TOPIC: **P1-ICAAP Reconciliation**

MACRO-PROCESS:	RISK MANAGEMENT
PROCESS:	ICAAP - Internal Capital Adequacy Assessment Process
DISCLOSURE DATE:	**19/04/2017**
VERSIONING:	**001**

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1 – INTRODUCTION

This document aims describes the difference between the measures of P1 and ICAAP capital requirements, pursuant to SREP Guidelines. With this purpose, the document provides details on methodologies and rationales which lead activities of risk integration (Pillar 2 perspective) put in place for the Group, and on reconciliation with respect to Pillar 1 logic.

2 – RISK INTEGRATION AND RECONCILIATION

Pursuant to SREP Guidelines, the Group ensure ICAAP and ILAAP's coverage of all risks to which it is or might be exposed. In particular, the Group ensure that ICAAP and ILAAP are fully and exhaustively implemented with respect to risk **identification**, risk relevance assessment, **integration** and **reconciliation** with regulatory capital requirements.

Concerning risk integration and reconciliation, the Group, consistently with the approach used by the Supervision Authorities to define the Total SREP Capital Requirements, decided to use the **Pillar 1 Plus approach** in order to provide risk integration and, hence, to end up with the estimation of Total Internal Capital Requirements.

The methodology mainly takes into account the Pillar 1 risks and the significant measurable Pillar 2 risks. In addition, the Group evaluates the completeness and adequacy of Pillar 1 measures. In particular, if the Pillar 1 measure is considered insufficient or missing to accurately estimate the risk of the Group, the Pillar 1 measure is replaced by internal model estimation within the ICAAP scope.

The main differences between Pillar 1 and Pillar 2 capital estimates concern **Market Risk** and **additional Pillar 2 risks**. Regarding Market Risk, the Group believes that the Pillar 1 approach is not a complete methodology to estimate the risk under Pillar 2 perspective; therefore, an internal model for quantifying the Internal Capital is used. The internal model covers both Trading Book and AFS portfolio of Banking Book; the approach used for the estimation of the Internal Capital is based on VaR methodology. In particular, the VaR model involves:

- all risk factors except the interest rate (included in the IRRBB) for the AFS portfolio; hence, the measure includes the credit spread risk for sovereign positions (not considered in Pillar 1);
- all risk factors for the Trading Book.

As mentioned in the previous paragraph, additional Pillar 2 risks identified within the ICAAP scope are:

- Interest Rate Risk on Banking Book;
- Concentration Risk;
- Business and Strategic Risk.

Coherently with the Pillar 1 Plus approach, and in order to ensure the accuracy of regulatory capital adequacy assessment, a one-year holding period is used for all risk categories, while the considered confidence level is 99,9%, except for Market Risk (see chapter 3 – Methodological Annexes).

In order to estimate the Total Internal Capital Requirements, the Internal Capital Requirements of each risk are added up (**Building Block approach**) without considering inter-risk diversification.

Basing on Pillar 1 Plus and Building Block approaches, the Group provides the risk aggregation, under Pillar 2 perspective, by reconciling risk items between Pillar 1 and Pillar 2 as shown in the figure below.

MONTEPASCHI GROUP			
(Eur mln)	Current		
REGULATORY RWA	dic-16	dic-16	INTERNAL RWA
Credit and Counterparty Risk	**53.521**		
Credit Risk	40.477	40.477	Credit Risk
AIRB	*29.918*	*29.918*	*AIRB*
Standard	*10.559*	*10.559*	*Standard*
Counterparty Risk	2.285	2.285	Counterparty Risk - Default risk
Issuer Risk Banking Book	1.673	1.673	Issuer Risk Banking Book
Market Risk Banking Book	196	6.733	Market Risk AFS
Participation Risk	1.715	1.715	Participation Risk
Real Estate Risk	2.219	2.219	Real Estate Risk
DTA	3.538	3.538	DTA
Other	1.417	1.417	Other
Market Risk	**3.046**		
Market Risk Trading Book	2.810	743	Market Risk HFT
Bond and securitization Specific risk	235	235	Issuer Risk Trading Book
Operational Risk	**8.476**	8.476	Operational Risk
CVA	**480**	480	Counterparty Risk - CVA
Settlement and Delivery Risk	**-**	-	Settlement and Delivery Risk
Pillar 1	**65.522**		
		2.705	Interest Rate Risk Banking Book
		1.138	Concentration Risk
		4.990	Business and Strategic Risk
		78.824	**Pillar 2**

Items evidenced by red box are those exclusive components differently measured.

Interest Rate Risk on Banking Book, **Concentration Risk** and **Business and Strategic Risk** represent other additional Pillar 2 risks identified and measured within ICAAP scope, together with Pillar 2 **Market Risk**.

3 – METHODOLOGICAL ANNEXES

The table below summarises the main methodological peculiarities concerning the capital requirements measurement for all identified risk categories (scope: **ICAAP 2016**).

INTERNAL CAPITAL (Eur mln)	Approach	Confidence Level	Holding Period	Intra-risk Diversification
Credit Risk*	**Pillar 1**			
	Advanced Internal Rating Based - AIRB	99,9%	1y	No
	Standard			
Market Risk**	**Pillar 2**			
AFS	*MarIR Var*	99,0%	20d	Yes
HFT	*VaR*	99,0%	20d	Yes
Operational Risk	**Pillar 1**			
	Advanced Modelling Approach - AMA	99,9%	1y	Yes - T-Student copula
	Basic Indicator Approach - BIA			
Interest Rate Risk BB	**Pillar 2**			
	EV Sensitivities approach and prudential buffer			
Business and Strategic Risk	**Pillar 2**			
	Earnings Volatility and Expert Layer Component	99,9%	1y	No
Counterparty Risk	**Pillar 1**			
Default Risk	*Standard*			
CVA	*Standard*			
Participation Risk	**Pillar 1**			
	Standard			
Real Estate Risk	**Pillar 1**			
	Standard			
Issuer Risk	**Pillar 1**			
	Standard			
Concentration Risk	**Pillar 2**			
	Internal model			Yes
Settlement and Delivery Risk	**Pillar 1**			
	Standard			
Other Risk	**Pillar 1**			
	Standard			
Total				

** only lending portfolio*
*** The confidence level is compliant with Regulatory Capital Requirements Framework (cf. Reg EU 575/2013 - CRR). FX and Commodities Risks of the L&R portfolio are transferred to the trading book.*