GRUPPO BANCARIO

BANCA FARMAFACTORING

2015 PILLAR III

DISCLOSURE TO THE PUBLIC

GRUPPO BANCARIO
BANCA FARMAFACTORING

Contents

Introduction

Starting January 1, 2014, the Basel Committee ("Basel 3") accords became part of the regulations of the European Union. The accords are aimed at strengthening the ability of banks to absorb shocks arising from financial and economic tensions, improving the management of risk and the governance structures, as well as strengthening the transparency and disclosure of the banks themselves.
Having said this, within the European Community, the contents of Basel 3 have been transposed into two distinct regulatory acts:
– Regulation (EU) 575/2013 of June 26, 2013 (CRR), which governs the prudential requirements for credit institutions and investment firms (Pillar 1) and the regulations on public disclosure (Pillar 3);
– Directive 2013/36/EU of June 26, 2013 (CRD IV), which regards, among other, the conditions for the authorization of banking activities, freedom of establishment and freedom to provide services, the supervisory review process and provisions governing additional capital.

The above European legislation was transposed into Italian law pursuant to Bank of Italy Circular 285 "*Supervisory provisions for banks*" of December 17, 2013, which implemented the CRR and the CRD IV.

The Committee has also maintained the approach based on three "Pillars", which was the basis of the previous accord on capital, known as "Basel 2", integrating it so as to improve the quantity and quality of the capital in the banking system.

In particular:

• **Pillar 1** defines the system of capital requirements that banks are required to comply with for the typical risks of banking activities: credit risk (which also includes counterparty risk) market risk and operational risk.
This aspect has been reinforced by the introduction of a definition of best quality capital and the obligation of additional reserves for the preservation of capital, with the introduction of rules for the management of liquidity risk, both in the short term (*Liquidity Coverage Ratio - LCR*) and long term (*Net Stable Funding Ratio - NSFR*) and with the introduction of a leverage limit.

• **Pillar 2** requires banks to adopt strategies, control processes and instruments for determining, in addition to the risks of Pillar 1, present and prospective capital adequacy, charging the Supervisory Authority with the task of verifying the reliability and accuracy of the relative results and to adopt, where necessary, the appropriate corrective measures.
The BFF Group presents the ICAAP summary each year to the Bank of Italy, updating the risk management system aimed at the determination of the adequacy of capital.

• **Pillar 3** establishes specific periodical disclosure obligations concerning capital adequacy, risk exposure and the general features of the related systems for the identification, measurement and management of said risks. This aspect has also been reviewed and additional transparency requirements have been introduced in addition to more detailed information on the composition of regulatory capital and the ways in which the Bank calculates the capital ratios.

In accordance with Art. 433 of the CRR, banks shall public disclosures required by community regulations at least once a year, together with publication of their financial statements. Additionally, institutions are required to assess the need to publish some disclosure, specifically on own funds and capital requirements, or all disclosures more frequently, in light of the relevant characteristics of their business.

To this end, the Banca Farmafactoring Board of Directors approved a dedicated procedure called "Procedure for Public Disclosure (Pillar III)".
The procedure provides that the public disclosure must be:
• approved by the Board of Directors before distribution;
• published on the website **www.bancafarmafactoring.it** at least once a year, within the time frame established for the publication of the financial statements, therefore, within 30 days of the approval of the financial statements by the Shareholders' Meeting.

In line with the provisions of Regulation (EU) 575/2013 (CRR), beginning with the December 31, 2015 reporting, the area of consolidation considered only for purposes of prudential supervision considers the company BFF Lux Holdings S.à r.l. as head of the Group.
For purposes of the preparation of the financial statements, this document and the transmission of so-called non-harmonized reporting, reference will continue to be the Banking Group ex T.U.B.

On January 8, 2016 Banca Farmafactoring announced a public tender offer to purchase 100% of the shares of Magellan S.A., a Polish joint-stock company listed on the Warsaw Stock Exchange. Magellan is a leader in the financial services market targeting the healthcare sector in Poland and operates also in the Czech Republic, Slovakia and Spain.
The tender offer is conditional on receipt by Banca Farmafactoring of approval from the Bank of Italy. Clearance instead was received from the Polish Antitrust Authority on February 17, 2016.

This document has 15 sections setting out qualitative and quantitative information at December 31, 2015 and therefore does not consider the possible acquisition indicated above. The sections without information content are not published.

All amounts are expressed in thousands of euro, unless otherwise indicated.

A summary of the sections required by the reference law, with an indication of the disclosure published in this document, is presented below.

Section	Description/Reference to CRR Articles	Qualitative information	Quantitative information
1	Objectives and policies for the management of risk - Art. 435	x	n.a. (*)
2	Scope of application - Art. 436	x	n.a. (*)
3	Own funds - Art. 437	x	x
4	Capital requirements - Art. 438	x	x
5	Exposure to counterparty risk - Art. 439	x	x
6	Credit risk adjustments - Art. 442	x	x
7	Unencumbered assets - Art. 443	x	x
8	Use of ECAIs - Art. 444	x	x
9	Exposure to market risk - Art. 445	x	x
10	Operational risk - Art. 446	x	x
11	Exposure to interest rate risk on positions not included in the trading book - Art. 448	x	x
12	Exposure to securitization positions - Art. 449	x	x
13	Remuneration policy - Art. 450	x	x
14	Leverage - Art. 451	x	x
15	Exposures in equities not included in the trading book - Art. 447	x	x

(*) n.a., i.e. not applicable.

Section 1. Objectives and Policies for the Management of Risk

Qualitative information

Introduction

The Banca Farmafactoring Banking Group has adopted a system of rules, practices and processes for corporate governance and adequate mechanisms for the management and control of its operations for the purpose of managing the risks to which it is exposed.
Such safeguards are part of the organization and the system of internal controls and are aimed at ensuring a management inspired by the canons of efficiency, effectiveness and fairness, covering every type of corporate risk consistently with the characteristics, size and complexity of the business activities carried out by the Group.
With this in mind, the Group designed its risk management policies, over which it carries out periodic reviews, for the purpose of ensuring effectiveness over time and supervising, on an ongoing basis, the actual functioning of the processes for the management and control of risks.

These policies define:
• the *governance* of the risks and the responsibilities of the Organizational Units involved in the management process;
• the identification of the risks to which the Group is exposed, the measuring and *stress testing* methods and the information flows that summarize the monitoring activities;
• the annual *assessment* process on the adequacy of internal capital;
• the activities for the assessment of the prospective adequacy of capital associated with the strategic planning process.

The Corporate Bodies of the Bank, as the Parent company of the Banca Farmafactoring S.p.A. Banking Group, define the governance and risk management model at the Group level, taking into account the specific type of business and the related profiles of risk characterizing the entire Group, for the purpose of creating an integrated and consistent risk management policy. Within this environ, the Corporate Bodies of the Group Parent carry out the functions assigned to them with reference not only as it applies to the Bank but also to the evaluation of the overall operations of the Group and the risks to which it is exposed, engaging, in the most appropriate ways, the Corporate Bodies of the subsidiary in the decisions taken as to the procedures and policies of risk management.

As for the second-level controls aimed at the management of risk, these are implemented by the Risk Management, Compliance and AML Function, organized as follows:
• Risk Management Function (hereafter "Risk Management") monitors the controls over the management of risks in order to take part in defining the methodologies used to measure risk, verifies that the limits assigned to the various operating functions are being observed and checks that the operations of the individual productive areas are consistent with the assigned risk and return objectives.
• Compliance Function (hereafter "Compliance") is responsible for controls over risks of non-compliance, aimed at verifying whether the activities of the bank and the relative processes are suit-

able for preventing the violation of laws.
• The Anti-Money-Laundering Function (hereafter "AML") oversees compliance in matters of anti-money laundering and anti-terrorism, and is responsible for the controls required by the anti-money laundering law so as to prevent the use of the financial system for purposes of money laundering the profit from criminal activities, and the financing of terrorism.

The head of the Risk Management, Compliance and AML Function is assigned, according to the principle of proportionality, the role of coordinating the underlying second-level control functions, divided into two specific organizational units (the Risk Management O.U. and the Compliance and AML O.U.).

The function is within the system of internal control organizationally and is in a staff position to the Chief Executive Office and operates according to established operating autonomies supporting the same Chief Executive Officer.

The Risk Management Function has, inter alia, the responsibility for:
• cooperating with the Corporate Bodies in defining the overall risk management system;
• ensuring adequate *risk management* processes by introducing and maintaining appropriate risk management systems to identify, measure, control and mitigate all relevant risks;
• ensuring the assessment of capital absorbed and relative adequacy, by defining the processes and procedures for managing every type of present and prospective risk, taking into account the strategies and changes to the environment;
• overseeing the functioning of the risk management process and ascertaining compliance thereto;
• monitoring the adequacy and effectiveness of the measures adopted to remedy weaknesses identified in the risk management system;
• submitting periodical reports to the Corporate Bodies on the activities carried out and advising them on matters of risk management.

The management policies adopted for each risk category of the Banking Group are described below.

CREDIT RISK

Factoring activities, disciplined by the Italian Civil Code (Book IV – Heading V, Articles 1260–1267) and by Law 52 of February 21, 1991 and subsequent laws, consist of a plurality of financial services articulated in various ways through the sale of with recourse and non-recourse trade receivables. A particular characteristic of factoring arrangements is the involvement of three different parties:

• Factor (assignee)
• Client (assignor)
• Debtor (of the account)

Credit risk management policies

Organization

In view of the above considerations, the assessment of a factoring arrangement must be conducted through the analysis of a multiplicity of factors: from the degree of fragmentation of risk to the characteristics of the trade transaction underlying the credit quality, from the reimbursement capability of the customer assignor to the solvency of the account debtors.
The monitoring and management of credit risk start with a preliminary background check for credit lines, before a factoring service is offered. The various corporate functions work together and coordinate with meticulous synergy to provide an analytical and subjective assessment of the counterparties, both from a quantitative standpoint (current economic and financial situation, in the past and prospectively) and from a qualitative point of view (level of management, competitiveness, prospects of the product and potential receivables volumes to be managed).
The guidelines and the procedures for monitoring and controlling credit risk are contained in the "Credit Regulation" in force, approved by the Board of Directors on February 23, 2004, and subsequent updates. A further organizational control to meet credit risk is represented by the "Credit Control Regulation" approved by the Board of Directors on July 21, 2009, and subsequent updates, which describes the credit control process on the debtor and is an integral part of the "Credit Regulation".
The credit risk is thus adequately controlled at various levels, within the various operational processes.

Management, measurement and control systems

The assessment of credit risk is part of an overall analysis of the capital adequacy of the Bank in relation to the risks connected with lending.
With this in mind, the Group uses the "Standardized" approach for the measurement of credit risk, as indicated in Bank of Italy Circular 285 "*Supervisory provisions for banks*" and Circular 286 "*Instructions for the preparation of regulatory reporting for banks and investment firms*", both of December 17, 2013, and subsequent updates. This approach involves the division of the exposures into various portfolios according to the nature of the counterparty and the application of diversified weighted ratios to each portfolio.
In particular, for the "Central administrations and central banks" portfolio, the weighting depends on the *rating* assigned by the specialized credit assessment agencies, ECAIs, or ECAs, to the individual States; for the "Supervised institutions" portfolio, the weighting depends on the *rating* of the State in which the supervised institution has its headquarters; for the "Public Sector Entities" portfolio, the rules for weighting are the same as those for supervised institutions.

Starting from the reporting at June 30, 2013 the Banking Group has adopted *Dominion Bond Rating Service* (*DBRS*) as the ECAI ratings agency.

The *unsolicited rating* assigned to the Republic of Italy by DBRS is "*A low*" and therefore the receivables exposures from the Public Administration fall in the Credit Rating Class of 2, with a risk weight equal to 50%.
The exposures of the Group are almost completely composed of receivables due from counterparties belonging to the Public Administration.

The Banking Group constantly maintains, as a capital requirement covering credit risk, an amount of own funds equal to at least 8% of the weighted exposure to credit risk.

Capital requirement = 8% RWA

The *Risk-Weighted Amount* is determined by the sum of the *risk-weighted* assets of the various classes.

On the basis of the above methodology, the consolidated capital requirement in relation to credit risk at December 31, 2015 is equal to €60,809 thousand.

Moreover, the "Credit Regulation" describes the stages of the process which the regulations of the sector have identified as components of the credit process:
- background check;
- decision;
- disbursement;
- monitoring and review;
- dispute.

In order to identify the main risk factors, the principal activities carried out by the Bank are described as follows:
- receivables management only;
- non-recourse factoring;
- with recourse factoring.

Under the "receivables management only" service, the credit risk is considerably reduced because it is limited to the exposure to the customer for the payment of the agreed fees and commissions, or the reimbursement of legal fees incurred. The contract for "receivables management only" follows the normal procedures used in the credit process even if the decision can be taken by a body that is not a collegiate body.
"Non-recourse factoring" by its very nature represents the service that is most exposed to credit risk. For this reason, the background check for the credit line is conducted with the utmost attention and the decision-making power is reserved for the bodies that can provide approval.

Credit risk management, therefore, besides following internal corporate regulations must also abide by external regulations (Bank of Italy Circulars 285 "*Supervisory provisions for banks*" and 286 "*Instructions for the preparation of regulatory reporting for banks and investment firms*", and subsequent updates), with regard to concentrations of risk. In particular:

- a "large risk" is defined as every position equal to or greater than 10% of eligible capital. For the Banking Group, eligible capital corresponds to own funds;
- for banking groups and banks not belonging to a banking group each risk-weighted position must be within the limit of 25% of eligible capital.

In view of the fact that the Banking Group has an exposure that is almost completely composed of receivables due from the Public Administration, the portfolio risk is to be considered limited.

Furthermore, Banca Farmafactoring files a monthly report with the Central Credit Register (Bank of Italy Circular 139 of February 11, 1991 – 14th update of April 29, 2011 "*Central Credit Register. Instructions for Credit Intermediaries*") providing information on the financial debt of the debtor over the course of time and on the agreed/utilized ratio (which expresses the financial commitment of the company and the debt margins that it has with the system).

Qualitative assessment of receivables

An *impairment* test is performed on the receivables portfolio in order to identify any impairment of the financial assets.

This analysis made it possible to distinguish between *performing* and *non-performing receivables*; included in the non-performing category are financial assets that show an individual risk of loss, while the remaining financial assets have been classified in the *performing* category.

Performing receivables

The measurement of *performing receivables* includes those receivables from customers which, although past due more than 90 days, show no objective indication of loss at an individual level.

This representation is consistent with the criterion of measuring non-recourse receivables purchased at "amortized cost" which, in fact, is based on discounting estimated future cash flows according to an estimate of the time to collection.

Although the receivables are due almost entirely from the Public Administration, as in previous years, at the date of the interim and year-end financial statements, the Bank, in accordance with IAS 39, carried out a collective *impairment test* of *performing receivables* in order to monitor the quantitative content.

In order to determine the Loss Given Default (LGD), the Bank assumed the value proposed by the "Basel Accord" for credits not covered by real guarantees from sovereign states, companies and banks as being equal to 45% of the Probability of Default (PD) found.

The collective assessment of the PD was performed by assigning a *rating* to the debtors (ASLs-Local Health Service Agencies/AOs-Hospital Companies), corresponding to the credit rating assigned by the major rating agencies to the particular Region to which the debtors belong. This rating is then applied to exposures that are not classified as non-performing Exposures At Default (EAD).

Such analysis and the manner of calculation were formulated when the transition was made to international accounting standards. This calculation has never produced significant data since the PD attributed to the Regions based on the *rating* led to a modest impairment according to the impairment test.

Starting from July 2012, the input parameters for the collective impairment model led, as a result of the continual *downgrades* of the Republic of Italy and the consequent *downgrades* of the Regions from the fourth quarter of 2011, to a higher PD calculation compared to the past and, consequently, to a collective impairment loss that is no longer negligible.
Specifically, at December 31, 2015, the impairment test indicated an impairment loss of about €2.9 million, higher by €0.9 million compared to 2014 owing primarily to the increase in the *outstanding* receivables of the Bank.

Non-performing receivables
In accordance with IAS 39, and for purposes of an analytical evaluation, the Bank carried out an assessment of the financial assets classified as *non-performing receivables* in order to identify any objective impairment of individual positions.

Non-performing receivables of the Banking Group consist of non-performing exposures of Banca Farmafactoring that, net of individual impairment losses of €1,719 thousand, amount to €2,507 thousand (€4,226 thousand gross).

Credit mitigation techniques

In order to render non-recourse receivables purchased compatible with the *derecognition* principle, the risk mitigation clauses, which could have in some way invalidated the effective transfer of risks and rewards, have been eliminated from the relative contracts.

Impaired financial assets

To this end, on July 24, 2014, the European Banking Authority (EBA) proceeded to publish the "Final Draft Implementing Technical Standards on Supervisory Reporting on Forbearance and Non-performing Exposures" (EBA/ITS/2013/03/rev1 7/24/2014): this document introduces new definitions on the subject of impaired assets and *forbearance measures*.
Such definitions have been introduced in the 7^{th} update of Bank of Italy Circular 272 of January 20, 2015: such new definitions provide for the breakdown of impaired assets into:

- Past due exposures, for a net amount of €43,234 thousand;
- Unlikely to pay, not applicable;
- Non-performing exposures, for a net amount of €2,507 thousand.

Past due exposures
These are exposures to central administrations and central banks, territorial entities, public sector entities, non-profit entities and companies which, at December 31, 2015, are past due more than 90 days.

In particular, exposures to central administrations and central banks, public sector entities and territorial entities, are considered past due when the debtor has not made any payment for any debt positions due to the Group for more than 90 days.
At December 31, 2015, total net past due receivables amount to €43,234 thousand, compared to €9,779 thousand at the end of 2014, of which €9,873 thousand is due from the entities of the Public Administration compared to €6,669 thousand at the end of 2014.
Past due exposures at December 31, 2015 include €32.6 million from a publicly held joint stock company belonging to the Italian National Health System, equal to 75.3% of gross past due exposures.

Unlikely to pay
The definition of this type of exposure represents the Group's assessment that, without recourse to actions such as the realization of collateral, it is unlikely that the debtor will pay (principal and/

or interest) its credit obligations in full. This assessment is conducted regardless of the existence of any past due and unpaid amounts (or installments).

Therefore it is not necessary to wait for the explicit symptom of the event (e.g., failure to make payment) where elements exist that imply the risk of non-payment by the debtor. Exposures to *retail* parties can be classified in the "unlikely to pay" category at the level of individual transaction, provided that the bank assesses that no conditions exist for the classification in this category of the total exposure to the given debtor.

At December 31, 2015 the Group does not have any positions classified as "unlikely to pay".

Non-performing exposures

These refer to exposures to parties that are in a state of insolvency or in basically similar situations, regardless of any estimates of loss formulated by the Bank.

At December 31, 2015 the total of non-performing receivables, net of writedowns due to estimated impairment losses, amounts to €2,507 thousand and is a decrease from €2,936 thousand in the prior year.

Of this amount, €0.9 million is due from Fondazione Centro San Raffaele del Monte Tabor in liquidation and in a composition agreement with creditors.
To this end, in July 2015 a third distribution was received of €1.5 million equal to approximately 6% of the liability, bringing the residual exposure from €2.4 million to €0.9 million. There was no effect on the income statement since the principal amount had not been written down.
With regard to the percentages of recovery established in the composition agreement, and as a result of the recognition of receivables for interest on late payments, the principal was not written down.

The other non-performing positions amount to approximately €3.3 million, of which about €1.6 million was completely written off against the provision account and the net book value is now zero. The remaining positions of about €1.6 million have not been written down since they refer to positions guaranteed by sureties and to exposures relating to local entities in financial difficulties (of which €743 thousand was non-performing when purchased and €312 thousand was purchased performing and later became non-performing), for which no provision for loss was made as it is expected that at the end of the period of financial difficulty 100% of the receivables will be recovered. The portion of the provision account for interest on late payments, relating to non-performing positions, recognized when the estimation method was changed in 2014, amounts to €13.6 million and is completely written off. This refers mainly to the position with Fondazione Centro San Raffaele del Monte Tabor in liquidation and in a composition agreement with creditors.

Unlike the considerations made for non-performing exposures, the assessment of past due exposures is made at the level of portfolio since such positions show no objective indication of loss at an individual level.

Securitization transactions

At December 31, 2015 there is still a securitization transaction on healthcare receivables structured with Deutsche Bank, which is described in detail in Section 12.
As regards this transaction the receivables are sold to the vehicle company but not derecognized since all the risks and rewards of ownership were not transferred upon sale.
As a result, all the risks and rewards remain with the Group and the relative securitization risk is included under the credit risk.

COUNTERPARTY RISK

Counterparty risk represents a particular type of credit risk that generates a loss if the transactions put in place with a specific counterparty have a positive value in the event of insolvency.
For Banca Farmafactoring the counterparty risk is generated by repurchase transactions with Cassa Compensazione e Garanzia as the counterparty.

MARKET RISK

Market risk is measured by the Group using the "Standardized" method. The regulation identifies and regulates the treatment of the various types of market risk in reference to the regulatory trading book, in which there were no outstanding positions at December 31, 2015.

INTEREST RATE RISK

In order to assess interest rate risk, potentially linked to fluctuations in interest rates, the Bank is guided by the methodology contained in the prudential regulation (Bank of Italy Circular 285 - Attachment C). This methodology is applied monthly, in order to record on a timely and continual basis any loss in the event of a market shock determined on the basis of annual changes in interest rates recorded during an observation period of six years considering alternatively the first percentile (decrease) and the 99th percentile (increase) and ensuring that rates are not negative.

EXCHANGE RATE RISK

Exchange rate risk is represented by the exposure of the Banking Group to fluctuations in exchange rates, considering both positions in foreign currency and those that provide for indexation clauses linked to the trend in the exchange rates of a specific currency.
The Group's asset portfolio is entirely expressed in euros; accordingly, the risk connected with the volatility of foreign currencies is to be considered non-existent.

LIQUIDITY RISK

Liquidity risk is represented by the possibility that the Group will be unable to fulfil its payment obligations due to the inability to access funds on the financial market, or limits that are present which restrict the disposal of assets. This risk is also represented by the inability to raise adequate new resources, in terms of amount and cost according to operating necessities, which would force the Bank to slow or halt the development of activities or sustain excessive funding costs to meet its obligations, with significant adverse impacts on the profits of its business.

Liquidity risk may be manifested through the following risk components:

• ***Liquidity Mismatch Risk:*** the risk of mismatch between the amounts and/or the timing inflows and outflows.
• ***Liquidity Contingency Risk:*** the risk that future unexpected events may require a materially larger amount of liquidity than the business currently requires in a scenario as a normal going concern. This risk may be generated by events such as failure to renew loans, the need to finance new activities, the difficulty in disposing of liquid assets or obtaining new loans in the event of a liquidity crisis.
• ***Market Liquidity Risk:*** the risk of incurring losses on liquidating *assets* that would be considered liquid under normal market conditions, and being forced to keep them in the absence of the market itself.
• ***Operational Liquidity Risk:*** the risk of being unable to fulfill payment obligations due to errors, violations, interruptions or damages due to internal processes, persons or external events, even though the Group is in a situation of financial equilibrium.
• ***Funding Risk:*** the risk of incurring a loss due to the inability to draw from sources of financing at an economical cost to meet obligations and/or the possible increase in the costs of funding due to a change in *rating* (internal factor) and/or a wider gap in the *credit spreads* (external factor).

The Group, in accordance with Bank of Italy's regulations for prudential supervision, has adopted a risk management Regulation and a Treasury and Finance Regulation aimed at maintaining a high degree of diversification, in order to reduce liquidity risk, and identifying the *governance* and control principles as well as the structures responsible for the operational and structural management of liquidity risk.

The internal regulation sets out:
• the criteria adopted for the management of liquidity risk, defined in relation to the specific operations of the Bank and the potential sources of liquidity risk;
• the operating procedures through which the Bank monitors this risk, which include a diversification of short-term assets (operational liquidity management) and medium-term assets (structural liquidity management);
• the criteria for defining and carrying out *stress tests*, aimed at measuring in quantitative terms the capacity of the Bank to meet potential adverse events that could affect the level of liquidity risk;
• the *Contingency Funding Plan* in which the strategies and organizational and operating procedures are defined for the management of early warning, warning and crisis situations as well as the resulting responsibilities.

In order to ensure control over the processes for the management and control of liquidity risk, the Bank has adopted a *governance* model based on the following principles:
• separation between the processes for the management of liquidity and processes for the control of liquidity risk;
• development of the processes for the management and control of liquidity risk, consistently with

the hierarchy structure and through a process of the delegation of powers;
• sharing of the decisions and clarity of responsibilities among management, control and operations bodies;
• conforming the management and monitoring processes of liquidity risk with prudential supervisory indications.

Stress tests on liquidity risk were conducted for the purpose of evaluating the potential impacts of *stress* scenarios on the financial conditions of the Group.

ENCUMBERED ASSETS MANAGEMENT PROCESS

The process for the management of encumbered assets and the risks connected with them, consistently with the approach used in the risk management Regulation, can be expressed in the following phases:

• Identification of risks connected with encumbered assets: identification of encumbered assets, of the risks connected with them and the relative sources to be measured for the purpose of ensuring that the regulatory requirements have been complied with, both under ordinary operating conditions and in stress scenarios. This assessment is performed periodically by the Risk Management Function, as part of the overall evaluation of the risks to which the Group is exposed;

• Measurement of risks connected with encumbered assets: measurement of the exposure to the risks generated by encumbered assets on the basis of approved qualitative and quantitative methods;

• Management of risks connected with encumbered assets: assumption of risks according to established policies and in accordance with the operational limitations and the thresholds defined in the Risk Appetite Framework (RAF);

• Monitoring of risks connected with encumbered assets: report on encumbered assets and relative controls; falling within this area are the report of the planned inspection of the Compliance and Internal Audit Functions and the periodical reporting produced by the Finance department and the Risk Management Function.

OPERATIONAL RISKS

Operational risk is the risk of loss due to inadequacy or failures of procedures, caused by personnel and internal systems or as a result of external events. Falling in this category, among other, are fraud, human error, business interruption, system failure, breach of contracts and natural disasters; operational risk comprises legal risks but not strategic and reputational risk.
Operational risk therefore refers to various types of events that would not be significant individually unless analyzed together and quantified for the entire category of risk.

For the Banking Group, the exposure to this category of risk is generated predominately by failures in the working process and in the organization and governance structure – human errors, malfunctioning of computer applications, inadequate organizational management and control – as well as any loss of human resources in key positions within corporate management. Exposures to operational risks deriving from external sources, instead, appear to be of negligible importance, partly in view of the mitigation tools adopted to meet these unfavorable events, such as the business *continuity plan*, data *storage* processes, *back up* instruments, insurance policies, etc.

The process adopted by the Group for the management and control of operational risks is founded on the principle of promoting a corporate culture for managing risk and defining the proper standards and incentives with the aim of adopting professional and responsible behavior, at all levels of operations as well as the design, implementation and management of an integrated system for operational risk management adequate in relation to the nature, operations, size and profile of risk.

A "mixed" type assessment model for operational risks is employed by the Group. Such model is based on assessments that are both qualitative – linked to the mapping of the processes, the risk activities and relative controls put in place – and quantitative, using the methodologies set out by Bank of Italy.

Within the framework of the controls put in place over the exposure to operational risk, the following specific risks are also monitored by the Bank:

• Money-laundering risk, regarding the risk that counterparties of the Bank, whether financial, commercial, suppliers, partners, collaborators and consultants, may be implicated in transactions that might potentially favor the laundering of cash coming from illegal or criminal activities;
• *Compliance risk*, concerning the risk of legal and administrative sanctions, significant financial losses or reputational losses due to failure to comply not only with laws and regulations but also with internal standards and conduct applicable to corporate activities. For this type of risk, a review is carried out annually of the related assessment method, developed for all activities falling within the Bank's legal scope of reference, according to a *risk-based* approach. In particular, for the relevant laws that do not call for the creation of specialized controls (i.e. privacy and workplace health and safety), the Compliance Function provides guidance *ex ante* to the Bank's structures and assesses *ex post* the adequacy of the organizational measures and the control activities adopted under the *Compliance Risk Assessment* method. As for the laws monitored by specialized functions, the Compliance Function carries out an indirect control by cooperating with these specialized functions in defining the *compliance* risk assessment methods in addition to mapping the risks and the relative controls (*Compliance Risk Matrix*).

For the calculation of the capital requirement for operational risk, the Banking Group uses the *Basic Indicator Approach - BIA*, by applying a regulatory coefficient to an indicator of the volume of the Bank's operations (Relevant Indicator).
The Group also assesses operational risks in connection with the introduction of new products, activities, relevant processes and systems and mitigates the consequence of any operational risk that may arise through the preventive involvement of the corporate control functions and the drawing up of specific *policies* and regulations on various subjects and topics.

To control the above risks, the Group adopts *ad hoc* organizational models for the management of the risks regarding money laundering, safety and health in the workplace and information security.

RISKS OF THE OTHER COMPANIES

The consolidated financial statements of the Banking Group reflect the aggregation of the elements of the balance sheets and income statements of the Parent Banca Farmafactoring S.p.A., Farmafactoring España S.A. (a wholly-owned subsidiary of Banca Farmafactoring S.p.A.), the special purpose entity, Farmafactoring SPV I S.r.l., and the Polish vehicle company Mediona Spolka z ograniczona odpowiedzialnoscia (vehicle company for the acquisition of the Magellan group).

The special purpose entity Farmafactoring SPV I S.r.l. was set up for the securitization transaction structured with Deutsche Bank. The company is included in the scope of consolidation because it meets the criteria set out in the IAS/IFRS standards which establish the obligation of consolidating a special purpose entity when, in the absence of an investment relationship, the company that prepares the financial statements, in substance, controls the special purpose entity.

These companies do not show further and relevant elements of risk other than those mentioned in the preceding paragraphs.

Declarations by the management body, pursuant to Art. 435, paragraph 1, letters e) and f) of Regulation (EU) 575/2013

The Chief Executive Officer of Banca Farmafactoring S.p.A., Massimiliano Belingheri, by mandate of the Board of Directors, declares, pursuant to Art. 435, paragraph 1, letters e) and f) of Regulation (EU) 575/2013, that:

a) the risk management systems in place in the Banca Farmafactoring Banking Group and described in this document "Pillar III – Public Disclosure – 2015" are adequate with regard to the profile and strategy of the bank;

b) in particular, this section, "Objectives and policies for the management of risk", of the aforementioned document describes, in summary, the overall risk profile of the Banca Farmafactoring Banking Group.

Information relating to the governance systems

NUMBER OF BOARD OFFICES HELD BY MEMBERS OF THE BOARD OF DIRECTORS OF BANCA FARMAFACTORING

The number of positions held by members of the Board of Directors in other companies is summarized below:

Name	Date of birth	Office	Role	Date of appoint.	Date office expires	N. of other positions
Salvatore Messina	1/1/1946	Chairman	Independent	11/4/2015	Appr. Fin. Stat. 12/31/2017	1 non-executive
Luigi Sbrozzi	11/30/1982	Vice Chairman	Non-executive	11/4/2015	Appr. Fin. Stat. 12/31/2017	-
Massimiliano Belingheri	10/30/1974	Chief Executive Officer	Executive	11/4/2015	Appr. Fin. Stat. 12/31/2017	-
Mark John Arnold	3/2/1968	Director	Non-executive	12/21/2015*	Appr. Fin. Stat. 12/31/2017	-
Federico Fornari Luswergh	9/26/1964	Director	Independent	11/4/2015	Appr. Fin. Stat. 12/31/2017	1 executive
Ben Carlton Langworthy	8/12/1978	Director	Non-executive	11/4/2015	Appr. Fin. Stat. 12/31/2017	3 non-executive
Elisabetta Oliveri	10/25/1963	Director	Independent	11/4/2015	Appr. Fin. Stat. 12/31/2017	1 executive 4 non-executive
Marco Rabuffi	5/26/1948	Director	Non-executive	11/4/2015	Appr. Fin. Stat. 12/31/2017	-
Gabriele Michaela Aumann Schindler	6/16/1953	Director	Independent	12/21/2015*	Appr. Fin. Stat. 12/31/2017	-
Giampaolo Zambeletti Rossi	5/4/1941	Director	Independent	11/4/2015	Appr. Fin. Stat. 12/31/2017	3 non-executive

** Director co-opted on December 21, 2015 and confirmed by the shareholders' meeting on March 31, 2016.*

PROCESS FOR THE SELECTION OF THE MEMBERS OF THE BOARD OF DIRECTORS AND THEIR EFFECTIVE SKILLS, COMPETENCES AND EXPERIENCE

The Board of Directors of Banca Farmafactoring S.p.A. is composed of ten members with various and sufficiently diversified competences among each other so that each member can effectively contribute to ensuring effective governance over risks in all of the areas of the Bank.

With regard to the policy for the selection of board members, the Regulation of the Board of Directors establishes that, besides the requisites of professionalism dictated by existing law, the directors of Banca Farmafactoring S.p.A. must also possess at least one of the following requisites:

a) adequate knowledge of the banking sector, of the dynamics and of the economic and financial system, of banking and financial regulations and, above all, the methodologies for the management and control of risks, acquired through various years of experience in administration, management and control in the financial sector;

b) experience gained in the management of direct operations to facilitate the sale, management and collection of receivables, particularly with entities providing health care services as well as with entities of the Public Administration;

c) entrepreneurial management and company organizational experience acquired through various years of experience in the administration, management or control of companies, or groups of relevant economic size or in the Public Administration;

d) ability to read and interpret economic and financial data acquired through various years of experience in administration and control of companies or professional activities or teaching in university;

e) international experience and knowledge of foreign markets gained through years of carrying out entrepreneurial or professional activities at foreign institutions or entities, companies or international groups.

The board is composed of independent, executive and non-executive directors.

Independent directors autonomously monitor the management of the company, contributing to ensuring that it is conducted in the interests of the Bank and in a manner consistent with sound and prudent management objectives.

The number of independent directors is decided taking into consideration the total number of directors, the composition of any committees and, in any case, cannot be less than two, if the board is composed of seven members, at least three if it is composed of up to twelve members and at least four if it is composed of a higher number.

POLICY OF DIVERSITY ADOPTED IN THE SELECTION OF THE MEMBERS OF THE BOARD OF DIRECTORS, THE RELATIVE OBJECTIVES AND ANY TARGETS ESTABLISHED WITHIN THE FRAMEWORK OF SUCH POLICY, IN ADDITION TO THE DEGREE TO WHICH SUCH OBJECTIVES AND TARGETS HAVE BEEN REACHED

The Regulation of the Board of Directors states that its members must have diversified characteristics in terms of competences, experience, age, type, geographic origins and international projection, although not having fixed any specific objectives or targets.

RISKS COMMITTEE AND NUMBER OF MEETINGS

By resolution of the July 24, 2014 meeting of the Board of Directors of Banca Farmafactoring, the Risks Committee was formed pursuant to the provisions of Bank of Italy on corporate governance.

Following the Shareholders' Meeting held on November 4, 2015 in which the shareholders appointed the new Board of Directors, the management body of the Bank – on the same date – renewed the Risks Committee with a different composition that was subsequently integrated on December 21, 2015.

The composition of the Risks Committee was reconfirmed by the Board of Directors of the Bank on March 31, 2016 after the confirmation of the directors co-opted by the Shareholders' Meeting held on the same date.

The Risks Committee provides support to the Board of Directors in the area of risks and the system of internal control and may use outside experts whenever it deems necessary.

The Risks Committee particularly carries out the following activities:

a) with the contribution of the Nomination Committee (where formed), identifies and proposes the heads of the corporate control functions to be appointed;
b) examines the activity programs in advance (including the audit plan prepared by the *Audit* Function) and the annual reports of the corporate control functions addressed to the Board of Directors;
c) offers evaluations and formulates opinions to the Board of Directors on the principles on which it should be kept informed: a) the internal control system and b) the corporate organization of the Bank and the Group;
d) offers assessments and formulates opinions to the Board of Directors on the requirements that should be observed by the corporate control functions, bringing to the Board's attention any weaknesses found and the consequent actions to be taken. To this end the Committee takes into account the proposals of the Chief Executive Officer;
e) contributes, with its evaluations and opinions, to the definition of the corporate policy on outsourcing the corporate control functions;
f) verifies that the corporate control functions correctly conform to the indications and guidelines established by the Board of Directors, and assists the latter in writing the coordination document required by Section II of the Provisions on the Internal Control System under Part 1, Heading IV, Chapter 3, of Bank of Italy Circular 285 (the *"Regulation of Corporate Bodies, of Control Functions and of Information Flows"*);

g) assesses the correct use of accounting principles in the preparation of the separate and consolidated financial statements, coordinating in this work with the board of statutory auditors.

With particular reference to the area of the management and the control of risks, the Risks Committee provides support to the Board of Directors in the following activities:

a) definition and approval of the strategic guidelines and governance policies of the risks.
As part of the Risk Appetite Framework (RAF), the Risks Committee conducts necessary evaluation and proposal activities so that the Board of Directors, in conformity with what is established in the Provisions on the Internal Control System – included in the *"Regulation of Corporate Bodies, of Control Functions and of Information Flows"* adopted by the Bank – can define and approve the *risk appetite* and *risk tolerance*;
b) verification of the correct implementation of the risk strategies and governance policies and the RAF approved by the Board of Directors;
c) definition of the policies and processes for the evaluation of corporate activities, including periodical verification of consistency between the profitability and the risks assumed in dealings with the clientele, compared to the *business* model and the strategies defined in the area of risk.

Without prejudice to the responsibilities of the Remuneration Committee, the Risks Committee ascertains that the incentives underlying the compensation and incentive system of the Bank and the Group are consistent with the RAF.

During 2015 the Risks Committee held twelve meetings.

DESCRIPTION OF THE FLOW OF INFORMATION ON RISKS ADDRESSED TO THE BOARD OF DIRECTORS

The representation of the flow of information on risks addressed to the Board of Directors, subject to evaluation by the Risks Committee is as follows:

Owner	Product Information Flows	Frequency	BoD/Risks Committee
Risk Management Function	Activity Plan	*annual*	✓
	Activity Report	*annual*	✓
	ICAAP	*annual*	✓
	Risk Management Report	*monthly*	*when issued*
	Tableau de Bord of the Risk Management Function (Risk Report)	*quarterly*	✓
Compliance Function	Activity Plan	*annual*	✓
	Compliance Report	*monthly*	*when issued*
	Tableau de Bord of the Compliance Function	*quarterly*	✓
	Annual Compliance Activity Report	*annual*	✓
AML Function	Inspection Report*	*quarterly*	-
	Activity Report	*annual*	✓
Internal Audit Function	Activity Plan	*ann./pluriann.*	✓
	Audit Report	*when issued*	*when issued*
	Tableau de Bord of the Internal Audit Function	*quarterly*	✓
	ICAAP Audit Report	*annual*	✓
	Audit Report on Functions/Important Out-sourced Activities	*annual*	✓
	Audit Report on Remuneration and Incentive System**	*annual*	✓
	Annual Report on Internal Audit Activities	*annual*	✓
	Whistleblowing Annual Report	*annual*	✓
Supervisory Body	Supervisory Report	*half-yearly*	✓
Board of Statutory Auditors	Statutory Auditors' Opinions	*when issued*	✓
	Statutory Auditors' Reporting	*when issued*	✓

** This report is also sent to the Chairman of the BoD as the person who has responsibility for dubious transactions.*
*** Final recipient of the report is the shareholders' meeting.*

Section 2. Scope of Application

Qualitative information

The disclosure requirements set out in this document, as reported in Art. 436 of Regulation (EU) 575/2013 refer to the Banca Farmafactoring Banking Group, registered in the Register of Banking Groups, of which Banca Farmafactoring is the Parent.
The subsidiaries are companies controlled by the Group. The Group controls a company when it is exposed, or has rights, to variable returns from its involvement with the company and has the ability to affect those returns through its power over the company. Generally, control exists when the company holds, directly or indirectly, more than half of the voting rights, considering also the exercisable or convertible potential voting rights.
The subsidiaries also include special purpose entities in which the Group, in substance, holds the majority of the risks and rewards of their activities or those over which it exercises control. The existence of an equity investment in these entities is not relevant for this purpose.
All subsidiaries are consolidated line-by-line from the date the Group obtains control until such control ceases.
The consolidated financial statements and the notes thereto prepared by the companies consolidated line-by-line are drawn up in accordance with IAS/IFRS for purposes of inclusion in the consolidated financial statements.

The scope of consolidation relevant for purposes of the consolidated financial statements thus reflects the aggregation of the elements of the balance sheets and income statements of the Parent Banca Farmafactoring S.p.A., Farmafactoring España S.A. (a wholly-owned subsidiary of Banca Farmafactoring S.p.A.) and the special purpose entity, Farmafactoring SPV I S.r.l., and the Polish vehicle company Mediona Spolka z ograniczona odpowiedzialnoscia.
All balances and transactions between companies of the Banking Group are eliminated on consolidation.

The scope of consolidation for regulatory requirement purposes is defined by Bank of Italy Circular 115 "*Instructions for the preparation of supervisory reporting on a consolidated basis*" of August 7, 1990, and subsequent updates, and Bank of Italy Circular 285 "*Supervisory provisions for banks*" of December 17, 2013, and subsequent updates.

The following chart gives the most important information about the companies in the Group.

Company name	Registered office	Type of relationship (*)	Investment relationship		Voting Rights %
			Held by	Ownership %	
A. Company					
A.1 Line-by-line consolidation					
1. Farmafactoring España S.A.	Madrid - C/ Luchana 23	1	Banca Farmafactoring	100%	100%
2. Mediona Spolka z ograniczona odpowiedzialnoscia	Warsaw- Plac Marszalka Jozefa 1	1	Banca Farmafactoring	100%	100%
3. Farmafactoring SPV I S.r.l.	Milano - Via Statuto 10	4	Banca Farmafactoring	0%	0%
A.2 Consolidated proportionally					

(*) Type of relationship:
1 – majority of voting rights in ordinary shareholders' meeting
4 – other forms of control

Quantitative information

The subsidiaries controlled by Banca Farmafactoring are all within the scope of consolidation.

Section 3. Own Funds

Qualitative information

Own funds represent the first line of defense against risks associated with overall financial activities and constitutes the main parameter of reference for the assessment of the capital adequacy of the Banking Group.
The purpose of the prudential supervision regulation is to ensure that the banks have a minimum obligatory capital in relation to the risks assumed.

Own funds are determined, beginning January 1, 2014, in accordance with Bank of Italy Circulars 285 "*Supervisory provisions for banks*" and 286 "*Instructions for the preparation of regulatory reporting for banks and investment firms*", both of December 17, 2013, which introduce Regulation (EU) 575/2013 relating to the new discipline harmonized for banks and investment firms, contained in the CRR community regulation (*Capital Requirements Regulation*) and in the European Directive CRD IV (*Capital Requirements Directive*) of June 26, 2013.

These regulations include the standards set forth by the Basel Committee for banking regulations (known as the Basel 3 *framework*), whose implementation, pursuant to the Consolidated Law on Banking, is the responsibility of the Bank of Italy, and define the ways with which the discretionalities attributed by community discipline to the national authorities were exercised.

Own funds are composed of Common Equity Tier 1 Capital (CET1), Additional Tier 1 Capital (AT1) and Tier 2 Capital (T2) net of items to be deducted and IAS/IFRS prudential filters.

The main elements that form the own funds of the Banking Group are computed in Common Equity Tier 1 Capital (CET1), and are the following:

- share capital paid-in;
- reserves (legal reserve, extraordinary reserve, retained earnings);
- profit for the year;
- valuation reserves: actuarial gains/losses relating to defined benefit plans;
- valuation reserves: special revaluation laws.

Items to be deducted from the above items are other intangible assets.

In reference to the contents of Bank of Italy Circular 285 of December 17, 2013 – Section II, paragraph 2, last subsection, wherein it is stated that banks have the right "not to include unrealized gains or losses in any element of own funds relating to exposures to the central administrations classified in the 'Available-for-sale financial assets' category of IAS 39 approved by the EU" (option allowed by the Supervisory Bulletin No. 12 of December 2013, in the paragraph relating to "Regulation on own funds"), on January 24, 2014 the Board of Directors of Banca Farmafactoring decided to exercise such option.

Accordingly, beginning January 1, 2014 and until the end of the transitional period, the companies in the Banca Farmafactoring Banking Group will exclude unrealized gains or losses relating to the above-indicated exposures.

Own funds of the Banking Group do not include capital items qualifying as Additional Tier 1 Capital (AT1) and Tier 2 Capital (T2).

Quantitative information

Composition of own funds

Item/Amounts	Total 12/31/2015	Total 12/31/2014
A. Common Equity Tier 1 Capital (CET1) before prudential filters	**262,012**	**262,106**
of which grandfathered CET1 instruments		
B. CET1 prudential filters (+/-)		
C. CET1 gross of items to be deducted and effects of transitional adjustments (A +/- B)	262,012	262,106
D. Elements to be deducted from CET1	(2,747)	(2,053)
E. Transitional adjustments – Effect on CET1 (+/-), including minority interests subject to transitional adjustments		
F. Total Common Equity Tier 1 Capital (CET1) (C - D +/- E)	**259,265**	**260,053**
G. Additional Tier 1 Capital (AT1) gross of items to be deducted and effects of transitional adjustments		
of which grandfathered AT1 instruments		
H. Elements to be deducted from AT1		
I. Transitional adjustments – effect on AT1 (+/-), including qualifying instruments issued by subsidiaries and computable in AT1 due to transitional provisions		
L. Total Additional Tier 1 Capital (AT1) (G - H +/- I)		
M. Tier 2 Capital (T2) gross of items to be deducted and effect of transitional adjustments		
of which grandfathered T2 instruments		
N. Elements to be deducted from T2		
O. Transitional adjustments – Effect on T2 (+/-), including qualifying instruments issued by subsidiaries and computable in T2 due to transitional provisions		
P. Total Tier 2 Capital (T2) (M - N +/- O)		
Q. Total own funds (F + L + P)	**259,265**	**260,053**

Model for the publication of own funds information

Own Funds Information	(A) Amount at date of reference	(B) Article reference in Regulation (EU) 575/2013	(C) Amounts subject to pre-Regulation (EU) 575/2013 treatment
1. Equity instruments and related share premium reserves	130,900	26, paragraph 1, 28	
2. Retained earnings	92,034	26, paragraph 1, letter c)	
3. Accumulated other comprehensive income and other reserves	29,972	26, paragraph 1, letter d), e)	
5a. Profit for the period verified by independent persons net of all foreseeable charges or dividends	9,106	26, paragraph 2	
6. Common Equity Tier 1 Capital (CET1) before regulatory adjustments	**262,012**		
Common Equity Tier 1 Capital (CET1): regulatory adjustments			
8. Intangible assets (net of related tax liability)	(2,747)	36, paragraph 1, letter b)	
28. Total regulatory adjustments to Common Equity Tier 1 Capital (CET1)	**(2,747)**		
29. Common Equity Tier 1 Capital (CET1)	**259,265**		
Additional Tier 1 (AT1): instruments			
45. Tier 1 (T1 = CET1 + AT1)	**259,265**		
Tier 2 Capital (T2): instruments and provisions			
58. Tier 2 Capital (T2)	**0**		
59. Total capital (TC = T1 + T2)	**259,265**		
60. Total risk-weighted assets	**1,065,819**		
61. Common Equity Tier 1	24.3%	92, paragraph 2, letter a)	
62. Tier 1 capital	24.3%	92, paragraph 2, letter b)	
63. Total capital	24.3%	92, paragraph 2, letter c)	
64. Institution specific buffer requirement (CET1 requirement pursuant to Art. 92 paragraph 1, letter a), capital conservation buffer, countercyclical buffer, systemic risk buffer and the systemically important institution buffer requirements, expressed as a percentage of risk exposure amount	2.50%	CRD art. 129	
65. of which: the capital conservation buffer requirement	2.50%		
68. Common Equity Tier 1 available to meet buffer requirement	21.8%		

Reconciliation of balance sheet accounting equity and regulatory own funds, with transitional items

Equity items	Total
Share capital	130,900
Share premium	
Reserves	127,409
Capital instruments	
(Treasury shares)	
Valuation reserves:	
- Available-for-sale financial assets	481
- Property, plant and equipment	
- Intangible assets	
- Hedges of net investments in foreign subsidiaries	
- Cash flow hedges	
- Exchange differences	
- Non-current assets classified as held for sale	
- Actuarial gains (losses) on remeasurement of defined benefit plans	(120)
- Portion of valuation reserves from investments accounted for using the equity method	
- Special revaluation laws	3,823
Profit (Loss) for the year (+/-) attributable to owners of the parent and non-controlling interests	68,791
Equity	**331,283**
Dividends	(68,765)
Portion of non-controlling interests not eligible	
CET1 before application of prudential filters, transitional adjustments and deductions	262,492
Prudential filters	
Transitional adjustments (1)	(481)
Deductions	(2,747)
CET1	**259,265**
Own funds	**259,265**

(1) AFS reserves, as indicated above.

Section 4. Capital Requirements

Qualitative information

The Banking Group has adopted an appropriate system of corporate governance and adequate mechanisms for the management and control of its operations in order to mitigate the risks to which it is exposed. Such safeguards are part of the organization and the system of internal controls and are aimed at ensuring a management inspired by the canons of efficiency, effectiveness and fairness, covering every type of corporate risk consistently with the characteristics, size and complexity of the business activities carried out by the Group.

The Banking Group constantly assesses its capital structure, developing and utilizing techniques for monitoring and managing regulated risks, also through its internal Risks Committee.
From the standpoint of Prudential Supervision, the amount of capital required is determined on the basis of the current reporting regulations.

The *CET1 Capital Ratio* is given by the ratio of Common Equity Tier 1 Capital to Risk-Weighted Assets.
The *Tier 1 Capital Ratio* is given by the ratio of Tier 1 Capital to Risk-Weighted Assets.
The *Total Capital Ratio* is given by the ratio of Total own funds to Risk-Weighted Assets.

In accordance with the provisions of Bank of Italy Circular 262 of December 22, 2005, and subsequent updates, "*The Financial Statements of Banks: layout and preparation*", the amount of risk-weighted assets is determined as the product of the total of prudential capital requirements and 12.5 (the inverse of the minimum obligatory ratio equal to 8%).

The Banca Farmafactoring Banking Group's total exposure to business risks at December 31, 2015 is adequate in relation to the level of capitalization and the profile of risk identified.
The *CET1 Capital Ratio*, the *Tier 1 Capital Ratio* and the *Total Capital Ratio* are 24.3%.

<u>Pillar 1 – Capital adequacy to meet the typical risks associated with financial activities</u>

From the standpoint of operations, the absorption of risks is calculated using various methods:
- credit risk → standardized approach;
- counterparty risk → standardized approach;
- operational risk → basic approach;
- market risk → standardized approach.

Credit risk

The application of the Standardized approach involves the division of the exposures into various portfolios based upon the nature of the counterparty, and the application of diversified weighted coefficients to each portfolio.

In particular, for the "Central administrations and central banks" portfolio, the weighting depends on the *rating* assigned by the External Credit Assessment Institutions (ECAIs), or Export Credit Agencies (ECAs), to the individual States; for the "supervised institutions" portfolio, the weighting depends on the *rating* of the State in which the supervised institution has its headquarters; for the "public sector entities" portfolio, the rules for weighting are the same as those for supervised institutions.

With regard to the reporting of own funds and capital requirements, the credit assessment agency (ECAI) for exposures to central administrations and central banks recognized by Banca Farmafactoring is "DBRS", with the "*Unsolicited*" type of rating.

For the calculation of credit risk, the Bank applies the following weighting factors established by Bank of Italy's regulation on Prudential Supervision:
• 0% for receivables from central administrations and central banks with headquarters in a member State of the European Union, denominated and financed in the local currency;
• 20% for receivables from territorial entities with headquarters in a member State of the European Union, denominated and financed in the local currency, and for receivables from the Public Administration for countries with a credit rating class of 1;
• 50% for receivables from the Public Administration, for countries with a credit rating class of 2, (which include those from AOs in the National Healthcare System and ASLs) except for exposures with an original term equal to or less than three months for which a weighting is applied of 20%;
• 50% for receivables from supervised institutions except for exposures with an original term equal to or less than three months for which a weighting is applied of 20%;
• 100% for receivables from the Public Administration of countries in a credit rating class of 3 (for example, Portugal);
• 100% for receivables from private debtors;
• 100% for property, plant and equipment, investments and other assets;
• 150% for impaired receivables (past due);
• 100% for impaired receivables (past due), if the risk adjustments are equal to or higher than 20% of the non-guaranteed portion, before credit adjustments.

The non-recourse receivables purchased by Farmafactoring España are weighted at 20% since the counterparties of reference for such exposures are represented by the *"Comunidad"* (the Regions) and not by the entities of the Public Administration.

The Group constantly maintains, as a capital requirement against credit risk, an amount of regulatory capital equal to at least 8% of the weighted exposure to credit risk.

$$\text{Capital requirement} = 8\%\ \text{RWA}$$

The *Risk-Weighted Amount* is determined by the sum of the *risk-weighted* assets of the various classes.

Counterparty risk
Counterparty risk represents a particular type of credit risk that generates a loss if the transactions put in place with a specific counterparty have a positive value in the event of insolvency.
For Banca Farmafactoring the counterparty risk is generated by repurchase transactions with Cassa Compensazione e Garanzia as the counterparty. The counterparty risk for repurchase agreements is measured using the simplified method.

Operational risk
The Group uses the "Basic" indicator approach to measure operational risk: the capital requirement is determined by applying a 15% coefficient to the three-year average of the relevant indicator, calculated on the items of the financial statements of the last three years, in accordance with Regulation (EU) 575/2013.

Market risk
The Group measures market risk using the "Standardized" method. The regulation identifies and regulates the treatment of the various types of market risk in reference to the regulatory trading book, in which there were no outstanding positions at December 31, 2015.

Pillar 2 – The ICAAP Summary

The supervisory legislation requires banks to have control strategies and processes for determining the adequacy of current and prospective capital. It is the Supervisory Authority's responsibility to verify the reliability and accuracy of the relative results and, where necessary, to take the appropriate corrective actions.

The Banking Group presents the ICAAP summary to the Bank of Italy by April 30, 2016. The ICAAP summary shows the updated risk management system for the determination of the adequacy of capital.
The following reports the principal cases of risk considered relevant under Pillar 2:

- Concentration risk: is the relevant risk associated with the concentration of relationships on the individual entities in the extended National Health System or Public Administration;
- Interest rate risk: is the risk of fluctuations in the basic indexed rates affecting the assets and liabilities in the *banking book*;
- Liquidity and excessive leverage risk: is the relevant risk due to the inability to access funds on the financial market or limitations that are present and restrict the disposal of assets, or excessive leverage;
- Strategic and country risk: is the relevant current or prospective risk of a decline in earnings or capital deriving from changes in the operating environment or adverse corporate decisions, improper implementation of decisions, lack of responsiveness to changes in the competitive environment; this also includes the country risk in respect of potential losses caused by events occurring in a country other than Italy;
- Reputational risk: is the relevant risk identified by the negative perception of the Banking Group's image on the part of *stakeholders* such as clients, counterparties, shareholders, employees and supervisory authorities.

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Capital requirement in relation to credit risk and counterparty risk

Portfolios/Exposures	Weighting factors	Credit risk			Counterparty risk		
		Non-weighted exposure	Weighted exposure	Capital require-ment	Non-weighted exposure	Weighted exposure	Capital require-ment
Exposure to central administrations and central banks *Credit rating class: 2*	0%	1,566,545	0	**0**			
Exposure to territorial entities *Credit rating class: 2*	20%	539,434	107,887	**8,631**			
Exposure to public sector entities *Credit rating class: 2* *Credit rating class: 3*	20%	132,594	26,519	**2,122**			
	50%	901,646	450,823	**36,066**			
	100%	27,903	27,903	**2,232**			
Exposures to supervised institutions *Credit rating class: 2*	20%	55,815	11,163	**893**			
	50%	0	0	**0**			
	100%	0	0	**0**			
Exposure to companies and other parties *Credit rating class: no rating*	100%	53,446	53,446	**4,276**	89	89	**7**
Past-due exposures	150%	45,746	68,619	**5,490**			
	100%	237	237	**19**			
Equity instruments exposures *Credit rating class: no rating*	100%	23	23	**2**			
	250%	3	7	**1**			
Other exposures *Credit rating class: no rating*	0%	1	0	**0**			
	100%	13,395	13,395	**1,072**			
Total		**3,336,788**	**760,022**	**60,802**	**89**	**89**	**7**

Capital requirement in relation to market risks

	Weighted exposure - RWA	Capital requirement
Regulatory trading book		
Position risk – OTC derivative contracts	0	0
Concentration risk	0	0
Entire portfolio		
Regulatory risk	0	0
Currency risk	0	0
Commodity risk	0	0
Capital requirement in relation to market risks	***0***	***0***

Capital requirement in relation to operational risk

	Weighted exposure - RWA	Capital requirement
Operational risk	*305,708*	*24,457*

Capital ratios

Item/Amounts	Total 12/31/2015
Common Equity Tier 1 Capital/Risk-weighted assets (*CET 1 capital ratio*) (%)	24.3%
Tier 1 Capital/Risk-weighted assets (*Tier 1 capital ratio*) (%)	24.3%
Total Own Funds/ Risk-weighted assets (*Total capital ratio*) (%)	24.3%

For the presentation of more meaningful disclosure, the following table reports the capital ratios for the area of consolidation according to the provisions of Regulation (EU) 575/2013 (CRR) which, only for purposes of prudential supervision, considers the company BFF Lux Holdings S.à r.l. as head of the Group.

Item/Amounts	Total 12/31/2015
Common Equity Tier 1 Capital/Risk-weighted assets (*CET 1 capital ratio*) (%)	23.9%
Tier 1 Capital/Risk-weighted assets (*Tier 1 capital ratio*) (%)	24.0%
Total Own Funds/ Risk-weighted assets (*Total capital ratio*) (%)	24.1%

Section 5. Exposure to Counterparty Risk

Qualitative information

Counterparty risk represents a particular type of credit risk, which generates a loss if the transactions put in place with a specific counterparty have a positive value in the event of insolvency.
The risk, for the Group, is principally generated by repurchase transactions with Cassa Compensazione e Garanzia as the counterparty. To measure the counterparty risk in repurchase transactions the simplified method is used so that the part of exposure covered by collateral is assigned a weighting factor that corresponds to the weighting factor assigned to the instrument used as collateral.
At December 31, 2015 there are repurchase transactions outstanding with the counterparty Cassa Compensazione e Garanzia.

As reported in the previous schedules, the reduced exposure to counterparty risk does not require the use of additional control instruments compared to those already used in ordinary operations.

Quantitative information

Repurchase transactions: covered amount

Regulatory portfolio	Exposure without mitigation of credit risk	Collateral – Simplified method	Guarantee	Exposure post mitigation of credit risk
Securities financing transactions (SFT)	917,694	917,605	-	89
Total	917,694	917,605	-	89

At December 31, 2015 the capital requirement for repurchase transactions amounts to approximately €7 thousand.

Section 6. Credit Risk Adjustments

Qualitative information

Credit risk represents the possibility of incurring losses due to the counterparty's default and insolvency. It is linked to the possibility that an unexpected movement in the creditworthiness of the counterparty, towards which an exposure exists, generates a corresponding decrease in the value of the credit position.

In accordance with the provisions of Bank of Italy Circular 262 of December 22, 2005 – *"The Financial Statements of Banks: layout and preparation"*, and subsequent updates, and by the Regulatory Reporting in force defined in Bank of Italy Circular 272 of July 30, 2008 "*Matrix Accounts*", and subsequent updates, the Group has divided its receivables and loans between *"performing"* and "impaired".

"*Performing* assets" include:

• **Past due not impaired exposures.** Exposures past due more than 90 days, which are not considered impaired according to prudential regulations, and exposures that are past due and/or over the limit by not more than 90 days, as defined in Bank of Italy Circular 272 of July 30, 2008, "*Matrix Accounts*", and subsequent updates.
• **Other exposures.** Exposures not falling within the preceding category.

"Impaired assets" include:

• **Past due exposures.** These are exposures to central administrations and central banks, territorial entities, public sector entities, non-profit entities and companies which, at December 31, 2015, are past due more than 90 days.
In particular, exposures to central administrations and central banks, public sector entities and territorial entities, are considered past due when the debtor has not made any payment for any debt positions due to the Group for more than 90 days.

• ***Unlikely to pay.*** This type of exposure represents the Group's assessment that, without recourse to actions such as the realization of collateral, it is unlikely that the debtor will pay (principal and/or interest) its credit obligations in full. This assessment is conducted regardless of the existence of any past due and unpaid amounts (or installments).

• **Non-performing exposures.** These refer to exposures to parties that are in a state of insolvency or in basically similar situations, regardless of any estimates of loss formulated by the Bank.

With regard to the method adopted in determining accounting impairment adjustments, Banca Farmafactoring has carried out an analysis of its receivables and loans portfolio for the purpose of identifying any impairment of its financial assets.

This analysis made it possible to distinguish between *"performing"* and *"non-performing"* receivables; included in the non-performing category are financial assets that show an individual risk of loss, while the remaining financial assets are classified in the *performing* category.

Performing receivables include those receivables from customers which, although past due more than 90 days, show no objective indication of loss at an individual level.

Two different measurement approaches have been adopted depending on the classification of the exposure.

As regards *non-performing receivables*, through internal valuations and external legal opinions on the individual credit positions, the Bank determined the probable impairment losses to be recorded.

Although the receivables are due almost entirely from the Public Administration, as in previous years, at the date of the interim and year-end financial statements, the Bank, in accordance with IAS 39, carried out a collective impairment test of *performing receivables* in order to monitor the quantitative content.

In order to determine the Loss Given Default (LGD), the Bank assumed the value proposed by the "Basel Accord" for credits not covered by real guarantees from sovereign states, companies and banks as being equal to 45% of the Probability of Default (PD) found.
The collective assessment of the PD was performed by assigning a *rating* to the debtors (ASLs-Local Health Service Agencies/AOs-Hospital Companies), corresponding to the credit rating assigned by the major rating agencies to the particular Region to which the debtors belong. This rating is then applied to exposures that are not classified as non-performing Exposures At Default (EAD).

Such analysis and the manner of calculation were formulated when the transition was made to international accounting standards. The calculation has never produced significant data since the PD attributed to the Regions based on the rating led to a modest impairment according to the impairment test.

Starting from July 2012, the input parameters for the collective impairment model led, as a result of the continual *downgrades* of the Republic of Italy and the consequent *downgrade* of the Regions from the fourth quarter of 2011, to a higher PD calculation compared to the past and, consequently, to a collective impairment loss that is no longer negligible.

Specifically, at December 31, 2015, the impairment test indicated an impairment loss of about €2.9 million, higher by €0.9 million compared to 2014 owing primarily to the increase in the *outstanding* receivables of the Bank.

Quantitative information

Distribution of financial assets by portfolio and credit quality (carrying amount)

Portfolios/Quality	Non-performing	Unlikely to pay	Past due impaired	Other impaired exposures	Not impaired exposures	Total
1. Available-for-sale financial assets					429,414	**429,414**
2. Held-to-maturity financial assets					822,859	**822,859**
3. Due from banks					55,778	**55,778**
4. Due from customers	2,507		43,234		1,916,263	**1,962,004**
5. Financial assets at *fair value* through profit or loss						
6. Financial assets held for sale						
Total 12/31/2015	**2,507**		**43,234**		**3,224,314**	**3,270,055**
Total 12/31/2014	**2,936**	**62**	**9,779**		**2,945,656**	**2,958,433**

Distribution of credit exposures by portfolio and credit quality (gross and net amounts)

Portfolio/Quality	Impaired assets			Not impaired assets			Total (net exposure)
	Gross exposure	Specific impairment losses	Net exposure	Gross exposure	Specific impairment losses	Net exposure	
1. Available-for-sale financial assets				429,414		429,414	**429,414**
2. Held-to-maturity financial assets				822,859		822,859	**822,859**
3. Due from banks				55,778		55,778	**55,778**
4. Due from customers	47,536	1,795	45,741	1,920,013	3,750	1,916,263	**1,962,004**
5. Financial assets at fair value through profit or loss							
6. Financial assets held for sale							
Total 12/31/2015	**47,536**	**1,795**	**45,741**	**3,228,064**	**3,750**	**3,224,314**	**3,270,055**
Total 12/31/2014	**14,676**	**1,899**	**12,778**	**2,948,325**	**2,668**	**2,945,657**	**2,958,434**

Distribution by significant geographical area of exposures to banks, by main type of exposure

Exposures/ Geographical areas	Italy		Other European countries		America		Asia		Rest of the world	
	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses
A. On-balance sheet exposures										
A.1 Non-performing										
A.2 Unlikely to pay										
A.3 Past due impaired exposures										
A.4 Not impaired exposures	55,393		385							
Total A	**55,393**		**385**							
B. Off-balance sheet exposures										
B.1 Non-performing										
B.2 Unlikely to pay										
B.3 Other impaired assets										
B.4 Not impaired exposures										
Total B										
Total (A+B) 2015	**55,393**		**385**							
Total (A+B) 2014	**74,470**		**2,671**							

Distribution by significant geographical area of exposures to Italian banks, by main type of exposure

Exposures/ Geographical areas	Northwest Italy		Northeast Italy		Central Italy		South Italy and Islands	
	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses
A. On-balance sheet exposures								
A.1 Non-performing								
A.2 Unlikely to pay								
A.3 Past due impaired exposures								
A.4 Not impaired exposures	51,495		1,909		1,389		600	
Total A	**51,495**		**1,909**		**1,389**		**600**	
B. Off-balance sheet exposures								
B.1 Non-performing								
B.2 Unlikely to pay								
B.3 Other impaired assets								
B.4 Not impaired exposures								
Total B								
Total (A+B) 2015	**51,495**		**1,909**		**1,389**		**600**	
Total (A+B) 2014	**23,250**		**9,841**		**40,093**		**1,556**	

Distribution by significant geographical area of exposures to customers, by main type of exposure

Exposures/ Geographical areas	Italy		Other European countries		America		Asia		Rest of the world	
	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses
A. On-balance sheet exposures										
A.1 Non-performing	2,507	1,719								
A.2 Unlikely to pay										
A.3 Past due impaired exposures	43,220	76	14							
A.4 Not impaired exposures	2,947,189	3,700	221,347	50						
Total A	**2,992,916**	**5,496**	**221,361**	**50**						
B. Off-balance sheet exposures										
B.1 Non-performing										
B.2 Unlikely to pay										
B.3 Other impaired assets										
B.4 Not impaired exposures	117,461									
Total B	**117,461**									
Total (A+B) 2015	**3,110,377**	**5,496**	**221,361**	**50**						
Total (A+B) 2014	**2,623,047**	**4,537**	**269,278**	**30**						

Distribution by geographical area of exposures to Italian customers, by main type of exposure

Exposures/ Geographical areas	Northwest Italy		Northeast Italy		Central Italy		South Italy and Islands	
	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses	Net exposure	Total imp. losses
A. On-balance sheet exposures								
A.1 Non-performing	914	346	397	58	131	951	1,077	363
A.2 Unlikely to pay								
A.3 Past due impaired exposures	2,300	4	1,047	2	2,705	5	37,168	66
A.4 Not impaired exposures	165,823	272	81,816	138	1,884,331	1,852	815,208	1,438
Total A	**169,036**	**622**	**83,259**	**198**	**1,887,167**	**2,808**	**853,454**	**1,867**
B. Off-balance sheet exposures								
B.1 Non-performing								
B.2 Unlikely to pay								
B.3 Other impaired assets								
B.4 Not impaired exposures	5,539		4,157		102,038		5,726	
Total B	**5,539**		**4,157**		**102,038**		**5,726**	
Total (A+B) 2015	**174,575**	**622**	**87,416**	**198**	**1,989,206**	**2,808**	**859,180**	**1,867**
Total (A+B) 2014	**205,417**	**671**	**108,081**	**159**	**1,645,486**	**2,281**	**664,063**	**1,426**

Distribution by industry or by counterparty type of exposures to customers, by type of exposure (carrying amount)

Exposures/Counterparties	Governments			Other public entities		
	Net exposure	Specific impairment losses	Portfolio impairment losses	Net exposure	Specific impairment losses	Portfolio impairment losses
A. On-balance sheet exposures						
A.1 Non-performing				1,229	451	
- of which: forborne						
A.2 Unlikely to pay						
- of which: forborne						
A.3 Past due impaired exposures	31			9,543	17	
- of which: forborne						
A.4 Not impaired exposures	1,533,844		499	1,584,139		3,225
- of which: forborne						
Total A	**1,533,875**		**499**	**1,594,911**	**468**	**3,225**
B. Off-balance sheet exposures						
B.1 Non-performing						
B.2 Unlikely to pay						
B.3 Other impaired assets						
B.4 Not impaired exposures	7,360			18,861		
Total B	**7,360**			**18,861**		
Total (A+B) 2015	**1,541,235**		**499**	**1,613,772**	**468**	**3,225**
Total (A+B) 2014	**1,441,086**	**9**	**179**	**1,390,157**	**581**	**2,446**

Exposures/Counterparties	Financial companies			Insurance companies		
	Net exposure	Specific impairment losses	Portfolio impairment losses	Net exposure	Specific impairment losses	Portfolio impairment losses
A. On-balance sheet exposures						
A.1 Non-performing						
- of which: forborne						
A.2 Unlikely to pay						
- of which: forborne						
A.3 Past due impaired exposures						
- of which: forborne						
A.4 Not impaired exposures	28,932					
- of which: forborne						
Total A	**28,932**					
B. Off-balance sheet exposures						
B.1 Non-performing						
B.2 Unlikely to pay						
B.3 Other impaired assets						
B.4 Not impaired exposures						
Total B						
Total (A+B) 2015	**28,932**					
Total (A+B) 2014	**24,868**		**1**			

Exposures/Counterparties	Non-financial companies			Other entities		
	Net exposure	Specific impairment losses	Portfolio impairment losses	Net exposure	Specific impairment losses	Portfolio impairment losses
A. On-balance sheet exposures						
A.1 Non-performing	234	850		1,044	418	
- of which: forborne						
A.2 Unlikely to pay						
- of which: forborne						
A.3 Past due impaired exposures	33,473	59		186		
- of which: forborne						
A.4 Not impaired exposures	6,491		8	15,131		18
- of which: forborne						
TOTAL A	**40,198**	**909**	**8**	**16,361**	**418**	**18**
B. Off-balance sheet exposures						
B.1 Non-performing						
B.2 Unlikely to pay						
B.3 Other impaired assets						
B.4 Not impaired exposures	91,240					
TOTAL B	**91,240**					
TOTAL (A+B) 2015	**131,438**	**909**	**8**	**16,361**	**418**	**18**
TOTAL (A+B) 2014	**24,751**	**852**	**38**	**11,463**	**457**	**5**

Time breakdown by contractual residual duration of financial assets

Items/Duration	on demand	1 to 7 days	7 to 15 days	15 days to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	un-specified maturity
Balance sheet assets	**572,886**	**11,622**	**48,463**	**23,432**	**177,037**	**353,056**	**622,900**	**1,437,286**	**38,646**	
A.1 Government securities			11,121		42,334	67,509	177,186	945,442		
A.2 Other debt securities										
A.3 Units in investment funds										
A.4 Loans	572,886	11,622	37,342	23,432	134,703	285,547	445,714	491,844	38,646	
- Due from banks	*49,989*	*5,788*								
- Due from customers	*522,897*	*5,834*	*37,342*	*23,432*	*134,703*	*285,547*	*445,714*	*491,844*	*38,646*	

On-balance sheet credit exposures to customers: change in total impairment losses

Source/Categories	Non-performing		Unlikely to pay		Past due impaired	
	Total	of which: forborne	Total	of which: forborne	Total	of which: forborne
A. Beginning total impairment losses	**1,883**				**16**	
- of which: receivables sold but not derecognized						
B. Increases	**143**				**77**	
B.1 impairment losses	143				72	
B.2 losses on sale						
B.3 transfer from other categories of impaired exposures						
B.4 other increases					5	
C. Decreases	**307**				**17**	
C.1 impairment reversals					1	
C.2 impairment reversals from recoveries	123				9	
C.3 gains on sale						
C.4 derecognitions						
C.5 transfer to other categories of impaired exposures						
C.6 other decreases	184				7	
D. Ending total impairment losses	**1,719**				**76**	
- of which: receivables sold but not derecognized	18				7	

Section 7. Unencumbered Assets

Qualitative information

Disclosure of encumbered and unencumbered assets by banks is required by Bank of Italy Circular 285, in the manner established by the European Banking Authority guidelines of June 27, 2014.
In particular, the purpose of the required disclosure is to assess the institutions' recourse to types of *secured funding* (for example, guaranteed bank bonds, repurchase agreements, credit lines from central banks).

The institutions disclose information on encumbered and unencumbered assets on a consolidated level by product, taking into account the instructions specified in Appendix XVII of the Commission Implementing Regulation (EU) 2015/79 issued by the Commission of the European Union.
Encumbered assets are those used as collateral, subject to limitations on withdrawal or otherwise reserved to improve credit (*credit enhancement*).

Beginning from this disclosure report at December 31, 2015, the information published on encumbered and unencumbered assets is calculated on the basis of the average values of the quarterly data relating to the year 2015, as established in the EBA/GL/2104/03 guidelines.

Quantitative information

A - Encumbered assets in the financial statements

	Encumbered assets		Unencumbered assets	
	Carrying amount	Fair Value	Carrying amount	Fair Value
Total Assets of the Banking Group	**1,664,797**	**X**	**1,466,236**	**X**
1. Equity instruments			23	23
2. Debt securities	1,169,466	1,169,467	126,909	126,909
3. Other assets	495,331	X	1,339,303	X

B - Collateral received by the reporting institution

At December 31, 2015 there was no collateral received.

C - Encumbered assets/collateral received and associated liabilities

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Associated liabilities and assets, collateral received or own securities encumbered	**1,460,617**	**1,664,685**

The Banca Farmafactoring Banking Group holds the following types of encumbered assets:

• High credit quality debt securities issued by the Italian State encumbered as part of *secured funding* transactions (refinancing operations with the ECB and repo transactions);

• ECB eligible trade receivables (purchased non-recourse) used for refinancing operations with the ECB based on eligibility rules established by ECB itself;

• Trade receivables (purchased non-recourse) used as the underlying for medium-/long-term transactions for the purpose of liquidity transactions, typically to guarantee securitization transactions (sold but not derecognized);

• Guarantee funds and initial margins placed with the clearing systems and central counterparties.

About 70% of the entire amount of encumbered assets is composed of owned government securities used as collateral in repurchase transactions and for secured funding transactions with the Eurosystem.

Section 8. Use of ECAIs

Qualitative information

The Group uses the "Standardized" approach for the measurement of credit risk, as indicated in Bank of Italy Circulars 285 "*Supervisory provisions for banks*" and 286 "*Instructions for the preparation of regulatory reporting for banks and investment firms*", both of December 17, 2013, and subsequent updates. This approach involves the division of the exposures into various portfolios based on the nature of the counterparty and the application of diversified weighted coefficients to each portfolio.
In particular, for the "Central administrations and central banks" portfolio, the weighting depends on the rating assigned by the specialized credit assessment agencies, ECAIs, or ECAs, to the individual States; for the "supervised institutions" portfolio, the weighting depends on the rating of the State in which the supervised institution has its headquarters; for the "public sector entities" portfolio, the rules for weighting are the same as those for supervised institutions.

Starting from the June 30, 2013 reporting, the Banking Group adopted *Dominion Bond Rating Service (DBRS)* as the ECAI ratings agency, with the *"Unsolicited"* type of rating.

The *unsolicited rating* of the Republic of Italy by DBRS is *"A low"* and therefore the receivables exposure from the Public Administration fall in the Credit Rating Class of 2, with a risk weight equal to 50%.
The exposures of the Group are almost completely composed of receivables due from counterparties belonging to the Public Administration.

The following is a comparison between the credit quality ratings and the DBRS ratings.

Credit Rating Class	ECAI DBRS Ratings Limited
1	AAA to AAL
2	AH to AL
3	BBBH to BBBL
4	BBH to BBL
5	BH to BL
6	CCC

The credit rating classes of the principal countries in which both the BFF Banking Group and the companies in the Magellan Group (subject of a tender offer as indicated in the introduction) operate are the following:
Class 2: Italy, Spain and Poland
Class 3: Portugal

Quantitative information

The distribution of the exposures of the Banking Group, subject of credit risk according to the standardized method, by credit quality rating and by regulatory class of activity is presented below.

Portfolios/Exposures	Weighting factors	Credit risk		
		Non-weighted exposure	Weighted exposure	Capital requirement
Exposures to central administrations and central banks *Credit rating class: 2*	0%	1,566,545	0	**0**
Exposures to territorial entities *Credit rating class: 2*	20%	539,434	107,887	**8,631**
Exposure to public sector entities *Credit rating class: 2* *Credit rating class: 3*	20%	132,594	26,519	**2,122**
	50%	901,646	450,823	**36,066**
	100%	27,903	27,903	**2,232**
Exposures to supervised institutions *Credit rating class: 2*	20%	55,815	11,163	**893**
	50%	0	0	**0**
	100%	0	0	**0**
Exposure to companies and other parties *Credit rating class: no rating*	100%	53,535	53,535	**4,283**
Past-due exposures	150%	45,746	68,619	**5,490**
	100%	237	237	**19**
Equity instruments *Credit rating class: no rating*	100%	23	23	**2**
	250%	3	7	**1**
Other exposures *Credit rating class: no rating*	0%	1	0	**0**
	100%	13,395	13,395	**1,072**
Total		**3,336,877**	**760,111**	**60,809**

Section 9. Exposure to Market Risk

Qualitative information

The Group measures market risk using the "Standardized" method. The regulation identifies and regulates the treatment of the various types of market risk in reference to the regulatory trading book.
At December 31, 2015, there are no outstanding positions included in the regulatory trading book.

Quantitative information

Capital requirements in relation to market risk

	Weighted exposure - RWA	Capital requirement
Regulatory trading book		
Risk position – OTC derivative contracts	0	0
Concentration risk	0	0
Entire portfolio		
Regulatory risk	0	0
Currency risk	0	0
Commodity risk	0	0
Capital requirement in relation to market risk	***0***	***0***

Section 10. Operational Risk

Qualitative information

Operational risk is the risk of loss due to inadequacy or failures of procedures, caused by personnel and internal systems or as a result of external events. Falling in this category, among other, are fraud, human error, business interruption, system failure, breach of contracts and natural disasters; operational risk comprises legal risks but not strategic and reputational risk.
Operational risk therefore refers to various types of events that would not be significant individually unless analyzed together and quantified for the entire category of risk.

For the Banking Group, the exposure to this category of risk is generated predominately by failures in the working process and in the organization and governance structure – human errors, malfunctioning of computer applications, inadequate organizational management and control – as well as any loss of human resources in key positions within corporate management. Exposures to operational risks deriving from external sources, instead, appear to be of negligible importance, partly in view of the mitigation tools adopted to meet these unfavorable events, such as the business *continuity plan*, data *storage* processes, back up instruments, insurance policies, etc.

The process adopted by the Group for the management and control of operational risks is founded on the principle of promoting a corporate culture for managing risk and defining the proper standards and incentives with the aim of adopting professional and responsible behavior, at all levels of operations as well as the design, implementation and management of an integrated system for operational risk management adequate in relation to the nature, operations, size and profile of risk.

A "mixed" type assessment model for operational risks is employed by the Group. Such model is based on assessments that are both qualitative – linked to the mapping of the processes, the risk activities and relative controls put in place – and quantitative, using the methodologies set out by Bank of Italy.

Within the framework of the controls put in place over the exposure to operational risk, the following specific risks are also monitored by the Bank:

• Money laundering risk, regarding the risk that counterparties of the Group, whether financial, commercial, suppliers, partners, collaborators and consultants, may be implicated in transactions that might potentially favor the laundering of cash coming from illegal or criminal activities;
• Compliance risk, concerning the risk of legal and administrative sanctions, significant financial losses or reputational losses due to failure to comply not only with laws and regulations but also with internal standards and conduct applicable to corporate activities. For this type of risk, a review is carried out annually of the related assessment method, developed for all activities falling within the Bank's legal scope of reference, according to a *risk-based* approach. In particular, for the relevant laws that do not call for the creation of specialized functions (e.g. privacy and workplace health and safety), the Compliance Function provides guidance *ex ante* to the Bank's structures and assesses *ex post* the adequacy of the organizational measures and the control activities adopted under the Compliance Risk Assessment method. As for the laws monitored by specialized

functions, the Compliance Function carries out an indirect control by cooperating with these specialized functions in defining the *compliance* risk assessment methods in addition to mapping the risks and the relative controls (Compliance Risk Matrix).

For the calculation of the capital requirement on the operational risk, the Banking Group uses the *Basic Indicator Approach - BIA*, by applying a regulatory coefficient to an indicator of the volume of the Bank's operations (Relevant Indicator).

The Group also assesses operational risks in connection with the introduction of new products, activities, relevant processes and systems and mitigates the consequence of any operational risk that may arise through the preventive involvement of the corporate control functions and the drawing up of specific policies and regulations on various subjects and topics.

To control the above risks, the Group adopts *ad hoc* organizational models for the management of the risks regarding money laundering, safety and health in the workplace and information security.

Quantitative information

On the basis of the above methodology, the capital requirement for operational risk at December 31, 2015 is equal to €24,457 thousand.

Section 11. Exposure to interest rate risk on positions not included in the trading book

Qualitative information

In order to assess interest rate risk, potentially linked to fluctuations in interest rates, the Bank is guided by the methodology contained in the prudential regulation (Bank of Italy Circular 285 - Attachment C). This methodology is applied monthly, in order to record on a timely and ongoing basis any loss in the event of a market shock determined on the basis of annual changes in interest rates recorded during an observation period of six years considering alternatively the first percentile (decrease) and the 99th percentile (increase) and ensuring that rates are not negative.

The sensitivity analysis of interest rate makes it possible to highlight the exposure, represented:
• for liabilities, by the total amount of loans revalued in relation to the maturity of the single *tranches* of utilization, the exposure in derivatives and by *funding* from Conto Facto and from the issue of bonds;
• for assets, by lending represented by exposure from the purchase of non-recourse receivables, whose collections are estimated using statistics of debtor payment times, and adjusted according to any settlement agreements with the individual regions and/or with significant debtors, or adjusted as a result of the sale of *assets* or by investments in the government securities portfolio.

The methodology used calls for:
• Classification of assets and liabilities in different time periods: the allocation to different time periods is made, for fixed-rate assets and liabilities, on the basis of their residual life; for variable-rate assets and liabilities, on the basis of the interest rate renegotiation date.
• Weighting of net exposures within each period: the asset positions and liability positions within each period are offset, obtaining a net position. Each net position, for each time period, is multiplied by weighting factors, obtained as the product of the hypothetical variation in the rates and an approximation of the modified *duration* relating to the single periods.
• Sum of the weighted exposures of the different time periods: the weighted exposures of the different periods are all summed together, obtaining a total weighted exposure.

The various items reported are divided according to the criteria established in Bank of Italy Circular 272 "*Matrix Accounts*" and Bank of Italy Circular 115 of August 7, 1990 "*Instructions for the preparation of supervisory reporting by credit institutions on a consolidated basis*", except for bank overdraft accounts and unrestricted deposits, which are distributed in the range "on demand" for a fixed portion of 25% (so-called non-*core* components); for the remaining amount (so-called *core* component) in the following eight time ranges (from "up to 1 month" to "4-5 years") in proportion to the number of months contained therein.

The Total Weighted Exposure represents the change in the present value of cash flows, generated by the hypothetical interest rate scenario.

Interest rate risk is assumed in connection with Banca Farmafactoring's funding activity and occurs as a result of complying with the policies and limits set by the Board of Directors and is regulated by specific powers delegated in this area, which set autonomous limits for those authorized to operate in the Finance Department.

The corporate functions responsible for ensuring the proper management of interest rate risk are the Finance Department, the Risk Management Function and Senior Management, which annually propose the policies for lending and funding and interest rate risk management to the Board of Directors, and suggest, if necessary, any opportune actions to ensure that business is carried out consistently with the risk management policies approved by Banca Farmafactoring.
The interest rate risk position is reported quarterly to Senior Management and the Board of Directors of the Bank, in accordance with the procedures set out by the Risk Management Function for senior management.
Furthermore, at the level of operations, the Finance Department monthly monitors interest rate risk, as well its management, through *ad hoc* reporting.

Quantitative information

The situation arising from the application of the interest rate management *framework* at December 31, 2015, reported below, points to a potential loss of value in the present value of cash flows, in the event of shock, equal to €15.1 million, equivalent to 5.8% on the risk index.

Consolidated rate risk at December 31, 2015
[Euro/000]

Maturity	Assets	Liabilities	Delta	Shock (market)	Weighted value
On sight and upon revocation	574.4	131.9	442.5	0.00%	-
up to 1 month	83.6	1,911.0	- 1,827.5	0.04%	- 0.7
from more than 1 month to 3 months	176.3	199.9	- 23.6	0.14%	- 0.0
from more than 3 months to 6 months	770.6	40.7	730.0	0.32%	2.3
from more than 6 months to 12 months	607.8	164.9	442.8	0.71%	3.1
from more than 12 months to 24 months	862.4	375.7	486.7	1.36%	6.6
from more than 2 year to 3 years	115.6	28.1	87.5	1.99%	1.7
from more than 3 years to 4 years	21.4	4.2	17.2	2.45%	0.4
from more than 4 years to 5 years	25.0	6.9	18.1	2.84%	0.5
from more than 5 years to 7 years	21.8	0.0	21.7	3.03%	0.7
from more than 7 years to 10 years	9.5	-	9.5	3.49%	0.3
from more than 10 years to 15 years	1.8	-	1.8	4.60%	0.1
from more than 15 years to 20 years	0.0	-	0.0	18.81%	0.0
over 20 years	-	-	-	22.23%	-
	3,270.1	2,863.4			

TOTAL WEIGHTED VALUE (TWV)	**15.1**
OWN FUNDS AT 12/31/2015	***259.3***
RISK INDEX (TWV/Own Funds)	**5.8%**

Section 12. Exposure to Securitization Positions

Information on the transactions with "Banca IMI - FF Finance S.r.l." and "BayernLB – Farmafactoring SPV II S.r.l."

The reimbursement of the Senior Notes under the FF Finance S.r.l. securitization program, originally for an amount of €100 million, was completed on February 25, 2015.
During March 2015 agreements were signed with SPV (*Issuer*), the Intesa Sanpaolo Group (*Account Bank* and *Cash Manager*), Duomo Funding Plc (*Noteholder*) and other counterparties to the transaction for the closing of the securitization transaction, authorizing:
• cancellation of all the contracts relating to the transaction;
• repurchase, on the part of Banca Farmafactoring, of the receivables portfolio still *outstanding* with the SPV and the debit notes issued and not yet collected.

During 2015 the Bank then liquidated and cancelled the special purpose vehicle FF Finance S.r.l..
Securitization transactions were also conducted with BayernLB - Farmafactoring SPV II S.r.l. and the Senior Notes and the closing of the securitization program had been completed in 2014.

The accounting records of the special purpose vehicles showed only a single important asset, a tax credit of €126 thousand, with regard to the FF Finance program, and €66 thousand, with regard to the Farmafactoring SPV II S.r.l. program.

Each of the SPVs filed a request for the reimbursement of the respective credits through the procedure for the reimbursement of IRES taxes through the tax account, with the issue of a four-year guarantee by the Bank.

In order to facilitate the cancellation of the SPVs, the credit was assigned to the Bank. After assigning the tax credit and paying what was due to the Bank, the companies FF Finance S.r.l. and Farmafactoring SPV II S.r.l. were cancelled from the Companies Register.

The Bank became the holder of the tax credit and is continuing to take the necessary steps to obtain a refund from the Revenue Office for the IRES credit.

Information on the transaction with "Deutsche Bank – Farmafactoring SPV I S.r.l."

Qualitative information

Strategies, processes and objectives
During 2015 the Bank renegotiated the securitization transaction with the Deutsche Bank Group on the non-recourse sale of receivables due from the ASLs and AOs, with the aim of diversifying the Bank's *funding* activities.

Characteristics of the transaction

The receivables were sold under ex Law 130/99 to a special purpose vehicle, Farmafactoring SPV I S.r.l., which financed the purchase by issuing securities for €150 million, subscribed to by Deutsche Bank AG.

The transaction provides for a revolving period valid up to June 30, 2016 during which sales of receivables will be made against collections on receivables, in order to maintain the collateralization ratio established in the contract.

At the end of the revolving period there will be an amortization period correlating to the residual life of the outstanding receivables during which the securities will be repaid in full.

Description of the risk profile

Banca Farmafactoring, as the *originator* and *subordinated provider*, maintains a role in the securitization transaction, even though it sells the non-recourse receivables.

The transaction provides for a *credit enhancement* mechanism through an *overcollateralization* ratio (equal to 133.33% of the amount of the securities issued) and the subordinated loan carried by Banca Farmafactoring.

At the end of the transaction, subsequent to the repayment of the securities and other senior expenses on the transaction, all the remaining amounts from the collection of the receivables sold, including interest on late payment, will be due to Banca Farmafactoring as the subscriber of the subordinated loan. In light of this condition, together with the right of the company to repurchase and/or substitute the receivables at any time, all the risks and rewards of the transaction were not transferred to the assignee but remain with Banca Farmafactoring itself and, therefore, the securitization risk is included in the credit risk.

Quantitative information

Type of financial instruments held

Banca Farmafactoring does not hold any financial instruments connected with the aforementioned transaction.

Sub-servicer activity

Banca Farmafactoring, having the mandate for collection, recovers and collects the receivables on behalf of the *servicer* Zenith Service S.p.A.

Following the sales of receivables made during the revolving phase of the transaction, the nominal outstanding amount of receivables at December 31, 2015 is about €250.5 million.

Banking Group – Exposure arising from the main "in-house" securitization transactions by type of securitized asset and by type of exposure

Type of securitized assets/Exposure	On-balance sheet exposure						Guarantees given						Credit lines					
	Senior		Mezzanine		Junior		Senior		Mezzanine		Junior		Senior		Mezzanine		Junior	
	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.	Carrying amount	Impair loss/rev.
A. Full derecognition																		
B. Partial derecognition																		
C. Not derecognized	87,837	(40)																
C.1 Farmafactoring SPV I																		
- *Factoring*	87,837	(40)																

Banking Group – Interests in securitization vehicle companies

(in € thousands)

Securitization/Vehicle company name	Registered office	Consolidation	Assets			Liabilities		
			Receivables	Debt securit.	Altre	Senior	Mezzan.	Junior
Farmafactoring SPV I S.r.l.	Milan - Via Statuto, 10	Line-by-line	311,234		16	150,000		

Section 13. Remuneration Policy

Qualitative information

Remuneration policy definition

The remuneration and incentive policies of the Banca Farmafactoring Banking Group have been designed with the ultimate objective of arriving at, in the interests of the *stakeholders*, schemes of remuneration that are in line with the values, the strategies and the objectives of the company over the long term. These schemes are linked to the results of the company and adjusted to take into account the risks assumed by the Group and, in particular, the levels of capital and liquidity necessary to manage the activities undertaken, so as to avoid distorted incentives that may cause an inducement to commit violations of laws or an excessive assumption of risks for the Group.

The following is mentioned in conjunction with the process for defining the remuneration policy:

i) the Board of Directors:

- drafts, submits to the shareholders' meeting and reviews at least once a year the remuneration policy and oversees its proper implementation;
- ensures that the remuneration policy is adequately documented and can be accessed internally;
- proposes the remuneration and incentive policy to the shareholders' meeting for its approval.

The Board of Directors defines, for the Group, the remuneration and incentive schemes for the executive directors, those heading the major lines of business, executives and those in charge of the corporate control functions.

In particular, the board ensures that such schemes are consistent with the overall decisions of the Bank in terms of the assumption of risks, strategies, long-period objectives, corporate governance structure and internal controls.

ii) the Remuneration Committee:

On January 25, 2013 the Board of Directors formed the Remuneration Committee, which has advisory and proactive functions in the matter of personnel remuneration and incentive policies. It is charged with contributing to the definition of the guidelines for remuneration and incentive policies and periodical assessment, in addition to formulating proposals for remuneration and/or incentives for the directors who hold special positions and for material risk takers.

In 2015 the Remuneration Committee held ten meetings.
The Remuneration Committee is composed of three members, one of whom is the Chairman of the Board of Directors.

iii) the Risks Committee:

On July 24, 2014 the Board of Directors formed the Risks Committee, which has among its functions that of ascertaining that the incentives in the remuneration scheme of the Group are consistent with the RAF.

Based upon an analysis of the labor market, changes in the organization or in the strategic guidelines of the Group, at least once a year the Personnel Function verifies whether the remuneration and incentive policies need to be revised. The personnel function also reviews the incentive scheme from the standpoint of instruments, conditions, operational mechanisms and parameters adopted by the Group so as to translate the policy provisions operationally.

Moreover, the implementation of the remuneration and incentive policies is subject to verification at least once a year by the control functions, each according to its specific authority, in order to ensure that the remuneration policies and practices adopted and their proper functioning are adequate in relation to and in correspondence with the law.

In particular:
- the Compliance Function evaluates *ex ante* the correspondence of the remuneration and incentive policies with the legal framework of reference and verifies *ex post*, among other, the consistency of the corporate reward system with the objectives of the regulations, bylaws and the Code of Ethics and any other *standards* of conduct applicable so that any legal or reputational risks are duly limited;
- the Audit Function verifies at least annually the correspondence of the remuneration and incentive practices with the policies approved and the reference law.

The process for the formation of the remuneration and incentive policies of the BFF Group also calls for the participation of the following functions:
- Risk Management O.U.: supports the identification of material risk takers, providing indications relating to the current and prospective risk profile in line with the ICAAP analysis, also at a consolidated level;
- Planning and Development Function: aids in the identification of material risk takers providing indications on the current and prospective risk profile, in line with the regulations on the subject of the responsibilities of the corporate structures and the corporate procedures;
- Administration and Control department: ensures the fairness and correctness of accounting documents supporting actual earnings and financial *performance*.

Identification of "material risk takers"

The remuneration and incentive policies are based on a corporate role classification system consistent with the definition of "material risk taker" (so-called "*risk taker*") as set out by the Group in accordance with the Community Directive approved on June 24, 2014.

The BFF Group has identified risk takers according to a self-evaluation process – conducted by the Personnel and General Services Function in collaboration with the Planning and Development Function and the Risk Management O.U. – performed on the basis of the provisions of existing law, the regulation on the subject of duties and responsibilities by the organizational unit, the corporate procedures, the job description and the individual powers of attorney. As a result, considering the effective levels of autonomy and the impact on the *business*, the following have been identified as risk takers:
- Chief Executive Officer
- Vice President of Operations

- Vice President of Finance
- Vice President of Administration and Control
- Head of Online Banking
- Head of Planning and Development
- Head of Credit Assessment
- Head of ICT
- Head of Personnel and General Services
- Head of Internal Audit
- Head of Risk Management, Compliance and AML
- Head of Commercial and Business Development
- Head of Credit Management
- Head of Treasury and Collections
- General Manager of Farmafactoring España S.A.

Remuneration components

Fixed and variable components

The BFF Group, using adequate remuneration and incentive mechanisms, intends to encourage corporate competitiveness while promoting sound and prudent management and strengthening the management of the company, guaranteeing that independent, informed and timely decisions are taken at an appropriate level, so as to avoid conflicts of interest and ensuring proper disclosure as required by the competent authorities.
In short, the remuneration policies adopted by the Group are the following:

All directors:
- are recipients of compensation fixed by the shareholders' meeting in addition to the reimbursement of expenses effectively incurred in the execution of their duties;
- for those who are chairpersons of committees, additional compensation under ex Art. 2389, third paragraph of the Italian Civil Code may be decided by the Board of Directors;
- have a liability insurance policy.

Under no circumstance are non-executive directors entitled to compensation for the profitability indexes or earnings targets having been reached by the Group.

Chairman of the Board of Directors:
The Chairman of the Board of Directors is paid a fixed component of compensation established by the Board of Directors pursuant to Art. 2389, third paragraph of the Italian Civil Code determined *ex ante* and consistent with the role assigned to the Chairman, in an amount not in excess of the fixed compensation received by the Chief Executive Officer.

Chief Executive Officer:
The Chief Executive Officer is paid:
- a fixed component of compensation established by the Board of Directors pursuant to Art. 2389, third paragraph of the Italian Civil Code, and *benefits*, if any;
- is paid a variable component linked to reaching and exceeding the profit goal set out in the budget, adjusted by the risk as indicated in the *risk appetite framework*, besides maintaining the minimum parameters for regulatory capital and liquidity. Ex post malus and *clawback* mechanisms are

applied to variable compensation;
• a benefits package in line with those normally offered to those in topmost positions.

Statutory Auditors
The Statutory Auditors:
• are recipients of a fee established by the shareholders' meeting;
• are not recipients of any compensation that is variable or linked to the results of the Bank or the Group;
• have a liability insurance policy.
In accordance with the provisions of paragraph 16 of IAS 24, disclosure of the compensation paid to Directors and Statutory Auditors is reported in Part H of the notes to the separate financial statements under the disclosure on the compensation to key executives.

Supervisory Body
The members of the Supervisory Body, who are not employees of the Bank – to ensure the independence and autonomy of the body and the diligent execution of their duties –, are paid a fixed fee established by the Board of Directors on the basis of market conditions and responsibilities assumed.
Under no circumstances is the Supervisory Body entitled to variable compensation linked to the results of the Group.

Remaining personnel
Compensation for the remaining personnel, depending on the circumstances, is decided by the Board of Directors (in reference to executives and senior executives or similar to them) and by the Chief Executive Officer or persons authorized by the CEO, in accordance with the *Group Remuneration and Incentive Policy* and with applicable contract law (in particular, on the basis of the National Labor Collective Agreement for management staff and for personnel in professional areas of the credit, financial and related institutions, and the basis of the National Labor Collective Agreement for executives of credit, financial and related institutions and similar collective labor agreements for the Spanish organization).

More specifically, "risk takers" (see iii in this section) are paid a fixed component that compensates for the position held and the magnitude of their responsibility, and an incentive component which aims to recognize the results achieved by creating a direct link between compensation and actual results in the short and medium to long term of the Group and, on the whole, the company and the risk taker.

The *paymix* limits the incidence of the variable to the fixed component and was determined based on total compensation and according to existing law, principles of continuity with the past and coherence between the various roles and responsibilities, however without omitting market comparison. The basis of the calculation for the ratio between fixed and variable components is formed by fixed compensation and *benefits* based on their gross amount for tax purposes.

The parameters used in determining the variable component of compensation are well known and agreed with those entitled to such compensation.

The *up front* and deferred payment of the variable component is in any case subject to the observance of the parameters identified in the RAF and capital requirements and liquidity.

The deferred variable component is subject to *ex post* (*malus* and *clawback*) adjustment mechanisms, within the limits permitted by the applicable collective labor agreement, as established by the supervisory provisions for banks and, in any case, in accordance with the limits and directives laid down in applicable legislation.

No forms of guaranteed variable compensation are allowed except in special cases when new persons are hired and only for the first year of employment.

Compensation linked to the continuation of an employment relationship, in the form of a *retention bonus*, constitutes variable compensation and as such is subject to the rules applied to variable compensation, including the limit on the variable to fixed compensation ratio.

The BFF Board of Directors may grant discretional pension benefits, as defined above and provided by Bank of Italy Circular 285.

Benefits

Executives and Senior Executives of the Group are entitled to a benefit package.

For the remaining personnel each company of the Group may at its discretion offer benefit packages, consistently with the provisions of local law, according to the significance and complexity of the positions held, and considering the principles of equality and alignment to the local labor market and, in any case, following the guidelines of the Group.

Early termination of the working relationship

The treatment applied in the event of the early termination of the working relationship is that provided by the relative employment contract. The Board of Directors of the Parent company may offer *golden parachutes* for material risk takers in such event or in the case of the cessation of the post held, according to the conditions provided by existing regulations and criteria approved by the shareholders' meeting.

In order to determine such consideration, qualitative and quantitative indicators are applied which reflect the *performance* level and risks assumed by the person and by the Bank, in addition to *ex post* (*malus* and *clawback*) adjustment mechanisms, within the limits permitted by the collective labor agreement applicable to the working relationship, as established by the supervisory provisions for banks and, in any case, in accordance with the limits and directives laid down in applicable legislation.

Non-competition agreements

If an employee is a risk taker and signs a non-competition agreement which binds him/her from professionally not accepting a job with certain companies for a certain period of time starting from the date the working relationship ends, the BFF Group company involved will pay that person a sum of money. The amount is determined using the gross annual salary of the most recent year as the basis of calculation to which qualitative and quantitative indicators are applied which reflect the *performance* level and risks assumed by the person and by the Group, in addition to *ex post* (*malus* and *clawback*) adjustment mechanisms, within the limits permitted by the collective labor agreement applicable to the working relationship, as laid down in applicable legislation as provided by laws and, in any case, in observance of the limits and prescriptions of the laws on the matter.

Quantitative information

Compensation paid by the Group in 2015 for fixed and variable components of compensation to the various categories of recipients is as follows:

(in € thousands)

Position	No. of recipients	Fixed compensation (**)	Variable compensation	Deferred portion *(of which, already agreed portion)*	Deferred portion paid during the year
Executive Directors or Directors with special assignments	1	695	534	160	-
Chairman of the board with strategic supervision functions	1	201	-	-	-
Other non-executive Directors (*)	14	261	-	-	-
Statutory Auditors (*)	5	177	-	-	-
Heads of the principal line and staff structures	11	1,715	737	221	-
Heads of the Control functions	3	438	234	70	-
Total	**35**	**3,487**	**1,504**	**451**	**-**

(*) The number of directors and statutory auditors is due to the change of control of the Bank which took place during the year. It should be noted that four directors waived their compensation.
(**) Fixed compensation includes benefits, before the tax effect.

Note should be taken that during 2015 there was only one case of compensation of more than €1 million.

Section 14. Leverage

Qualitative information

The leverage ratio introduced by Bank of Italy Circulars 285 "*Supervisory provisions for banks*" and 286 "*Instructions for the preparation of regulatory reporting for banks and investment firms*", both of December 17, 2013, which implement Regulation (EU) 575/2013 relating to the new discipline harmonized for banks and investment firms, contained in the CRR community regulation (*Capital Requirements Regulation*) and subsequent updates, relating to the new discipline harmonized for banks and investment firms, became an integral part of the disclosure which institutions must provide, in accordance with Art. 451 of the CRR.

European Commission Implementing Regulation (EU) 2016/200 defined the implementing technical standards for Art. 451, rendering it applicable from January 1, 2015 and supplying the relative specifics.

Description of the processes used to manage the risk of excessive leverage
The Group, as set out in the Commission Delegated Regulation (EU) 2015/62, calculates the leverage ratio at the end of every quarter on a consolidated basis. This ratio is calculated as the ratio of Tier 1 Capital and a denominator based on non-weighted existing assets by their degree of risk. The exposures should be presented net of the regulatory adjustments indicated for the determination of Common Equity Tier 1 Capital, in order to avoid accounting for these assets twice. In the CRR, the minimum thresholds have not yet been established.

Since the regulation on the disclosure of the leverage ratio in the Public Disclosure document came into effect on January 1, 2015, the comparative data at December 31, 2014 is not presented. The risk of excessive leverage is treated consistently with the rationale adopted for the RAF, by a current and prospective assessment carried out on the values assumed by the indicator, included in the set of indicators used by the Group to determine its capital policy correlated to the level of asset growth.

Quantitative information

Summary reconciliation of accounting assets and leverage ratio exposures

		Applicable amounts
1	Total assets as per published financial statements	3,321,555
2	Adjustment for institutions consolidated for accounting purposes but excluded from regulatory consolidation	(4,736)
3	(Adjustment for fiduciary assets recorded on the balance sheet based on the applicable accounting framework but excluded from the leverage ratio exposure measure under Art. 429, paragraph 13, of Regulation (EU) 575/2013)	
4	Adjustment for derivative financial instruments	
5	Adjustment for securities financing transactions (SFT)	917,605
6	Adjustment for off-balance sheet items (conversion to credit equivalent amounts of off-balance sheet exposures)	23,492
EU-6a	(Adjustment for intragroup exposures excluded from the leverage ratio exposure measure under Art. 429, paragraph 7, of Regulation (EU) 575/2013)	
EU-6b	(Adjustment for exposures excluded from the leverage ratio exposure measure under Art. 429, paragraph 14, of Regulation (EU) 575/2013)	
7	Other adjustments	(3,523)
8	***Total leverage ratio exposure***	***4,254,394***

Leverage ratio common disclosure

		Leverage ratio exposure (CRR)
	On-balance sheet exposures (excluding derivatives and SFTs)	
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	4,233,560
2	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	(2,747)
3	**Total On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) (sum of lines 1 and 2)**	4,230,813
	Derivative exposures	
4	Replacement cost associated with *all* derivatives transactions (net of eligible cash variation margin)	
5	Add-on amounts for potential future exposures associated with *all* derivatives transactions (mark-to-market method)	
EU-5a	Exposure determined under Original Exposure Method	
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	
7	(Deductions of receivables for cash variation margin provided in derivatives transactions)	
8	(Exempted CCP component of client-cleared trading exposures)	
9	Adjusted effective notional amount of written credit derivatives	
10	(Adjusted effective notional netting and add-on deductions for written credit derivatives)	
11	**Total Derivative exposures (sum of lines 4 to 10)**	
	Securities financing transactions (SFTs) exposures	
12	Gross SFT assets (with no recognition of netting), after adjusting for transactions accounted for as sales	
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	
14	Counterparty credit risk exposure for SFT assets	89
EU-14a	Derogation for SFTs: Counterparty credit risk exposure under Art. 429, paragraph 4, of Regulation (EU) 575/2013 and Art. 222 of Regulation (EU) 575/2013	
15	Agent transaction exposures	
EU-15a	(Exempted CCP component of client-cleared SFT trading exposures)	
16	**Total Securities financing transactions (SFTs) exposures (sum of lines 12 to 15a)**	89
	Other off-balance sheet exposures	
17	Off-balance sheet exposures at gross notional amount	117,461
18	(Adjustments for conversion to credit equivalent amounts)	93,969
19	**Total Other off-balance sheet exposures (sum of lines 17 and 18)**	23,492
	(Exempted exposures under Art. 429, paragraphs 7 and 14, of Regulation (EU) 575/2013 (on- and off-balance sheet exposures))	
EU-19a	(Exemption of intragroup exposures (individual basis) under Art. 429, paragraph 7, of Regulation (EU) 575/2013 (on- and off-balance sheet))	
EU-19b	(Exposures exempted under Art. 429, paragraph 14, of Regulation (EU) 575/2013 (on- and off- balance sheet))	
	Capital and total exposures	
20	Tier 1 Capital	259,265
21	Total leverage ratio exposure (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)	4,254,394
	Leverage ratio	
22	**Leverage ratio**	6.094%
	Choice on transitional provisions and amount of derecognized fiduciary items	
EU-23	Choice on transitional provisions for the definition of the capital increase	
EU-24	Amount of derecognized fiduciary items under Art. 429, paragraph 11, of Regulation (EU) 575/2013	

Split of on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

		Leverage ratio exposure (CRR)
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures) of which:	4,230,813
EU-2	Trading book exposures	
EU-3	Banking book exposures, of which:	4,230,813
EU-4	covered bonds	
EU-5	exposures treated as sovereign issuers	1,563,304
EU-6	exposures to regional governments, multilateral development banks, international organizations and public sector entities not treated as sovereign issuers	1,583,005
EU-7	institutions	55,815
EU-8	secured by mortgages of immovable properties	
EU-9	retail exposures	
EU-10	companies	969,526
EU-11	exposures in default	45,741
EU-12	other exposures (e.g. equity instruments, securitizations, and other non-credit assets)	13,422

Section 15. Exposures in Equities not included in the Trading Book

Qualitative information

The Group does not have significant exposures in equities in the banking book. The only asset of this type, included in "available for sale financial assets", is the €23 thousand investment in the company Nomisma S.p.A. Società di Studi Economici, measureed at cost, in the absence of other elements of measurement.

Quantitative information

(€/cents)

Description	Carrying amount (€/cent)	No. of shares purchased	Nominal value per share (€/cents)	Percentage of investment holding
Nomisma S.p.A.	23,491.75	72,667	0.32	0.356%

Key figures on Nomisma S.p.A. are the following:

Head office	Bologna - Strada Maggiore 44
Share capital	€6,605,829.68 fully paid-in

(amounts in euros, referring to December 31, 2014)

Equity	4,874,450
Profit for the year	80,063

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