BFF BANKING GROUP

2016 PILLAR III PUBLIC DISCLOSURE

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 (so-called 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 (so-called 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 reserves.

The above European legislation was transposed into Italian law pursuant to Bank of Italy Circular 285 *"Oversight provisions for banks"* of December 17, 2013, and subsequent updates, 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 I** 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 II** 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 Regulatory 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 III** 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 areas. 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 publish 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 or all disclosures, specifically concerning Own Funds and capital requirements, 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 public disclosure must be:
• approved by the Board of Directors before distribution;
• published on the corporate website www.bffgroup.com, under Investor Relations, 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.

It should be noted that in accordance with the provisions of Regulation (EU) 575/2013 (CRR), beginning with December 31, 2015 reporting, the area of consolidation used only for purposes of prudential supervision considered the company BFF Lux Holdings S.à r.l. as head of the Group.
As part of the process to simplify the Banking Group's chain of control, BFF Lux Holdings S.à r.l. was put into liquidation on June 20, 2016. Therefore, beginning with June 30, 2016 reporting, the CRR Group includes the Banking Group and BFF Luxembourg S.à r.l., as head of the Group, for prudential supervision purposes only.
For purposes of the preparation of the financial statements and Pillar III reporting, for the tables that do not refer to prudential supervision reporting, the reference will continue to be the Banking Group ex T.U.B..

It should be mentioned that on May 31, 2016 Banca Farmafactoring acquired control of the Magellan Group, leader in the financial services marked targeting the healthcare sector in Poland. The Magellan Group also operates in the Czech Republic and Slovakia, through the Polish vehicle company Mediona, as described in greater detail in the following Section 2 – Scope of Application.

This document is organized into 15 sections, setting out qualitative and quantitative information at December 31, 2016. 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	Risk Management Objectives and Policies - 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	Exposures in Equities not included in the Trading Book – Art. 447	x	x
12	Exposure to Interest Rate Risk on Positions not included in the Trading Book - Art. 448	x	x
13	Exposure to Securitization Positions - Art. 449	x	x
14	Remuneration Policy - Art. 450	x	x
15	Leverage - Art. 451	x	x

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

Section 1. Risk management Objectives and Policies (Art. 435 CRR)

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 parent carry out the functions assigned to them with reference not only as it applies to the company 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 subsidiaries in the decisions taken as to the procedures and policies of risk management.

System of Internal Control

The **first-level controls**, so-called line controls, aim to ensure that transactions are properly executed and are performed by the operating structures that carry them out, with the support of computer procedures.

The **second-level controls**, so-called risk management and compliance controls, aim to guarantee the correct implementation of the risk management process, the compliance of company operations with procedures and control over the risk of money laundering and terrorism financing – are entrusted to the Risk Management Function and the Compliance and Anti-Money Laundering (AML) Function, which, consistently with the existing prudential supervisory discipline, have the following main responsibilities:

• Risk Management: ensures the interconnectivity of the risk measurement and control system with the processes and methodologies of the company's activities, coordinating with the interested company structures. It oversees the realization of the process for determining capital adequacy, monitors the controls over the management of risk in order to define the methodologies used to measure risk, assists the Corporate Governing Bodies in designing the Risk Appetite Framework (RAF), verifies that the limits assigned to the various operating functions are being observed and checks that the operations of the individual areas are consistent with the assigned risk and return objectives.

• Compliance: supervises, according to a risk-based approach, the management of the risk of non-compliance with regulations, with regard to all the activities falling within the regulatory perimeter for BFF and the Group, continuously verifying whether internal processes and procedures are adequate in preventing such risk and identifying the relevant risks to which BFF and the subsidiaries are exposed; it measures, assesses and monitors the relevant risks; guarantees an overall and integrated vision of the risks to which BFF and the subsidiaries are exposed, ensuring adequate disclosure to the corporate governing bodies of BFF and the subsidiaries.

• Anti-Money Laundering (AML): has the task of preventing and avoiding the occurrence of money laundering and terrorism transactions, also identifying continuously the applicable rules in this area. In addition, it must verify the consistency of the processes with the objective of ensuring that BFF and the Group conform to the law on matters of anti-money laundering and anti-terrorism. It is also responsible for the controls required by the anti-money laundering law, so as to prevent the use of the financial system for purposes of laundering the profit from criminal activities, and the financing of terrorism.

During 2016, the Risk Management Function and the Compliance and AML Function were separated and the new individual with the necessary professional characteristics was appointed head of the Compliance and AML[1] Function. Moreover, "local" Compliance and AML and Risk Management Functions were set up at Magellan S.A., which report directly to the president of the Management Board of this company and, functionally, to the same Functions of the Bank.

At the Group level, the Risk Management Function and the Compliance and AML Function are within the framework of the Internal Control System, joining in the process for defining and implementing the risk governance policies using a suitable process for managing the risks themselves, each with regard to its competences. The persons in charge of the second-level controls are in an appropriate functional position in the hierarchy structure and are not involved in the operational activities which they control; the duties and respective responsibilities are regulated internally by the applicable internal regulations of the functions.

(1) At the date the new person took over the Compliance and AML Function, it was under the responsibility ad interim of the person in charge of the Bank's Risk Management Function.

The Risk Management Function has, inter alia, the responsibility at the Group level for:
• collaborating with the corporate governance bodies in defining the overall risk management system and the entire reference framework specific to the assumption and control of Group risks (Risk Appetite Framework);
• ensuring adequate risk management processes by introducing and maintaining appropriate risk management systems to identify, measure, control and mitigate all ascertained risks;
• ensuring the assessment of capital absorbed, also under stress conditions, and relative capital 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 governance bodies on the activities carried out and advising them on matters of risk management.
The Compliance Function has, among other responsibilities at the Group level, that of:
• identifying, on a continuous basis, the laws applicable to the Group and evaluating and measuring their impact on company processes and procedures, pinpointing the interested company functions and structures, informing them of this situation;
• identifying the risks of non-compliance arising from the introduction of new laws, assessing beforehand the relative potential impact on processes and procedures;
• monitoring the adoption of organizational changes (in structures, processes, procedures, also operational and commercial) required to prevent the risk of non-compliance, and verifying the effectiveness;
• verifying the existence and reliability, on a continuous basis, of procedures and systems that are appropriate for ensuring the observance of all legal obligations and those established by internal regulations on the subject of risk activities and conflicts of interest vis-à-vis related parties;
• providing consulting and assistance with corporate governance bodies on all matters in which non-compliance risk is relevant;
• collaborating in the training of employees about the requirements applicable to the activities carried out, in order to spread a corporate culture grounded on the principles of honesty, correctness and respect of the spirit and the letter of law.

The Risk Management Function and the Compliance and AML Function – organizationally and functionally independent and distinct – are in a staff position to the Chief Executive Officer, reporting to him and independent of the internal audit function, since it is subject to control by that function.

From the standpoint of **third-level controls**, internal audit activities are conducted by the Group's Internal Audit Function, in a staff position to the Board of Directors. The Internal Audit Function carries out independent controls, not only at the Parent but also at the subsidiary Farmafactoring España S.A. under a specific servicing agreement which governs the provision of the audit service, and in an institutional environment, as a function of the Parent for the subsidiary Magellan S.A.. The Regulation approved by the Board of Directors specifies that the Internal Audit Function must evaluate the overall functioning of the ICS and bring to the attention of the corporate governance boards possible improvements, with particular reference to the Risk Appetite Framework, to the process for the management of risks as well as the tools for their measurement and control.

The person in charge of the Internal Audit Function has the necessary autonomy and is independent of the operating structure, in compliance with Bank of Italy's regulation on the subject of internal controls, and, with regard to internal regulations, organizationally oversees the company processes. The Internal Audit Function carried out, for the year 2016, the testing activities established in the three-year 2016-2018 audit plan of the Banking Group, conducting follow-up activities and reporting on the results of its testing on a quarterly basis to governance and control bodies of the Bank.
Specifically, the Internal Audit Function lent support to BFF in restructuring the audit process for the subsidiary Magellan S.A., based upon a rationale referring to subsidiaries of a supervised banking group. It also carried out intragroup testing on the processes considered of greater relevance from a regulatory standpoint.
Furthermore, the testing was completed that was planned for 2016, according to a risk-based framework, on the Bank's structures, on the subsidiary Farmafactoring España and on the Spanish branch in Madrid.
The process for audit planning and management was certified under the quality standard UNI ISO 9001:2008.

The person in charge of the Internal Audit Function, as the head of the internal whistleblowing process, in conformity with the banking regulatory requirements of reference, prepared the 2016 statement, which indicates that no reports were received in this regard.

BFF has an Organizational, Management and Control Model designed pursuant to Legislative Decree 231/2001. The model consists of a General Part and Special Parts, with a **Supervisory Body** that periodically monitors the model's adequacy through planned testing activities.
The activities performed by the Supervisory Body in 2016 were principally directed to the assessment of the adequacy of the 231 Organizational Model also within a Group rationale, the control over information flows, anti-money laundering and workplace safety issues, careful examination of reporting by the Internal Audit Function and by all other control functions and independent verification. The Supervisory Body is also kept constantly informed, within the scope of its competence, on the projects of strategic relevance for BFF.
It should also be noted that in the second half, Farmafactoring España S.A. began a project aimed at the adoption, pursuant to Article 31-bis of the Spanish Criminal Code, of an organizational, management and control Model similar to the Italian Model, with the consequent identification of a Supervisory Body with functions similar to that of the Italian Supervisory Body.

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

CREDIT RISK

Factoring activities, disciplined by the Italian Civil Code (Book IV, Title I, 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).

The acquisition of Magellan, and the group of companies controlled by it, brought significant growth for the Group, which extended its business to the Eastern European market, while at the same time diversifying its range of financial services offered.
The business carried out by the Group in the Eastern European market is mainly developed over three sectors:
- financing the working capital of suppliers of the public administration;
- financing current and future receivables;
- financing investments in the public and healthcare sector.

Credit risk management policies

1. Organizational issues
In view of the above considerations, the assessment of a factoring transaction must be conducted through the analysis of a number of factors, ranging from the degree of risk fragmentation to the characteristics of the commercial transaction underlying the credit quality, from the reimbursement ability of the customer assignor to the solvency of the assigned debtors.
The monitoring and management of credit risk, within the Group, starts with a preliminary review of the credit line application, before services are offered to the clientele. The various corporate functions collaborate with maximum synergy to provide analytical and subjective assessments of the counterparties, both from a quantitative (current, past and future economic conditions) and qualitative (managerial ability, competitiveness, product prospects and potential credit volumes to be managed) standpoint.

A further organizational safeguard against credit risk is provided by the internal regulation for monitoring credit quality, which describes the credit control process on the debtor. Credit risk is therefore adequately safeguarded at various levels within the framework of the multiple operating processes.

2. Management, measurement and control systems
The assessment of credit risk is part of an overall analysis of the adequacy of the Group's capital in relation to the risks connected with lending.
With this in mind, the Group uses the standardized approach to measure credit risk, as required by the Bank of Italy in Circular No. 285 "*Oversight provisions for banks*" and Circular No. 286 "*Instructions for the preparation of supervisory reporting by banks and securities intermediaries*", both dated December 17, 2013, and subsequent updates. This approach involves the classification of exposures into different classes (portfolios), depending on the type of counterparty and the application of diversified weighted ratios to each portfolio, described in detail in Section 4 of this document.

The exposures of the Banking Group are principally represented by receivables from counterparties of the Public Administration or healthcare companies in the countries in which the Group operates.
BFF adopted the ECAI Dominion Bond Rating Service (DBRS). The unsolicited rating assigned to the Italian Republic by DBRS, on January 13, 2017, went from "A low" to "BBB high" and, consequently, the country was downgraded from Credit Quality Class 2 to Credit Quality Class 3.

The exposures for receivables from the Italian Public Administration, which include those from entities belonging to the National Healthcare System and from the Local Healthcare Entities (ASL), therefore, starting from the March 2017 supervisory reporting, will be rated in Credit Quality Class 3, with a 100% weighting, compared to 50% adopted up to December 31, 2016.
The Group is already taking steps to generate capital to meet the capital requirement needs deriving from the impacts of the aforementioned downgrade.

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

Capital requirement = 8% RWA

The Risk Weighted Amount (RWA) is determined by the sum of the risk weighted assets of the various classes.
Based on the method described above, the capital requirement covering credit risk at December 31, 2016, for the CRR Group, is €83,496 thousand.

The stages identified as components of the above credit process are:

- background check;
- decision;
- disbursement;
- monitoring and review;
- dispute.

In order to identify the main risk factors, the principal activities carried out by the company, with regard to the parent and the Spanish subsidiary, are as follows:
- receivables management only;
- non-recourse factoring.

In the "receivables management only" service the credit risk is considerably reduced because it is limited to the Group's exposure with the customer for payment of the stipulated fees and commissions, or the reimbursement of legal fees incurred. The granting of a credit line for "receivables management only" follows the normal procedures used in the credit process even when the credit line can be approved by a single-person 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 application is carried out with the utmost care and the decision-making power is reserved for designate approval bodies.
The acquisition of Magellan, and the group of companies controlled by it, in 2016, brought significant growth for the Group, which extended its business to the Eastern European market, while at the same time diversifying its range of financial services offered.

The business conducted by Magellan is mainly developed over three sectors:
- financing the working capital of suppliers of the public administration;
- financing current and future receivables;
- financing investments in the public and healthcare sector.

The objective of credit risk management is that of building a robust and balanced portfolio of financial assets to reduce to a minimum the risk of impaired exposures and at the same time generate the set profit margin and the estimated value of the receivables portfolio. As a general rule, Magellan enters into arrangements with customers that have an adequate credit capacity and, if necessary, require additional guarantees to mitigate the risk of financial loss arising from non-performance by clients.
Magellan's exposure to the credit risk of the clientele is monitored on a continuous basis.
The credit quality of the entities of the public sector is analyzed within the context of the risk of delay in the reimbursement of liabilities.

Credit risk management, therefore, besides following internal corporate regulations must also abide by external regulations (Bank of Italy Circulars No. 285 "*Oversight provisions for banks*" and No. 286 "*Instructions for the preparation of regulatory reporting by banks and securities intermediaries*" and subsequent updates) regarding risk concentration.

More specifically:
• a "large exposure" is defined as any position equal to or greater than 10% of the eligible capital, as defined in Regulation No. 575 of 2013 (sum of Class 1 Capital and Class 2 Capital equal to or lower than one-third of Class 1 Capital);
• for banking groups and banks not belonging to a banking group, each risk position must not be greater than 25% of eligible capital.

In view of the fact that the 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, the Bank files a monthly report with the "*Central Credit Register*" (Bank of Italy Circular No. 139 of February 11, 1991, and subsequent updates, "*Central Credit Register. Instructions for Credit Intermediaries*") providing information on the financial debt trend of the debtor over the course of time and on the available/utilized ratio (which shows the financial obligations of the company and its debt margins vis-à-vis the system).

3. Qualitative assessment of receivables

The Group performs an impairment test on the receivables portfolio in order to identify any impairment of its financial assets.
This analysis makes it possible to differentiate between performing and non-performing receivables, including in the latter category financial assets that show an individual risk of loss, while the remaining financial assets are classified in the performing category.

Performing receivables

The assessment of performing receivables applies to those receivables from customers that, while more than 90 days past due, show no objective indication of impairment at the individual level.
This representation is consistent with the assessment criterion of receivables purchased on a non-recourse basis at "amortized cost," which, in fact, is based on discounting to present value estimated future cash flows according to an estimate of the time to collection.

Even though the receivables of the parent and Farmafactoring España are owed almost exclusively by the Public Administration, as in previous years, when preparing its annual financial statements

or interim reports, the company, in accordance with the provisions of IAS 39, carries 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 company assumed the value proposed by the "Basel Accord Framework" for unsecured receivables 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/AOs), corresponding to the credit rating assigned by the major rating agencies for the particular Region to which the debtors belong. This product was then applied to the exposures not classified as non-performing Exposures At Default (EAD).
At December 31, 2016, the impairment test indicated an impairment loss of about €3.2 million.

As regards Magellan, the collective impairment is calculated, at this time, exclusively on private counterparties. In this case, Magellan carries out a writedown of the portfolio by applying to the receivable's purchase value a percentage that varies according to the type of counterparty to which the exposure refers. Magellan also assesses whether to record individual impairments by analyzing the economic and financial situation of the debtor and the actual possibility of recovering the receivable.
The impairment policies adopted by Magellan include specific periodic reports sent to the parent so that it can check the correctness of the approach adopted.

Non-Performing receivables
As required by IAS 39 and for purposes of an analytical assessment, the Group carried out a review of the financial assets classified as non-performing receivables in order to identify any objective impairment of individual positions.
The Group's non-performing receivables, net of individual impairment losses, amount to €12,065 thousand, including those of Magellan of €4,872 thousand.

4. Credit risk mitigation techniques
In order to render receivables purchased on a non-recourse basis compatible with the derecognition principle, the risk mitigation clauses that could in some way invalidate the effective transfer of risks and benefits were eliminated from the respective contracts.
With regard to Magellan, for each transaction, the credit risk is measured when the request arrives and then monitored regularly during the successive stage, including changes in external conditions and the financial capacity of the debtors. The expected level of credit risk is assured by guarantees, amortization and accruals relating to the receivables exposures. The amount of the guarantees assumed is monitored and amortized.

5. Impaired financial assets
On July 24, 2014, the European Banking Authority (EBA) published the "Final draft implementing technical standards on supervisory reporting of forbearance and nonperforming exposures" (EBA/ITS/2013/03/rev 1 7/24/2014): this document introduces new definitions for impaired assets and forbearance measures.
These definitions, which were adopted by the Bank of Italy with the seventh update to Circular No. 272 of January 20, 2015, call for impaired assets to be classified into the following categories:

- Past-due exposures, for a net value of €46,167 thousand;
- Unlikely to pay, for a net value of €3,614 thousand;
- Non-performing exposures, for a net value of €12,065 thousand.

Past due exposures

These are exposures with central administrations and central banks, territorial entities, public sector entities, non-profit entities and companies that, at December 31, 2016 were more than 90 days past due.
More specifically, exposures with central administrations and central banks, public sector entities and territorial entities, are considered past due when the debtor has not made any payments for any debt positions owed to the financial intermediary for more than 90 days.

At December 31, 2016, net past due exposures total €46,167 thousand for the entire Group. With regard to BFF, these exposures amount to €45,529 thousand, including €38.8 million with the Italian Public Administration (largely with territorial entities) compared to €9.8 million at December 31, 2015. The amount relating to public companies is €6.2 million. Past due exposures for the Magellan Group amount to €0.7 million, referring almost entirely to private counterparties.

Probable default

The "unlikely to pay" concept is used to define this type of exposure and, consequently, the probable default reflects the judgment made by the intermediary about the unlikeliness, absent such actions as the enforcement of guarantees, that the debtor will fully fulfill (for principal and/or interest) its credit obligations. This assessment should be arrived at independently of the existence of any past due and unpaid amounts or installments.

Therefore, it is not necessary to wait for an explicit sign of anomaly (e.g. failure to repay) when there are factors that signal a default risk situation for the debtor. Exposures with retail customers can be classified in the probable default category at the individual transaction level, provided the intermediary believes that the conditions for classifying in this category the entire complex of exposures with same debtor cannot be met.
At December 31, 2016, exposures classified as unlikely to pay refer entirely to the Magellan portfolio and total €3.6 million, of which €3.4 million refers to public debtors.

Non-performing exposures

These are exposure with parties that are in a state of insolvency or in basically similar situations, regardless of any loss projections recognized by the company.

At December 31, 2016, total non-performing exposures of the Group, net of writedowns for estimated impairment losses, amount to €12.1 million. Gross non-performing exposures including the provision for late-payment interest amount to €30.0 million and the relative impairment losses total €17.9 million with a coverage ratio of 59.8%.
The total non-performing receivables of BBF, net of writedowns for estimated impairment losses, are €7.2 million at December 31, 2016.
Of this amount, €492 thousand refers to local government entities that were already distressed when the receivables were purchased. Another €0.9 million is owed by Fondazione Centro San Raffaele del Monte Tabor in liquidation and in a composition with creditors.

The other non-performing positions total about €8.6 million, including positions amounting to about €1.7 million that were completely written off against the provision for impairment and consequently have a zero balance. BFF's remaining positions, totaling about €6.9 million, are written down based only on the time value, as they consist of positions secured by sureties and exposures with local government entities in distress (including €492 thousand already purchased as distressed), for which no provisions were recognized, as the distressed condition is expected to be remedied resulting in the collection of 100% of the claim.
The portion of late-payment interest relating to non-performing positions, recognized when the estimate criteria were changed, in 2014, amounts to €13.6 million and was 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.
As for Magellan, total non-performing exposures, net of writedowns due to estimated impairment losses of €1,950 thousand, are €4,872 thousand.

6. Securitization transactions

At December 31, 2016 there is a transaction outstanding that was structured with Deutsche Bank and described in detail in Section 13.
As regards this transaction, the healthcare receivables were sold to a 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.

CREDIT VALUATION ADJUSTMENT (CVA) RISK

With reference to the capital requirements for CVA risk, meaning an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty, the Group has applied the standardized method set out in Art. 384 of the CRR.
More specifically, the requirement is applied on derivative contracts put in place with the intention of hedging fluctuations in exchange rates through the forward sale of foreign currency at a specific spot rate and on interest rate swap (IRS) derivative contracts as instruments hedging the rate applied to funding.

COUNTERPARTY RISK

Counterparty risk represents a particular type of credit risk, which generates a loss if the transactions executed with a given counterparty have a positive value in the event of default.
This risk is measured by the simplified approach, under which any portion of the exposure secured by collateral is assigned a weighting factor corresponding to the weighting factor assigned to the instrument used as collateral.
For the Group, the counterparty risk is generated by repurchase agreements with *Cassa Compensazione e Garanzia* as the counterparty, and by derivative contracts relating to BFF and Magellan.

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.
Financial assets held for trading include, in 2016, financial instruments executed to hedge interest rate risk, for which hedge accounting was not applied.
The financial instruments recorded in this category are derivative contracts executed to hedge fluctuations in the exchange rates between the forward exchange rate and the spot exchange rate. These derivative financial contracts are recognized as assets/liabilities held for trading in accordance with the provisions of IAS 39, even though at the operational level they are treated as instruments hedging risks.
As operational hedging instruments, these derivatives hedge the risk relative to credit valuation adjustments.

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 method is applied monthly, in order to detect on a timely and ongoing basis any loss resulting from a market shock determined based on the annual changes in interest rates recorded during an observation period of six years, considering alternatively the first percentile (reduction) or the 99th percentile (increase) and ensuring that rates are not negative.

EXCHANGE RATE RISK

Exchange rate risk is represented by the Group's exposure to fluctuations in exchange rates, considering both positions in foreign currency and those that call for indexation clauses linked to changes in the exchange rate of a specific currency.
The Group's asset portfolio at December 31, 2016 is denominated in:
- euro;
- Polish zloty;
- Czech koruna.

The Group thus manages and monitors the risk of fluctuations in exchange rates. The Group has a specific internal regulation for the management of exchange risk referring to exposures from the management of assets, funding transactions, the purchase or sale of financial instruments in foreign currency and any other type of transaction in a currency other than the reference currency. More to the point, the Group uses specific hedging instruments in order to mitigate exchange rate risk.
Exchange rate risk is hedged by instruments that are linear and without optional components such as forex swaps and forex forwards. These offer the Group an adequate hedge of exchange rate risk on the loans in foreign currency extended to the subsidiaries that operate in currencies other than the euro.
The Group companies use the same instruments noted above to hedge exchange rate risk, after checking with BFF.

LIQUIDITY RISK

Liquidity risk is represented by the possibility that the Group may not be able to fulfil its payment obligations due to the inability to access funding in the financial markets, or because of restrictions on the disposal of assets. This risk is also represented by the impossibility to raise adequate new financial resources, in terms of amount and cost, according to operating needs, which would force the Group to slow or halt the development of activities or sustain excessive funding costs to meet its obligations, with significant adverse impacts on the profitability of its operations.

Liquidity risk may be incurred through the following components of risk:

- Liquidity Mismatch Risk, which is the risk of a mismatch between the amounts and/or timing of inflows and outflows.
- Liquidity Contingency Risk, which is the risk that future unexpected events may require a materially larger amount of liquidity than the business currently requires in a normal going concern scenario. This risk may be generated by such events as the 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, which is the risk of incurring losses on liquidating assets that would be considered liquid under normal market conditions, or the seller is forced to keep those assets in the absence of a market for them.
- Operational Liquidity Risk, which is the risk of being unable to fulfill payment obligations due to errors, violations, interruptions or damages caused by internal processes, persons or external events, while the Bank remains solvent.
- Funding Risk, which is the risk of incurring a loss due to the impossibility to access sources of financing at an affordable cost to meet obligations and/or a possible increase in the costs of funding due to a change in rating (internal factor) and/or a widening of credit spreads (external factor).

The Group, as required by the provisions of the prudential supervision regulation published by the Bank of Italy, adopted a Group Policy for the Management of risks and a Group Treasury and Finance Regulation aimed at maintaining a high degree of diversification, in order to reduce liquidity risk, and identify the governance and control principles and the organizational units responsible for the operational and structural management of liquidity risk.

These internal regulations define:

- the liquidity risk management criteria adopted, defined in relation to the specific operations of the Bank and the potential sources of liquidity risk;
- the operating procedures through which the Group 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 performing stress tests, aimed at measuring in quantitative terms the Bank's ability to handle potential adverse events that could affect the level of liquidity risk;
- a contingency funding plan that specifies the strategies and operational modalities for the management of early warning, warning and crisis situations, as well as the resulting roles and responsibilities.

To ensure control over the liquidity risk management and control processes, the Group adopted a governance model based on the following principles:
• separation of the processes for the management of liquidity and processes for the control of liquidity risk;
• development of processes to manage and control liquidity risk, consistent with the hierarchical structure and through a process for the delegation of powers;
• sharing of the decisions and clarity of responsibilities among management, control and operational entities;
• making liquidity risk management and monitoring processes consistent with prudential supervisory guidelines.
Liquidity risk stress tests were performed for assessing the potential impact of stress scenarios on the Group's solvency conditions.

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 by the following stages:

• 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 RISK

Operational risk is the risk of incurring a loss due to inadequacy or failures of procedures, human resources and internal systems or as a result of external events. This category includes, among other, losses caused by fraud, human error, business interruption, system failure, breach of contracts and natural disasters; operational risk also includes legal risk but not strategic and reputational risks.

Operational risk therefore refers to various types of events that would not be significant individually unless analyzed together and quantified for the entire risk category.

With regard to the Group, exposure to this category of risk is generated predominately by failures in work processes and in organization and governance-human errors, computer software malfunctions, inadequate organization and control safeguards-as well as any loss of human resources in key corporate management positions. On the other hand, exposure to operational risks deriving from external sources are adequately controlled, partly due to the mitigation tools adopted to address such adverse events (such as, by way of example: the business continuity plan, data storage processes, back up tools, insurance policies, etc.).

The process adopted by the Group to manage and control operational risks is founded on the principle of promoting a corporate culture for managing risk and defining the appropriate standards and incentives, with the aim of fostering the adoption of professional and responsible behavior at all operational levels, as well as the design, implementation and management of an integrated system for operational risk management that is adequate in relation to the nature, activities, size and risk profile.
The operational risk assessment model adopted by the Group is of the "mixed" type, meaning a model based both on qualitative assessments, linked to the mapping of the processes and to at-risk activities and the corresponding controls adopted, and on quantitative assessments, using the methodologies specified by the Bank of Italy.
Within the framework of the controls adopted regarding the exposure to operational risk, the following specific risks are also monitored by the Group:

• Money laundering risk, regarding the risk that financial and commercial counterparties and Group suppliers, partners, associates and consultants may be parties to transactions that might potentially facilitate the laundering of money coming from illegal or criminal activities;

• Compliance risk, regarding the risk of legal and administrative penalties, significant financial losses or reputational losses due to failure to comply not only with laws and regulations but also with internal and conduct standards applicable to corporate activities. For this type of risk, a review is performed annually of the related assessment methodology, developed for all activities falling within the scope of the Group's regulatory framework, in accordance with a risk-based approach. More specifically, for the relevant laws that do not call for the establishment of specialized safeguards (i.e., privacy and occupational health and safety), the Compliance Function provides *ex ante* consulting support to BFF's functions and assesses *ex post* the adequacy of the organizational measures and control activities adopted. As for laws and regulations monitored by specialized functions, the Compliance Function carries out an indirect control by cooperating with the specialized functions in defining compliance risk assessment methods in addition to mapping risks and the corresponding controls (Compliance Risk Control Matrix).

For computing capital requirements for operational risk, the Group uses the Basic Indicator Approach - BIA, according to which capital requirements are computed by applying a regulatory coefficient to an indicator of the volume of business activity (Relevant Indicator).
The Group also assesses operational risks in connection with the introduction of relevant new products, activities, 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

definition of specific policies and regulations on various subjects and topics.
In addition, to control the abovementioned risks, the Group adopts specific organizational models for the management of the risks regarding money laundering, occupational health and safety and information security.
Based on the above methodology, the capital requirement for operational risk was equal to €29,775 thousand at December 31, 2016.

RISKS OF THE OTHER COMPANIES

The consolidated financial statements at December 31, 2016 reflect the aggregation of the balance sheets of Banca Farmafactoring S.p.A., Farmafactoring España S.A. the special purpose vehicle Farmafactoring SPV I S.r.l. and the companies of the Magellan Group acquired during the year.
The SPV, Farmafactoring SPV I S.r.l., was established for the securitization transaction structured with Deutsche Bank and was included in the scope of consolidation consistent with the requirements of the IAS/IFRS accounting standards which establish the obligation to consolidate a special purpose entity when, even absent an investment relationship, the company that prepares the financial statements, in substance, controls the special purpose entity.
In any event, these companies do not show any 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 – 2016 are adequate with regard to the profile and strategy of the bank;

b) in particular, this section, "Risk management objectives and policies", of this 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 offices held by members of the Board of Directors in other companies is as follows:

Name	Date of birth	Office	Role	Date of appointment	Date office expires	Number of other offices
Salvatore Messina	01/01/1946	Chairman	Independent	11/4/2015	Approval Fin. Statements 12/31/2017	1 non-executive
Luigi Sbrozzi	11/30/1982	Vice Chairman	Non-executive	11/4/2015	Approval Fin. Statements 12/31/2017	-
Massimiliano Belingheri	10/30/1974	Chief Executive Officer	Executive	11/4/2015	Approval Fin. Statements 12/31/2017	-
Mark John Arnold	3/2/1968	Director	Non-executive	12/21/2015*	Approval Fin. Statements 12/31/2017	-
Federico Fornari Luswergh	9/26/1964	Director	Independent	11/4/2015	Approval Fin. Statements 12/31/2017	1 executive
Ben Carlton Langworthy	8/12/1978	Director	Non-executive	11/4/2015	Approval Fin. Statements 12/31/2017	5 non-executive
Elisabetta Oliveri	10/25/1963	Director	Independent	11/4/2015	Approval Fin. Statements 12/31/2017	1 executive 3 non-executive
Marco Rabuffi	5/26/1948	Director	Non-executive	11/4/2015	Approval Fin. Statements 12/31/2017	1 executive
Gabriele Michaela Aumann Schindler	6/16/1953	Director	Independent	12/21/2015*	Approval Fin. Statements 12/31/2017	-
Giampaolo Zambeletti Rossi	5/4/1941	Director	Independent	11/4/2015	Approval Fin. Statements 12/31/2017	3 non-executive

** Director co-opted on 12/21/2015 and confirmed by the 3/31/2016 shareholders' meeting.*

POLICY 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.

The Board of Directors of Banca Farmafactoring is comprised of 2 women and 8 men. The Board of Statutory Auditors is comprised of 1 woman and 2 men. Directors with a non-Italian nationality represent 30% of the members of the Board of Directors.

RISK COMMITTEE AND NUMBER OF MEETINGS

By resolution of the July 24, 2014 meeting of the Board of Directors of Banca Farmafactoring, the Risk 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 Risk Committee with a different composition that was subsequently integrated on December 21, 2015.

The composition of the Risk 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 Risk 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 Risk 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, Title 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 Risk 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 Risk 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 Framework and the 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 Risk Committee ascertains that the incentives underlying the remuneration and incentive system of the Bank and the Group are consistent with the Risk Appetite Framework.

During 2016, twenty meetings were held by the Risk Committee.

DESCRIPTION OF THE FLOW OF INFORMATION REGARDING RISKS ADDRESSED TO THE STRATEGIC SUPERVISION BODY

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

Prepared by	Product Information Flow	Timing	**Board of Directors/Risk Committee**
Risk Management Function	Activity plan	*annually*	✓
	Report on activities carried out	*annually*	✓
	ICAAP	*annually*	✓
	Risk Report Management	*monthly*	*as required*
	Tableau de bord of the Risk Management Function (Risk Report)	*quarterly*	✓
Compliance Function	Activity plan	*annually*	✓
	Compliance Report	*monthly*	*as required*
	Tableau de bord of the Compliance Function	*quarterly*	✓
	Annual Report of the Compliance Function	*annually*	✓
AML Function	Testing Report*	*quarterly*	-
	Report on activities carried out	*annually*	✓
Internal Audit Function	Activity plan	*annually/ multi-year*	✓
	Audit Report	*as required*	*as required*
	Tableau de bord of the Internal Audit Function	*quarterly*	✓
	ICAAP Audit Report	*annually*	✓
	Significant external Audit functions/activities Report	*annually*	✓
	Remuneration and Incentive Scheme Audit Report**	*annually*	✓
	Annual Internal Audit Activity Report	*annually*	✓
	Annual Whistleblowing Report	*annually*	✓
Supervisory Body	Report on activities carried out	*semiannually*	✓
Board of Statutory Auditors	Board of Statutory Auditors' opinions	*as required*	✓
	Weaknesses reported	*as required*	✓

** This Report is also sent to the Chairman of the Board of Directors as the person having responsibility regarding suspicious transactions.*
*** Final recipient of the Report is the shareholders' meeting.*

Section 2. Scope of Application (Art. 436 CRR)

Qualitative information

The disclosure requirements set out in this document, as reported in Art. 436 of the CRR 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 is deemed to exist when the company holds, directly or indirectly, more than half of the voting rights, considering also potential exercisable or convertible voting rights.
The subsidiaries also include special purpose entities in which the Group, in substance, holds the majority of the risks and rewards deriving from 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 financial statements and accompanying notes of companies consolidated line-by-line are prepared in accordance with IAS/IFRS for 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 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 companies of the Magellan Group, acquired during the year.
All balances and transactions between companies of the Banking Group are eliminated on consolidation.

On May 31, 2016, BFF acquired control of the Magellan Group, a company listed on the Warsaw Stock Exchange, through the Polish vehicle company Mediona, and from that date Magellan's income statement is consolidated in the BFF Group's financial statements.
The Group's balance sheet is consolidated line-by-line and therefore includes the balances of the Magellan Group as at the date of December 31, 2016.

The Magellan shareholders' meeting met on September 30, 2016 and approved the delisting of the shares issued by Magellan and, consequently, on December 1, 2016, the Warsaw Stock Exchange ordered the delisting of Magellan shares from the main Warsaw Stock Market, effective beginning December 6, 2016.

On December 16, 2016, the merger of Mediona with and into Magellan was registered with the Lodz registry office, after which BFF acquired the 67,471 treasury shares that were held by Magellan in Mediona, for PLN 23 million, equal to €5.2 million, which thus increased the value of the investment by the same amount.

Magellan S.A. is an independent specialized operator and leader in the market for financial services offered to companies operating in the healthcare sector in Poland and Slovakia.
In the European Union, Magellan also has a presence in the Czech Republic. Magellan began its expansion into Western Europe during 2015, opening a branch in Spain that was merged into Farmafactoring España after its acquisition.
Magellan's business mainly operates in three sectors through the following activities:
- financing the working capital of suppliers of the public administration;
- financing current and future receivables;
- financing investments in the public and healthcare sector.

As a result of the Magellan acquisition, the Group operates in a position of leadership on the Polish market of alternative financing in the hospital area, where other specialized operators also operate, and, in a limited manner, some national banks.
The acquisition of Magellan offers the Group the possibility of growing significantly through exposure on markets experiencing growth and the creation of a functional platform from which to increasingly expand in Eastern Europe.
The acquisition will also make it possible to acquire specific know-how for a potential expansion of the product portfolio and the range of services offered by the Group.

It should be noted that in accordance with the provisions of Regulation (EU) 575/2013 (CRR), beginning with December 31, 2015 reporting, the area of consolidation used only for purposes of prudential supervision considered the company BFF Lux Holdings S.à r.l. as head of the Group.
As part of the process to simplify the Banking Group's chain of control, BFF Lux Holdings S.à r.l. was put into liquidation on June 20, 2016. Therefore, beginning with June 30, 2016 reporting, the CRR Group includes the Banking Group and BFF Luxembourg S.à r.l., as head of the Group, for prudential supervision purposes only.

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

Company name	Registered office	Type of Relation (1)	Investment relationship		Voting rights % (2)
			Held by	Owner-ship %	
A. Company					
A.1 Line-by-line consolidation					
1. Farmafactoring España S.A.	Madrid C/ Luchana 23	1	Banca Farmafactoring	100%	100%
2. Farmafactoring SPV I S.r.l.	Milano Via Statuto 10	4	Banca Farmafactoring	0%	0%
3. Magellan S.A.	Łodz - Al. Marszalka Jozefa Pilsudskiego 76	1	Banca Farmafactoring	100%	100%
4. MedFinance S.A.	Łodz - Al. Marszalka Jozefa Pilsudskiego 76	1	Magellan S.A.	100%	100%
5. Magellan Česka Republika S.R.O.	Prague, Nadrazni 29/21	1	Magellan S.A.	100%	100%
6. Magellan Central Europe S.R.O.	Bratislava, Mostova 2	1	Magellan S.A.	100%	100%
7. Debt-Rnt sp. Z.O.O.	Łodz - Al. Marszalka Jozefa Pilsudskiego 76	1	Magellan S.A.	100%	100%
8. Kancelaria Prawnicza Karnowski I Wspolnik sp.k.	Łodz - Al. Marszalka Jozefa Pilsudskiego 76	4	Magellan S.A.	99%	0
9. Restrukturyzacyjna Prawnicza Karnowski I Wspolnik sp.k.	Łodz - Al. Marszalka Jozefa Pilsudskiego 76	4	Debt-Rnt sp. Z.O.O.	99%	0
A.2 Consolidated proportionally					

The companies in points 8 and 9 are limited partnerships.

Key:
(1) Relationship type:
1 = majority of voting rights in ordinary shareholders' meetings
2 = significant influence in ordinary shareholders' meetings
3 = agreements with other shareholders
4 = other forms of control
5 = centralized management under Art. 26, paragraph 1 of Legislative Decree No. 87/92
6 = centralized management under Art. 26, paragraph 2 of Legislative Decree No. 87/92
(2) Voting rights in the ordinary shareholders' meetings, distinguishing between actual and potential voting rights.

Quantitative information

All subsidiaries controlled by Banca Farmafactoring are in the scope of consolidation.

Section 3. Own Funds (Art. 437 CRR)

Qualitative information

Own Funds represent the first line of defense against risks associated with the complexity of financial activities and constitute the main parameter of reference for the assessment of the capital adequacy of the Group.
The purpose of prudential supervision regulations is to ensure that all credit intermediaries have a minimum obligatory capitalization in relation to the risks assumed.

The Group constantly assesses its capital structure, developing and employing techniques for monitoring and managing regulated risks, also through a Risk Committee, in its capacity as the responsible multi-member internal body.
From the standpoint of prudential supervision, the amount of capital required is determined based on the current reporting regulations.

Own Funds are the sum 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 components of the Group's Own Funds are computed in Common Equity Tier 1 (CET1), and are the following:
- paid-in share capital;
- reserves (legal reserve, extraordinary reserve, retained earnings);
- undistributed portion of the profit for the year;
- revaluation reserves: actuarial gains (losses) relating to defined benefit plans;
- revaluation reserves: special revaluation laws;
- any non-controlling interests eligible for inclusion in the computation of CET1.

Intangible assets, including goodwill, if any, are deducted from the above.

As regards the prudential treatment of unrealized gains or losses relating to exposures with the central administrations classified in the "Available-for-sale" portfolio, the CRR requires banks to include such reserves in Own Funds.
On January 24, 2014, BFF's Board of Directors decided to exercise the option permitted by the Bank of Italy Circular No. 285 of December 17, 2013 – Section II, Paragraph 2, last sentence, wherein it is stated that banks have the option of "not including in any component of Own Funds unrealized gains or losses relating to exposures with the central administrations classified in the 'Available-for-sale' category of IAS 39, as approved by the EU" (option allowed also under Supervisory Bulletin No. 12 of December 2013, in the paragraph relating to "Own Funds Regulations").
Therefore, as reasserted by the Bank of Italy Communication No. 90517/17 of January 24, 2017, and until the end of the transition period, that is, until the adoption of IFRS 9 (now January 1, 2018), the companies belonging to the Group will not include in Own Funds unrealized profit or loss relative to the above exposures.

Additional Tier 1 Capital (AT1) and Tier 2 Capital (T2) include exclusively the non-controlling interests given recognition to in consolidated Own Funds, in accordance with the CRR, Part 2 – Title II

"Non-controlling interests and additional Tier 1 and Tier 2 Class 1 and equity instruments issued by affiliates".
In relation to the determination of non-controlling interests in Additional Tier 1 Capital and in Tier 2 Capital, account is taken, as reported in the Bank of Italy Circular No. 285, of the transitory factor applicable pursuant to Art. 480, paragraphs 2 and 3 of the CRR, equal to 0.6 for the current year.
Own Funds amount to €234.7 million compared to €258 million at December 31, 2015. The difference is mainly due to the acquisition of the Magellan Group which led to the recognition of goodwill, a deduction from Own Funds, equal to €22.1 million.

Quantitative information

Breakdown of Own Funds

Items/Amounts	Total 12/31/2016	Total 12/31/2015
A. Common Equity Tier 1 - CET1 before the application of prudential filters	470,535	458,568
CET1 instruments subject to transitory provisions		
B. CET1 prudential filters (+/-)		
C. CET1 gross of items to be deducted and of the transitory regime effects (A +/- B)	470,535	458,568
D. Elements to be deducted from CET1	(241,744)	(208,618)
E. Transitory regime - Impact on CET1 (+/-), including minority interests subject to transition requirements	3,073	5,425
F. Total Common Equity Tier 1 - CET1 capital (C - D +/- E)	231,865	255,376
G. Additional Tier1 - AT1 capital gross of items to be deducted and of the transitory regime effects	2,047	1,794
AT1 instruments subject to transitory provisions		
H. Elements to be deducted from AT1		
I. Transitory regime - Impact on AT1 (+/-), including instruments issued by subsidiaries and included in AT1 due to transitional provisions	(819)	(660)
L. Total Additional Tier1 - AT1 capital (G - H +/- I)	1,228	1,134
M. Tier2 - T2 capital gross of items to be deducted and of the transitory regime effects	2,620	2,297
T2 instruments subject to transitory provisions		
N. Elements to be deducted from T2		
O. Transitory regime - Impact on T2 (+/-), including instruments issued by subsidiaries and included in T2 due to transitional provisions	(1,048)	(844)
P. Total Tier 2 - T2 capital (M - N +/- O)	1,572	1,452
Q. Total Own Funds (F + L + P)	234,665	257,962

Own Funds of the Group pursuant to the Consolidated Law on Banking amount to €235.3 million at December 31, 2016, compared to €259.3 million at December 31, 2015, as presented in the following table.

Items/Amounts	Total 12/31/2016	Total 12/31/2015
A. Common Equity Tier 1 - CET1 before the application of prudential filters	**261,139**	**262,012**
CET1 instruments subject to transitory provisions		
B. CET1 prudential filters (+/-)		
C. CET1 gross of items to be deducted and of the transitory regime effects (A +/- B)	261,139	262,012
D. Elements to be deducted from CET1	**(25,795)**	**(2,747)**
E. Transitory regime - Impact on CET1 (+/-), including minority interests subject to transition requirements		
F. Total Common Equity Tier 1 - CET1 capital (C - D +/- E)	**235,345**	**259,265**
G. Additional Tier1 - AT1 capital gross of items to be deducted and of the transitory regime effects		
AT1 instruments subject to transitory provisions		
H. Elements to be deducted from AT1		
I. Transitory regime - Impact on AT1 (+/-), including instruments issued by subsidiaries and included in AT1 due to transitional provisions		
L. Total Additional Tier1 - AT1 capital (G - H +/- I)		
M. Tier2 - T2 capital gross of items to be deducted and of the transitory regime effects		
T2 instruments subject to transitory provisions		
N. Elements to be deducted from T2		
O. Transitory regime - Impact on T2 (+/-), including instruments issued by subsidiaries and included in T2 due to transitional provisions		
P. Total Tier 2 - T2 capital (M - N +/- O)		
Q. Total Own Funds (F + L + P)	**235,345**	**259,265**

In this case, too, the difference is mainly due to the acquisition of the Magellan Group, which led to the recognition of goodwill, a deduction from Own Funds, equal to €22.1 million.

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	4,314	26, paragraph 1, 28	
2 Retained earnings	33,229	26, paragraph 1, letter c)	
3 Accumulated other comprehensive income and other reserves	425,752	26, paragraph 1, letter d), e)	
5 Minority interests (amount allowed in consolidated Class 1 capital)	10,313	84	
5a Profit for the period verified by independent persons net of all foreseeable charges or dividends	0	26, paragraph 2	
6 Common Equity Tier 1 Capital (CET1) before regulatory adjustments	**473,609**		
Common Equity Tier 1 Capital (CET1): regulatory adjustments			
8 Intangible assets (net of related tax liability)	(241,744)	36, paragraph 1, letter b)	
28 Total regulatory adjustments to Common Equity Tier 1 Capital (CET1)	**(241,744)**		
29 Common Equity Tier 1 Capital (CET1)	**231,865**		
Additional Tier 1 (ATI): instruments			
34 Eligible Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	1,228	85, 86	
44 Additional Tier 1 (AT1) capital	**1,228**		
45 Tier 1 capital (T1 = CET1 + AT1)	**233,093**		
Tier 2 Capital (T2): instruments and provisions			
48 Qualifying Own Funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	1,572		
58 Tier 2 Capital (T2)	**1,572**		
59 Total capital (TC = T1 + T2)	**234,665**		
60 Total risk-weighted assets	**1,416,833**		
61 Common Equity Tier 1	16.4%	92, paragraph 2, letter a)	
62 Tier 1 capital	16.5%	92, paragraph 2, letter b)	
63 Total capital	16.6%	92, paragraph 2, letter c)	
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%	Art. 129 CRD	
65 of which: the capital conservation buffer requirement	2.50%		
68 Common Equity Tier 1 available to meet buffer requirement	13.9%		

The following table gives the reconciliation between the equity of the Banking Group according to the Consolidated Law on Banking reported in Part F of the consolidated financial statements, with Own Funds relating to the same Banking Group.

Equity items	Total
Share capital	130,983
Share premium	
Reserves	126,132
Capital instruments	
(Treasury shares)	
Valuation reserves:	
- Available-for-sale financial assets	471
- Property, plant and equipment	
- Intangible assets	
- Hedges of net investments in foreign subsidiaries	
- Cash flow hedges	345
- Exchange differences	
- Non-current assets classified as held for sale	
- Actuarial gains (losses) on remeasurement of defined benefit plans	(144)
- 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	72,136
Equity	**333,746**
Dividends	(72,126)
Portion of non-controlling interests not eligible	
CET1 before application of prudential filters, transitional adjustments and deductions	261,610
Prudential filters	
Transitional adjustments (1)	(471)
Deductions	(25,795)
CET1	**235,345**
Own Funds - Banking Group	**235,345**

(1) AFS reserves, as indicated above.

Section 4. Capital Requirements (Art. 438 CRR)

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

Compliance with capital adequacy limits, both for the CET1 Capital Ratio, Tier 1 Capital Ratio and the Total Capital Ratio, is constantly monitored by the relevant corporate bodies.

The CET1 Capital Ratio is the ratio of Common Equity Tier 1 Capital to the amount of Risk- Weighted Assets.
The Tier 1 Capital Ratio is the ratio of Tier 1 Capital to the amount of Risk-Weighted Assets. The Total Capital Ratio is the ratio of Own Funds to the amount of Risk-Weighted Assets.

In accordance with the provisions of Bank of Italy Circular No. 262 of December 22, 2005 – "*Bank financial statements: presentation format and preparation rules*", and subsequent updates, the amount of Risk-Weighted Assets was 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 Group's total exposure to risks at December 31, 2016, in relation to its business, is adequate according to the level of capitalization and the risk profile identified.
The CET1 Capital Ratio is 16.4%;
The Tier 1 Capital Ratio is 16.5%;
The Total Capital Ratio is 16.6%.
These ratios do not include the net profit of the Banking Group.

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

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

Credit risk

The adoption of the standardized approach involves dividing the exposures into various classes ("portfolios") based on the type of counterparty, and applying diversified weighting coefficients to each portfolio.

More specifically, for the "Central administrations and central banks" portfolio, the weighting depends on the rating assigned by the ECAIs and the ECAs to the individual countries. For the "Supervised intermediaries" portfolio, the weighting depends on the rating of the country where the supervised intermediary has its headquarters. For the "public sector entities" portfolio, the rules for weighting are the same as those for supervised intermediaries.

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 BFF is Dominion Bond Rating Service (DBRS), with the "Unsolicited" type of rating.

For the calculation of credit risk, the Group applies the following weighting factors established by the CRR and introduced into the Bank of Italy's regulation on "Prudential Supervision":

- 0% for receivables from central administrations and central banks with offices in an European Union member state and financed in the local currency;
- 20% for receivables from territorial entities located in an European Union member state, denominated and financed in the local currency, and for receivables from the Public Administration of countries in Credit Quality Class 1.
- The non-recourse receivables from the Spanish Healthcare System fall into this category since the counterparties of these exposures are represented by the "Comunidad" (the Regions);
- 50% for receivables from the Public Administration of countries in Credit Quality Class 2, which include exposures with entities of the Polish and Slovakian public sector and, up until December 31, 2016, those of the Italian Public Administration;
- 100% for countries in Credit Quality Class 3 (Italy, starting from 2017, and Portugal). For exposures with an original duration of three months or less, a weighting of 20% is applied;
- 50% or 100% for receivables from supervised intermediaries according to the Credit Quality Class of the country in which they have their offices, except for exposures with an original duration of three months or less, for which a weighting of 20% is applied;
- 75% for receivables from retail and small business counterparties;
- 100% for receivables from private debtors;
- 100% for property, plant and equipment, equity investments, investment funds and other assets;
- 150% for past due loans;
- 100% for past due loans, if the specific value adjustments are 20% or more of the non-collateralized portion, before value adjustments.

The unsolicited rating assigned to the Italian Republic by DBRS, on January 13, 2017, went from "A low" to "BBB high" and, consequently, the country was downgraded from Credit Quality Class 2 to Credit Quality Class 3.

The exposures for receivables from the Public Administration, which include those from entities belonging to the National Healthcare System and Local Healthcare Entities (ASL), therefore, starting from the March 2017 supervisory reporting, will be rated in Credit Quality Class 3, with a 100% weighting, compared to 50% adopted up to December 31, 2016.

The Group is already putting into place capital management measures to meet the needs in terms of capital requirements, following the impacts of the aforementioned downgrade.

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

Capital requirement = 8% RWA

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

Credit valuation adjustment (CVA) risk

With reference to the capital requirements for CVA risk, meaning an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty, the Group has applied the standardized method set out in Art. 384 of the CRR.
More specifically, the requirement is applied on derivative contracts put in place with the intention of hedging fluctuations in exchange rates through the forward sale of foreign currency at a specific spot rate and on interest rate swap (IRS) derivatives as instruments hedging the rate applied to funding.

Counterparty risk

Counterparty risk represents a particular type of credit risk, which generates a loss if the transactions executed with a given counterparty have a positive value in the event of default.
This risk is measured by the simplified approach, under which any portion of the exposure secured by collateral is assigned a weighting factor corresponding to the weighting factor assigned to the instrument used as collateral.
For the Group, the counterparty risk is generated by repurchase agreements with *Cassa Compensazione e Garanzia* as the counterparty, and by derivative contracts relating to BFF and Magellan.

Operational risk

The Group measures operational risk using the "Basic" approach: the capital requirement is determined by applying a 15% coefficient to the three-year average of the relevant indicator, calculated on the financial statements items of the last three years, in accordance with European Regulation No. 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.
Financial assets held for trading include, in 2016, financial instruments executed to hedge interest rate risk, for which hedge accounting was not applied.
The financial instruments recorded in this category are derivative contracts executed to hedge fluctuations in the exchange rates between the forward exchange rate and the spot exchange rate.
These derivative financial contracts are recognized as assets/liabilities held for trading in accordance with the provisions of IAS 39, even though at the operational level they are treated as instruments hedging risks.

As operational hedging instruments, these derivatives hedge the risk relative to credit valuation adjustments.

Pillar II – The ICAAP Summary

The supervisory regulation requires intermediaries to adopt control strategies and processes for determining the adequacy of current and future capital. It is the Regulatory Authority's responsibility to verify the reliability and accuracy of the results generated and, where necessary, takes appropriate corrective action.

By April 30, 2017 the Group must submit the "ICAAP Summary", to the Bank of Italy, updating the risk management system aimed at the determination of the capital adequacy.
The following reports the principal cases of risk considered relevant under Pillar 2:

- Concentration Risk: relevant risk associated with the concentration of relationships on the individual entities in the extended National Health System or Public Administration.
- Interest Rate Risk: relevant risk of fluctuations in the basic indexed rates affecting the assets and liabilities in the banking book.
- Liquidity Risk: relevant risk due to the impossibility to access funds on the financial market or limitations that are present and restrict the disposal of assets.
- Excessive leverage risk: relevant risk arising from a particularly high level of debt compared to equity.
- Strategic Risk: 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.
- Country Risk: relevant risk of potential losses caused by events occurring in a country other than Italy.
- Reputational Risk: 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.

Capital requirements in relation to credit risk and counterparty risk

Portfolios/Exposures	Weighting factors	Credit risk: Non-weighted exposure	Credit risk: Weighted exposure	Credit risk: Capital requirement	Counterparty risk: Non-weighted exposure	Counterparty risk: Weighted Exposure	Counterparty risk: Capital requirement
Exposures to central administrations and central banks *Credit rating class: 2*	0%	2,484,748	0	**0**			
Exposures to territorial entities *Credit rating class: 2*	20%	530,816	106,163	**8,493**			
Exposures public sector entities *Credit rating class: 2*	20%	142,910	28,582	**2,287**			
	50%	1,047,022	523,511	**41,881**			
Credit rating class: 3	100%	34,075	34,075	**2,726**			
Exposures to supervised intermediaries *Credit rating class: 2*	20%	228,149	45,630	**3,650**	693	1,399	**11**
	50%				1,171	586	**47**
	100%				1,265	1,265	**101**
Exposures to companies and other parties *Credit rating class: without rating*	0%	1,805,779	0	**0**			
	100%	127,622	127,622	**10,209**	800	800	64
Past-due exposures	150%	56,762	85,143	**6,811**			
	100%	5,226	5,226	**418**			
Equity instruments *Credit rating class: without rating*	100%	496	496	**40**			
	250%						
Other exposures *Credit rating class: without rating*	0%						
	100%	17,786	17,786	**1,423**			
Retail exposures	75%	84,363	63,272	**5,062**			
Exposures secured by property	100%						
Units in investment funds	100%	3,401	3,401	**272**			
Total		**6,569,159**	**1,040,907**	**83,272**	**3,930**	**2,790**	**223**

Other capital requirements

	Weighted exposure - RWA	Capital requirement
Risk relating to credit valuation adjustments (CVA)	950	76
Market risk	0	0
Operational risk	372,188	29,775

Capital ratios

Items / Amounts	Total 12/31/2016
Common Equity Tier 1 Capital/Risk-weighted assets (CET1 capital ratio) (%)	**16.4%**
Tier 1 Capital/Risk-weighted assets (Tier 1 capital ratio) (%)	**16.5%**
Total Own Funds/Risk-weighted assets (Total capital ratio) (%)	**16.6%**

For the presentation of more meaningful disclosure, the following table reports the capital ratios for the area of consolidation of the Banking Group according to the Consolidated Law on Banking (T.U.B.), which therefore does not include BFF Luxembourg S.à r.l..

Items / Amounts	Total 12/31/2016
Common Equity Tier 1 Capital/Risk-weighted assets (CET1 capital ratio) (%)	**16.7%**
Tier 1 Capital/Risk-weighted assets (Tier 1 capital ratio) (%)	**16.7%**
Total Own Funds/Risk-weighted assets (Total capital ratio) (%)	**16.7%**

Section 5. Exposure to Counterparty Risk (Art. 439 CRR)

Qualitative information

Counterparty risk represents a particular type of credit risk, which generates a loss if the transactions executed with a given counterparty have a positive value in the event of default.
This risk is measured by the simplified approach, under which any portion of the exposure secured by collateral is assigned a weighting factor corresponding to the weighting factor assigned to the instrument used as collateral.

For the Group, the counterparty risk is generated by repurchase agreements with *Cassa Compensazione e Garanzia* as the counterparty, and by derivative contracts relating to BFF and Magellan.

Repurchase transactions are in place at December 31, 2016 with the counterparty *Cassa Compensazione e Garanzia*, from which the fair value of the securities used as collateral is deducted; the capital requirement, as indicated in the following table, is calculated on this value, if positive.

The capital requirement is also applied to derivative contracts executed to hedge fluctuations in exchange rates through the forward sale of foreign currency at a spot rate and interest rate swaps as instruments hedging interest rates on funding.
More specifically, the Group has the following types of hedge:
• cash flow hedge: interest rate swap contract with a notional amount in Polish currency (zloty) executed to hedge a variable rate medium-term loan obtained in 2016 in Polish currency from changes in future cash flows arising from fluctuations in market interest rates (Wibor). Instead, the risk component of the loan attributable to changes in the euro-zloty exchange rate is not hedged.
• fair value hedge: foreign exchange swap contracts executed to hedge intragroup loans entered into in 2016 in Polish currency (zloty) and in Czech currency (koruna), from changes in fair value arising from fluctuations in the euro-zloty and euro-koruna exchange rates.

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:

Regulatory portfolio	Exposure without mitigation of credit risk	Collateral – Simplified method	Personal guarantees	Exposure post mitigation of credit risk
Securities financing transactions (SFT)	1,806,580	(1,805,780)	-	800
Total	1,806,580	(1,805,780)	-	800

Derivatives:

Regulatory portfolio	Exposure without mitigation of credit risk	Collateral – Simplified method	Personal guarantees	Exposure post mitigation of credit risk
Derivatives	3,130	-	-	3,130
Total	3,130	-	-	3,130

At December 31, 2016, the capital requirement relating to repurchase agreements is approximately €64 thousand and those relating to derivatives is €159 thousand.

Section 6. Credit Risk Adjustments (Art. 442 CRR)

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 No. 262 of December 22, 2005, and subsequent updates, "*Bank Financial Statements: layout and preparation rules*", BFF classified receivables from customers into "performing receivables" and "impaired receivables".
On this point, on July 24, 2014, the European Banking Authority (EBA) published the "Final draft implementing technical standards on supervisory reporting of forbearance and nonperforming exposures" (EBA/ITS/2013/03/rev 1 7/24/2014): this document introduces new definitions for impaired assets and forbearance measures, so that all the categories reported below now include a "forborne" sub-category.
These definitions were adopted by the Bank of Italy with the seventh update to Circular No. 272 of January 20, 2015.

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, "Account Matrix", and subsequent updates.
• Other exposures. Exposures not falling within the preceding category.

Impaired assets include:

• Past due exposures. These are exposures with central administrations and central banks, territorial entities, public sector entities, non-profit entities and companies that, at December 31, 2016 were more than 90 days past due.
More specifically, exposures with central administrations and central banks, public sector entities and territorial entities, are considered past due when the debtor has not made any payments for any debt positions owed to the financial intermediary for more than 90 days. At December 31, 2016, net past due exposures total €46,167 thousand compared to €43,234 thousand in the prior year, mainly relating to receivables due from territorial entities.

• Probable default (Unlikely to pay). The "unlikely to pay" concept is used to define this type of exposure and, consequently, the probable default reflects the judgment made by the intermediary about the unlikeliness, absent such actions as the enforcement of guarantees, that the debtor will fully fulfill (for principal and/or interest) its credit obligations. This assessment should be arrived at independently of the existence of any past due and unpaid amounts or installments. Therefore, it is not necessary to wait for an explicit sign of anomaly (e.g. failure to repay) when there are factors that signal a default risk situation for the debtor. Exposures with retail customers can be classi-

fied in the probable default category at the individual transaction level, provided the intermediary believes that the conditions for classifying in this category the entire complex of exposures with same debtor cannot be met.
At December 31, 2016, the Group has net exposures classified as unlikely to pay that refer entirely to the Magellan portfolio and total €3,614 thousand.

• Non-performing exposures. These are exposures with parties that are in a state of insolvency or in basically similar situations, regardless of any loss projections recognized by the company. Total non-performing exposures of the Group, net of writedowns for estimated impairment losses, amount to €12.1 million, of which €7.2 million refers to Banca Farmafactoring and €4.9 million to Magellan.

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 makes it possible to differentiate between performing and non-performing receivables, including in the latter category 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 from the face due date, show no objective indication of loss at an individual level.
Although the receivables are owed almost entirely by the Public Administration, as in previous years, when preparing its annual financial statements or interim reports, the Bank, as required by IAS 39, carries out a collective assessment (impairment test) of its performing receivables in order to correctly monitor the intrinsic risk of the portfolio even in the absence of individual impairment indicators.
This assessment is performed using, as a basis, the risk parameters of Probability of Default (PD) and Loss Given Default (LGD) and applying them to the exposures not classified as non-performing (EAD).
The assessment of the "Probability of Default" (PD) was performed by assigning to the debtors (ASLs/AOs) a rating corresponding to the credit rating assigned by the major rating agencies to the particular Region to which the debtors belong.
To determine the "Loss Given Default" (LGD), the Group used the value recommended in the "Basel Accord Framework" for non-collateralized receivables owed by sovereign states, companies and banks, equal to 45%.

At December 31, 2016, the calculation of collective adjustments indicated a result of about €3.2 million, higher by €0.3 million compared to 2015, owing primarily to the increase in the outstanding receivables of the Bank.
Magellan and its subsidiaries applied the provisions of IAS 39 even before the acquisition by Banca Farmafactoring, performing a collective assessment. However, the composition of Magellan's portfolio is different than Banca Farmafactoring's portfolio mainly because the most important exposures are with private debtors. Consequently, the assessment of receivables is made by applying a percentage to the receivable's purchase value that varies in relation to the type of counterparty to which the exposure refers. The amount of the collective impairment loss is €2.3 million.

Quantitative information

Breakdown of financial assets by portfolio and credit quality (carrying amounts)

Portfolio/Quality	Non-performing	Unlikely to pay	Past due impaired exposures	Past due exposures not impaired	Assets not impaired	Total
1. Available-for-sale financial assets					385,086	385,086
2. Held-to-maturity financial assets					1,629,320	1,629,320
3. Due from banks					144,871	144,871
4. Due from customers	12,065	3,614	46,167	398,204	2,039,044	2,499,094
5. Financial assets designated at fair value					3,401	3,401
6. Financial assets held for sale						
Total 12/31/2016	**12,065**	**3,614**	**46,167**	**398,204**	**4,201,722**	**4,661,772**
Total 12/31/2015	**2,507**	**0**	**43,234**	**386,219**	**3,224,314**	**3,656,274**

Breakdown 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 impair. loss	Net Exposure	Gross Exposure	Portfolio impair. loss	Net Exposure	
1. Available-for-sale financial assets				385,086		385,086	385,086
2. Held-to-maturity financial assets				1,629,320		1,629,320	1,629,320
3. Due from banks				144,871		144,871	144,871
4. Due from customers	66,372	4,526	61,847	2,443,009	5,761	2,437,248	2,499,094
5. Financial assets designated at fair value				3,401		3,401	3,401
6. Financial assets held for sale							
Total 12/31/2016	**66,372**	**4,526**	**61,847**	**4,605,687**	**5,761**	**4,599,926**	**4,661,772**
Total 12/31/2015	**47,536**	**1,795**	**45,741**	**3,228,064**	**3,750**	**3,224,314**	**3,270,055**

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

Exposures/ Geographical areas	Italy		Other European countries	
	Net exposure	Total impairment losses	Net exposure	Total impairment losses
A. On balance sheet exposures				
A.1 Non-performing				
A.2 Unlikely to pay				
A.3 Past due impaired				
A.4 Not impaired exposures	130,381		14,490	
TOTAL	**130,381**		**14,490**	
B. Off-balance sheet exposures				
B.1 Non-performing				
B.2 Unlikely to pay				
B.3 Past due impaired				
B.4 Not impaired exposures	22		773	
TOTAL	**22**	-	**773**	-
TOTAL 12/31/2016	**130,403**	-	**15,264**	-
TOTAL 12/31/2015	**55,393**	-	**385**	-

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

Exposures/ Geographical areas	Italy Northwest		Italy Northeast		Italy Central		Italy-South and Islands	
	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses
A. On balance sheet exposures								
A.1 Non-performing								
A.2 Unlikely to pay								
A.3 Past due impaired								
A.4 Not impaired exposures	73,774		20,793		523		35,291	
TOTAL	**73,774**		**20,793**		**523**		**35,291**	
B. Off-balance sheet exposures								
B.1 Non-performing								
B.2 Unlikely to pay								
B.3 Past due impaired								
B.4 Not impaired exposures					22			
TOTAL					**22**			
TOTAL 12/31/2016	**73,774**		**20,793**		**545**		**35,291**	
TOTAL 12/31/2015	**51,495**		**1,909**		**1,389**		**600**	

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

Exposures/ Geographical areas	Italy		Other European countries	
	Net exposure	Total impairment losses	Net exposure	Total impairment losses
A. On balance sheet exposures				
A.1 Non-performing	7,194	2,392	4,872	1,950
A.2 Unlikely to pay			3,614	101
A.3 Past due impaired	45,429	82	739	
A.4 Not impaired exposures	3,824,180	3,409	627,474	2,352
TOTAL	**3,876,802**	**5,883**	**636,698**	**4,404**
B. Off-balance sheet exposures				
B.1 Non-performing				
B.2 Unlikely to pay				
B.3 Past due impaired	716			
B.4 Not impaired exposures	6,100		121,170	
TOTAL	**6,816**	-	**121,170**	-
TOTAL 12/31/2016	**3,883,618**	**5,883**	**757,867**	**4,404**
TOTAL 12/31/2015	**3,110,377**	**5,496**	**221,361**	**50**

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

Exposures/ Geographical areas	Italy Northwest		Italy Northeast		Italy Central		Italy-South and Islands	
	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses	Net exposure	Total impairment losses
A. On balance sheet exposures								
A.1 Non-performing	905	355	176	78	322	1,159	5,988	800
A.2 Unlikely to pay								
A.3 Past due impaired	4,275	8	1,772	3	5,333	10	34,049	61
A.4 Not impaired exposures	205,990	358	92,641	171	2,788,746	1,232	736,802	1,648
TOTAL	**211,171**	**721**	**94,588**	**253**	**2,794,401**	**2,401**	**776,840**	**2,509**
B. Off-balance sheet exposures								
B.1 Non-performing								
B.2 Unlikely to pay								
B.3 Past due impaired	573				38		105	
B.4 Not impaired exposures	659		1,427		2,001		2,013	
TOTAL	**1,233**		**1,427**		**2,038**		**2,118**	
TOTAL 12/31/2016	**212,403**	**721**	**96,015**	**253**	**2,796,440**	**2,401**	**778,958**	**2,509**
TOTAL 12/31/2015	**174,575**	**622**	**87,416**	**198**	**1,989,217**	**2,808**	**859,180**	**1,867**

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 impair. losses	Portfolio impair. losses	Net exposure	Specific impair. losses	Portfolio impair. losses
A. On-balance sheet exposures						
A.1 Non-performing				6,131	931	
- forborne exposures						
A.2 Unlikely to pay				3,376		
- forborne exposures						
A.3 Past due impaired exposures	4,662	9		34,136	63	
- forborne exposures						
A.4 Not impaired exposures	2,423,898		755	1,782,764		4,174
- forborne exposures						
TOTAL A	**2,428,560**	**9**	**755**	**1,826,408**	**994**	**4,174**
B. Off-balance sheet exposures						
B.1 Non-performing						
B.2 Unlikely to pay						
B.3 Other impaired exposures	6			676		
B.4 Not impaired exposures	1,775			34,873		
TOTAL B	**1,780**	-	-	**35,550**	-	-
TOTAL (A+B) 12/31/2016	**2,430,340**	**9**	**755**	**1,861,957**	**994**	**4,174**
TOTAL (A+B) 12/31/2015	**1,541,235**	-	**499**	**1,613,772**	**468**	**3,225**

Exposures/Counterparties	Financial companies			Insurance companies		
	Net exposure	Specific impair. losses	Portfolio impair. losses	Net exposure	Specific impair. losses	Portfolio impair. losses
A. On-balance sheet exposures						
A.1 Non-performing	312	296				
- forborne exposures						
A.2 Unlikely to pay						
- forborne exposures						
A.3 Past due impaired exposures	341					
- forborne exposures						
A.4 Not impaired exposures	117,790		604			
- forborne exposures						
TOTAL A	**118,444**	**296**	**604**	-	-	-
B. Off-balance sheet exposures						
B.1 Non-performing						
B.2 Unlikely to pay						
B.3 Other impaired exposures						
B.4 Not impaired exposures						
TOTAL B	-	-	-	-	-	-
TOTAL (A+B) 12/31/2016	**118,444**	**296**	**604**	-	-	-
TOTAL (A+B) 12/31/2015	**28,932**	-	-	-	-	-

Exposures/Counterparties	Non-financial companies			Other subjects		
	Net exposure	Specific impair. losses	Portfolio impair. losses	Net exposure	Specific impair. losses	Portfolio impair. losses
A. On-balance sheet exposures						
A.1 Non-performing	33	853		5,589	2,262	
- forborne exposures						
A.2 Unlikely to pay				237	101	
- forborne exposures						
A.3 Past due impaired exposures	6,497	11		532	0	
- forborne exposures						
A.4 Not impaired exposures	29,460		32	97,740		195
- forborne exposures						
TOTAL A	**35,990**	**864**	**32**	**104,099**	**2,364**	**195**
B. Off-balance sheet exposures						
B.1 Non-performing						
B.2 Unlikely to pay						
B.3 Other impaired exposures	34					
B.4 Not impaired exposures	90,622					
TOTAL B	**90,656**	-	-	-	-	-
TOTAL (A+B) 12/31/2016	**126,646**	**864**	**32**	**104,099**	**2,364**	**195**
TOTAL (A+B) 12/31/2015	**131,438**	**909**	**8**	**16,361**	**418**	**18**

On-balance sheet credit exposures with customers: changes in total impairment losses

Sources/Categories	Non-performing		Unlikely to pay		Past due impaired	
	TOTAL	Forborne exposures	TOTAL	Forborne exposures	TOTAL	Forborne exposures
A. Beginning total impairments	**1,719**		**0**		**76**	
- of which: receivables sold but not derecognized	18				7	
B. Increases	**2,703**		**101**		**66**	
B.1 impairment losses	198					
B.2 losses on sale						
B.3 transfers from other categories of impaired exposures	1,950		101			
B.4 other increases	555				66	
C. Decreases	**80**		**0**		**60**	
C.1 impairment reversals						
C.2 impairment reversals from collections	24				49	
C.3 gains on sale						
C.4 derecognition						
C.5 transfer to other categories of impaired exposures	3					
C.6 other decreases	53				10	
D. Ending total impairments	**4,342**		**101**		**82**	
- of which: receivables sold but not derecognized	169				30	

Section 7. Unencumbered Assets (Art. 443 CRR)

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 basis 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).

Quantitative information

Model A – Encumbered assets in the financial statements

	Encumbered assets		Unencumbered assets	
	Carrying amount	Fair value	Carrying amount	Fair value
Total Assets of the Group	**2,496,487**	X	**2,484,512**	X
1. Equity instruments			194	194
2. Debt securities	1,808,374	1,807,088	206,031	205,554
3. Loans	630,025	X	1,985,910	X
4. Other assets	58,088	X	292,376	X

Other assets refer to margins to operate with repurchase agreements and the deposit relating to the Mandatory Reserve.

Model B – Collateral received by the reporting institution

At December 31, 2016 there was no collateral received.

Model C – Encumbered assets/collateral received and associated liabilities

	Matching liabilities, contingent liabilities or securities lending	Assets, collateral received and debt securities issued other than covered bonds and encumbered ABSs
Associated liabilities and assets, collateral received or own securities encumbered	**2,209,092**	**2,438,399**

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 repurchase 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 72.5% 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 (Art. 444 CRR)

Qualitative information

The Group uses the standardized approach to measure credit risk, as required by the Bank of Italy in Circular No. 285 "*Oversight provisions for banks*" and Circular No. 286 "*Instructions for the preparation of supervisory reporting by banks and securities intermediaries*", both dated December 17, 2013, and subsequent updates. This approach involves the classification of exposures into different classes (portfolios), depending on the type of counterparty and the application of diversified weighted ratios to each portfolio.
More specifically, for the "Central administrations and central banks" portfolio, the weighting depends on the rating assigned by the ECAIs and the ECAs to the individual countries. For the "Supervised intermediaries" portfolio, the weighting depends on the rating of the country where the supervised intermediary has its headquarters. For the "public sector entities" portfolio, the rules for weighting are the same as those for supervised intermediaries.

Banca Farmafactoring adopted the ECAI Dominion Bond Rating Service (DBRS). The unsolicited rating assigned to the Italian Republic by DBRS, on January 13, 2017, went from "A low" to "BBB high" and, consequently, the country was downgraded from Credit Quality Class 2 to Credit Quality Class 3.
The exposures for receivables from the Italian Public Administration, which include those from entities belonging to the National Healthcare System and from the Local Healthcare Entities (ASL), therefore, starting from the March 2017 supervisory reporting, will be rated in Credit Quality Class 3, with a 100% weighting, compared to 50% adopted up to December 31, 2016.

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

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

The credit quality rating of the countries in which the companies in the Banking Group operate, at December 31, 2016, are presented below.

Class 2: Italy, Spain, Poland and Slovakia
Class 3: Portugal

Quantitative information

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

Portfolios/Exposures	Weighting factors	Credit risk and Counterparty Risk		
		Non-weighted exposure	Weighted exposure	Capital requirement
Exposures to central administrations and central banks *Credit rating class: 2*	0%	2,484,748	0	**0**
Exposures to territorial entities *Credit rating class: 2*	20%	530,816	106,163	**8,493**
Exposures public sector entities	20%	142,910	28,582	**2,287**
Credit rating class: 2	50%	1,047,022	523,511	**41,881**
Credit rating class: 3	100%	34,075	34,075	**2,726**
Exposures to supervised intermediaries *Credit rating class: 2*	20%	228,843	45,769	**3,661**
	50%	1,171	585	**47**
	100%	1,265	1,265	**101**
Exposures to companies and other parties *Credit rating class: without rating*	0%	1,805,779	0	**0**
	100%	128,423	128,433	**10,274**
Past-due exposures	150%	56,762	85,143	**6,811**
	100%	5,226	5,226	**418**
Equity instruments *Credit rating class: without rating*	100%	496	496	**40**
	250%			**0**
Other exposures *Credit rating class: without rating*	0%			**0**
	100%	17,786	17,786	**1,423**
Retail exposures	75%	84,363	63,272	**5,062**
Exposures secured by property	100%			**0**
Units in investment funds	100%	3,401	3,401	**272**
Total		**6,576,089**	**1,043,697**	**83,496**

Section 9. Exposure to Market Risk (Art. 445 CRR)

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.
Financial assets held for trading, in 2016, include financial instruments executed to hedge exchange rate risk, for which hedge accounting was not applied.

The financial instruments recorded in this category are derivative contracts executed to hedge fluctuations in the exchange rates between the forward exchange rate and the spot exchange rate. Financial derivatives are recognized as assets/liabilities held for trading in accordance with the provisions of IAS 39, even though at the operational level they are treated as instruments hedging risks.
As operational hedging instruments, these derivatives hedge the risk relative to credit valuation adjustments.

Quantitative information

At December 31, 2016, there are no positions that generate capital requirements relating to market risk. The following derivative financial contracts are recorded as trading assets/liabilities, in accordance with IAS 39, even though at the operational level they are considered as risk hedging instruments.

Regulatory trading portfolio: year-end notional amounts

Underlying assets/ Derivative type	Total 12/31/2016		Total 12/31/2015	
	Over the counter	Clearing house	Over the counter	Clearing house
1. Debt securities and interest rates	4,535			
a) Options				
b) Swaps	4,535			
c) Forwards				
d) Futures				
e) Other				
2. Equity securities and share indexes				
a) Options				
b) Swaps				
c) Forwards				
d) Futures				
e) Other				
3. Currencies and gold	43,666			
a) Options				
b) Swaps	43,666			
c) Forwards				
d) Futures				
e) Other				
4. Commodities				
5. Other underlyings				
Total	**48,200**			

Section 10. Operational Risk (Art. 446 CRR)

Qualitative information

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

With regard to the Group, exposure to this category of risk is generated predominately by failures in work processes and in organization and governance—human errors, computer software malfunctions, inadequate organization and control safeguards—as well as any loss of human resources in key corporate management positions. On the other hand, exposure to operational risks deriving from external sources are adequately controlled, partly due to the mitigation tools adopted to address such adverse events (such as, by way of example: the business continuity plan, data storage processes, back up tools, insurance policies, etc.).

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

The operational risk assessment model adopted by the Group is of the "mixed" type, meaning a model based both on qualitative assessments, linked to the mapping of the processes and to at-risk activities and the corresponding controls adopted, and on quantitative assessments, using the methodologies specified by the Bank of Italy.

Within the framework of the controls adopted regarding the exposure to operational risk, the following specific risks are also monitored by the Group:

• Money laundering risk, regarding the risk that financial and commercial counterparties and Group suppliers, partners, associates and consultants may be parties to transactions that might potentially facilitate the laundering of money coming from illegal or criminal activities;

• Compliance risk, regarding the risk of legal and administrative penalties, significant financial losses or reputational losses due to failure to comply not only with laws and regulations but also with internal and conduct standards applicable to corporate activities. For this type of risk, a review is performed annually of the related assessment methodology, developed for all activities falling within the scope of the Bank's regulatory framework, in accordance with a risk-based approach. More specifically, for the relevant laws that do not call for the establishment of specialized safeguards (i.e., privacy and occupational health and safety), the Compliance Function provides *ex ante* consulting support to BFF's functions and assesses *ex post* the adequacy of the organizational measures and control activities adopted. As for laws and regulations monitored by specialized functions, the Compliance Function carries out an indirect control by cooperating with the specialized functions in defining compliance risk assessment methods in addition to mapping risks and the corresponding controls (Compliance Risk Control Matrix).

For computing capital requirements for operational risk, the Group uses the Basic Indicator Approach - BIA, according to which capital requirements are computed by applying a regulatory coefficient to an indicator of the volume of business activity (Relevant Indicator).
The Group also assesses operational risks in connection with the introduction of relevant new products, activities, 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 definition of specific policies and regulations on various subjects and topics.
In addition, to control the abovementioned risks, the Group adopts specific organizational models for the management of the risks regarding money laundering, occupational health and safety and information security.

Quantitative information

Based on the above methodology, the capital requirement for operational risk was equal to €29,775 thousand at December 31, 2016.

Section 11. Exposure in Equities not included in the Trading Book (Art. 447 CRR)

Qualitative information

The Group does not have significant exposures in equities in the banking book. The only assets of this type, included in "available for sale financial assets", are:

- the €17 thousand investment in Nomisma S.p.A. Società di Studi Economici, accounted for at cost, in the absence of other valuation inputs;
- the €177 thousand investment in the FITD Voluntary Scheme for interventions to support the member banks in conditions or at the risk of financial difficulties. In May 2016, in fact, Cassa di Risparmio di Cesena requested the intervention of the Voluntary Scheme to increase its share capital so that it could resolve the Bank's difficulties.

Quantitative information

Key figures on the investment in Nomisma are as follows:

Description	Carrying amount (€/cent)	No. of shares purchased	Nominal value per share (€/cents)	Percentage of investment holding
Nomisma S.p.A.	17,335.18	72,667	0.239	0.25%

Head office	Bologna - Strada Maggiore 44
Share capital	€6,963,500 fully paid-in

(in euros, at 12/31/2015)

Equity	7,177,384
Profit (loss) for the year	213,882

The difference of €7 thousand in the carrying amount of the investment between the current and prior year was recognized in the income statement in item 130 b "Net losses/recoveries on impairment of available-for-sale financial assets".

As for the investment in the Voluntary Scheme, Banca Farmafactoring's share was paid in September 2016 and amounted to €235 thousand. The relative fair value at December 31, 2016, communicated by FITD on January 20, 2017, was €177 thousand. The difference of €57 thousand was recorded in the income statement in item 130 b "Net losses/recoveries on impairment of available-for-sale financial assets".

Section 12. Exposure to Interest Rate Risk on Positions not included in the Trading Portfolio (Art. 448 CRR)

Qualitative information

General issues, operational procedures and methods for measuring interest rate risk and price risk
In order to assess interest rate risk, potentially linked to fluctuations in interest rates, the Group is guided by the methodology contained in the prudential regulation (Bank of Italy Circular 285 - Attachment C). This method is applied monthly, in order to detect on a timely and ongoing basis any loss resulting from a market shock determined based on the annual changes in interest rates recorded during an observation period of six years, considering alternatively the 1st percentile (reduction) or the 99th percentile (increase) and ensuring that rates are not negative.
The sensitivity analysis of the interest rate requires the construction of a management framework that makes it possible to highlight the exposure, represented:
• on the liability side, by the total amount of loans revalued in relation to the maturity of the single tranches utilized and the derivative exposure, and by funding derived from Conto Facto and from the placement of bonds;
• on the asset side, by lending represented by exposure from the purchase of non-recourse receivables, the collection of which is estimated using statistics of debtor payment times, adjusted for any settlement agreements with the individual regions and/or with significant debtors, or adjusted as a result of asset sales or by investments in the government securities portfolio.

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

The assumption of interest rate risk in connection with Banca Farmafactoring's funding activity can only occur in compliance with the policies and limits set by the Board of Directors. It is governed by specific powers delegated in this area, which set autonomous limitations 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 submits to the Board of Directors proposals for lending and funding policies and interest rate risk management and recommends, if necessary, any opportune actions to ensure that business is carried out consistently with the risk management policies approved by BFF. The interest rate risk position is reported on a quarterly basis to BFF's senior management and Board of Directors, in accordance with the procedures established by the Risk Management Function for senior management.

Furthermore, at the operational level, on a monthly basis, the Finance Department monitors the interest rate risk, as well its management, through a specific reporting.

Fair value hedging activities

The company executed foreign exchange swap contracts to hedge intragroup loans (between Banca Farmafactoring and Magellan), entered into in 2016 in Polish currency (zloty) and in Czech currency (koruna), from changes in fair value arising from fluctuations in the euro-zloty and euro-koruna exchange rates.

Cash flow hedging activities

Hedging transactions are aimed at neutralizing potential losses attributable to specific types of risks.
The Bank uses interest rate swaps (IRS) as tools to hedge the interest rate applied to its funding.
Like all derivatives, hedging financial derivatives are initially recognized at fair value and subsequently measured at fair value.
When a financial instrument is designated as a hedge, the Bank formally documents the relationship between the hedging instrument and the hedged item.
Changes in the fair value of derivatives are recognized based on evidence provided by retrospective tests at the reporting date through a one-to-one correlation of derivatives to loans and in keeping with the provisions of IAS 39 (documentation of the hedge and effectiveness test of the derivative).

The provisions of IAS 39 require:
- documenting both the hedged item and the hedging instrument;
- carrying out retrospective quantitative tests to determine the effectiveness of the hedge.

Effectiveness tests are carried out by comparing changes in the fair value of the hedging instrument with those of the hypothetical derivative. The hypothetical derivative is a derivative with technical financial characteristics equal to those of the hedged item and initial fair value equal to zero and is defined in such a way as to represent the perfect hedge.
At each reporting date, retrospective tests are performed that produce the ratio between the differences in fair value between the hedging instrument and the hypothetical derivative. If the ratio of the retrospective tests is between a range of 80% and 125%, the hedge is effective; in the opposite case, the derivative is classified "for trading".

The changes in the fair value of the derivative are therefore recognized:

- through equity, if the test is effective (up to 100%). If the hedging relationship always remains effective, at the expiry of the transaction (maturity of the derivative and the loan) the equity reserve is used up without any impact on the income statement;
- through profit or loss, if the test is effective but for a value other than 100% for the fair value difference between 100% and the percentage resulting from the effectiveness test;
- fully through profit or loss, if the hedge is ineffective (below 80% or higher than 125%).

Quantitative information

Banking portfolio: notional amounts of hedging derivatives at year-end

Underlying assets/ Derivative type	Total 12/31/2016		Total 12/31/2015	
	Over the counter	Clearing house	Over the counter	Clearing house
1. Debt securities and interest rates	80,486			
a) Options				
b) Swaps	80,486			
c) Forwards				
d) Futures				
e) Other				
2. Equity securities and share indexes				
a) Options				
b) Swaps				
c) Forwards				
d) Futures				
e) Other				
3. Currencies and gold	75,233			
a) Options				
b) Swaps	75,233			
c) Forwards				
d) Futures				
e) Other				
4. Commodities				
5. Other underlyings				
Total	**155,719**			

The situation arising from the application of the interest rate management framework at December 31, 2016, reported below, points to a potential loss in the present value of cash flows, in the event of shock, equal to €9.3 million, equivalent to 3.9% on the risk index. The determination of internal capital makes references to the annual changes in interest rates recorded during an observation period of six years, considering alternatively the 1st percentile (reduction) or the 99th percentile (increase) and ensuring that rates are not negative.

Consolidated rate risk at December 31, 2016

Maturity	Assets	Liabilities	Delta	Market Shock	Weighted Value
On sight and upon revocation	638.4	194.7	443.7	0.00%	-
up to 1 month	201.9	2,028.4	- 1,826.5	0.01%	- 0.1
from more than 1 month to 3 months	465.8	436.8	28.9	0.03%	0.0
from more than 3 months to 6 months	1,147.6	721.3	426.3	0.08%	0.4
from more than 6 months to 12 months	839.3	526.8	312.6	0.22%	0.7
from more than 12 months to 24 months	544.3	102.1	442.2	0.20%	0.9
from more than 2 years to 3 years	186.8	126.5	60.3	0.72%	0.4
from more than 3 years to 4 years	147.0	10.3	136.8	1.22%	1.7
from more than 4 years to 5 years	281.9	197.3	84.6	1.69%	1.4
from more than 5 years to 7 years	83.5	-	83.5	2.37%	2.0
from more than 7 years to 10 years	10.6	-	10.6	3.23%	0.3
from more than 10 years to 15 years	16.3	-	16.3	4.40%	0.7
from more than 15 years to 20 years	0.0	-	0.0	18.51%	0.0
over 20 years	4.0	-	4.0	21.92%	0.9
	4,567.5	4,344.3			

TOTAL WEIGHTED VALUE (TWV)	**9.3**
OWN FUNDS AT 12/31/2015	***234.7***
RISK INDEX (TWV/OWN FUNDS)	**3.9%**

Section 13. Exposure to Securitization Positions (Art. 449 CRR)

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

Qualitative information

Strategies, processes and objectives

The securitization transaction with the Deutsche Bank Group was renewed for €85 million in August 2016. This transaction, which involves the non-recourse sale of receivables owed by Local Healthcare Entities and Hospital Companies, was carried out with the aim of diversifying funding activities.

Characteristics of the transaction

Pursuant to Law No. 130/99, the receivables were sold to an SPV, i.e., Farmafactoring SPV I S.r.l., which financed the purchase of the receivables by issuing securities for €85 million, underwritten by Deutsche Bank A.G..

The renewed structure, after an amortization period that ended on the note payment date of August 25, 2016 (which made it possible to reduce the amount of the securities issued from the original €150 million to the current €85 million), provides for a new revolving period valid until July 31, 2017, during which revolving sales will be made against collections of receivables to maintain the contractually stipulated collateralization ratio.

The late-payment interest collected by the SPV is paid to the Bank, based on available cash, when either the sale and/or requests for payment of the collections of receivables sold to the SPV are higher than the overcollateralization ratio established by contract.

At the end of the revolving period there will be a maximum two and a half years amortization period correlated to the performance of existing receivables collection during which the securities will be repaid.

Description of the risk profile

Banca Farmafactoring, as the originator, maintains a role in the securitization transaction, even though it sells the receivables on a non-recourse basis.

This transaction calls for a credit enhancement mechanism through an overcollateralization ratio (equal to 137.93% of the amount of the securities issued) and a subordinated loan carried by Banca Farmafactoring.

Following the renewal, the Bank as the assignor, and the SPV, as the issuer, could have:

(i) early terminated the revolving phase at any time up to the January 2017 payment date (by sending the relative communication by December 31, 2016) or, and only as regards the Bank,

(ii) terminate the program by buying back all the outstanding receivables by the January 2017 payment date during the revolving phase (by sending the relative communication by December 31, 2016), or at any time during the amortization period.

Neither solution provides for the payment of any consideration to the SPV. Consequently, the Bank may decide to start the amortization phase in relation to the repayment of the securities or directly repay the notes through the buyback of the remaining portfolio. To date, early termination has not been requested.
At the conclusion of the transaction, subsequent to the repayment of the securities and other senior transaction expenses, all the remaining amounts from the collection of the receivables sold, including late-payment interest, will belong to Banca Farmafactoring, in its capacity as underwriter of the subordinated loan.
Because of this condition, together with the Bank's right to buy back and/or substitute the receivables at any time, all of the risks and benefits of the transaction were not transferred to the assignee but remained with Banca Farmafactoring. Consequently, the securitization risk is included in the credit risk.

Quantitative information

Type of financial instrument held

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

Sub-servicer activity

Banca Farmafactoring, in its capacity as collection agent, handles receivables recovery and collection activities on behalf of the servicer Zenith Service S.p.A..
Following the sales of receivables made during the revolving phase of the transaction, the face amount of the outstanding receivables totaled about €140 million at December 31, 2016.

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

Types of securitized assets/Exposures	On-balance sheet exposure						Guarantees provided						Credit lines					
	Senior		Mezzanine		Junior		Senior		Mezzanine		Junior		Senior		Mezzanine		Junior	
	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.	Carrying amt.	Impair. loss/rev.
A. Full derecognition																		
B. Partial derecognition																		
C. Not derecognized	**30,923**	**153**																
C.1 Farmafactoring SPV I																		
- *Factoring*	30,923	153																

Section 14. Remuneration Policy (Art. 450 CRR)

Qualitative information

Remuneration policy definition

The remuneration and incentive policies of the Banca Farmafactoring Banking Group have been designed with the ultimate objective of achieving, in the interests of the stakeholders, remuneration schemes that are in line with the values, the strategies and the goals 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, more specifically, with levels of capital and liquidity necessary to manage business activities, such as to avoid distorted incentives that may serve as an inducement to commit violations of laws or the excessive assumption of risks for the Group.

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

i) The shareholders' meeting

Besides its legal responsibilities, as regards the remuneration policy, Banca Farmafactoring's by-laws state that the ordinary shareholders' meeting shall:

- decide the compensation to be paid to the Directors, Statutory Auditors and the independent auditors charged with the audit;
- approve the remuneration and incentive policies for the strategic supervision, management and control bodies, and also personnel;
- approve any remuneration plans based on financial instruments;
- approve the criteria for determining compensation in the case of early termination of employment or early resignation of the role held, including the limits fixed for such compensation in terms of multiples of annual fixed remuneration, and the maximum amount arising from their application;
- resolve, at the time of approval of the remuneration and incentive policies, on any proposal by the Board of Directors to set a limit to the ratio between the variable and fixed component of individual remuneration at higher than 1:1 – but, nevertheless not higher than two hundred percent –, as set out in the provisions of the Bank of Italy on the subject. This proposal is approved by the shareholders' meeting:
    - with a vote in favor of at least two-thirds of the capital represented at the shareholders' meeting duly convened with at least one-half the share capital, or, when that does not occur,
    - with a vote in favor of at least three-quarters of the capital represented in the shareholders' meeting, regardless of the capital with which the shareholders' meeting was convened;
- take note, at least annually, of the disclosure on the remuneration and incentive policies adopted by the Bank, and on their implementation in the manner established by supervisory regulations. This disclosure contains the same information on the remuneration and incentive practices provided to the public, as set out in provisions of Circular 285.

ii) 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, ensuring that such policy is adequately documented and can be accessed internally;

- defines the remuneration and incentive schemes for the Chief Executive Officer, the Executive Directors with specific roles, the Senior Executives, the Executives, and also, for the parent, those in charge of the corporate control functions of the parent. 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-term objectives, corporate governance structure and internal controls;
- defines, at Group level, the compensation for Executive Directors and, for the parent, the compensation for Directors with specific roles; defines, at Group level, the compensation and – as proposed by the Chief Executive Office – the annual targets, and the relative assessment of the: Senior Executives, Executives reporting directly to the Chief Executive Officer, those heading the corporate control functions of the parent, while ensuring observance of the law and the remuneration policy for the members of the strategic supervision, management and control bodies and, of the staff of the Banca Farmafactoring banking group.

iii) The Remuneration Committee
On January 25, 2013 the Board of Directors formed the Remuneration Committee, which acts in an advisory and proposing capacity to the Board of Directors in matters of staff remuneration and incentive policies. The Committee, composed of three non-executive members, two of whom are independent, is charged with formulating proposals for staff compensation, whose remuneration and incentive schemes are decided by the Board of Directors, and has a consulting role in matters of determining the criteria for compensation to all the most relevant staff.

In 2016, the Remuneration Committee held 14 meetings. The most important work regarded:
- reporting on the 2015 performance results relating to the Chief Executive Officer and the Executives of the Group for defining the MBOs within its competence;
- defining the 2016 quantitative objectives relating to the Chief Executive Officer and the Executives of the Group;
- defining the annual report on the remuneration and incentive schemes;
- analyzing and approving the remuneration packages for the hiring of new Executives;
- updating the remuneration and incentive policy for the members of the strategic supervision, management and control bodies, and staff of the Banca Farmafactoring Banking Group, as it refers to the acquisition of the Magellan Group and Banca Farmafactoring S.p.A.'s new qualification as an intermediate-class bank;
- review of the Non-competition Agreement in relation to existing legislation;
- approval of the Stock Option Plan, in advance, subject to the project for listing the company on the MTA.

iv) The Risk Committee
On July 24, 2014 the Board of Directors formed the Risk 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 operationally translate the provisions found in the policy.

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.

More specifically:
• 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 Internal Audit Function verifies at least annually the correspondence of the remuneration and incentive practices with the approved policies 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 Function: supports the identification of material risk takers, providing indications relating to the current and prospective risk profile in line with the ICAAP analysis, also on a consolidated basis;
• Organization, Systems and Personnel Department: 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'

Remuneration and incentive policies are based on a corporate role classification system consistent with the definition of 'material risk taker' as set out by the Group. More specifically, the Group has identified material risk takers according to an evaluation process – conducted by the Personnel Operating Unit, together with the Organization Operating Unit and Risk Management Function – performed on the basis of existing law, the internal regulation of the Group, the corporate procedures, the job description and the individual powers of attorney. As a result, considering the effective levels of autonomy and the impact of the various roles and their impact on the business, the following have been identified as material risk takers in 2016:
• Chief Executive Officer
• Head of Factoring Department
• Head of Finance and Credit Department
• Head of Planning, Administration and Control Department
• Head of Online Banking Department
• Head of Organization, Systems and Personnel Department
• Head of Credit Evaluation O.U.
• Head of Information and Communication Technologies O.U.
• Head of Personnel and General Services O.U.
• Head of Internal Audit Function
• Head of Risk Management Function
• Head of Compliance and AML Function

- Head of Commercial O.U.
- Head of Credit Management O.U.
- Head of Treasury O.U.
- General Manager of Farmafactoring España S.A.
- Member of the Management Board of Magellan S.A.
- Head of Credit Risk Evaluation at Magellan S.A.
- Chairman of the Management Board of Med Finance S.A.
- Member of the Management Board of Magellan Ceska Republika s.r.o.
- Member of the Management Board di Magellan Central Europe s.r.o.

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, in 2016, 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 remuneration because of 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 Group – 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 staff

Compensation for the remaining staff, 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 Collective Labor Agreement for management staff and for personnel in professional areas of the credit, financial and related institutions, and on the basis of the National Collective Labor Agreement for Executives of credit, financial and related institutions and similar collective labor agreements under Spanish legislation).

More specifically, risk takers 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 benefits package.
For the remaining personnel, each company of the Group may at its discretion offer benefits 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 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 the event of the early termination or the working relations 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 agreement

If an employee is a risk taker and a non-competition agreement is signed which obliges the person professionally not to accept 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 compensation 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 established by the supervisory provisions and, in any case, in accordance with the limits and directives laid down in applicable legislation.

Quantitative information

Compensation paid by the Group in 2016 for fixed and variable components of compensation to the various categories of recipients is as follows:

Position	No. of recipients (****)	Fixed compensation (*****)	Variable compensation earned in 2016	of which, Deferred portion (cash + financial instruments)	Deferred portion paid during 2016
A. Executive Directors or Directors with specific mandates (*)	1	780	697	209	-
B. Chairman of the Board with strategic supervision functions (*)	1	205	-	-	-
C. Other non-executive Directors (**)(***)	7	252	-	-	-
D. Statutory auditors	5	189	-	-	-
E. Heads of the principal line and staff structures	18	2,615	961	288	248
F. Heads of the Control Functions	4	650	103	31	63
Total	**36**	**4,691**	**1,761**	**528**	**310**

(*) Fixed compensation also includes compensation as a Director.
(**) The Chairman and the Chief Executive Officer of BFF are not counted as their compensation as a Director is included in fixed compensation (see line A and B).
(***) The compensation of the Chairman and internal Board Committees are included.
(****) Those who hold more than a one office are only counted once.
(*****) Fixed compensation includes benefits.

It should be noted that during 2016 there was only one case of compensation in excess of €1 million.

Section 15. Leverage (Art. 451 CRR)

Qualitative information

The leverage ratio introduced by Bank of Italy Circulars 285 "*Oversight provisions for banks*" and 286 "*Instructions for the preparation of regulatory reporting by banks and securities intermediaries*", 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 – CET1 capital, in order to avoid accounting for these assets twice.

The risk of excessive leverage is treated consistently with the rationale adopted for the RAF, by a current and prospective evaluation of the values assumed by the indicator, included in the set of indicators used by the Group to determine its capitalization 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	4,981,991
2	Adjustment for institutions consolidated for accounting purposes but excluded from regulatory consolidation	(993)
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	2,357
5	Adjustment for securities financing transactions (SFT)	800
6	Adjustment for off-balance sheet items (conversion to credit equivalent amounts of off-balance sheet exposures)	25,618
UE-6a	(Adjustment for intragroup exposures excluded from the leverage ratio exposure measure under Art. 429, paragraph 7, of Regulation (EU) 575/2013)	
UE-6b	(Adjustment for exposures excluded from the leverage ratio exposure measure under Art. 429, paragraph 14, of Regulation (EU) 575/2013)	
7	Other adjustments	(242,463)
8	***Misura dell'esposizione complessiva del coefficiente di leva finanziaria***	***4,767,310***

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)	4,979,538
2	(Assets deducted from the calculation of Tier 1 Capital)	(241,760)
3	**Total On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) (sum of lines 1 and 2)**	4,737,778
	Derivative exposures	
4	Replacement cost associated with all derivatives transactions (net of eligible cash variation margin)	1,557
5	Add-on amounts for potential future exposures associated with all derivatives transactions (mark-to-market method)	1,573
UE-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)**	3,130
	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	800
UE-14a	Derogation for SFTs: Counterparty credit risk exposure under Art. 429 ter, paragraph 4, and Art. 222 of Regulation (EU) 575/2013	
15	Agent transaction exposures	
UE-15a	(Exempted CCP component of client-cleared SFT trading exposures	
16	**Total Securities financing transactions (SFTs) exposures (sum of lines 12 to 15a)**	800
	Other off-balance sheet exposures	
17	Off-balance sheet exposures at gross notional amount	128,008
18	(Adjustments for conversion to credit equivalent amounts)	(102,406)
19	**Total Other off-balance sheet exposures (sum of lines 17 and 18)**	25,602
	((Exempted exposures under Art. 429, paragraphs 7 and 14, of Regulation (EU) 575/2013 (on- and off-balance sheet exposures))	
UE-19a	(Exemption of intragroup exposures (individual basis) under Art. 429, paragraph 7, of Regulation (EU) 575/2013 (on-and off- balance sheet))	
UE-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	233,093
21	Total leverage ratio exposure (sum of lines 3, 11, 16, 19, UE-19a and UE-19b)	4,767,310
	Leverage ratio	
22	**Leverage ratio**	4.889%
	Choice on transitional provisions and amount of derecognized fiduciary items	
UE-23	Choice on transitional provisions for the definition of the capital increase	
UE-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)
UE-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures) of which:	4,737,778
UE-2	Trading book exposures	
UE-3	Banking book exposures, of which:	4,737,778
UE-4	covered bonds	
UE-5	exposures treated as sovereign issuers	2,484,393
UE-6	exposures to regional governments, multilateral development banks, international organizations and public sector entities not treated as sovereign issuers	1,747,866
UE-7	institutions	228,150
UE-8	secured by mortgages of immovable properties	
UE-9	retail exposures	79,623
UE-10	companies	114,238
UE-11	exposures in default	61,845
UE-12	other exposures (e.g. equity instruments, securitizations, and other non-credit assets)	21,663

ideogramma.it

20149 Milan
Via Domenichino, 5
T +39 02 49905.1
F +39 02 4818157

00197 Rome
Via Bertoloni, 1/E int. F
T +39 06 809139.1
F +39 06 809139.41

info-it@bffgroup.com
bffgroup.com