7, 10 and 11 of Circular 263/06 are not applicable to the Mediolanum Banking Group.
The information herein is based on management and financial information for the year ended December 31, 2012. Amounts are expressed in thousands of euro.

Banca Mediolanum discloses this information to the public on its website at www.bancamediolanum.it in the public section 'Bilanci' (Annual and Interim Reports), as well as on the website of the holding company Mediolanum S.p.A., at www.mediolanum.com in the section Investor Relations/Annual & Interim Reports.

1. RISK MANAGEMENT - GENERAL INFORMATION

1.1. Risk Management and Internal Control System

The internal control system consists of the set of rules, procedures and functions established to ensure the effectiveness and efficiency of corporate processes, the protection of corporate assets as well as the proper management of customer assets, the reliability and accurateness of management representations and financial information as well as the compliance of transactions with the law, the regulations issued by Supervisory Authorities, self-discipline and internal rules.

The various entities within the Mediolanum Banking Group have in place a comprehensive, effective internal control system in accordance with applicable regulations and the business they conduct.

The Board of Directors and Management play a key role in the establishment of an adequate risk management framework and the implementation of an effective internal control system.

The following general principles form the bedrock of the Group risk management framework:

- identification and full coverage of all categories of risks;
- separation and independence of the Compliance & Risk Control function from Operating Units (OU). Ultimately, there will be separation and independence also from Internal Control bodies. However, certain derogations are allowed in the transitional phase according to the complexity of the business, business volumes and potential risks;
- use of uniform, consistent models and methods for the collection of data and information as well as for the analysis and measurement of risks by all organisational units and/or companies within the Group;
- timely and consistent analysis and measurement of risks; subsequent preparation of reports to support control and decision-making processes;
- transparency and dissemination of models, methods and criteria applied in the analysis and measurement of risks to promote a control culture within the organisation and understanding of the reasons underlying the choices made;
- delegation of risk management authorities and responsibilities from the Board of Directors to the Operating Units for their direct management of the risks to which corporate processes are exposed.

To ensure adherence to the principles above and have a comprehensive risk management framework, the Mediolanum Banking Group has adopted a set of risk policies.

The main purposes of risk policies are to:

- ensure that any material breaches/anomalies be promptly identified by the internal control system and adequate corrective/mitigating actions be taken;
- ensure the consistent application of risk management principles and rules across the Group;
- promote a risk management culture at all levels of the organisation and encourage consistent, knowledgeable operating choices and practices, in a structured way.

In pursuing said purposes staff are inspired by:

- the values set out in the Business Conduct and Ethics Code;
- general policies, i.e. guidelines that apply across the entire risk management and control system.

Internal control is not just the responsibility of certain functions or committees, but all departments are responsible to a different extent for the transactions they execute.

The internal control system is designed to encompass the following three main lines of defence:

- **line controls**: this first line of defence consists of front-office and back-office controls made by the individuals who carry out a certain activity and by their supervisors, generally within the same organisational unit or function, either embedded in automated procedures or conduced under specific operational procedures (e.g. hierarchical controls), properly documented and known to the heads of the individual operating units. Line controls are geared to assess the accurateness, completeness and consistency of transactions information and compliance with the operating licences and limits of the respective operating units;
- **risk controls**: these are specific controls performed by units other than operating units; they contribute to the definition of risk measurement methods, control of operating limits of officers to whom authorities are delegated, and verify compliance of transactions with the risk/return targets set by corporate bodies in their respective areas of responsibility. This second line of defence is tailored to the risk profile of the individual business. Specifically, it includes controls over credit risk, capital risk and investment risk, operational and reputational risks. It also includes control of compliance with the law, the regulations issued by Supervisory Authorities and self-discipline rules (e.g. codes of conducts) as well as with any other rules applicable to the entity;
- **internal audit**: this third line of defence entails the periodic assessment of the completeness, effectiveness and adequacy of the internal control system in relation to the nature of the business and the level of risks undertaken. The head of Internal Audit (Chief Auditor) is appointed by the Board of Directors. The Internal Audit function is separate and independent of operating units. Due to the scope and sensitiveness of the internal audit work, expert knowledge is required of internal auditors.

In the performance of their duties, internal auditors are granted access to all corporate structures as well as to any information they may need to assess outsourced activities. The Board of Directors and the Board of Statutory Auditors receive regular reports on internal audit work so that they can promptly take suitable corrective measures if deficiencies are detected.

1.2. Compliance & Risk Control Function

The Compliance & Risk Control function is an integral part of the Mediolanum Group internal control system. It is a second level control function responsible for monitoring the financial and credit risk exposure of the Bank as well as of the other Group subsidiaries and associates (under outsourcing arrangements). It is also responsible for assessing the impact of operational, legal and reputational risks, and for monitoring capital adequacy vis-à-vis the activities performed.

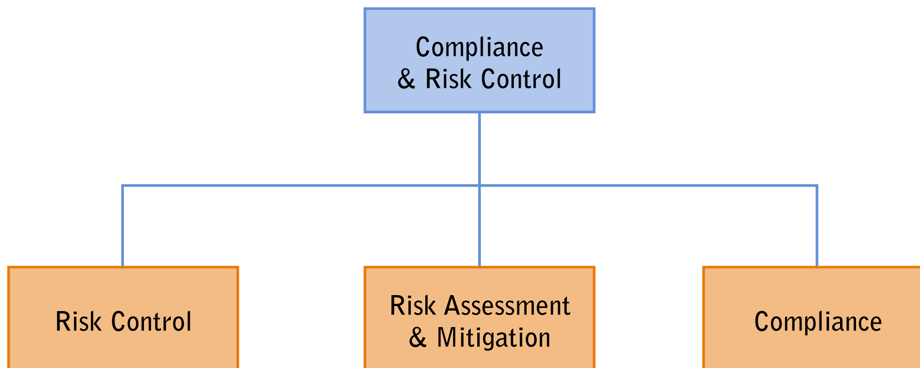
The Compliance & Risk Control team ensures the adequacy of procedures for the management of financial, operational and credit risks as well as regulatory compliance of the Financial Conglomerate.

The team informs the Chief Executive Officer and General Manager and reports on the overall risk exposure in its various components to the Board of Directors, through the Audit and Risk Committee.

The team continuously monitors the banking, financial and insurance regulatory environment to anticipate the impact of statutes and regulations on the Group business and ensure compliance therewith.

The Compliance & Risk Control team works with Internal Audit staff responsible for verifying the effectiveness and efficiency of the internal control system, to determine the overall risk profile of the Bank, identify areas and processes characterised by high operational risk sensitivity, any operational or organisational shortfalls, and fine-tune that system on an ongoing basis in accordance with the regulatory framework.

The team coordinates the Internal Capital Adequacy Assessment Process (ICAAP) for those activities specifically attributed to them and falling with the scope of the ICAAP Regulation.
The team also monitors management of customer complaints and supervisory requirements.
The Compliance & Risk Control Function is organised into the following units: *Risk Control*, *Risk Assessment & Mitigation, Compliance.*



1.2.1. Risk Control Unit

The Risk Control team is mainly responsible for:

- assessing and monitoring exposures to market risk, country risk as well as to counterparty risk, credit risk and operational risk while continuously monitoring capital adequacy in relation to the activities that are being carried out. The Risk Control team is also responsible for developing quantitative metrics for the identification and management of aforesaid risks;
- verifying the validation process for the flows of information needed to ensure timely control of exposure to operational and financial risks associated with assets managed by subsidiaries, starting risk mitigation actions and, whenever possible, prevent any anomalies;
- preparing reports to the Audit & Risk Committee, the Board of Directors, Senior Management and heads of operating units on risk evolution within Group companies, including any proposed corrective measures;
- assisting the line control units of subsidiaries in assessing Asset - Liability Management models and techniques for proper understanding and management of risk exposures arising from any asset/liability mismatch;
- gathering, analysing and reporting on losses arising from operational risk;
- participates in the Internal Capital Adequacy Assessment Process (ICAAP) for those activities specifically attributed to them and falling with the scope of the ICAAP Regulation;
- takes care of coordination activities within the Banking Group for the areas falling within its remit.

The Risk Control unit consists of two offices: Risk Control & Reporting, and Quantitative Modelling.

1.2.2. Risk Assessment & Mitigation Unit

The Risk Assessment & Mitigation team is responsible for identifying, monitoring and assessing compliance and operational risk exposures of the various organisational units, collaborating with the other units within the Compliance & Risk Control Function to arrive at a common assessment of the risks to which the various organisational areas and processes are exposed, their mitigation and subsequent optimisation of operational effectiveness and efficiency.
This team works with Compliance unit staff on any compliance issues and operational risk exposures resulting from non-compliant business practices, sharing information tools for adequate operational risk assessment and measurement as required by regulations and operating procedures.
The Risk Assessment & Mitigation unit is composed of three offices: Risk Assessment, Ongoing Controls, Complaints Analysis & Requirements Management.

1.2.3. Compliance Unit

The Compliance team is responsible for continuously monitoring the banking, financial, insurance and pension regulatory environment to anticipate the impact of statutes and regulations on the Group business. Compliance Unit staff provide advice and assistance to the Chief Executive Officer and General Manager in the assessment of compliance of procedures and practices with applicable laws and regulations as well as in the timely introduction of amendments thereto in case of regulatory changes.
The team also sees that customer complaints be properly handled and supervisory requirements satisfied, checking their progress also in view of promptly identifying any needs for improvement in the control processes in place within the organisation.

1.3. Internal Auditing Function

Internal Audit staff conduct independent, objective audit work and provide advice to improve the effectiveness and efficiency of the organisation as well as the overall internal control system.
They assess the overall internal control system and make sure it works properly, bringing to the attention of the Board of Directors and the Chief Executive Officer any possible improvements in risk management policies, governance and measurement tools.

1.4. Key Risks

1.4.1. First Pillar risks

Credit Risk (including counterparty risk)

Credit risk is the risk of loss arising from the deterioration in the creditworthiness up to default of retail/corporate customers and institutional counterparties of whom the bank is a creditor in its investment or lending business, as a result of which debtors fail to meet all or part of their contractual obligations.

Market Risk

The risk of losses arising from adverse performance of sensitive market variables (e.g. interest rates, exchange rates, stock prices, volatility and bond yield spreads) in the investment and trading activities conducted by the Group.
For banks using the standardised approach the capital requirement for market risk is the sum of capital requirements for position risk, settlement risk, concentration risk and commodity risk.

Operational Risk

Banca Mediolanum defines operational risk as "the risk of economic loss or damage to assets, and sometimes legal and administrative consequences, resulting from any misconduct or inappropriate behaviour of its personnel, inadequate or failed systems or internal processes, or external events."

1.4.2. Second Pillar risks

Concentration Risk

Concentration risk is the risk resulting from exposure to individual counterparties, groups of related counterparties or counterparties in the same industry, business segment or geographical location.

Interest Rate Risk

Interest rate risk arising on activities other than trading: the risk of potential movements in interest rates.

Liquidity Risk

Liquidity risk is typically the risk that arises from the difficulty of liquidating assets. More specifically, it is the risk that a financial instrument cannot be bought or sold without a material decrease/increase in its price (wide bid-ask spread) due to the potential inability of the market to settle the transaction wholly or partly. Liquidity risk is also the potential that an entity will be unable to obtain adequate funding.

Residual Risk

The risk that the credit risk mitigation techniques adopted by the Bank turn out to be less effective than anticipated.

Strategic Risk

Strategic risk is the current or prospective risk of impact on earnings or capital arising from changes in the industry, adverse business decisions, improper implementation of decisions, lack of responsiveness to industry changes.

Reputational Risk

Reputational risk is the current or prospective risk of impact on earnings or capital arising from the negative perception of the bank's image by clients, counterparties, shareholders, investors or supervisory authorities.

1.5. Credit Risk

The Mediolanum Banking Group has in place models and measurement tools as well as controls that ensure proper credit risk management. As already noted, credit risk in the 'retail portfolio' is managed differently and separately from credit risk in the 'wholesale portfolio'.

The credit risk management system for both the retail and wholesale portfolios ensures the Group is always current with its risk exposure in relation to each customer or group of customers, and takes prompt corrective actions, when needed, in accordance with related policies.
The credit risk management system pursues the following objectives:

- develop adequate credit risk identification, measurement and monitoring processes in relation to each counterparty and portfolio;
- ensure a steady flow of timely information to effectively monitor the composition and quality of the loan portfolio and promptly adjust loss estimates and capital charges;
- ensure compliance with the prudential requirements of domestic and international supervisory authorities;
- promote the adoption of policies and procedures for credit risk prudent management;
- support operational decisions of lending officers by providing the information needed to properly assess the borrower creditworthiness and type of financing;
- provide an adequate flow of information on credit risk exposures and mitigation techniques to senior management.

The credit risk management system reflects the specific characteristics of the banking lending business and any changes therein in addition to any regulatory or statutory changes.
The different levels of credit risk controls for the 'retail portfolio' are described below.

1. First level control

First level controls are carried out by operational staff in the Lending Division under the coordination and supervision of the Credit Policy and Monitoring team that also ensures monitoring of the activities conducted by the Banking Services Division with respect to amounts overdrawn by those customers who do not have arranged overdraft facilities (up to 30 days overdrawn).
Division staff are responsible for ensuring that the guidelines prepared by the Credit Policy and Monitoring team together with the Risk Control team are complied with and that adequate procedures are implemented at all times.
The Credit Policy and Monitoring team and staff in operating units within the Lending Division ensure that control procedures are effectively implemented and prepare related reports for business and superior control functions.
In particular, they are responsible for ensuring regular assessment of:

- any security taken, with proper procedures according to their legal nature;
- performance of portfolios by type of loan, channel, borrower, geography, month of origination and main variables that are most indicative of risk.

First level controls, carried out directly by the heads of lending units, fall into two categories: line controls and performance monitoring.

2. Second level control

Second level controls relating to credit risk mitigation for both the loan portfolio and the Finance Division portfolio are carried out by the Risk Control team within the Compliance & Risk Control Function of Banca Mediolanum.
Being the owner of the ICAAP process, the Compliance & Risk Control Function of Banca Mediolanum is responsible for fine-tuning the calculation of the relevant capital charge as well as for validating aggregate data already checked and validated as correct by the line functions.
The Risk Control unit within the Compliance & Risk Control Function, that is separate and independent of lending operations, is responsible for assessing the overall credit risk exposure of the Banking Group.

The Risk Control team is responsible also for defining risk measurement methods by borrower category and type of borrowing as well as for continuously monitoring capital adequacy vis-à-vis the Group credit risk.
As part of the system of controls relating to the Loan Portfolio credit risk exposure, second level controls carried out by the Risk Control team include:

- identification, analysis and definition of methods to measure the Bank's loan portfolio risk exposure in collaboration with the relevant Business Operations Management units, using appropriate calculation tools differentiated by borrower category and type of loan;
- support to the line staff in the definition of risk measurement methods according to the activities carried out;
- oversight of credit risk monitoring, collaborating on an ongoing basis with the Credit Policy and Monitoring unit to prevent any anomalies;
- measurement of credit risk at portfolio level and verification of capital adequacy as per regulatory requirements;
- effective reporting to the Board of Directors, Senior Management and heads of operating units on the evolution of risks, assessing and proposing risk prevention and mitigation measures, where appropriate;
- sensitivity analyses and stress testing, maintenance of assessment systems and methods.

Second level controls are carried out by the Risk Control team within the Compliance & Risk Control Function of Banca Mediolanum. This function is separate and independent of lending operations.
These controls are designed to assess overall credit risk exposure in the loan portfolio of the Banking Group.
The Risk Control team is also responsible for defining risk measurement methods as well as continuously monitoring capital adequacy pursuant to both Pillar 1 and Pillar 2 requirements.
Specifically, in relation to the Loan Portfolio Risk Exposure, the Risk Control team:

- identifies, defines and analyses risk measurement methods with the assistance of line staff;
- oversees credit risk monitoring, collaborating on an ongoing basis with the Lending Division first level units staff;
- ensures effective reporting to the Board of Directors, Senior Management and heads of operating units;
- assesses and proposes risk prevention and mitigation actions, when necessary.

Credit risk controls relating to the 'Wholesale Portfolio' handled by the Finance Division are described below.

1. First level controls

These are line controls conducted by front-office and back-office staff and geared to assess the accurateness, completeness and consistency of transactions information and compliance with the operating licences and limits of the respective operating units.
These activities are the responsibility of the Finance Division.

2. Second level controls

Second level controls are carried out by staff in the Risk Control unit. This unit is separate and independent of those operating units that engage in investment transactions with institutional counterparties on behalf of the Bank.
In relation to credit risk controls, Risk Control unit staff:

- coordinate collection, processing and preparation of financial data and statistics for risk analysis;
- manage the credit risk control process at Banking Group level;
- report on financial market performance and the related risk position taken by the Bank and the Banking Group;
- assess and monitor the risk exposure of the Bank and other entities, proposing corrective measures when needed;
- gather real economy, monetary policy, credit and financial market information and data including for the purpose of preparing financial statements.

1.5.1. Control Process

The credit risk control process consists of various steps that engage a multitude of players with different roles and responsibilities. These are the key steps in the process:

A. Annual review of operating licenses and limits

The annual review of operating licenses and limits entails reviewing strategic guidelines and the maximum risk appetite for the year. This exercise includes the review of counterparties, their public rating, when available, and credit limits in accordance with their creditworthiness which is assessed by the Lending Division staff for operations and counterparties falling within its remit. For other operations creditworthiness is determined primarily using the public rating given by external credit assessment institutions (ECAI) recognised by the Bank of Italy.

The Institutional Counterparties credit risk management Policy is usually examined by Banca Mediolanum's Board of Directors during its first meeting for the year and the version approved by Banca Mediolanum's Board of Directors serves as Group guidelines for all entities within the Banking Group. The operating licenses and limits thus approved reflect the maximum risk appetite (MRA) for the year and can be revised only upon approval by the Board of Directors. The revision of limits is regulated as part of the management process for requests to raise the limits as set out below.

B. Daily risk management practices

Daily risk management practices consist of daily monitoring and reporting practices put in place to ensure risk exposure is within operating licences and limits. On a daily basis, the Risk Control team monitors risk through measurements and checks, analysing the output of this exercise. Exposure to credit and market risks documented in reports is carefully analysed. If this exercise reveals exposure is within limits no action is taken. If limits are exceeded the procedure for the relevant authorisation and the establishment of higher limits gets started. Procedures are documented in specific detailed documents.

C. Amendments to operating licences and limits

The policy document with operating licences and limits approved by the Board of Directors reflects the Bank's Maximum Risk Appetite (MRA), therefore these limits cannot be exceeded unless specifically approved by those officers to whom authorities have been delegated under the policy document.

When dealing with new counterparties the Financial Management team submits a preliminary request with details of the transaction (e.g. type of financing, amount, length) to the Risk Control staff for their examination and recommendation. Said request is to be received at least one week (5 business days) before the Meeting of the Finance and Treasury Management Committee (FTMC) that will examine the transaction. The Risk Control team delivers its recommendation to the Financial Management team before the date of the FTMC Meeting. The FTMC assesses the transaction on its merits and issues its recommendation for examination and approval/rejection at the next Meeting of the Board of Directors. In case of proven urgent circumstances, for counterparties meeting specified requirements and conditions as set out in the relevant policy, after consulting the risk management team, the Chief Executive Officer has the authority to temporarily approve transactions with new counterparties for amounts up to 30% of the MRA, subject to ratification by the Board of Directors at its next scheduled meeting.

For increases in existing limits as approved by the Board of Directors, the Financial Management team submits a preliminary request with details of the transaction (e.g. type of financing, amount, length) to the Risk Control team for its examination and recommendation. The Risk Control team delivers its recommendation to the Financial

Management team before the date of the meeting of the Control & Risk Committee. If, after examination, the Control & Risk Committee expresses its favourable opinion, the transaction can be authorised upon approval by the CEO at the Control & Risk Committee meeting. The CEO has the authority to temporarily approve increases in credit limits for amounts within 20% of the credit limit, subject to ratification by the Board of Directors at its next scheduled meeting.

D. Monthly reports to the Board of Directors

The Risk Control team prepares a monthly report, called Risk Dashboard, for the Board of Directors. This report is submitted to the Board of Directors after examination by the Audit & Risk Committee at its scheduled meetings and contains information on risk analysis and control activities conducted in the previous month regarding the securities portfolio, ALM and liquidity management.

The purpose of the report is to provide information on existing exposure to market risk, credit risk, liquidity risk and operational risk. For financial and credit risks it provides information on risk management activities carried out by the Finance team, while for operational risk it set out operational risk data gathered from each operational unit of the Bank.

The report features an initial section with macroeconomic data for the relevant industry, the situation/position of the Bank in relation to each type of risk, as captured by key trend indicators. The other sections of the report set out specific information on each of the relevant risks.

For reasons related to the control activities conducted by the Financial Management team, the report is generated monthly and sent to the various heads of functions and to Senior Management.

E. Annual reports on control activities

Annually, the Risk Control team prepares a report summarising its control activities with information on any circumstances in which limits were exceeded or significant operational loss events, if any.

This annual report is submitted to the Board of Directors for approval at the first Board meeting of the year.

F. Stress testing

As part of the ICAAP process the Risk Control team has in place stress testing procedures for all key risks. Key risks are stress-tested applying the methods set out in the relevant policy. For details on stress testing procedures readers are referred to the relevant documentation.

1.5.2. Reporting System

An adequate credit risk reporting system enables to analyse precisely quantitative and qualitative information about the composition of the portfolio and the level of portfolio exposure as well as to identify any variables that impact the level of provisioning and capital requirements.

As part of first level controls, staff prepare information on the retail loan portfolio. In particular, the following quarterly reports are prepared:

- loan portfolio analysis: by type of loan, regulatory portfolio and geography;
- default analysis: distribution of default rates by type of loan and by geography;
- concentration analysis.

These reports are prepared for the Board of Directors, Senior Management, and for the Heads of Operating Units. As part of its second level control duties the Risk Control team prepares summary and detailed reports. Summary reports are submitted to the Head of the Compliance & Risk Control function, the Chief Executive Officer and the Board of Directors on a monthly, quarterly and annual basis. Detailed reports are submitted to the staff and heads of operating units on a daily basis. Detailed reports contain information on daily risk management practices in relation to limits for allocation, positions in securities, in funds and forex, as well as individual credit limits.

1.6. Market Risk

The market risk management system of the Mediolanum Banking Group consists of a suite of control models and tools.
The main types of controls put in place to manage market risk exposures are described below.

1. First level controls

These are line controls conducted by front office and back-office staff and geared to assess the accurateness, completeness and consistency of transactions information and compliance with the operating licences and limits of the respective operating units.
Specifically, these controls are carried out by staff in the Finance Division and the Retail Securities Trading office.

2. Second level controls

The Risk Control unit staff are responsible for second level controls. The Risk Control unit is separate and independent of operating units that engage in investment transactions with institutional counterparties on behalf of the Bank. As to market risk, the staff in this unit:

- coordinate collection, processing and preparation of financial data and statistics for risk analysis;
- manage the market risk control process at Banking Group level;
- report on financial market performance and the related risk position taken by the Bank and the Banking Group;
- assess and monitor the risk exposure of the Bank and other entities, proposing corrective measures when needed;
- gather real economy, monetary policy, credit and financial market information and data, including for the purpose of preparing financial statements.

1.6.1. Control Process

The market risk control process is organised in the same way as the credit risk control process.

1.6.2. Reporting System

As part of their control duties the Risk Control unit staff are responsible for preparing reports, namely:

- Internal reports to be submitted to the Board of Directors during scheduled meetings and to the competent operating unit officers;
- Market disclosures in the manner and within the timeframe required by the Supervisory Authorities.

Specifically, summary reports are submitted to the head of the Compliance & Risk Control function, the Chief Executive Officer, and the Board of Directors on a monthly, quarterly and annual basis. Detailed reports are submitted to the heads and staff of the Finance Division and the Retail Securities Trading office on a daily basis. Detailed reports contain information on daily risk management practices in relation to VaR limits, stress test scenarios, Stop Loss limits, limits for allocation, positions in unlisted derivatives, positions in funds, forex positions and individual credit limits.

1.7. Operational Risk

The operational risk framework of the Mediolanum Banking Group is based on the following underlying principles:

- identification and full coverage of operational risk;
- separation and independence from Operating Units;
- use of uniform, consistent models and methods for the collection of data and information as well as for the analysis and measurement of risks by all organisational units and/or entities within the Group;
- timely and consistent analysis and measurement of risk; subsequent preparation of reports to support control and decision-making processes;
- transparency and dissemination of models, methods and criteria applied in the analysis and measurement of risk to promote a control culture within the organisation and understanding of the reasons underlying the choices made;
- delegation of risk management authorities and responsibilities to Operating Units for their direct management of operational risk.

The principles and guidelines above, as well as the nature and features of operational risk entail that:

- operational risk identification, measurement, monitoring and management are based on the analysis of Group operations and main operational processes;
- controls are carried out by all organisational units and functions in accordance with their respective roles and responsibilities with frequent interactions and mutual exchanges of information to ensure synergistic, effective risk management.

Specifically, the controls they conduct are as follows:

1. First level controls

First level controls are controls made by the individuals who carry out a certain activity and by their supervisors, generally within the same organisational unit or function.

2. Second level controls

Second level controls are conducted by organisational units that are separate from operating units, and specifically, units within the Compliance & Risk Control Function, Sales Network Inspectors and the Anti-Money Laundering team.

3. Third level controls

Third level controls include controls conducted by Internal Audit staff on operating processes as well as on annual self-assessment of operational risk that is required of banks and banking groups applying the standardised approach.

1.7.1. Reporting System

An adequate operational risk reporting system promotes the dissemination of a control culture within the Group and greater awareness of the level of risk to which organisational units are exposed.
The reporting system used by the Compliance & Risk Control Function is differentiated by information recipient and scope of analysis.
Information about the following aspects is particularly important:

- actual operational losses and related recoveries;
- developments in the operating environment and in the internal control system that change significantly the operational risk profile;
- identification of vulnerable spots in major business processes;
- education and information sessions with the heads of operating units;
- assessment of operational risk connected with the introduction of new products, activities, processes and systems;
- estimate of operational risk capital charge under the approach in use;
- risk transfer, if any.

The reports prepared by the Compliance & Risk Control Function staff are submitted to the heads of organisational units, the head of the Compliance & Risk Control Function, the Audit and Risk Committee, the Chief Executive Officer and General Manager, the Board of Directors and the Supervisory Authorities. These reports are prepared with varied frequency depending on their scope and recipient. Frequency and content are detailed in the policy framework documents and periodically reviewed.
An annual self-assessment report is also produced as well as reports to Supervisory Authorities pursuant to Circular 263/2006.

1.8. Risk Management and Mitigation

The Banking Group defines, implements and maintains an adequate risk management and mitigation system in relation to all risks to which it is exposed.
The adequacy and effectiveness of this system entails that, in exceptional circumstances, the Group may allocate capital also to cover risks that cannot be measured beforehand.
The risk management and mitigation system consists of a set of procedures, methods, rules and functions that operate in a coordinated fashion to ensure:

- adherence to corporate strategies;
- effectiveness and efficiency of corporate processes;
- protection of the entity's assets;
- reliability and integrity of accounting and management information;
- compliance with internal and external rules and regulations.

Specifically, for each type of risk, the Banking Group's risk management and mitigation system consists of:

- strategies, conduct rules, general principles and goals, risk-taking, protection and mitigation policies that are set forth in 'guidelines' and 'policy statements';

- clear roles and responsibilities of governing bodies and corporate functions involved in risk management, set forth in 'internal rules';
- risk management processes set forth in 'organisational procedures' and 'operating instructions';
- information flows set out in 'organisational procedures' and 'operating instructions'.

The risk management and mitigation system includes internal risk measurement methods developed and applied to properly manage risk and enhance awareness of risks taken also in view of future capital requirements. These methods are also used to check the appropriateness of capital charges calculated under the standardised approach vis-à-vis actual risk exposures based on the analysis of corporate processes and positions held.
The main goals pursued by the Banking Group's risk management system are to:

- ensure the internal control system effectively captures any significant anomalies and adequate risk prevention and mitigation actions are taken;
- ensure the broadest and deepest possible understanding, implementation and consistency of risk management principles, rules and approaches within the Group;
- promote a risk management culture at all levels of the organisation and encourage consistent, knowledgeable operating choices and practices, in a structured way.

The corporate bodies that are responsible for risk supervision, management and control play a key role in the definition and implementation of the risk management and mitigation system across the organisation whose adequacy and effectiveness depend on the degree of engagement of all people within the Group.

2. SCOPE OF APPLICATION

The information contained in this document relates to the Mediolanum Banking Group. Within the Group there are no legal or other material obstacles, either in existence or foreseeable, that could hamper a prompt transfer of assets or funds.

The scope of consolidation is the same as the scope of consolidation set out in the consolidated financial statements prepared under IAS/IFRS which include the accounts of Banca Mediolanum S.p.A. and those of its directly or indirectly controlled subsidiaries.

Analysis of subsidiaries consolidated on a line-by-line basis is set out in the tables below.

Group companies that are directly owned by Banca Mediolanum S.p.A. and consolidated on a line-by-line basis

Company	Share capital	% holding	Registered Office	Business
Mediolanum Gestione Fondi SGR p.A.	5,165	51.00%	Basiglio	Fund Management
Mediolanum Fiduciaria S.p.A.	240	100.00%	Basiglio	Trust company
Mediolanum International Funds Ltd	150	51.00%	Dublin	Fund Management
Mediolanum Asset Management Ltd	150	51.00%	Dublin	Asset management and advice
Banco Mediolanum S.A.	86,032	100.00%	Barcelona	Banking
Bankhaus August Lenz & Co. AG	20,000	100.00%	Munich	Banking
Gamax Management AG	7,161	100.00%	Luxembourg	Fund Management
Fermi & Galeno Real Estate S.r.l.	10	99.996%	Basiglio	Management of real estate funds

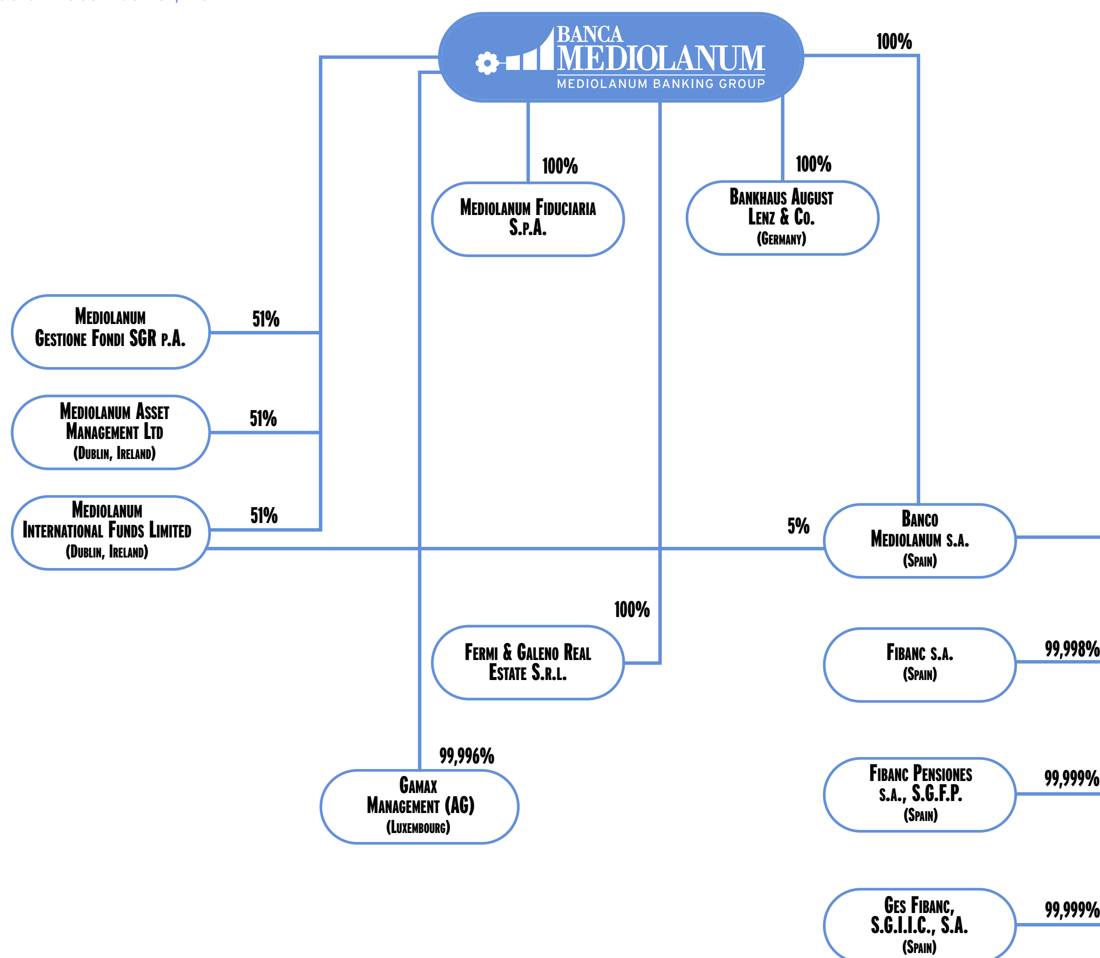
Group companies that are indirectly owned by Banca Mediolanum S.p.A. through Banco Mediolanum S.A., and consolidated on a line-by-line basis

Company	Share capital	% holding	Registered Office	Business
Ges Fibanc SGIIC S.A.	2,506	100.00%	Barcelona	Fund management
Fibanc S.A.	301	100.00%	Barcelona	Financial Advice
Fibanc Pensiones S.G.F.P. S.A.	902	100.00%	Barcelona	Pension Fund management
Mediolanum International Funds Ltd	150	5.00%	Dublin	Asset management and advice

Subsidiaries are consolidated on a line-by-line basis, which means the accounts of the parent company and those of its subsidiaries are combined line by line by adding together like items of the balance sheet and the income statement.
The financial statements of the Parent Company and those of its subsidiaries used in the preparation of the consolidated financial statements are prepared as of the same reporting date.
When a company within the Group uses different accounting policies, in preparing the consolidated financial statements adjustments are made to make them uniform with the accounting policies adopted by the Group.
The scope of application of Pillar 3 supervisory requirements is shown in the chart below that sets out the entities that make up the Mediolanum Banking Group.

Group Structure

as of December 31, 2012



3. COMPOSITION OF REGULATORY CAPITAL

Regulatory capital and capital ratios have been determined in accordance with the new regulations issued by the Bank of Italy (13th update of Circular 263 of December 2006 and 14th update of Circular 155 of December 1991) following the transposition into Italian law of amendments to Directives 2009/27/EC, 2009/83/EC and 2009/111/EC (amendment II to the Capital Requirements Directive or CDR II) and 2010/76/EC of November 24, 2010 (amendment III to the Capital Requirements Directive or CDR III) adopting the New Basel Capital Accord ('Basel II').

Regulatory capital is calculated as the sum of positive and negative components based on their quality. Positive components must be fully available to the bank to be included in the calculation.

Regulatory capital is made up of core capital and supplementary capital adjusted by so called 'prudential filters' after certain deductions.

Core capital (or Tier 1 capital) includes paid up ordinary share capital, reserves, innovative and non-innovative capital instruments, and net profit for the period (only for the portion that it is intended to be appropriated to reserves) plus Tier 1 positive prudential filters. The sum of the aforesaid items less treasury shares, intangible assets, loss for the period as well as for prior years, other negative components and prudential filters result in Tier 1 capital before deductions. Tier 1 capital is the difference between Tier 1 capital before deductions and deduction items.

Supplementary capital (or Tier 2 capital) includes valuation reserves, innovative and non-innovative capital instruments that cannot be included in core capital, hybrid capital instruments, tier 2 subordinated liabilities, net unrealised gains on equity investments plus Tier 2 positive prudential filters. The sum of the aforesaid items less net unrealised losses on equity investments, the negative components relating to loans, other negative items and prudential filters results in Tier 2 capital before deductions. Tier 2 capital is the difference between Tier 2 capital before deductions and deduction items.

Total regulatory capital is the sum of core capital, included in the calculation without restrictions, and supplementary capital, which cannot exceed the amount of Tier 1 capital before deductions, plus Tier 3 capital. Tier 3 capital can be used only to cover market risk (net of counterparty risk and settlement risk in the banking book) and up to 71.4% of capital requirements for market risk.

At December 31, 2012, Mediolanum Banking Group's capital did not include any instruments falling within Tier 3 capital.

Management of regulatory capital entails a set of policies and choices needed to define the size of capital as well as the optimal combination of the various alternative capital instruments to ensure capital adequacy vis-à-vis the risks undertaken.

The tables below set out information about share capital and treasury shares and their movements in the year.

Table 3.1 - Analysis of 'Share Capital' and 'Treasury Shares'

€/'000	Share Capital		Treasury Shares	
	Dec. 31, 2012	Dec. 31, 2011	Dec. 31, 2012	Dec. 31, 2011
Ordinary shares	600,000	450,000	-	-
Other shares	-	-	-	-
Total	600,000	450,000	-	-

Table 3.2 - Year's movements in share capital and treasury shares

€/'000	Ordinary	Other
A. Opening balance	450,000	-
- fully paid up	450,000	-
- not fully paid up	-	-
B. Increases	150,000	-
- new issues	150,000	-
- sale of treasury shares	-	-
- other increases	-	-
C. Decreases	-	-
- cancellations	-	-
- purchase of treasury shares	-	-
- sale of businesses	-	-
- other decreases	-	-
D. Closing balance	600,000	-

The analysis of Consolidated Regulatory Capital is set out in the table below.

Table 3.3 - Analysis of regulatory capital (part. 1)

€/'000	Dec. 31, 2012	Dec. 31, 2011
Tier 1 positive components		
Share capital	602,670	452,670
Share premium account	-	-
Reserves	198,111	187,058
Non innovative equity instruments	-	-
Innovative equity instruments	-	-
Profit for the period	29,043	9,401
Prudential filters: increases in Tier 1 capital	-	-
Total Tier 1 positive components	**829,824**	**649,129**
Tier 1 negative components		
Treasury shares	-	-
Goodwill	(177,424)	(198,314)
Other intangible assets	(15,317)	(13,348)
Loss for the period	-	-
Other negative components	-	-
Prudential filters: deductions from Tier 1 capital	(2,535)	(15,642)
Total Tier 1 negative components	**(195,276)**	**(227,304)**
Tier 1 before deductions	**634,548**	**421,825**
Deductions from Tier 1 capital		
Shareholdings in lenders and financial institutions above 20% of their capital	(5,073)	(5,000)
Shareholdings in lenders and financial institutions above 10% but below 20% of their capital	-	-
Shareholdings in insurers	-	-
Expected losses in excess of total impairment losses	-	-
Deductions in connections with securitisations	-	-
Deductions for settlement risk on non-DVP transactions	-	-
Total deductions	**(5,073)**	**(5,000)**
TOTAL TIER 1 CAPITAL	**629,475**	**416,825**
Tier 2 positive components		
Valuation reserves	-	-
Non innovative equity instruments that cannot be included in Tier 1 capital	-	-
Hybrid equity instruments	-	-
Tier 2 subordinated liabilities	93,041	122,415
Total impairment losses in excess of expected losses	-	-
Net unrealised gains on equity investments	-	-
Other positive components	-	-
Prudential filters: increases in Tier 2 capital	-	-
Total Tier 2 positive components	**93,041**	**122,415**

Table 3.1 - Analysis of regulatory capital (part 2)

€/'000	Dec. 31, 2012	Dec. 31, 2011
Tier 2 negative components		
Net unrealised losses on equity investments	-	-
Loans	-	-
Other negative components	-	-
Prudential filters: deductions from Tier 2 capital	-	-
Total Tier 2 negative components	-	-
Tier 2 before deductions	93,041	122,415
Deductions from Tier 2 capital		
Shareholdings in lenders and financial institutions above 20% of their capital	(5,073)	(5,000)
Shareholdings in lenders and financial institutions above 10% but below 20% of their capital	-	-
Shareholdings in insurers	-	-
Expected losses in excess of total impairment losses	-	-
Deductions in connections with securitisations	-	-
Deductions for settlement risk on non-DVP transactions	-	-
Total deductions	(5,073)	(5,000)
TOTAL TIER 2 CAPITAL	87,968	117,415
Deductions from Tier 1 & Tier 2 capital	-	-
TOTAL REGULATORY CAPITAL	717,443	534,240
TOTAL TIER 3 CAPITAL	-	-
REGULATORY CAPITAL INCLUDING TIER 3	717,443	534,240

4. CAPITAL ADEQUACY

The capital adequacy assessment process is based on both Pillar 1 requirements which entail the calculation of the minimum capital requirements for credit risk (including counterparty risk), market risk and operational risk, and Pillar 2 requirements which entail assessment of own internal capital requirements to cover all material risks, hence the Group's total capital requirements.

To that end the Group has in place strategies and processes that enable it to assess its capital adequacy and ensure it holds internal capital or risk capital that is adequate, in terms of both size and composition, to cover all material risks to which it is or may be exposed.

The Group estimates its current and future capital adequacy in relation to its risk profile and business strategies through the Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP entails the following steps:

- identification of all material risks, i.e. under both Pillar 1 and Pillar 2;
- measurement/assessment of individual risks and related internal capital level;

- assessment of the overall internal capital level. The Mediolanum Banking Group calculates the total capital requirement applying a simplified building-block approach, i.e. by adding up the capital requirements for each identified risk. The building-block approach does not assume any diversification effects due to the interaction of items that contribute to determine each individual risk.

Capital adequacy is managed through a set of policies that define the size as well as the optimal combination of the various alternative capital instruments to ensure the Group and its subsidiaries hold enough capital to cover risks in compliance with regulatory requirements.
Pursuant to the "New Regulatory Requirements for Banks" (Bank of Italy's Circular No. 263 of December 27, 2006, as subsequently amended) the minimum requirement for the Group's total capital ratio is 8% of risk-weighted assets (RWA) for risks that are typical of banking and financial business (credit risk, counterparty risk, market risk, operational risk), weighted in accordance with debtors' regulatory segmentation, taking account of credit risk mitigation techniques. To assess capital strength other ratios are used in addition to the total capital ratio, namely the Tier 1 capital ratio (core capital/RWA) and the Core Tier 1 capital ratio (core Tier 1/RWA).
At December 31, 2012, the Mediolanum Banking Group had a Tier 1 capital ratio (core capital/RWA) of 12.14% and a total capital ratio (regulatory capital/RWA) of 13.84%.

Table 4.1 - Capital Adequacy (part. 1)

€/'000	Dec. 31, 2012		Dec. 31, 2011	
	Weighted exposure	Capital Requirement	Weighted exposure	Capital Requirement
ASSETS / CREDIT RISK				
Standardised approach				
Exposures to/guaranteed by governments & central banks	-	-	-	-
Exposures to/guaranteed by local government agencies	20,007	1,601	20,208	1,617
Exposures to/guaranteed by nonprofits and public entities	4,806	384	5,149	412
Exposures to/guaranteed by multilateral development banks	-	-	-	-
Exposures to/guaranteed by international organisations	-	-	-	-
Exposures to/guaranteed by supervised intermediaries	1,143,086	91,447	1,171,706	93,736
Exposures to/guaranteed by companies	466,963	37,357	227,820	18,226
Retail exposures	679,634	54,371	594,259	47,541
Exposures secured by properties	1,052,777	84,222	832,963	66,637
Past due exposures	38,017	3,041	65,496	5,240
High risk exposures	8,757	701	7,381	590
Exposures in secured bank bonds	36,705	2,936	-	-
Short-term exposures to companies	-	-	-	-
Exposures to UCITS	130,705	10,456	160,212	12,817
Other exposures	164,056	13,124	170,559	13,645
Securitisation exposures	13,140	1,051	10,430	834
TOTAL CREDIT RISK	3,758,653	300,692	3,266,183	261,295
ASSETS/MARKET RIS				
Standardised approach				
General risk	-	2,265	-	3,438
Specific risk	-	6,753	-	9,966
UCITS holdings risk	-	-	-	-
Options	-	-	-	1,997
Currency risk	-	11,059	-	-
Commodity risk	-	-	-	-
Concentration risk	-	286	-	1,630
TOTAL MARKET RISK	-	20,363	-	17,031

Table 4.1 - Capital Adequacy (part. 2)

€/'000	Dec. 31, 2012 Weighted exposure	Dec. 31, 2012 Capital Requirement	Dec. 31, 2011 Weighted exposure	Dec. 31, 2011 Capital Requirement
ASSETS/OPERATIONAL RISK				
Foundation approach		5,859		3,770
Standardised approach		87,798		72,264
Advanced approach		-		-
TOTAL OPERATIONAL RISK		**93,657**		**76,034**
OTHER PRUDENTIAL REQUIREMENTS		-		-
Adjustments to regulatory requirements for intercompany transactions		-		-
TOTAL PRUDENTIAL REQUIREMENTS		**414,712**		**354,360**
Risk-weighted assets (RWA)*		5,183,904		4,429,499
Tier 1/RWA (Tier 1 capital ratio)		12.14%		9.41%
Regulatory capital/RWA (Total Capital ratio)		13.84%		12.06%

(*) Total prudential requirements multiplied by the reciprocal of the mandatory minimum coefficient for credit risk (8%)

The table below provides separate information about the capital requirement for credit risk and counterparty risk.

Table 4.2 - Capital requirement for credit risk and counterparty risk

€/'000	Dec. 31, 2012	Dec. 31, 2011
Credit risk	300,136	261,029
Counterparty risk	556	266
Total capital requirement for credit risk and counterparty risk	**300,692**	**261,295**

5. CREDIT RISK - GENERAL INFORMATION (ALL BANKS)

Lending, be it the provision of home loans or consumer credit, or in other forms to meet other financing needs, is part of the business of the Mediolanum Banking Group. In line with the Group mission, lending complements the Group primary business i.e. the distribution of banking, asset management, insurance and retirement savings products. The Group applies prudent lending policies, which are geared to develop and strengthen the relationship with customers who invest in products managed by the entities within the Group.
Credit risk is largely in connection with traditional lending. It relates to all loans, either secured or unsecured, on balance sheet or similar off-balance sheet items, e.g. endorsements. The analysis of the Group's lending operations is therefore crucial to enforce an effective system of internal control.
The loans extended by the banking group essentially consist of:

- overdraft facilities repayable on demand or fixed-term credit lines;
- loans repayable in instalments;
- bank guarantees in favour of customers;
- residential mortgage loans.

The Group also monitors any amounts that exceed the credit limit, either under arranged or unarranged overdrafts, for any reasons, including under standard credit cards or credit cards with revolving credit facilities.

The risk management framework includes policies that set out general principles and instructions on lending as well as on monitoring the quality of the loan portfolio. The Parent Company of the Banking Group is responsible for assessing overall exposure to credit risk and defining credit risk measurement policies for the whole Group.
Credit risk exposure is also assessed at the level of individual companies in their respective areas of responsibility, by measuring and monitoring the risk associated with the various categories of financial instruments.

5.1. Definition of Default

To determine **'default'** Banca Mediolanum refers to the definition of 'impaired loans' used for the purpose of financial reporting[1]. Impaired loans include:

- nonperforming loans;
- watch list loans;
- restructured loans;
- past due loans.

Nonperforming loans consist of on and off-balance sheet exposures (e.g. loans, securities, derivatives) to borrowers that are unable to meet their payment obligations – even if their insolvency has not been established by a court of law – or in equivalent conditions, regardless of any losses estimated by the lender and irrespective of any security taken. This category does not include country risk exposures, but includes exposures to local government entities (municipal, provincial administrations) that are insolvent for the share of the exposure recognised in the insolvency proceedings, and loans or receivables acquired from third parties where the principal debtor is non-performing irrespective of the category into which they are classified on the balance sheet.

(1) Cf. Bank of Italy Circular 272 of July 30, 2008 – Third Update of December 23, 2011.

Watch list loans consist of on and off-balance sheet exposures (e.g. loans, securities, derivatives) to borrowers that are experiencing objective temporary difficulties in meeting their payment obligations, but are expected to make good within a reasonable timeframe. These exposures are recognised irrespective of any security taken. This category does not include country risk exposures.
Restructured loans consist of on and off-balance sheet exposures (e.g. loans, securities, derivatives) for which a bank (or a syndicate of banks) agrees to change the original loan terms and conditions (e.g. rescheduling payments, reducing debt and/or interest) due to the deterioration of the financial condition of the borrower, with ensuing losses. This category does not include exposures to companies that are going out of business (e.g. voluntary wind-up or similar conditions) as well as country-risk exposures.
Past due loans consist of on and off-balance sheet exposures (e.g. loans, securities, derivatives) to borrowers other than those classified in the categories above (nonperforming, watchlist, restructured) that at the reporting date were over 90 days past due or overdrawn. This category does not include country risk exposures.

5.2. Method used to Calculate Impairment

The Mediolanum Banking Group calculates impairment applying the following two-step approach:

- Identification of assets to be individually or collectively tested for impairment;
- Measurement and recognition of the impairment loss in accordance with the specific impairment rules.

The first step is preliminary to the impairment test that assesses and measures the impairment loss, if any.
Banca Mediolanum tests for impairment loans and endorsements with fixed or determinable payments extended to retail and institutional clients. Loans and endorsements to retail clients typically consist of arranged overdraft facilities, loans and credit lines repayable in instalments, while those extended to institutional clients (banks and other financial institutions) are made up of deposits, repurchase agreements (amount paid for the purchase of the asset under an agreement to resell it at a future date) and hot money facilities.
To identify loans and endorsements to be individually/collectively tested for impairment it is necessary to analyse the significance of the exposure and check whether there is objective evidence of any losses.
Banca Mediolanum individually tests for impairment all exposures classified as nonperforming, watchlist and over 180 days past due loans (pursuant to Bank of Italy's instructions) irrespective of their significance. In fact these are exposures for which there is objective evidence of impairment as per §64 of IAS 39. Other exposures, i.e. performing loans, are collectively tested for impairment. Only for monitoring purposes a €1,000,000 threshold is set for the determination of the significance of the individual exposure. Any exposure in excess of said threshold is examined separately and individually.
For exposures that are individually assessed for impairment the recoverable amount of the individual exposure is determined on the basis of:

- estimated recoverable cash flows;
- timing of recoveries;
- the interest rate used to discount future cash flows.

Banca Mediolanum treats nonperforming, watchlist, restructured and over 90 days past due exposures in accordance with the different level of risk of the respective category, taking account of the type and value of any security taken and other key indicators of potential risk based on management expertise and conservative estimates.

Exposures that are not individually assessed are grouped on the basis of similar risk characteristics and collectively assessed for impairment.
The collective impairment loss is obtained by adding up the losses of each group. The collective impairment amount is compared with the previous carrying amount of loans to determine the amount of provisions to set aside or use.
The process for the identification of the groups of loans to be collectively assessed under IAS is in line with the credit risk approach under Bank of Italy's Circular 263 of December 27, 2006. Specifically, the risk parameters under said regulation, i.e. probability of default (PD) by rating class and Loss Given Default (LGD) are significant parameters for the classification of loans into groups with similar credit risk characteristics and for the calculation of provisions.
At present, the grouping of loans for the purpose of collective assessment is by rating and client segment (Retail/Corporate).
The calculation of the impairment loss is made applying a Basel-oriented approach, i.e. impairment is approximated to the concept of Expected Loss (EL) as set out in the relevant regulations. Expected Loss is the average loss the Bank expects to incur on an exposure as a result of the deterioration of credit quality or default of the borrower.
Banca Mediolanum's loan loss provision for collectively assessed exposures is therefore determined by calculating the Expected Loss (EL) on all exposures in a given rating class, applying the following formula:

$$EL^{class}_{exposure} = Balance_{exposure} \times PD^{class} \times LGD$$

where:
- $Balance_{exposure}$: is the book value for short-term financing and amortised cost for loans repayable in instalments;
- LGD: failed recoveries rate to be applied to performing loans;
- PD^{class}: probability of default over 1 year for performing loans in a given rating class.

The loan loss provision for collectively assessed exposures is thus obtained by adding up expected losses on each exposure:

$$Total\ provisions = \sum_{exposure\ class} EL$$

Especially in relation to the IAS rule that requires to consider the "time value of money" when calculating impairment, the Group is developing a model for the calculation of LGD that takes account of average time to recovery and recovery schedule as well as the type of asset and security taken.
Due to the lack of sufficiently robust historical data for internal loss estimates the Group used the LGD rates as per the Basel II Accord as follows:
- retail mortgage loans: LGD=25%;
- other retail loans: LGD=85%;
- loans extended to businesses: LGD=45%.

Based on observed historical loss data LGD was assumed to be zero (meaning no collective assessment is applied) for the following exposure categories:

- Hot money;
- Repurchase agreements with banks;
- Deposits with banks.

The 1-year PD is a good approximation of "*incurred but not reported (IBNR) losses*" calculated on the basis of current indications, for losses that are expected to materialise within one year.

Table 5.1 - Analysis of financial assets by category and credit quality (book value)

€/'000	Non performing	Watch list	Restructured	Past due	Other assets	Total
1. Financial assets held for trading	-	-	-	-	587,308	587,308
2. Available-for-sale financial assets	-	-	-	-	9,041,941	9,041,941
3. Held-to-maturity investments	-	-	-	-	1,025,038	1,025,038
4. Loans to banks	-	-	-	-	1,082,992	1,082,992
5. Loans to customers	9,032	21,473	7,842	5,876	5,088,818	5,133,041
6. Financial assets at fair value	-	-	-	-	-	-
7. Financial assets being disposed of	-	-	-	-	-	-
8. Hedging derivatives	-	-	-	-	1,366	1,366
Total at December 31, 2012	9,032	21,473	7,842	5,876	16,827,463	16,871,686
Total at December 31, 2011	8,424	53,240	226	6,344	13,880,878	13,949,112

Table 5.2 - Geographical distribution of on-balance sheet and off-balance sheet customer loans (book value)

	Italy		Other european countries		America		Asia		Rest of the world	
Exposure/Geographical area €/'000	Net exposure	Net impairment	Net exposure	Net impairment	Net exposure	Net impairment	Net exposure	Net impairment	Net exposure	Net impairment
A. On-balance sheet										
A.1 Non performing	8,918	(14,799)	114	(1,933)	-	-	-	-	-	-
A.2 Watch list	18,904	(6,408)	2,569	(1,725)	-	-	-	-	-	-
A.3 Restructured	7,842	(5,620)	-	-	-	-	-	-	-	-
A.4 Past due	5,876	(636)	-	-	-	-	-	-	-	-
A.5 Others exposures	13,147,173	(5,028)	1,565,575	(1,203)	841	-	295	-	4,143	-
Total	13,188,713	(32,491)	1,568,258	(4,861)	841	-	295	-	4,143	-
B. Off-balance sheet										
B.1 Non performing	-	-	-	-	-	-	-	-	-	-
B.2 Watch list	9	(8)	-	-	-	-	-	-	-	-
B.3 Other impaired assets	-	-	11	(502)	-	-	-	-	-	-
B.4 Others exposures	114,115	(65)	504	(42)	-	-	-	-	-	-
Total	114,124	(73)	515	(544)	-	-	-	-	-	-
Total at Dec. 31, 2012	13,302,837	(32,564)	1,568,773	(5,405)	841	-	295	-	4,143	-
Total at Dec. 31, 2011	8,591,265	(27,983)	1,637,879	(86,809)	736	-	309	-	226	-

Table 5.3 - Geographical distribution of on-balance sheet and off-balance sheet bank loans

Exposure/Geographical area €/'000	Italy		Other european countries		America		Asia		Rest of the world	
	Net exposure	Net impairment	Net exposure	Net impairment	Net exposure	Net impairment	Net exposure	Net impairment	Net exposure	Net impairment
A. On-balance sheet										
A.1 Non performing	-	-	-	-	-	-	-	-	-	-
A.2 Watch list	-	-	-	-	-	-	-	-	-	-
A.3 Restructured	-	-	-	-	-	-	-	-	-	-
A.4 Past due	-	-	-	-	-	-	-	-	-	-
A.5 Others exposures	1,706,718	-	390,779	-	5,685	-	41	-	2,206	-
Total	1,706,718	-	390,779	-	5,685	-	41	-	2,206	-
B. Off-balance sheet										
B.1 Non performing	-	-	-	-	-	-	-	-	-	-
B.2 Watch list	-	-	-	-	-	-	-	-	-	-
B.3 Other impaired assets	-	-	-	-	-	-	-	-	-	-
B.4 Others exposures	24,343	-	7,568	-	-	-	-	-	-	-
Total	24,343	-	7,568	-	-	-	-	-	-	-
Total at Dec. 31, 2012	1,731,061	-	398,347	-	5,685	-	41	-	2,206	-
Total at Dec. 31, 2011	3,109,747	-	757,168	-	6,741	-	24	-	-	-

Table 5.4 - Analysis of customer loans (on and off-balance sheet positions) by borrower category

Exposure/ Counterparty €/'000	Governments			Government agencies			Financial companies			Insurance companies			Non financial companies			Others		
	Net exposure	Individual impairment	Collective impairment	Net exposure	Individual impairment	Collective impairment	Net exposure	Individual impairment	Collective impairment	Net exposure	Individual impairment	Collective impairment	Net exposure	Individual impairment	Collective impairment	Net exposure	Individual impairment	Collective impairment
A. On-balance sheet																		
A.1 Non performing	-	-	X	-	-	X	-	-	X	-	-	X	51	(338)	X	8,981	(16,394)	X
A.2 Watch list	-	-	X	-	-	X	-	-	X	-	-	X	30	(32)	X	21,443	(8,101)	X
A.3 Restructured	-	-	X	-	-	X	7,614	(5,620)	X	-	-	X	228	-	X	-	-	X
A.4 Past due	-	-	X	-	-	X	-	-	X	-	-	X	18	(3)	X	5,858	(633)	X
A.5 Others exposure	8,915,072	X	-	32,862	X	-	458,934	X	(11)	21,381	X	-	234,932	X	(574)	5,054,846	X	(5,646)
Total A	8,915,072	-	-	32,862	-	-	466,548	(5,620)	(11)	21,381	-	-	235,259	(373)	(574)	5,091,128	(25,128)	(5,646)
B. Off-balance sheet																		
B.1 Non performing	-	-	X	-	-	X	-	-	X	-	-	X	-	-	X	-	-	X
B.2 Watch list	-	-	X	-	-	X	-	-	X	-	-	X	-	-	X	9	(8)	X
B.3 Other impaired assets	-	-	X	-	-	X	-	-	X	-	-	X	-	-	X	11	(502)	X
B.4 Others exposure	30	X	-	-	X	-	3,644	X	-	10,969	X	(31)	4,265	X	(4)	95,711	X	(72)
Total B	30	-	-	-	-	-	3,644	-	-	10,969	-	(31)	4,265	-	(4)	95,731	(510)	(72)
Total (A+B) at Dec. 31, 2012	8,915,102	-	-	32,862	-	-	470,192	(5,620)	(11)	32,350	-	(31)	239,524	(373)	(578)	5,186,859	(25,638)	(5,718)
Total (A+B) at Dec. 31, 2011	5,774,235	(81,320)	-	101,373	-	-	265,612	(3,705)	(15)	54,130	-	-	126,447	(532)	(128)	3,908,618	(23,530)	(5,562)

Table 5.5 - Time-to-maturity of financial assets and liabilities

Item/Time-to-Maturity €/'000	On demand	1 to 7 days	7 to 15 days	15 days to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Indefinite maturity
On-balance sheet assets										
Government securities	13,934	248	500,000	30,040	485,009	1,108,228	1,407,788	5,645,303	781,730	-
Other debt securities	2,614	13	46,372	8,090	353,336	99,464	530,538	855,362	22,315	-
Holdings in UCITS	133,456	-	-	-	-	-	-	-	-	-
Loans to:	894,203	270,862	81,438	24,462	116,177	91,683	163,119	865,108	2,504,134	73,712
- banks	135,356	163,963	81,345	-	9,614	-	-	-	-	69,876
- customers	758,847	106,899	93	24,462	106,563	91,683	163,119	865,108	2,504,134	3,836
On-balance sheet liabilities										
Deposits	6,393,498	31,201	82,341	187,406	764,467	830,510	1,229,254	31	-	-
- banks	1,766	-	33,524	67,095	160,266	101,276	122,326	-	-	-
- customers	6,391,732	31,201	48,817	120,311	604,201	729,234	1,106,928	31	-	-
Debt securities	-	-	-	-	9	21	431	86,116	7,958	-
Other liabilities	183,998	1,872,319	233,094	733,639	10,816	236	22,583	3,183,690	22,563	-
Off-balance sheet items										
Financial derivatives with exchange of principal	-	6,997	231,386	153,586	168,181	590	-	30,846	14,448	-
- long positions	-	1,675	117,000	75,792	97,975	560	-	9,285	-	-
- short positions	-	5,322	114,386	77,794	70,206	30	-	21,561	14,448	-
Financial derivatives without exchange of principal	17,264	-	-	1,312	2,531	3,887	7,834	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	17,264	-	-	1,312	2,531	3,887	7,834	-	-	-
Deposits and financing to be received	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
Firm commitments to disburse funds	-	-	-	-	-	-	-	-	-	-
- long positions	-	-	-	-	-	-	-	-	-	-
- short positions	-	-	-	-	-	-	-	-	-	-
Financial guarantees issued	-	-	-	-	-	-	-	-	-	-

Table 5.6 - Loans to customers: analysis of net impairment (on-balance sheet positions)

Description/Category €/'000	Non performing	Watch list	Restructured	Past due
Net impairment at beginning of the year	15,687	92,871	-	529
- of which: loans sold but not derecognised	-	-	-	-
Increases	4,619	4,805	5,620	667
impairment	2,644	4,568	1,916	626
reclassified from other impaired loan categories	1,973	237	3,704	41
other increases	2	-	-	-
Decreases	(3,574)	(89,543)	-	(560)
revaluations	(504)	(720)	-	(161)
repayments	(424)	(878)	-	(161)
cancellations	(2,646)	(907)	-	-
reclassified to other impaired loan categories	-	(5,718)	-	(238)
other decreases	-	(81,320)	-	-
Net impairment at end of the year	16,732	8,133	5,620	636
- of which: loans sold but not derecognised	-	-	-	-

Table 5.7 - Loans to banks: analysis of net impairment (on-balance sheet positions)

Description/Category €/'000	Non performing	Watch list	Restructured	Past due
Net impairment at beginning of the year	-	-	-	-
- of which: loans sold but not derecognised	-	-	-	-
Increases				
impairment	-	-	-	-
reclassified from other impaired loan categories	-	-	-	-
other increases	-	-	-	-
Decreases				
revaluations	-	-	-	-
repayments	-	-	-	-
cancellations	-	-	-	-
reclassified to other impaired loan categories	-	-	-	-
other decreases	-	-	-	-
Net impairment at end of the year	-	-	-	-
- of which: loans sold but not derecognised	-	-	-	-

Table 5.8 - Analysis of net impairment of loans

Item/Value €/'000	Impairment			Reversal of impairment				Dec. 31, 2011	Dec. 31, 2010
	Individual		Collective	Individual		Collective			
	Cancellations	Others		A	B	A	B		
Loans to banks:									
- Loans	-	-	-	-	-	-	-	-	-
- Debt securities	-	-	-	-	-	-	-	-	-
Loans to customers:									
- Loans	(1,525)	(10,291)	(1,355)	-	3,519	-	790	(8,862)	(6,068)
- Debt securities	-	-	-	-	-	-	-	-	-
Total	(1,525)	(10,291)	(1,355)	-	3,519	-	790	(8,862)	(6,068)

6. CREDIT RISK – EXPOSURES MEASURED UNDER THE STANDARDISED APPROACH

For credit risk weighing under the standardised approach, the Mediolanum Banking Group applies the ratings of the following rating agencies:

- Moody's;
- Cerved Group S.p.A.

The analysis of ratings applied to the Group's portfolios is set out in the table below.

Table 6.1 - Portfolios and official ratings

Portfolios	ECA/ECAI	Rating
Exposures to governments and central banks	Moody's	Solicited & Unsolicited
Exposures to international organisations	Moody's	Solicited
Exposures to multilateral development banks	Moody's	Solicited & Unsolicited
Exposures to companies and others	Moody's and Cerved Group S.p.A.	Solicited (Moody's) and Unsolicited (Cerved Group S.p.A.)
Exposures to UCITS	Moody's	Solicited
Positions in short-term rated securitisations	Moody's	N/A
Positions in securitisations other than short-term rated securitisations	Moody's	N/A

Pursuant to Bank of Italy's Circular 263 the Group has defined the criteria regarding the use of issue and issuer ratings for the purpose of assessing risk exposures. The prevalence rule was used when deciding the risk weighing for exposures in all banking portfolios. Said rule entails the use of the rating of the issue, and when not available the rating of the issuer.

The table below set out the analysis of credit risk exposures by category, with and without risk mitigation, as well as with indication of exposures deducted from regulatory capital.

Table 6.2 - Analysis of credit and counterparty risk exposures

	2012			2011		
Banking book €/'000	Exposures with credit risk mitigation	Exposures without credit risk mitigation	Exposures deducted from regulatory capital	Exposures with credit risk mitigation	Exposures without credit risk mitigation	Exposures deducted from regulatory capital
Exposures to/guaranteed by governments & central banks	10,199,764	10,411,538	-	6,649,081	6,962,129	-
Exposures to/guaranteed by local government entities	104,635	104,635	-	357,097	357,097	-
Exposures to/guaranteed by nonprofits and public entities	5,963	5,963	-	5,934	5,934	-
Exposures to/guaranteed by multilateral development banks	-	-	-	66,745	66,745	-
Exposures to/guaranteed by international organisations	-	-	-	20	20	-
Exposures to/guaranteed by supervised intermediaries	1,768,573	1,768,573	-	3,228,362	3,228,362	-
Exposures to/guaranteed by companies	1,088,015	1,088,015	-	900,214	900,402	-
Retail exposures	1,231,372	1,235,500	-	1,128,797	1,128,797	-
Exposures secured by properties	3,001,815	3,001,815	-	2,375,003	2,375,003	-
Past due exposures	41,923	41,923	-	67,605	67,605	-
High risk exposures	6,166	6,166	-	5,039	5,039	-
Exposures in secured bank bonds	73,410	73,410	-	-	-	-
Short-term exposures to companies	-	-	-	-	-	-
Exposures to UCITS	130,705	130,705	10,146	160,212	160,212	10,000
Other exposures	238,412	251,352	-	1,282,678	2,348,334	-
Securitisation exposures	44,282	44,282	-	52,152	52,152	-
Total credit risk & counterparty risk	**17,935,035**	**18,163,877**	**10,146**	**16,278,939**	**17,657,831**	**10,000**

8. RISK MITIGATION TECHNIQUES

The Banking Group does not offset credit risk exposures against positive balances of on or off-balance sheet items.

Credit risk mitigation (CRM) techniques consist of loan-related contracts or other instruments and techniques that reduce credit risk whose risk mitigating effect is recognised in the calculation of regulatory capital, as well as, for risk management purposes, in the internal policies of the Mediolanum Banking Group. Credit risk is inherent in lending transactions executed by the Retail Securities Trading office and in liquidity management conducted by the Finance Division.
Eligible CRM techniques fall into two broad categories:
1. real guarantees;
2. personal guarantees.

Real guarantees are:
1. financial collateral, i.e. cash, certain financial instruments, gold – pledged or transferred –, repurchase/reverse repurchase and securities lending/borrowing transactions;
2. master netting agreements;
3. on balance sheet netting;
4. mortgages and real estate leases.

Personal guarantees include personal guarantees and credit derivatives.
Currently, within the Mediolanum Banking Group, the use of credit derivatives is allowed only for trading purposes and not for banking book credit risk mitigation.
Eligible CRM techniques are mortgages and pledges or other equivalent security interests in assets with a reasonable degree of liquidity and a reasonably stable market value.
Conversely, although taken into account when deciding whether or not to extend a loan, 'irrevocable orders to sell other Group financial products' are not eligible for CRM purposes.
As to pledges, the financial asset that is directly or indirectly pledged as security must be one of the following:
- bank account balances held with Banca Mediolanum;
- treasuries or securities guaranteed by governments, and securities that are accepted as guarantee by central banks;
- holdings in mutual funds and open-end investment companies;
- liens on insurance policies issued by the Mediolanum Banking Group;
- assets in discretionary accounts managed by Banca Mediolanum;
- bonds and certificates of deposit issued by Banca Mediolanum or other banks;
- repo transactions relating to listed bonds, treasuries or accepted as guarantee by central banks, with retail customers;
- listed bonds;
- listed equities.

When the borrower's equity does not cover entirely the loaned amount, the loan is recognised at full risk.
Credit risk on mortgage loans is mitigated by the property given as collateral. Properties given as loan collateral must be located in Italy and be residential properties.

Semi-residential properties are accepted provided that they satisfy the following requirements:

- the non-residential portion does not exceed 40% of the estimated property value;
- the property is located in a residential area;
- the borrower is self-employed and intends to use the property as his/her primary residence.

In all these instances Loan-to-Value shall not exceed 70%.

The bank applies a disciplined approach to lending and adequate checks e.g. it checks the accurateness and completeness of the property appraisal as this is crucial to get a true view of risk. The bank requires than any request for mortgage loan approval be accompanied by a valid property appraisal setting out a true estimate of the value of the property for which the loan is sought and certifying to the highest possible degree that a valid building permit and any other authorisations for the property have been obtained. If not so, the loan will not be extended or the loan amount reduced to be commensurate with the true property value (which depends on its location, on how easily it can be resold, etc.).

The appraisal is made by qualified external valuers who have entered into an agreement with Banca Mediolanum.

The relevant unit within the Lending Division is responsible for ensuring that internal procedures for the preparation of property appraisals are thoroughly and properly applied.

Table 8.1 - Secured loans to customers

		Real guarantees (1)			Personal guarantees (2)									
					Credit derivatives					Endorsements				
					CLN	Other derivatives								
€/'000	Net exposure	Property	Securities	Others		Governments & central banks	Government agencies	Banks	Others	Governments & central banks	Government agencies	Banks	Others	Total (1)+(2)
1. Secured exposure on balance sheet:														
1.1 entirely secured	3,269,106	5,703,836	82,417	1	-	-	-	-	-	-	5	-	2,948,162	8,734,421
- of which impaired	23,490	45,383	28	-	-	-	-	-	-	-	-	-	8,977	54,388
1.2 partly secured	73,784	74,187	-	18,653	-	-	-	-	-	-	1,908	-	2,993	97,741
- of which impaired	4,218	7,180	-	-	-	-	-	-	-	-	98	-	755	8,033
2. Secured exposures off balance sheet:														
2.1 entirely secured	674	560	-	-	-	-	-	-	-	-	-	-	114	674
- of which impaired	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2.2 partly secured	20	-	-	-	-	-	-	-	-	-	-	-	17	17
- of which impaired	-	-	-	-	-	-	-	-	-	-	-	-	-	-

9. COUNTERPARTY RISK

The Mediolanum Banking Group devotes great attention to monitoring counterparty risk, i.e. the risk that a party to a financial contract (in particular repurchase agreements, OTC derivatives and long settlement transactions) may fail to perform its contractual obligations.

The methods used by the Mediolanum Banking Group to calculate counterparty risk exposures are set out in the table below.

Table 9.1 - Counterparty risk exposures

Exposure category	Method
OTC derivatives	Present Value
SFT transactions	CRM - simplified method
Long settlement transactions	Present Value

For the purposes of calculating the capital charge for counterparty risk arising on securities financing transactions (SFT), the Mediolanum Banking Group uses the simplified method, while for OTC derivatives and long settlement transactions the Group uses the present value method.
For each set of assets, the credit equivalent is calculated as the sum of the replacement cost and the future credit exposure ('add-on'). The replacement cost of each contract is its fair value, if positive. The fair value is positive if the bank is a net creditor of the counterparty. The credit exposure reflects the probability that the future fair value of the contract, if positive, may increase or, if negative, may turn positive. This probability is linked to the volatility of the underlying market variables as well as the residual life of the contract.

The Mediolanum Banking Group enters into derivative contracts essentially for hedging purpose, to protect against market risk (e.g. OIS – Overnight Indexed Swaps, futures), and risk in its loan portfolios, e.g. its mortgage loan portfolio via Interest Rate Swaps (IRS) and Interest Rate Options (IRO). IRS and IRO can be used only to hedge against risk in the mortgage loan portfolio. ISDA Master Agreements and the related Credit Support Annexes are to be made prior to entering into a contract with a new counterparty.
The Banking Group has no positions in credit derivatives.

Repurchase transactions are part of the activities conducted by the Finance Division and the Banking Services Division's Retail Securities Trading office, and are used for liquidity management and as part of the business with retail customers. Typically, the Finance Division uses repurchase agreements to refinance the securities portfolio while the Retail Securities Trading office uses them as part of its offering to customers. Credit risk in repurchase agreements used by the Finance Division is the risk of counterparty's default and the risk connected to the volatility of securities taken as guarantee. Therefore, any securities taken as guarantee need to satisfy minimum requirements in terms of rating (i.e. 'investment grade' – and any exception is to be approved by the head of the Finance Division) and institutional counterparties must be counterparties that were approved during the annual review process.

The analysis of counterparty risk exposures is set out in the table below.

Table 9.2 - Counterparty risk exposures

Item/Value €/'000	Exposure	Weighted exposure	Requirement
Derivative contracts	8,565	4,330	346
SFT & Long settlement transactions	228,510	2,615	209

The analysis of Mediolanum Banking Group's counterparty risk exposures in derivatives is set out in the table below.

Table 9.3 - Analysis of derivatives with positive fair value by type of product

Portfolios €/'000	Options	Interest Rate Swaps	Cross Currency Swaps	Equity Swaps	Forward	Futures	Others	TOTAL
Trading	-	-	2,620	-	-	-	-	**2,620**
Hedging	1,366	-	-	-	-	-	-	**1,366**

The table above includes the analysis by product of all OTC financial derivatives with institutional counterparties. Exposure is the positive fair value of derivatives and is determined in accordance with the regulations issued by the banking supervisor.

12. OPERATIONAL RISK

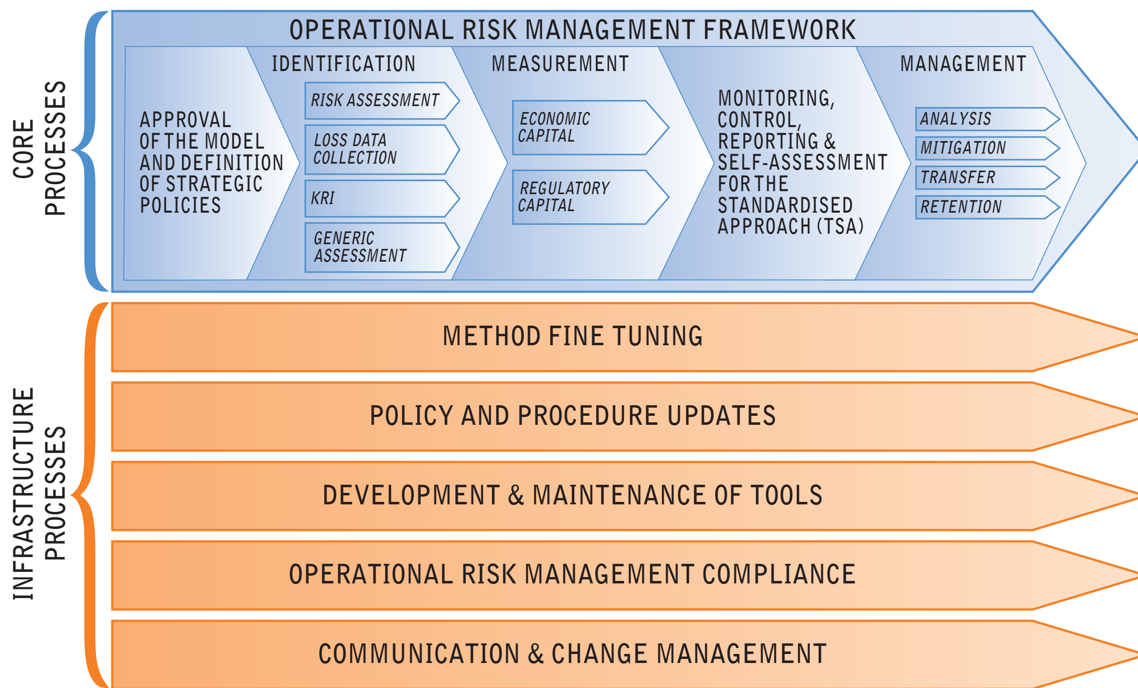
Operational risk is pervasive across the organisation and is closely correlated to legal risk and regulatory risk (compliance risk).

The Mediolanum Group defines operational risk as "*the risk of economic loss or damage to assets, and sometimes legal and administrative consequences, resulting from any misconduct or inappropriate behaviour of its personnel, inadequate or failed systems or internal processes, or external events*".

Therefore, the identification, monitoring and management of operational risk entail the analysis of the processes and activities carried out by the various companies within the Group, in addition to the activities conducted by the Parent Company.

The approach used to analyse risks entails the classification of processes into "core processes" and "infrastructure processes". Core processes include operating activities that are connected to the value chain, while infrastructure processes relate to activities supporting operations and to the Company's administrative activities.

Group Operational Risk Management is focused on both the assessment of the adequacy of risk management and monitoring procedures applied by the individual entities within the Group, in accordance with statutory and regulatory requirements and deadlines, as well as on the assessment of the specific operational risk to which the Parent Company may be exposed. These activities are conducted under the operational risk management framework set out in the diagram below:



Each main element in the diagram above indicates a macro-process which is divided into one or more sub-processes. In turn, these sub-processes consist of a series of steps and actions

'Identification' consists of the following:

1. Annual risk assessment: periodic assessment of risk exposures of organisational units through interviews with unit heads based on preliminary assessment of their riskiness. The assessment is built on combined analysis of risk indicators (including findings of prior years' assessments, operational loss events, key risk indicators monitored by the Risk Assessment & Mitigation team) and management information on operational processes (indicators of exposures and size of the structures, complaints received from customers, assessments of effectiveness of checkpoints) that is periodically updated to reflect the evolution of the business model or the organisational setup. The findings of this exercise make up an *ex-ante* estimate of risk exposure for the purposes of assigning an internal rating to organisational units and allow for an approach that is commensurate with the degree of operational riskiness, both in relative and absolute terms, i.e. with the risk appetite.
2. Measurement of actual or potential operational losses following particularly risky events (as part of the loss data collection exercise) or upon requests for insight and assistance for mitigation plans from the heads of organisational units. This exercise is supported by regular review of so called 'error reports' or transmission of specific warnings.
3. Preliminary analysis of exposure to operational, financial, compliance risks when entering a new market, or into new commercial arrangements/contracts or following changes in the organisation or regulations (generic assessment).
4. Collection, monitoring and analysis on a monthly basis of key risk indicators, i.e. indicators that provide insight into the status of operational processes and the main drivers of risk exposures.

The activities under paragraphs 1, 3 and 4 above are carried out by the Risk Assessment & Mitigation team, while Loss Data Collection is carried out by the Risk Control team.

'Measurement' relates to the calculation of risk capital, specifically:

- Economic capital: internal risk measurement through a rating system that enables to steer and calibrate risk management and mitigation according to the potential economic impact and the current risk management framework. This exercise is based on the outcome of risk identification analyses, applies an actuarial statistical model and is used also in the development of operational risk stress tests;
- Regulatory capital: calculated in accordance with capital requirements indicated by supervisory authorities (Bank of Italy's Circular 263 of December 27, 2006 on new capital requirements for Banks). Based on the examination of the results of self-assessment, initially made on November 7, 2007, and then reviewed on an annual basis (latest results examined on March 18, 2013), the Board of Directors resolved to apply the standardised approach to operational risk capital measurements on an individual basis. This decision was made considering that both quantitative and qualitative requirements for the adoption of said approach were satisfied. Notice thereof was duly given to the Bank of Italy. For the measurement of regulatory capital at consolidated level, the Board of Directors resolved to adopt a "combination of the basic indicator approach and the standardised approach". Said combination of approaches was applied after ascertaining the satisfaction of the relevant requirements for its use. The same approach will be applied for financial year 2013 as satisfaction of the relevant requirements was ascertained by the Board of Directors at its meetings of March 18, 2013.

'Monitoring, Control and Reporting' consists of the following:

- 'Monitoring and Control': analysis of actual exposure vs. estimated exposure to operational risk; identification of mitigating actions; fine tuning of risk assessment models;
- 'Reporting': preparation of regular reports to organisational units, Senior Management, Audit & Risk Committees and the Board of Directors.

'Management' is composed of the following:

- 'Management analysis';
- 'Risk mitigation';
- 'Management of risk transfer techniques';
- 'Risk retention management'.

The operational risk management framework is complemented by the following processes that cut across business lines:

- 'Policies & procedures';
- 'Fine-tuning of methods';
- 'Development and maintenance of tools and applications';
- 'Operational Risk Management Compliance';
- 'Internal Communications/Change Management'.

The tests and analyses performed within the Mediolanum Group show the adequacy of consolidated regulatory capital vis-à-vis operational risk, measured applying not only the standardised approach but also internal statistical analyses of processes and probability of adverse events.
In 2012, over 140 organisational units of companies within the Mediolanum Banking Group were examined, identifying over 3,000 operational risk checkpoints. Over 80% of these checkpoints were judged to be adequate or in need of being just better formalised. Some 49 risk mitigation actions were taken in relation to risk controls that were judged to be unsatisfactory or in need of improvement.

Said work was conducted by the operational risk management staff of each consolidated entity with the assistance of local officers at subsidiaries who are responsible for liaising with the correspondent unit of the Parent Company for guidance and control. In fulfilling said exercise, staff relied on an integrated database used across the Group for both operational risk management and assessment of statutory and regulatory compliance.
The activities carried out are subject to regular audit by an independent organisational structure.
No material aspect emerged from controls carried out.

13. EQUITY EXPOSURES

Equity exposures include either listed or unlisted equity instruments, controlling or non-controlling equity holdings.
Equity instruments classified as 'Financial Assets Held for Trading' are equity instruments held for trading purposes and are measured at fair value. If they are quoted in an active market[2] their fair value is determined using their market quotation. If the market for the equity instrument is not active, fair value is determined using estimation and valuation techniques which measure all instrument-related risks and use market data, e.g. the quoted price of instruments with similar characteristics, discounted cash flow analysis, option pricing models, recent comparable transactions.
Equity instruments classified as 'Available for Sale Financial Assets' consist of non-controlling interests. On initial recognition available-for-sale financial assets are measured at cost, i.e. the fair value of the instrument, plus any directly attributable transaction costs or income. After initial recognition available-for-sale financial assets continue to be measured at fair value, and are amortised through profit or loss, while gains or losses arising from a change in their fair value are recognised in a specific equity Reserve until the financial asset is derecognised or impaired. At the time of dismissal or impairment, the cumulative gain or loss previously recognised in equity is recognised in the income statement. Equity instruments whose fair value cannot be reliably measured as set out above are carried at cost.
Equity holdings in subsidiaries and associates are carried at cost.
If there is evidence that an equity holding may be impaired, its recoverable amount is calculated by estimating the present value of future cash flows expected to be generated by the equity holding, including the proceeds on its ultimate disposal. If the recoverable amount is lower than the carrying amount, the resultant difference is recognised in the income statement. If the value of a previously impaired equity holding increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed and the reversal recognised in the income statement.

(2) A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Table 13.1 - Analysis of equity exposures

€/'000	Book Value	Gains/losses for the period (*)
Held for trading		
Equity instruments	-	(90)
Available for sale		
Equity instruments	404	-
Non-controlling interests	13,253	695
Investments		
Controlling shareholdings	367,709	(8,821)

(*) For equity instruments in the HFT portfolio HFT these are trading profit/losses; for non-controlling interests these are dividends received, while for controlling shareholdings these are impairment losses.

14. INTEREST RATE RISK IN THE BANKING BOOK

Interest rate risk is the risk of potential impact of unexpected interest rate changes on the Bank's current earnings and equity. This risk is typical of banking book positions.

The Banking Book consists of on and off-balance sheet items that are not held for trading.

The goals pursued by the interest rate risk management system are to:

- ensure the stability of net interest income, minimising any adverse impact of changes in interest rates (earnings perspective), largely with near-term focus. The stability of net interest income is mainly influenced by re-pricing risk, yield curve risk, basis risk, re-fixing risk and optionality risk;
- protect the economic value, i.e. the present value of expected cash flows from assets and liabilities. The economic value perspective is focused on the potential medium/long-term effects of changes in interest rates and is mainly associated with re-pricing risk;
- ensure that interest rate risk that has been taken or can be taken be properly identified, measured, monitored and managed in accordance with uniform methods and procedures shared across the Group;
- make sure that risk measurement models are commensurate with actual earnings generated by the various risk owners;
- ensure that the quality of risk measurement and management systems is aligned with market standards and best practices;
- define risk limits and licences for the various levels of responsibility;
- ensure the generation of accurate data and reports by the various officers responsible for risk management and control at the different levels within the organisation;
- ensure compliance with requirements established by domestic and international supervisory authorities.

The definition of limits and licences reflects the risk appetite of the organisation and permits to control that practices at the various levels within the organisations are aligned with the strategic guidelines and policies adopted by the Board of Directors.

The application of the principles above led to the definition of the following indicators:

- **net interest income sensitivity** to parallel shifts in the yield curve;
- **economic value sensitivity** to parallel shifts in the yield curve.

Management of the interest rate risk in the banking book is part of Asset Liability Management (ALM). The Mediolanum Banking Group has in place an ALM system that measures performance of annual Net Interest Income and the Bank's Economic Value in relation to regulatory capital. The ALM system is also used by management to assess the impact of funding and lending policies on the entity's financial condition and earnings.

On a quarterly basis, the Risk Control unit staff prepare summary reports on overall interest rate risk exposures and stress test reports for the Board of Directors and Senior Management.
Stress tests are conducted applying the rate shocks scenarios set out in the relevant internal policy.
The main currency denomination of Mediolanum Banking Group exposures is the Euro; the value of positions in other currencies is not significant and therefore they were translated into Euros and grouped together with other euro-denominated items.

Table 14.1 - Interest rate risk indicators

Shift (+/-)	Effect on net interest income (*)	Effect on regulatory capital
Eur + 100bps	106	-
Eur - 100bps	(32,703)	-
Eur + 200bps	-	(127,156)
Eur - 200bps	-	52,284

(*) Figures relates only to Banca Mediolanum.

15. COMPENSATION POLICIES AND PRACTICES INCLUDING INCENTIVE PLANS

This chapter provides information about the "Group Compensation Policies" adopted by the Board of Directors of the Parent Company Banca Mediolanum on March 21, 2012, the related decision-making process, the roles and responsibilities of the various corporate bodies and functions.

15.1. Decision-making process

Shareholders - AGM

In addition to other matters as set forth in the Bylaws, at the AGM (Ordinary Meeting) the Shareholders vote on the Compensation Policy submitted by the Board of Directors. Shareholders are thus informed about the total costs, benefits and risks of the compensation policies including incentive plans adopted and can have their say. Shareholders are also informed on the implementation of remuneration policies especially with respect to the variable component of compensation and can thus assess their consistency with guidelines and set targets.

Board of Directors

The Board of Directors prepares and approves the compensation policies including incentive plans with the assistance of the Bank's Compensation Committee. The Board approves the criteria used to determine those staff who are considered material risk takers, the list of Identified Staff and share-based incentive plans.

Deputy Chairman of the Board

The Deputy Chairman of the Board submits proposals to the Board of Directors in relation to the appointment/revocation, pay and more generally the compensation and incentive plans, of the members of management and supervisory bodies of foreign banks within the Group, in particular of Bankhaus August Lenz & Co. AG.

Chief Executive Officer/General Manager

The Chief Executive/General Manager has the power to submit proposals on:

- staff who qualify as "material risk takers";
- compensation including incentive plans for "material risk takers", other than for control unit/function staff, as well as, more generally, for those staff whose duties may conflict with the powers of the Chief Executive Officer/General Manager.

Compensation Committee

The Compensation Committee is composed of a majority of independent Directors and plays a fundamental role with respect to the compensation and incentive plans in that it makes proposals to, advices and prepares analyses for the Board of Directors. Specifically, the Compensation Committee prepares proposals on pay and more generally the compensation and incentive plans of Senior Management and other "material risk takers"; provides advice on the process adopted for the preparation of compensation policies, the process applied and the criteria used to determine those staff who are considered material risk takers, the structure of compensation and incentive plans.

HR Team

The HR Team collaborates with competent bodies and functions in the definition of compensation policies including incentive plans taking care of the prior review of the regulatory framework, of market trends and practices as well

as of applicable collective labour agreements and supplementary company-based agreements with the Unions. The HR Team proposes the rules underpinning the organisation and operation of the process used to determine 'material risk takers', the structure of the variable component of compensation and amendments to the policies following changes in the organisation and/or the regulatory environment.

Planning & Control Team

The Planning & Control team contributes to the definition of compensation policies including incentive plans by providing, upon request of the competent bodies and functions, data and information for the determination of targets to be set for those staff whose variable component of compensation is linked to expected performance, and for the verification of the performance attained by them.

Risk Control and Risk Assessment & Mitigation teams

These teams contribute to the definition of compensation policies including incentive plans by preparing, upon request of the competent bodies and functions, opinions on the adoption of adequate performance indicators that reflect the profitability of the bank over time, taking account of current and future risks, cost of capital and liquidity needed for the conduct of business.

Compliance team

The Compliance team assesses the adequacy and regulatory compliance of adopted compensation policies and practices and their operation, both *ex ante* by analysing regulatory compliance of policies and implementation rules prepared by the competent structures, and *ex-post* by making sure, including on a test basis, that compensation policies are operated in compliance with regulations and principles.

Internal Audit team

The Internal Auditing team ensures that compensation practices are adequate to and consistent with the adopted compensation policies and operate properly. To that end, the team reviews compensation practices at least annually to verify their compliance with approved policies and reports on its findings to the Compensation Committee, the Board of Directors and the Board of Statutory Auditors for their adoption of corrective measures where appropriate.

15.2. Link between Compensation and Performance

The compensation structure adopted by the bank consists of a fixed component and a possible variable component in an appropriately balanced mix.

The proportion of the variable component (both short and long-term) is linked to target business performance.

Specifically, it is linked to the consolidated net profit attained by the Mediolanum Financial Conglomerate. Payment of the variable component of compensation is also subject to maintenance of a certain level of Return on risk adjusted capital" (RORAC) and of capital surplus according to the applicable capital requirements[3] at Mediolanum Financial Conglomerate level.

[3] Supplementary supervision of financial conglomerates: statement of capital adequacy of financial conglomerates.

15.3. Key features of the compensation system

Banca Mediolanum's compensation policies and incentive plans include any form of payment or benefit given[4], either directly or indirectly, in cash, share-based or in kind (fringe benefits) in exchange for services rendered by "staff". The term "staff"[5] includes:

- the members of the Board of Directors and of the Board of Statutory Auditors;
- employees;
- other individuals (including but not limited to external consultants), if they can generate significant risk for the Company.

With respect to said staff, Banca Mediolanum conducts an accurate internal assessment based on specific criteria and geared to identify those categories of staff whose activities may have a material impact on the Company's risk profile (so-called "material risk takers").
In general, the staff remuneration structure is inspired by the following rules:

- variable component of remuneration linked to performance indicators with risk-adjustment mechanisms applied both *ex ante* and *ex post*;
- a balance of shared-based or equivalent instruments and cash;
- deferred compensation systems.

The adopted remuneration structure is a balanced package consisting of:

- a fixed component that rewards staff for their role and responsibilities, according to the experience and talent required for the specific position as well as the level of excellence shown and the overall quality of their contribution to business performance;
- an incentive component that is aimed at rewarding staff for results attained with a direct link between compensation and actual performance recorded by the company and the individual in the short, medium and long term.

In accordance with supervisory regulations, incentive plans' beneficiaries pledge not to use any hedging nor insurance on their remuneration or other aspects that may alter or impair the risk alignment effects inherent in their compensation mechanisms, in particular in relation to incentive plans.

15.3.1. Incentive component

The incentive component consists of a variable compensation:

- short term incentive: annual rewards in the form of cash bonuses;
- medium/long term incentive: typically paid after three years (save for any specific provisions applicable to the sales Network) consisting of cash bonuses and/or shared-based awards.

The payment of the components above is conditional upon the achievement of financial and non-financial, business, individual and behavioural targets.

(4) Including discretionary pension benefits.
(5) Excluding marginal payments or benefits accorded on a non-discretionary basis to staff as part of a general company-wide policy and have no incentive effect in terms of risk assumption or control.

As medium/long-term incentive the bank uses the Mediolanum S.p.A. stock options plans reserved to the directors and executives of the Company and its subsidiaries with strategic roles within the Company and/or its subsidiaries, and the stock option plans reserved to the sales network.
Said plans entails annual awards of rights that entitle the beneficiaries to subscribe to newly issued Mediolanum S.p.A. ordinary shares.
Performance targets are determined applying a specific *Management Appraisal* process whereby individual targets are set at the beginning of the year, progress is monitored along the way and achievement of targets is verified at the end of the period.
The incentive component includes a deferral period (the vesting period) which is determined by the Board of Directors and is subject to the attainment of both individual and business performance targets as well as continuation of service within the organisation.
Said period is:

- nine years from the option grant date, for sales network members;
- three years from the option grant date, for Directors and Executives.

The exercise of the options and the subsequent subscription to the shares by the beneficiaries are allowed only after expiration of the vesting period, upon the exercise date and for the following three years.
Both short-term and the long-term incentives are awarded upon approval of the financial statements for the year to which the accrued rewards relate. In relation thereto, the link between profit attained and the percentage of exercisable options is a suitable *ex post* correction mechanism (*malus*).

15.4. Performance Indicators

The incentive component is linked to both business and individual performance.
Business performance is measured against profitability and risk profile at Mediolanum Financial Conglomerate level.
Individual performance is linked to both financial and non-financial performance and takes account of the role of staff. The compensation system in place for the sales network, namely Financial Advisors, includes parameters that take account of roles.

15.4.1. Incentive Component – Financial Performance Parameters

Individual financial performance parameters considered for the determination of the incentive component are based on the following criteria:

- performance needs to be assessed in areas on which the individual/function that benefits from the incentive has a significant influence;
- the performance indicators identified for said areas are to be closely correlated with the overall result/value generated by the organisational unit for which the individual has responsibilities;
- performance needs to be measurable as much as possible, relate to financial/budget plan targets and be visible to the Planning and Control team. In this respect, the performance indicator needs to be quantified by the Planning and Control team at the end of the measurement period;
- performance should be measured as much as possible against external benchmarks.

15.4.2. Incentive Component – Non-financial Performance Parameters

Non-financial performance parameters considered for the determination of the incentive component are closely linked to objective assessment of the activities carried out by the individual in the specific role (e.g. activities planned in the year preceding the year of assessment, ordinary activities carried out by the structure) and qualitative assessment of the effectiveness and efficiency of the activity itself.

Specifically, also taking account of the Management Appraisal system adopted by the Bank, the non-financial performance parameters for the short-term and medium/long-term variable incentive component of compensation for the various organisational units have the following features:

- for Executives they relate to planning and execution competencies, abilities and skills gained, increased responsibilities placed on them for the role they have in the management of resources, customer satisfaction and improvement of processes as well as specific projects assigned to them;
- for the Heads of control functions they are based on objective assessment of the activities conducted by the individual in the specific role and other purely qualitative aspects;
- for the rest of staff, where applicable, they are principally based on the recognition of gained competencies, abilities and skills, customer satisfaction and improvement of processes.

As to the Top Management Plan 2010, the exercise of options is also subject to the achievement of targets assigned to each beneficiary based on aforesaid Management Appraisal system.

15.4.3. Parameters applied to the Sales Network's compensation system

The compensation of the sales network, which mostly consists of Financial Advisors, is variable and differentiated by category, i.e.:

- Financial Advisors who are engaged exclusively in sales ("Bankers"); and
- Financial Advisors who in addition to sales also supervise, coordinate and coach other Financial Advisors ("Supervisors and Managers").

For the first category, compensation has two components:

- a so-called 'stable' component, which consists of commissions on sales that are paid on a monthly basis, plus management and service fees for the services rendered to the Customer on an ongoing basis that are linked to the (service) fees charged to the customer and are paid periodically to the financial advisor;
- a 'pure' incentive component, i.e. other incentive commissions paid under specific contests for the attainment of set targets, mostly sales targets. All this always in compliance with the guidelines geared to ensure Financial Advisors behave honestly, fairly, transparently and professionally, serving customer needs at best, as per MiFID Directive.

For the second category of Financial Advisors ("Supervisors and Managers") in addition to commissions paid on their individual sales (as set out above) compensation also includes commissions on sales made by the financial advisors and the size of the sales force they manage, as well as the level they have reached in the Sales Network commission scale. Other incentives may be earned for their role and their participation in the share-based incentive plan.

15.5. Rationale of the compensation systems

The aims of the compensation policy and incentive plans set by the bank are to attract and retain people with skills and talent that meet the needs of the company and to provide incentives that motivate and reward them for their enhanced engagement in boosting business performance.
The compensation policy pursues improved alignment between the interest of shareholders and the bank's management both in the short term, through creation of maximum shareholder value, and in the long-term, through appropriate risk management and delivery on the long-term strategy.
In this respect the compensation and incentive criteria based on objective parameters linked to performance and aligned with medium/long-term strategic targets are an effective way to stimulate greater engagement by all people and hence best serve the interest of the Bank.
At the same time, taking a disciplined approach, business targets are appropriately adjusted to take account of all risks and ensure adequate capital and liquidity for the conduct of business, avoiding distorted incentives that induce violations of regulations or excessive risk-taking for the bank and the system as a whole.
In relation to this last point, the compensation and incentive systems are designed so as to encourage compliance with regulations and statutes applicable to the Bank and the Banking Group.
Also for the purpose of mitigating legal and reputational risk, special attention is given to the compensation and incentive systems for the Financial Advisors network and staff with responsibilities of control in compliance, risk control and internal audit.

Table 15.1 - Information on aggregate compensation by business line*

Business line €/'000	Compensation
Trading & Sales	3,102
Retail Brokerage	329,808
Agency Services	268
Asset Management	6,940
Retail Banking	72,675

* With respect to the business lines identified for the purposes of disclosure on compensation policies we deemed it appropriate to conventionally adopt the model defined by the Basel Committee.

Under this approach the activities of a financial intermediary are classified into the following *Business Lines*:

1. Corporate finance;
2. Trading and sales;
3. Retail banking;
4. Commercial banking;
5. Payment and settlement;
6. Agency services;
7. Asset management;
8. Retail brokerage.

Table 15.2 - Information on aggregate compensation of material risk takers - Mediolanum Banking Group

	COMPENSATION FOR THE YEAR			VARIABLE COMPENSATION			
MATERIAL RISK TAKERS Mediolanum Banking Group	Number of beneficiaries *€/'000*	Fixed compensation *€/'000*	Variable compensation *€/'000*	Cash *€/'000*	Shares	Share-based instruments[1] *€/'000*	Other
Chief Executive Officer	7	3,029	1,179	264	N/A	916	N/A
Executive Directors	3	588	78	-	N/A	78	N/A
Non Executive Directors	2	350	-	-	N/A	-	N/A
General Manager	1	175	58	-	N/A	58	N/A
Heads of main business lines, functions, regions and direct reports to corporate bodies	12	2,880	809	432	N/A	377	N/A
Chief Auditor and senior internal auditors	12	1,744	10	10	N/A	-	N/A

[1] Fair value of stock options granted in the year under the long-term incentive plan.
[2] Fair value of stock options granted in the year under the long-term incentive plan whose exercise upon vesting is subject to the satisfaction of specific performance conditions.
[3] Fair value of stock options granted in prior years that became exercisable in the year.
[4] Fair value of stock options granted in prior years that were not exercisable as performance conditions were not entirely or partly satisfied.

DEFERRED COMPENSATION		DEFERRED COMPENSATION RECOGNISED IN THE YEAR		NEW PAYMENTS FOR NEW HIRES IN THE YEAR		NEW PAYMENTS FOR COMPLETION OF SERVICE IN THE YEAR		COMPLETION OF SERVICE AMOUNTS RECOGNISED DURING THE YEAR		
Granted[2] €/'000	Not granted €/'000	Exercisable[3] €/'000	Reduced due to performance results[4] €/'000	Number of beneficiaries	Amount €/'000	Number of beneficiaries	Amount €/'000	Number of beneficiaries	Amount €/'000	Highest amount recognised to a single individual €/'000
916	-	-	-	-	-	-	-	-	-	-
78	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-
58	-	-	-	-	-	-	-	-	-	-
377	-	75	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-

GLOSSARY

ALM *(Asset & Liability Management)* Integrated management of assets and liabilities for risk/return optimisation in resource allocation.

AMA *(Advanced Measurement Approaches)* Under the AMA a bank's operational risk regulatory capital requirement is calculated using internal operational risk measurement models that capture and process operational loss and other key data. To qualify for use of the Standardised and the Advanced Measurement Approaches a bank must satisfy specific criteria which for the AMA relate to risk measurement in addition to risk management.

Back-Office The functions that take care of processing transactions.

Banking book Portfolios of financial instruments, in particular securities, a bank holds for its business, and not for trading.

Budget Estimate or plan of future revenues and expenses of a business.

Categories of financial instruments under IAS 39: HFT (Held For Trading) financial assets held with trading intent which include assets purchased to be sold in the near term or that are part of portfolios held and managed exclusively to earn gains in the short term; ***HTM (Held To Maturity)*** held-to-maturity investments include non-derivative assets with fixed or determinable payments and fixed maturity that an entity intends and has the ability to hold to maturity; ***L&R (Loans & Receivables)*** include non-derivative assets with fixed or determinable payments, that are not quoted in an active market; ***AFS (Available For Sale)*** financial assets that are available for sale including those not classified in the other three categories.

Core tier 1 ratio The percentage of core capital (*tier 1*), excluding preference shares and savings shares, to risk-weighted assets. Preference shares are innovative capital instruments usually issued by international subsidiaries, that may be included in core capital if they meet inclusion requirements, i.e. contribute to the bank's capital soundness. The tier 1 ratio is the same ratio including preference shares in core capital.

Covered bonds Secured bank bonds that in addition to the guarantee given by the issuing bank are backed by a portfolio of mortgage loans or other high-quality loans transferred for that purpose to a special purpose vehicle.

CRD *(Capital Requirements Directive)* Directives 2006/48/EC and 2006/49/EC of the European Parliament and of the Council adopted by the Bank of Italy by Circular 263 of December 27, 2006, and subsequent amendments.

Credit default swap/option Contract whereby the credit risk of a loan or a security is transferred by one party who buys protection through premium payments to the other party who undertakes to make payments to the protection buyer upon occurrence of a defined event of impaired ability of the debtor to meet his obligation (with options, the option buyer has to exercise the option).

Credit derivatives Derivative contracts for the transfer of credit risk. Credit derivatives can be used for arbitrage and/or hedging, take exposures that are diversified by duration and intensity, change the risk profile of a portfolio, segregate credit risk from other market risks.

Credit risk The risk that the unexpected deterioration in the creditworthiness of a counterparty or in the value of security given by it, or in its ability to cover on margin calls, brings about an unanticipated change in the bank's exposure.

CRM Credit Risk Mitigation.

Default The inability to pay principal and/or interest when due.

Duration A weighted-average term-to-maturity of the bond's capital and interest payments, and an indicator of the interest rate risk of a security or bond portfolio.

EAD *(Exposure At Default)* Relates to both on-balance sheet and off-balance sheet exposures, it is the estimate of the future value of an exposure upon the counterparty's default.

ECAI *(External Credit Assessment Institution)* External credit rating agency recognised by the Bank of Italy.

Economic capital Level of capital required of a bank to cover losses that have a certain probability of occurrence, or confidence interval, over a one year period. Economic capital is a measure of the variance of expected losses in a given portfolio and depends on the level of diversification of the portfolio.

Expected loss (EL) The amount of loss on an exposure an entity might incur over a one year period. The expected loss of a portfolio indicates the average loss distribution for that portfolio.

Fair value The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial conglomerate A group where a regulated entity is at the head of the group or with activities mainly in the financial sector and at least one of the entities in the group is in the insurance sector and at least one is within the banking or investment services sector.

Forwards Contracts under which two parties agree the conditions today but settlement takes place at a specified future date when one party will pay the other party a difference which is calculated differently depending on the instrument under the contract. Forwards may relate, among others, to interest rates, currencies or stock indices, and generally trade over the counter (OTC).

Front-Office Functions authorised to operate on markets.

Futures Standardised contracts whereby two parties agree to buy or sell currencies, securities, or other assets, at a future date for a predetermined price. Futures are traded on regulated markets where execution is guaranteed.

IAS/IFRS International Accounting Standards/International Financial Reporting Standards issued by the International Accounting Standard Board (*IASB*), the private international accounting standard-setting body established in April 2001. The IASB is composed of members from accounting professions from the world's main countries, and, as observers, representatives from the European Union, the International Organization of Securities Commissions (IOSCO) and the Basel Committee. The IASB is the successor to the International Accounting Standards Committee (*IASC*), formed in 1973 to promote harmonisation of accounting standards. When the IASB was formed it was decided to name new international accounting standards "International Financial Reporting Standards" (*IFRS*).

ICAAP Under Basel II Pillar 2 (Title III of Bank of Italy's Circular 263/2006) banks are required to have a process (Internal Capital Adequacy Assessment Process, ICAAP) to estimate their own internal capital requirements to cover all risks, including those not captured by the total capital requirement (pillar 1) as part of the assessment of the bank's current and future exposure, taking account of the bank's strategies and possible developments in the environment in which it operates.

Impairment Under IAS/IFRS, the value decline of an asset when its carrying amount exceeds its recoverable amount, which is the higher of the amount obtainable from the sale of the asset in an arm's length transaction and its value in use.

IRO *(Interest Rate Option)* Option whose final value depends on future interest rates.

***IRS** (Interest Rate Swap)* A contract whereby two parties agree to exchange cash flows of opposite sign applying two different interest rates to the same notional amount at specified dates and over a predetermined period.

***LGD** (Loss Given Default)* The ratio of the loss on an exposure in the event of default of the counterparty to the amount outstanding at default.

Liquidity risk The possibility that the entity becomes unable to meet its payment obligations as a result of its inability to liquidate assets or obtain adequate funds from the market (*funding liquidity risk*) or the difficulty/inability to quickly convert financial assets to cash without significantly and adversely impacting their price due to the insufficient depth of financial markets or their temporary malfunctioning (*market liquidity risk*).

Market risk The risk of loss arising on movements in prices of market-traded financial instruments (e.g. equities, bonds, derivatives, foreign-currency-denominated securities) or of financial instruments whose value is linked to market variables (e.g. loans to customers for rates, deposits denominated in euro or foreign currencies).

MDB Multilateral Development Bank.

***MRA** (Maximum Risk Appetite)* The maximum amount of risk an undertaking is willing to accept in order to achieve its strategic objectives.

***OIS** (Overnight Indexed Swap)* A contract under which the two counterparties exchange the net cash flows resulting from the difference between a fixed rate and floating rate.

Operational risk The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk (the risk of loss arising from violations of statutes or regulations, liability in contract or in tort, or legal proceedings), but excludes strategic risk (the risk of loss resulting from bad strategic management choices) and reputational risk (the risk of loss of market share as a result of the bank's brand being associated with negative events).

OTC Over-The-Counter.

***OU** (Operating Unit).*

***PD** (Probability of Default)* The probability of default of a counterparty over a one year period.

Prudential filters Adjustments applied to financial items in the calculation of regulatory capital to safeguard its quality and reduce the potential volatility arising on the adoption of the international accounting and financial reporting standards (IAS/IFRS).

Rating Assessment of the quality of a company or its issues of debt securities based on the financial strength of the company and its outlook. Rating can be external when this assessment is made by external specialist agencies, and internal when made by the bank using internal models.

Retail Category of customers that includes individuals, small and medium-sized enterprises.

Risk Management Identification, measurement, assessment and management of the various types of risk and protection against risks.

***RWA** (Risk Weighted Assets)* On-balance sheet and off-balance sheet assets (derivatives and guarantees) classified and weighted for their associated risks. Risk weightings are established in accordance with the regulations issued by supervisory authorities in relation to calculation of capital ratios.

Securitisation A transaction whereby the risk associated with financial or tangible assets is transferred to a special purpose vehicle by transfer of the underlying assets or use of derivatives. In Italy securitisations are mainly regulated under Act 130 of April 30, 1999.

Sensitivity The degree with which certain assets or liabilities react to movements in rates or other parameters.

SFT *(Securities Financing Transactions)* Repurchase/reverse repurchase agreements on securities or commodities, lending/borrowing of securities or commodities and margin lending.

Shift Movement in the yield curve.

SREP *(Supervisory Review and Evaluation Process)* The SREP hinges on the use of the risk assessment system adopted by the Supervisor and on dialogue between the Banking Supervisor and banks. Through dialogue the Banking Supervisor can gain a deeper understanding of the banks' ICAAP including underlying assumptions, and banks can detail the assumptions underlying their internal capital adequacy assessment process. Where necessary, the Banking Supervisor take supervisory actions in relation to the organisation and financial setup of the regulated banks deploying the measures that are most appropriate to the specific case.

Stakeholder A person, group, organisation directly or indirectly involved with a company and with an interest in its successful operation.

Stop Loss Strategy intended to protect capital invested in a financial asset in the event that markets move in the opposite direction to the one originally anticipated.

Stress test A simulation used to measure the impact of extreme market scenarios on a bank's overall risk exposure.

Tier 1 Core capital. Tier 1 capital includes paid up share capital, share premium, retained earnings (including the IAS/IFRS first-time adoption reserve for the portion not recognised in valuation reserves) less treasury shares and intangible assets. Consolidated Tier 1 capital includes also minority interests.

Tier 2 Supplementary capital. Tier 2 capital includes valuation reserves, innovative and non-innovative capital instruments that cannot be included in Tier 1 capital, hybrid capital instruments, tier 2 subordinated liabilities, net unrealised gains on equity instruments, the excess of impairment over expected losses, other Tier 2 positive components plus prudential filters. The sum of the aforesaid items less net unrealised losses on equity investments, the negative components relating to loans, other negative items and prudential filters results in Tier 2 capital before deductions. Tier 2 capital is the difference between Tier 2 capital before deductions and 50% of deduction items.

Total capital ratio The percentage of total regulatory capital (Tier 1 + Tier 2 capital) to risk-weighted assets.

Trading book It usually refers to positions in securities, and more generally in financial instruments, held with trading intent.

UCITS Undertakings for Collective Investment in Transferable Securities.

VaR *(Value at Risk)* An estimate of the potential maximum loss that might arise from price movements with a certain probability of occurrence over a defined time horizon.

Yield Curve The curve that plots yields or interest rates across maturities.