MONTE DEI PASCHI DI SIENA
BANCA DAL 1472

Capital adequacy and RWAs evolution

Siena, 11/10/2018

Agenda

Capital dynamics

1) Update on the possibilities for issuing Tier 2 (namely after the release of the draft Government budget); What actions are being considered in partial/complete inability of issuing these instruments.
2) Update on actions to protect the Bank from unfavourable BTP-BUND spreads
3) Update on actions being taken by the Bank to comply with MREL requirements
4) IFRS9 impact computation

RWAs dynamics

1) Market risk
2) Credit risk

General

1) Actions allowing the Bank to comply with Capital requirements in 2019 as per ‘Forecast_Stampaqualità.pdf’.

1. Update on the possibilities for issuing Tier 2 (namely after the release of the draft Government budget); What actions are being considered in partial/complete inability of issuing these instruments.

BMPS has been strictly monitoring the market during the last months, also taking advantage of the opinion of the main investment banks that assisted it in January at the time of the first issue, to identify a possible window of issue for a TIER2, also in order to satisfy the commitment undertaken with the EC (issue of an additional 700 mln. by 31/12/2018). At the moment, market conditions have been unfavorable due to the strong widening of the BTP-Bund spread following the sell-off on Italian paper, and negative attitude by foreign investors towards the bonds of Italian issuers.
The bank will continue to monitor the market in the following weeks and has just given mandate to two of the above investment banks, in the alternative to a public issue, to survey some major investors in order to carry out a private issue (in the form of club deals or private placements) on an even smaller amount (200/300 mln.).
At present, market volatility makes also this solution difficult to achieve and it is estimated that a possible window will only be available after the effective presentation of the budget law (half-October), the decisions of the rating agencies (Moody's and S&P at end-October) and interlocutions of the Government with the European Commission (until the first half of November). Considering that the "black period" pre-results for BMPS will start since mid-October till 9 November, and that the program will have to be updated after results, the new potential window for an issue in 2018 will be the period between end-November and mid-December.

If the TIER2 issue is not realized, actions have been designed for matching effect on capital and liquidity, and represented in this document.

As a representation of the negative market situation, with specific reference to the issue of a TIER2, on the right side you may find represented the trend of the yield, at call date, of the TIER2 10nc5 issued in January at par by BMPS with coupon 5.375%. The yield is now at record levels (near to 13%), representing the lack of demand and the premium requested on a subordinated issued by BPMS, to access the market. This level is by far higher than the level estimated in the restrucuring plan (near to 6%).

We underline also that during the last BoD (in a scenario prior to the recent further growth of BTP-Bund spread) we had asked authorization (to be confirmed with other BoD, to set the final conditions) to issue a tier2 (10nc5) at a rate of 10% per annum on a total amunt of 700 mln. or a private placement at 12 % on a lower amount of 200/300 mln. (rate which was, at the date of authorization, aligned to the T2 yield already issued).

2. Update on actions to protect the Bank from unfavourable BTP-BUND spreads

The relevant market movements of Italian govies recorded during 2018 have strongly penalized the FVTOCI portfolio reserve of BMPS. Although the portfolio has a relatively short average life (about 3 years), the strong increase in the Btp-Bund spread highlighted the need to reduce the risk of this portfolio and, where possible, make more use of the Amortizing Cost (AC) category.

For reducing the risk of the portfolio, different strategies have been considered (i.e. short positions on BTP futures, put options on bonds, put options on Italian equity index). These strategies were found to be applicable to the FVTPL portfolios, but less suitable for use in relevant size for the banking portfolio, for lack of supply, difficulties of use in the Banking Book and high costs.

On the Banking Book, the main activity aimed at mitigating the risk of the portfolios has been therefore identified in the reduction of positions and gradual recombining of part of the portfolio from FVTOCI towards the AC accounting category. Pending a full review of the business model of financial portfolios that will be deployed in next RAS, a first intervention was made (approved by the board of directors on 27/9), through integration of the AC business model, which now permits the classification in this accounting category of government bonds which are bought with the specific purpose of matching risk exposure arising by of the Bank's bond issues (and therefore aimed at the detention to Maturity). Other and more structural changes will be realized early next year, at the RAS and connected strategies, aimed at more intensive use of AC also in the future.

The estimated changes for the last quarter of the year are now:

a) to further reduce the FVTOCI nominal in Italy Government bonds, for an amount we estimate of about -2 bn. (reducing the total amount at 31/12/2018 to about 10,5 bn. down from 12,9 bn. at 30/6 and 12,5 bn. at 30/9);

b) to increase the AC nominal, for an amount of about 2/3 bn. (increasing the total amount to about 3/4 bn., up from about 0.8 bn. at 30/6 and 1.1 bn. At 30/9).

These interventions, if fully realized, will contribute to risk mitigation of the FVTOCI portfolio (sensitivity to credit spread is expected to reduce at year end below -3 mln. per basis point, from -3.4 mln. as now; this compares also with -4.1 mln at start 2018 and -3.8 mln. of RAS evolution) and reducing the portion of FVTOCI on the banking book to 75/80%, with respect to to 20/25% of AC. The activity will be subject to market conditions, as the reduction in FVTOCI component at current prices has a negative impact on economics, which will have to be managed and minimized.

Moreover, also the risk of FVTPL Italian Sovereign Bond portfolio of MPS CS is being reduced (about nominal -2 bn. from June to September). Although the average life of this portfolio is even smaller than the banking portfolio (about 1 year), the increased in the nominal that was realized in the months of May/June is being gradually reabsorbed, subject to market conditions (minimizing impact on economics).

Further activity of de-risking has been planned on corporate/financials and portfolios, as anticipated on the module on “Capital Adequacy and RWA evolution”. The AC portfolio, in perspective, will also contribute to match the impact of the reduction in the financials/corporates portfolios.

2. Update on actions to protect the Bank from unfavourable BTP-BUND spreads

In the table below, last year evolution of Nominal in Italian Government Bonds, sensitivity to credit spread, BTP_Bund spread and OCI reserve are represented, together with the expected values at year end. More in detail:

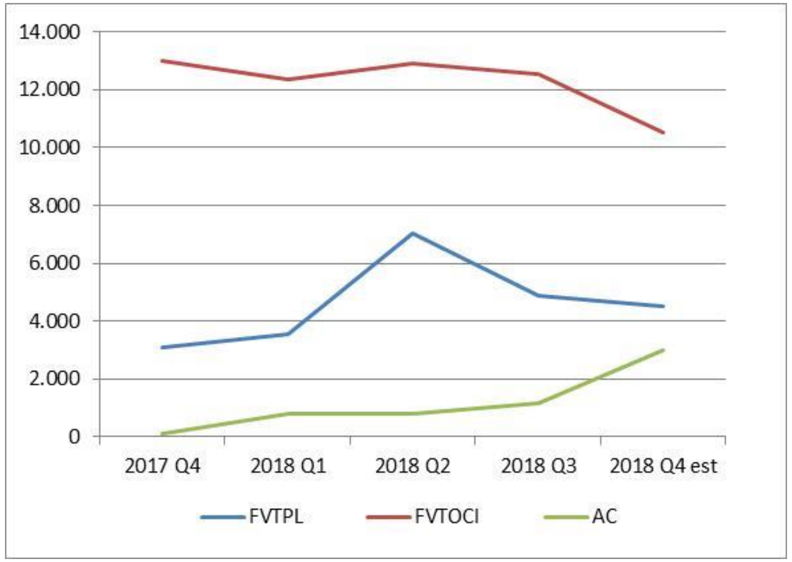
a) nominal is expected to reduce to Eur 18 bn. at year end (of which 13.5 on the BB and 4.5 in FBTPL), from a maximum of Eur 20.7 in Q2;

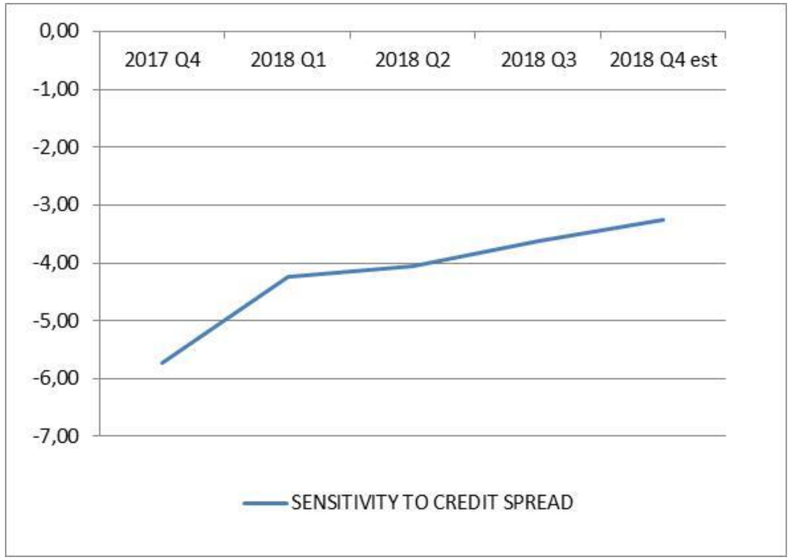
b) in the BB, FVTOCI is expected to decrease towards AC (Eur 10.5 bn. Vs. Eur 3 bn.);

c) In FVTPL nominal is expected to decrease to Eur 4.5 bn, from a maximum of Eur 7 bn. in Q2;

d) sensitivity to credit spread is expected to reduce to about Eur 3.25 mln. (from Eur -4.23 mln. In January).

		31/12/2017	2018 Q1	2018 Q2	2018 Q3	2018 Q4 est
NOMINAL (,000)	FVTPL (A)	3.071	3.570	7.039	4.891	4.500
	FVTOCI (B)	12.974	12.357	12.898	12.531	10.500
	A+B	16.045	15.927	19.937	17.421	15.000
	AC	109	782	793	1.145	3.000
	TOTAL	16.154	16.710	20.730	18.566	18.000
Percentage BB	FVTOCI	99,17%	94,05%	94,21%	91,63%	77,78%
	AC	0,83%	5,95%	5,79%	8,37%	22,22%
Cred. Sens. (MLN.)	FVTPL	-0,16	-0,06	-0,34	-0,27	-0,25
	FVTOCI	-5,56	-4,17	-3,72	-3,36	-3,00
	TOTAL	-5,72	-4,23	-4,06	-3,63	-3,25
OCI Reserve (MLN.)	Gross	-59	165	-272	-408	-495
	Net	-40	111	-184	-276	-335
Spread BTP-Bund 10Y		154	130	236	266	300





2. Update on actions being taken by the Bank to comply with MREL requirements

The Bank received the MREL target level from the SRB. In particular, a minimum level of MREL Target has been communicated, which must be respected in 2021. For the previous 2 years (2019-2020), no formal limits have been set, but a path has been calculated (with related intermediate targets) that includes the estimates for the evolution of the indicators and issues, as provided for in the restructuring plan.

The planned issues for the period 2018-2021, which have been used to calculate intermediate targets for 2019-2020 and the limit for 2021, are as follows:

- Eur 700 mln. of subordinated TIER2 bonds (as second tranche of Eur 1.450 mln. planned for the entire 2018);
- Eur 2700 mln. per year of senior bonds in 2019-2020 and Eur 2500 mln. in 2021 (of which, initially estimated Eur 1500 mln. per year of institutionals; after the last meeting with SRB, this amount has been increased, if possible, to Eur 1750 mln.)

The table below are calculated:

a) on the left, according to the numbers included into the restructuring plan;

b) on the right, including most recent projections on capital.

As represented, in the table on the left, the intermediate levels are in line or higher with respect to the intermediate target 2019-2020, and the level for 2021 is significantly higher compared with the limit.

In the table on the right, due to the reduction in capital projections for 2018, the level for 2019 is lower than the intermediate target. However both the intermediate target for 2020 and, most important, the formal limit for 2021, are strictly respected.

Stock of MREL Eligible Instruments (€mln)	2018	2019	2020	2021
Own Funds	10.534	10.716	10.881	11.822
Other eligible liabilities	4.222	3.180	5.680	6.948
TOTAL MREL ELIGIBLE INSTRUMENTS	**14.756**	**13.896**	**16.561**	**18.770**
TLOF		133.006	133.773	132.607
Total MREL TARGET (%TLOF)		10,45%	11,05%	11,05%
MREL demand		**13.896**	**14.782**	**14.653**
Surplus / Shortfall to MREL Target as % TLOF		**-**	**1.779**	**4.117**

Stock of MREL Eligible Instruments (€mln)	2018	2019	2020	2021
Own Funds	8.763	9.645	9.810	10.751
Other eligible liabilities	4.222	3.180	5.680	6.948
TOTAL MREL ELIGIBLE INSTRUMENTS	**12.985**	**12.825**	**15.490**	**17.699**
TLOF		131.935	132.702	131.536
Total MREL TARGET (%TLOF)		10,45%	11,05%	11,05%
MREL demand		**13.784**	**14.664**	**14.535**
Surplus / Shortfall to MREL Target as % TLOF		**- 959**	**826**	**3.164**

4. IFRS Impact computation

IFRS 9 FTA: accounting equity and CET 1

Effects of FTA on equity	Retained earnings	Valuation Reserves
Classification	51	-51
Measurement: other	23	149
Measurement: impairment	-1.557	20
Tax effect	42	-50
Total effect on equity	**-1.441**	**68**

Tax effect results from recognition of DTA on previous years tax losses and ACE on the basis of the probability test and is not referred to impairment

Transitional impacts on CET1	Amount
Impact of IFRS 9 due to a new impairment model	1.557
Net adjustment due to regulatory definitions and clarifications	-115
IFRS 9 full impact on CET1	**1.442**
% transitional adjustment for 2018	95%
Transitional adjustment amount added back to CET1	**1.370**
Impact of impairment IFRS 9 on CET 1 for 2018	**72**

Adjustment to CET1 as at 30/06/2018	Amount
Standandized approach (AB, SA)	**57**
A2, SA (Static component)	60
A4, SA (Dynamic component)	-
Increase of CET1 due to tax deductibility of A2, SA e A4, SA	-
IRB Approach (AB, IRB)	**1.313**
A2, IRB (Static component)	1.382
A4, IRB (Dynamic component)	-
Increase of CET1 due to tax deductibility of A2, IRB e A4, IRB	-
Adjustment to CET1 (AB, SA + AB, IRB)	**1.370**
Increase of RWA for application of SF	**81**

4. IFRS Impact computation

EBA Q&A 2018_3784 - 24 Aug 2018: change in thresholds calculation

Reduction of transitional regulatory capital/ratios following new threshold calculation set by EBA on 24 August 2018

OF reduction - €/mln	1H2018	2019	2020	2021	2022	2023
CET1	- 239	- 214	- 177	- 127	- 63	-
T1	- 239	- 214	- 177	- 127	- 63	-
TC	- 239	- 214	- 177	- 127	- 63	-
RWA	- 605	- 541	- 445	- 541	- 159	-
CET1 ratio	-0,25%	-0,23%	-0,19%	-0,23%	-0,07%	-
T1 ratio	-0,25%	-0,23%	-0,19%	-0,23%	-0,07%	-
TC ratio	-0,24%	-0,22%	-0,18%	-0,22%	-0,07%	-

The exclusion of transitional adjustment added back to CET 1 from the calculation of thresholds would have determined a reduction of CET 1 ratio as at 30 June 2018 of 25 bps.

Exclusion of the add-back from thresholds calculation seems in contrast with the treatment of transitional provisions applied for Basel 3, which impacted the thresholds calculation, as confirmed by EBA in Q&A 2014_842.

4. IFRS Impact computation

Impacts of transitional provisions on capital ratios at June 2018

Regulatory capital and ratios	30.06.2018 (IFRS 9 transitional) official	30.06.2018 (IFRS 9 full application)
CET 1	8.373	6.764
Tier 1	8.373	6.764
Total	9.244	7.634
RWA	64.275	63.590
CET1 ratio	13,03%	10,64%
T1 ratio	13,03%	10,64%
TC ratio	14,38%	12,01%

The full application of IFRS 9 as at 30 June 2018 would have determined a reduction of CET 1 ratio for approx. 239 bps as a result of the reduction of CET1 capital for € 1.609 mln and of the reduction of RWAs for € 685 mln.
The reduction of CET 1 capital is connected with the transitional adjustment added back to CET 1 for € 1.370 mln and with the related effect on thresholds for € 239 mln.

The reduction of RWAs is referred to the reduction of thresholds for € 604 mln and to the scaling factor applied to provisions on standard exposures for € 81 mln.