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**BANCA MONTE DEI PASCHI DI SIENA S.P.A.**

SHAREHOLDERS' MEETING

18 December 2017 (on single call)

EXPLANATORY REPORT BY THE BOARD OF DIRECTORS

CONCERNING ITEM 1) ON THE AGENDA - Extraordinary Session

drawn up pursuant to article 125-*ter* of Legislative Decree no. 58 of 24 February 1998, as subsequently amended and supplemented, and Articles 72 and 74 of the Regulation adopted by Consob by resolution no. 11971 of 14 May 1999, as subsequently amended.

## ITEM 1 ON THE AGENDA OF THE EXTRAORDINARY SHAREHOLDERS MEETING

REPORT OF THE BOARD OF DIRECTORS PURSUANT TO ARTICLE 125-TER OF LEGISLATIVE DECREE NO. 58 24 FEBRUARY 1998 AND TO ARTICLES 72 AND 74 OF THE REGULATIONS ADOPTED BY CONSOB WITH RESOLUTION NO. 11971 OF 14 MAY 1999, AS SUBSEQUENTLY AMENDED

Dear Shareholders,

The Board of Directors of Banca Monte dei Paschi di Siena S.p.A. (hereinafter the “**Bank**” or the “**Company**” or “**BMPS**”) has called you, *inter alia*, to an Extraordinary Meeting in Siena, Viale Mazzini 23, on 18 December 2017 at 9:30 a.m., on a single call, to discuss and resolve upon the following item on the agenda of the extraordinary meeting:

**1) “Measures pursuant to Article 2446 of the Italian Civil Code: proposed share capital reduction due to losses: resolutions pertaining thereto and resulting therefrom”.**

This explanatory report of the Board of Directors (the “**Report**”) has been drawn up pursuant to article 125-ter of Legislative Decree no. 58/98 (the “**Consolidated Finance Act**” or the “**CFA**”) and pursuant to articles 72 and 74 of the Regulation adopted by Consob resolution no. 11971 of 14 May 1999, as subsequently amended (the “**Issuers' Regulations**”), in accordance with the guidelines contained in Attachment 3A of the Issuers' Regulations.

The purpose of this Report is to illustrate: (i) the capital, economic and financial position of Banca Monte dei Paschi di Siena S.p.A. (the “**Company**” or “**BMPS**”) as at 30 September 2017, as approved by the Board of Directors on 7 November 2017 (the “**Capital Position**”) and (ii) the proposal of the Board of Directors to the Shareholders' Meeting regarding the adoption of appropriate measures following losses that have reduced share capital by more than one third.

## 1. Balance Sheet and Income Statement as at 30 September 2017

### 1.1 Balance Sheet as at 30 September 2017

Please refer to the balance sheet as at 30 September 2017 included in the Interim Financial Statements attached to this Report.

### 1.2 Income Statement as at 30 September 2017

Please find below the income statement of the Bank as at 30 September 2017 included in the Interim Financial Statements attached to this Report.

(in units of Eur)			
Items	30 09 2017	30 09 2016	
10 Interest income and similar revenues	1,997,659,079	2,438,536,956	
20 Interest expense and similar charges	(756,950,562)	(1,120,027,891)	
<b>30 Net interest income</b>	<b>1,240,708,517</b>	<b>1,318,509,065</b>	
40 Fee and commission income	1,381,518,140	1,545,655,474	
50 Fee and commission expense	(195,070,214)	(165,797,654)	
<b>60 Net fee and commission income</b>	<b>1,186,447,926</b>	<b>1,379,857,820</b>	
70 Dividends and similar income	32,096,396	67,264,364	
80 Net profit (loss) from trading	3,847,159	30,946,891	
90 Net profit (loss) from hedging	(18,415,000)	(18,007,992)	
100 Gains/(losses) on disposal/repurchase of:	610,278,250	154,083,926	
<i>a) loans</i>	<i>(6,462,277)</i>	<i>(2,538,187)</i>	
<i>b) financial assets available for sale</i>	<i>61,625,266</i>	<i>108,773,339</i>	
<i>d) financial liabilities</i>	<i>555,115,261</i>	<i>47,848,774</i>	
110 Net profit (loss) from financial assets and liabilities designated at fair value	3,083,890	137,596,314	
<b>120 Net interest and other banking income</b>	<b>3,058,047,138</b>	<b>3,070,250,388</b>	
130 Net impairment (losses)/reversals on	(4,073,236,364)	(1,792,131,260)	
<i>a) loans</i>	<i>(3,933,256,843)</i>	<i>(1,796,768,383)</i>	
<i>b) financial assets available for sale</i>	<i>(62,147,082)</i>	<i>(16,196,685)</i>	
<i>d) other financial transactions</i>	<i>(77,832,439)</i>	<i>20,833,808</i>	
<b>140 Net income from banking activities</b>	<b>(1,015,189,226)</b>	<b>1,278,119,128</b>	
150 Administrative expenses:	(2,411,054,103)	(2,276,296,556)	
<i>a) personnel expenses</i>	<i>(1,363,315,225)</i>	<i>(1,136,459,458)</i>	
<i>b) other administrative expenses</i>	<i>(1,047,738,878)</i>	<i>(1,139,837,098)</i>	
160 Net provisions for risks and charges	(61,559,168)	(374,622)	
170 Net adjustments to/recoveries on property, plant and equipment	(50,771,862)	(39,318,019)	
180 Net adjustments to/recoveries on intangible assets	(19,599,670)	(20,830,957)	
190 Other operating expenses/income	247,920,991	290,361,366	
<b>200 Operating expenses</b>	<b>(2,295,063,812)</b>	<b>(2,046,458,788)</b>	
210 Gains (losses) on investments	(111,766,539)	(583,102,348)	
240 Gains (losses) on disposal of investments	524,553,928	12,827,331	
<b>250 Profit (loss) before tax from continuing operations</b>	<b>(2,897,465,649)</b>	<b>(1,338,614,677)</b>	
260 Tax (expense)/recovery on income from continuing operations	391,434,726	(60,105,528)	
<b>270 Profit (loss) after tax from continuing operations</b>	<b>(2,506,030,923)</b>	<b>(1,398,720,205)</b>	
<b>290 Profit (loss)</b>	<b>(2,506,030,923)</b>	<b>(1,398,720,205)</b>	

The Bank's Total Banking Income amounted to EUR 3,058M, in line with the same period of the previous year, with a decrease in Net Interest Income and Net Fees and Commissions, largely offset by the increase in item 100 "Gains(losses) on disposals/repurchases" (impacted by the positive effects of burden sharing). The trend in Total Banking Income was influenced by Net Interest Income, amounting to approximately EUR 1,241M (-5.9% Y/Y), which was largely affected by the negative performance of interest-bearing assets, particularly loans to customers (decline in average volumes and fall in returns), whose performance was only partly mitigated by the decrease in interest expense following the lower cost of funding, the maturity of more expensive bonds and the effects of burden sharing. Net Fees and Commissions as at 30 September 2017, amounting to approximately EUR 1,186M, were down 14% compared to the same period of the previous year, having been largely affected by the cost of collateral on government bonds and by the sale of the merchant acquiring unit on 1 July 2017. Item 100 "Gains (losses) on disposals/repurchases" in the first nine months of the year totalled approximately EUR 610M (including effects from the burden sharing transaction), higher than the previous year.

Net impairment losses on loans, financial assets and other transactions amounted to approximately EUR 4,073M, up EUR 2,281M from those registered in the same period of the previous year. These include i) net provisions booked since the start of the year on loans subject to disposal following the adjustment to their realizable value (already booked as at 30 June 2017), ii) the write-down of certain shareholdings, including Atlante, and iii) the full write-off the stake held in the Voluntary Scheme in addition to the partial write-down of the Bank's irrevocable commitments towards the Voluntary Scheme - Caricesena/Carim/Carismi (registered in 3Q17).

Operating Costs amounted to EUR 2,295M (+12.1% Y/Y). Personnel expenses, which came to EUR 1,363M, registered a year-on-year growth of 20%, largely owing to the provisions recognized for the early-retirement scheme/funds (agreement signed on 3 August for 1,200 resources), net of which there would be a decrease resulting from both the reduction in headcount (primarily due to the exit of approx. 600 resources through the Solidarity Fund on 1 May 2017) and lower provisions on the variable component in 2017

compared with the same period in the previous year . Other administrative expenses in the first nine months of 2017 amounted to approximately 1,048M, down 8.1% year-on-year primarily as a result of the lower impact from DTA fees as well as the structural cost containment measures implemented in the first nine months of the years. Net value adjustments to tangible and intangible assets were in the region of EUR 70M, up from values registered for the same period in the previous year due to the higher impairment losses recognized on tangible assets up to 30 September 2017 (impairment on land and buildings totalling approximately EUR 12M).

As a result of the P&L aggregates referred to above and taking also account of the capital gain realized from the sale of the merchant acquiring unit to CartaSi (registered in June 2017 under the item “Gains on disposal of investments”), as well as the partial reassessment of DTAs from tax losses accrued and not accounted for in previous years, prompted by recent regulatory measures which have reduced the ACE benefit (see Article 7 of Decree Law no. 50 of 24 April 2017), the Bank registered a loss of approximately EUR 2,06M as at 30 September 2017 against a negative result of around EUR 1,399M in the same period in 2016.

Taking also account of the losses carried forward with the approval of the financial statements as at 31 December 2016, amounting to approximately EUR 2,324M, as well as the other adjustments posted to shareholders' equity under applicable accounting regulations (mainly the application of IFRIC 19 to the conversion of subordinated bonds and the early application of IFRS 9 limited only to the treatment of the credit standing of financial liabilities utilising the fair value option) for approximately EUR 534M, total losses as at 30 September 2017 amounted to approximately EUR 5,364M. It should also be noted that, at present, the Bank does not have any reserves available to cover these losses.

## **2. Other financial information as at 30 September 2017**

Please refer to the consolidated interim report of the Monte dei Paschi di Siena Group as at 30 September 2017 (the “**Interim Report**”) and to the liquidity ratios included therein.

The Report is available on the Bank's website at [www.gruppomps.it](http://www.gruppomps.it), under section "Investor Relations – Financial Results".

### **3. Proposed measures to cover the losses**

As shown in the income statement as at 30 September 2017 (please refer to Section 1.2 above), the Bank registered a loss for the period of EUR 2,506,030,922.68. In addition, EUR 2,324,050,500.90 in losses were carried forward with the approval of the financial statements for the financial year ending 31 December 2016 and other adjustments of EUR 534,099,667.25 were posted directly to shareholders' equity.

The combined effect of the loss for the period and the losses carried forward results in a total loss as at 30 September 2017 of EUR 5,364,181,090.83. The Board proposes this be fully deducted from share capital since the Company does not currently have any reserves available to cover the loss.

### **4. Actions the Bank intends to take to achieve operational turnaround and continue as a going concern**

#### *4.1 Operational turnaround*

The Restructuring Plan approved on 4 July by the European Commission aims for the Bank's and the Group's return to an adequate level of profitability with a target ROE of >10% in 2021. The Plan is based on the following 4 pillars:

1. full leveraging of Retail and Small Business customers thanks to a new, simplified and highly digitized business model;
2. renewed operating model, with a continuous focus on efficiency, which will result in a cost/income ratio of below 51% in 2021 and the reallocation to commercial activities of resources employed in the administrative area;
3. radically improved credit risk management, with a new Chief Lending Officer ("CLO") organizational structure that will make it possible to strengthen the Bank's

early detection processes and improve the recovery rate, and which will bring the cost of risk to below 60 bps and the gross NPE ratio to below 13% in 2021;

4. strengthened capital and liquidity position, with targets at 2021 that include a CET1 of >14%, a Loan to Deposit Ratio of <90% and a Liquidity Coverage Ratio (LCR) of >150% with, at the same time, a significant decrease in the cost of funding.

The Restructuring Plan includes the transfer of almost the entire doubtful loans portfolio as at 31 December 2016 for a gross value of EUR 28.6 billion.

In particular, the Restructuring Plan is consistent with and reflects the commitments undertaken with DG Comp (the “Commitments”) and is aligned with the parameters of the 2017 SREP Decision received in June 2017. In this letter, received on 19 June 2017, the ECB required the Bank to maintain a Total SREP Capital Requirement ratio of 11% at consolidated level as of 2018, which includes a minimum Pillar 1 requirement of 8% and an additional Pillar 2 requirement of 3% (P2R), entirely in terms of Common Equity Tier 1 capital.

As a result, the Bank must meet the following requirements at consolidated level as of 1 January 2018:

- CET1 Ratio of 9.44% on a transitional basis
- Total Capital Ratio of 12.94% on a transitional basis.

The revival of the commercial business will focus on Retail and Small Business customers, using a more simplified service model characterized by a high level of digitization with the launch of dedicated services e.g. (home purchasing, risk coverage, business requirements). It will also leverage the distinctive elements of Widiba to attract new customers and optimize the management of existing customers. There will be a new Small Business customer service model based on a simplified offer and a constant focus on the provision of loans as well as associated risks. Greater attention will be placed on the Affluent and Private Banking segments, by leveraging the offer of insurance and wealth management products, as well as advisory services, with the aim of obtaining significant growth in assets under management (through the bancassurance agreement

with AXA in the Life and Non-Life segments and the continuation of the collaboration with Anima in the investment funds segment).

The contribution of Widiba will be further leveraged as a vehicle for digitisation and innovation, through the extension to the Group of technological and automation solutions for certain processes, enabling the Group to benefit from an overall reduction in the cost-to-serve.

Corporate segment activities will be streamlined as a result of the revised business model and the optimization of capital absorption.

The new operating model will focus on greater efficiency, continuing on the path outlined since 2012, through:

- the launch of a Group digital programme which, thanks to technological infrastructural investments and the leveraging of the capacities developed by Widiba, will make it possible to reduce the absorption of resources (on “manual” processes, from 34% in 2016 to less than 20% in 2021);
- the complete overhaul of the distribution network, with a downsizing of branches (from 2,000 in 2016 to around 1,400 in 2021) and the relative commercial governance structures (Regional Areas and Local Market Units) and with growth in the percentage of resources dedicated to commercial activities from around 62% in 2016 to around 70% in 2021;
- a revision of the size of all of the Group’s organizational structures which, without impairing service quality, will result in a reduction of roughly 5,500 resources by the end of 2021 (of which 4,800 exits through the activation of the Solidarity Fund, 450 exits linked to the termination/closure of business activities, 750 exits deriving from natural turnover and roughly 500 new hires); the exit plan will result in one-off costs of around EUR 1.15 bn overall over the course of the plan;
- the further optimization of other administrative expenses, which will drop by 26% (from around EUR 0.8 bn in 2016 to less than EUR 0.6 bn in 2021) and will rank the Bank as one of the best sector operators in terms of cost management and optimization.



In line with what has already been implemented in recent years to improve credit quality and the credit risk management process, the Restructuring Plan envisages the:

- full reorganization of the CLO, with the centralization of lending decision-making mechanisms and the creation of direct links with the Regional Area governance structures, a strong push towards the automation of the lending process for smaller amounts for Retail and Small Business which in 2021 will result in an increase in the automated disbursement process to 70% for Retail and to 50% for the Small Business segment;
- enhancement of systems for the early detection and monitoring of at-risk positions, which will allow for a reduction of the default rate and growth in the recovery rate of past due exposures;
- the creation of a business unit within the CLO dedicated to the management of the non-performing loan portfolio, which will handle early remedial actions/restructuring, the control of the activities and performance of the debt collection platform, as well as recovery activities relating to new streams of doubtful loans not channeled to the platform;
- a specific plan to sell/reduce the unlikely-to-pay and doubtful loans portfolio, the P&L impact of which are included in the Restructuring Plan, in order to achieve the NPE ratio targets.

The Restructuring Plan envisages an overall capital increase of more than EUR 8BN, completed last August.

The capital increase, the partial voluntary public exchange offer and transaction – addressed to the holders of ordinary shares of the Bank (code ISIN IT0005276776) deriving from the conversion of subordinated bonds “Upper Tier II 2008 - 2018” (IT0004352586) – as well as the deconsolidation of the doubtful loans portfolio, expected in the first half of 2018, will have positive impacts on the main regulatory liquidity ratios, with the Liquidity Coverage Ratio and the Net Stable Funding Ratio considerably above the target level of 100% over the entire term of the plan.

On the commercial side, the Loan to Deposit ratio is expected to improve by roughly 16 percentage points (from 103% in 2016 to 87% in 2021) as a result of the growth in the level of funding coming from the network and the expected reduction in gross trade receivables. As a result of the share capital increase and the transfer of doubtful loans, a reduction in the cost of funding is also expected over the course of the plan, with a realignment to average market parameters.

The Group is expected to reach a CET1 ratio of >14% and an ROE of >10% in 2021.

The Restructuring Plan is consistent with the Commitments undertaken with DG Comp, pursuant to European regulations and regarding different aspects of the plan, including:

- cost reduction measures: annual restrictions in terms of the number of branches, employees, cost/income ratio and total operating expenses, reduction of additional costs up to a maximum of EUR 100M in the case of a deviation from the net operating margin targets (gross of provisions on loans);
- sale of non-strategic assets: sale of foreign banks, disposal of a list of equity investments over the course of the plan, without prejudice to the capital position of the Bank, and part of the real estate assets;
- risk containment: commitment to deconsolidate a portfolio of doubtful loans of EUR 26.1BN, strengthening of risk control oversight, restrictions on proprietary finance activities in terms of VaR and the nature of instruments traded;
- ban on acquisitions;
- the establishment of a remuneration ceiling corresponding to 10 times the average salary of BMPS employees

#### *4.2 Going concern*

In assessing the ability of the Group to continue to operate as a going concern, particular importance was placed on the following:

- approval of the Restructuring Plan by the European Commission on 4 July 2017;
- conversion of AT1 and T2 instruments into ordinary shares of the Parent Company in compliance with Article 23, paragraph 3 of Decree 237 and Article 2 of the

Burden Sharing Decree and capital increase of the Parent Company with subscription of capital by the Ministry of Economy and Finance for a value of EUR 4,473M and EUR 3,854M respectively, both of which were completed on 11 August 2017;

- return of capital ratios to above the SREP thresholds currently in force and those established for 2018.

As regards the liquidity position, after the significant deterioration in 2016, the Bank requested and obtained the State guarantee on financial liabilities to be issued for a total of EUR 15 bn (for a maximum duration of three years). To date, the Parent Company has carried out three issues of government-backed securities for a total of EUR 11 bn, which were used in full in sales transactions in the market and as collateral to back funding transactions. As a result of these transactions, the recovery of commercial funding and the financial contribution from the capital increase subscribed by the MEF, the liquidity indicators returned to ordinary levels.

For these reasons, the Bank can reasonably expect to continue operating in the foreseeable future.

#### 5. Amendment to Article 6 of the Articles of Association

Please find below the proposed amendment to Article 6, paragraph 1 of the Articles of Associations (referring to paragraph 2) on the Agenda of the Extraordinary session for additional amendments to the Articles of Association).

CURRENT VERSION	PROPOSED VERSION
<b>Article 6</b>	<b>Article 6</b>
1. The Company's share capital amounts to EUR 15,692,799,350.97 (fifteen billion six hundred and ninety two million seven hundred and ninety nine thousand three hundred and fifty point ninety seven) and is fully paid up.	1. The Company's share capital amounts to <b>EUR 10,328,618,260.14 (ten billion three hundred and twenty eight million six hundred and eighteen thousand two hundred and sixty point fourteen)</b> and is fully paid up.

#### 6. Clearance from authorities

The proposed transaction will be subject to the clearances required by law.

## 7. Assessments regarding the right of withdrawal

The resolution proposed in this Report will not trigger the Shareholders' right of withdrawal pursuant to Article 2437 of the Italian Civil Code..

## 8. Proposed resolution

In light of the foregoing, the Board of Directors proposes to adopt the following resolution:

### Item 1. on the agenda - Extraordinary Session:

*“The Extraordinary Shareholders' Meeting of Monte dei Paschi di Siena S.p.A., convened on a single call on 18 December 2017:*

- *given the Company's financial statements as at 30 September 2017, attached to the report of the Board of Directors;*
- *having acknowledged the overall loss of EUR 5,364,181,090.83;*
- *having considered the Board of Director's explanatory report drawn up pursuant to Article 72 of the Issuers' Regulations;*
- *having taken account of the considerations expressed by the Board of Statutory Auditors;*

### RESOLVES

- 1) *to approve the financial statements as at 30 September 2017, which register a loss for the period of EUR 2,506,030,922.68;*
- 2) *taking account of:*
  - (a) the financial statements as at 30 September 2017 and the resulting loss for the period of EUR 2,506,030,922.68,*
  - (b) the other adjustments of EUR 534,099,667.25 posted directly to shareholders' equity under applicable accounting regulations, as well as*
  - (c) the previous losses of EUR 2,324,050,500.90 (carried forward by resolution of the*

*shareholders' meeting of 12 April 2017,*

*to approve the coverage of the total loss of EUR 5,364,181,090.83 by reducing the share capital by the same amount, thereby bringing the share capital to EUR 10,328,618,260.14 (ten billion three hundred and twenty eight million six hundred and eighteen thousand two hundred and sixty point fourteen), with no cancellation of shares, since they have no par value, thus reducing the implicit par value in accounting terms of each share, defined as the quotient obtained by dividing the share capital amount by the number of shares, the number of which remains unchanged, with the consequent amendment to the first paragraph of art. 6 of the articles of association as set out below;*

- 3) *to approve the subsequent amendments to Article 6 of the Articles of Association to the wording reported below:*

*“1. The Company's share capital amounts to EUR 10,328,618,260.14 (ten billion three hundred and twenty eight million six hundred and eighteen thousand two hundred and sixty point fourteen) and is fully paid up.”*

- 4) *to grant the Board of Directors, and through it its Chairman and Managing Director in office pro tempore, jointly or severally and having the power to appoint special attorneys to this end, with any and all powers necessary or appropriate to implement the resolutions approved, exercising all powers necessary and expedient for this purpose, without exception, including the power to introduce any amendments, additions or suppressions that are not substantial but deemed as necessary or appropriate, as required by any competent authority or to file the Articles of Association in the Companies' Register as a representative of the Bank, with all powers necessary and expedient for this purpose, and all with promise of ratification and approval as of now.”*

Siena, 7 November 2017

For the Board of Directors  
Mr. Alessandro Falciai  
Chairman of the Board of Directors



*English translation for courtesy purposes only. In case of discrepancies between the Italian version and the English version, the Italian version shall prevail.*

**FINANCIAL STATEMENTS  
AS AT 30 SEPTEMBER 2017  
OF THE PARENT COMPANY  
BANCA MONTE DEI PASCHI DI SIENA S.P.A.**



Banca Monte dei Paschi di Siena S.p.a.

Share Capital: € 15,692,799,350.97 fully paid in

Siena Companies' Register no. and tax code 00884060526

Member of the Italian Interbank Deposit Protection Fund. Banks Register no. 5274.

Monte dei Paschi di Siena Banking Group, registered with the Banking Groups Register





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## FINANCIAL STATEMENTS AS AT 30 SEPTEMBER 2017

### Balance Sheet

		(in units of Eur)	
Assets		30 09 2017	31 12 2016
10	Cash and cash equivalents	813,767,576	1,069,604,797
20	Financial assets held for trading	987,563,116	1,417,381,341
40	Financial assets available for sale	14,835,155,651	16,273,985,792
60	Loans to banks	30,311,513,637	31,708,835,207
70	Loans to customers	75,032,989,205	85,043,670,980
80	Hedging derivatives	353,286,759	546,173,395
90	Change in value of macro-hedged financial assets (+/-)	23,337,697	111,645,893
100	Equity investments	1,861,949,748	1,942,743,006
110	Property, plant and equipment	999,330,158	1,031,921,236
120	Intangible assets	44,891,093	64,456,915
130	Tax assets	3,287,076,698	3,446,577,770
	<i>a) current</i>	<i>736,875,440</i>	<i>587,310,898</i>
	<i>b) deferred</i>	<i>2,550,201,258</i>	<i>2,859,266,872</i>
	<i>under Law 214/2011</i>	<i>1,155,084,795</i>	<i>2,019,633,025</i>
140	Non-current assets and groups of assets held for sale and discontinued operations	3,738,269,368	55,354,748
150	Other assets	1,965,499,852	1,775,856,746
	<b>Total Assets</b>	<b>134,254,630,558</b>	<b>144,488,207,826</b>



*continued:* **Balance Sheet**

	(in units of Eur)	
<b>Liabilities and Shareholders' Equity</b>	<b>30 09 2017</b>	<b>31 12 2016</b>
10 Deposits from banks	27,828,049,672	40,787,367,059
20 Deposits from customers	69,893,370,046	69,362,614,525
30 Debt securities issued	19,009,221,252	20,981,531,607
40 Financial liabilities held for trading	884,350,417	1,296,325,838
50 Financial liabilities designated at fair value	1,122,001,913	1,696,690,399
60 Hedging derivatives	797,409,689	1,206,200,053
70 Change in value of macro-hedging financial liabilities (+/-)	(153,376)	-
80 Tax liabilities	5,305,095	5,266,400
<i>a) current</i>	<i>5,305,095</i>	<i>5,266,400</i>
90 Liabilities associated with non-current assets held for sale and discontinued operations	-	10,402,474
100 Other liabilities	3,619,240,896	3,132,754,853
110 Provision for employee severance pay	227,482,910	245,263,981
120 Provisions for risks and charges:	893,338,978	996,511,563
<i>a) post-employment benefits</i>	<i>39,905,821</i>	<i>47,232,013</i>
<i>b) other provisions</i>	<i>853,433,157</i>	<i>949,279,550</i>
130 Valuation reserves	(91,647,200)	(198,344,475)
160 Reserves	(2,934,150,168)	1,322,720,205
180 Share capital	15,692,799,351	7,365,674,050
190 Treasury shares (-)	(185,957,994)	-
200 Profit (loss) (+/-)	(2,506,030,923)	(3,722,770,706)
<b>Total Liabilities and Shareholders' Equity</b>	<b>134,254,630,558</b>	<b>144,488,207,826</b>



## Income statement

(in units of Eur)		
Items	30 09 2017	30 09 2016
10 Interest income and similar revenues	1,997,659,079	2,438,536,956
20 Interest expense and similar charges	(756,950,562)	(1,120,027,891)
<b>30 Net interest income</b>	<b>1,240,708,517</b>	<b>1,318,509,065</b>
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90 Net profit (loss) from hedging	(18,415,000)	(18,007,992)
100 Gains/(losses) on disposal/repurchase of:	610,278,250	154,083,926
<i>a) loans</i>	<i>(6,462,277)</i>	<i>(2,538,187)</i>
<i>b) financial assets available for sale</i>	<i>61,625,266</i>	<i>108,773,339</i>
<i>d) financial liabilities</i>	<i>555,115,261</i>	<i>47,848,774</i>
110 Net profit (loss) from financial assets and liabilities designated at fair value	3,083,890	137,596,314
<b>120 Net interest and other banking income</b>	<b>3,058,047,138</b>	<b>3,070,250,388</b>
130 Net impairment (losses)/reversals on	(4,073,236,364)	(1,792,131,260)
<i>a) loans</i>	<i>(3,933,256,843)</i>	<i>(1,796,768,383)</i>
<i>b) financial assets available for sale</i>	<i>(62,147,082)</i>	<i>(16,196,685)</i>
<i>d) other financial transactions</i>	<i>(77,832,439)</i>	<i>20,833,808</i>
<b>140 Net income from banking activities</b>	<b>(1,015,189,226)</b>	<b>1,278,119,128</b>
150 Administrative expenses:	(2,411,054,103)	(2,276,296,556)
<i>a) personnel expenses</i>	<i>(1,363,315,225)</i>	<i>(1,136,459,458)</i>
<i>b) other administrative expenses</i>	<i>(1,047,738,878)</i>	<i>(1,139,837,098)</i>
160 Net provisions for risks and charges	(61,559,168)	(374,622)
170 Net adjustments to/recoveries on property, plant and equipment	(50,771,862)	(39,318,019)
180 Net adjustments to/recoveries on intangible assets	(19,599,670)	(20,830,957)
190 Other operating expenses/income	247,920,991	290,361,366
<b>200 Operating expenses</b>	<b>(2,295,063,812)</b>	<b>(2,046,458,788)</b>
210 Gains (losses) on investments	(111,766,539)	(583,102,348)
240 Gains (losses) on disposal of investments	524,553,928	12,827,331
<b>250 Profit (loss) before tax from continuing operations</b>	<b>(2,897,465,649)</b>	<b>(1,338,614,677)</b>
260 Tax (expense)/recovery on income from continuing operations	391,434,726	(60,105,528)
<b>270 Profit (loss) after tax from continuing operations</b>	<b>(2,506,030,923)</b>	<b>(1,398,720,205)</b>
<b>290 Profit (loss)</b>	<b>(2,506,030,923)</b>	<b>(1,398,720,205)</b>



## Statement of Comprehensive Income

		(in units of Eur)	
Items	30 09 2017	30 09 2016	
10 Profit (loss)	(2,506,030,923)	(1,398,720,205)	
<b>Other comprehensive income after tax not recycled to profit and loss</b>		<b>(157,024,038)</b>	<b>(4,883,200)</b>
40 Actuarial gains (losses) on defined benefit plans	3,778,635	(4,883,200)	
50 Non current assets held for sale	82,882	-	
* Financial liabilities measured at fair value with impact to profit and loss	(160,885,555)	-	
<b>Other comprehensive income after tax recycled to profit and loss</b>		<b>57,931,277</b>	<b>(49,723,267)</b>
80 Exchange differences	(5,330,595)	(1,946,912)	
90 Cash flow hedges	14,918,188	34,420,452	
100 Financial assets available for sale	63,668,992	(62,555,455)	
110 Non current assets held for sale	(15,325,308)	(19,641,352)	
<b>130 Total other comprehensive income after tax</b>	<b>(99,092,761)</b>	<b>(54,606,467)</b>	
<b>140 Total comprehensive income (Item 10+130)</b>	<b>(2,605,123,684)</b>	<b>(1,453,326,672)</b>	

\* Item added to the table following the partial early application of IFRS 9 limited to the recognition of changes in own creditworthiness on fair value option liabilities.



## Statement of Changes in Equity as at 30 September 2017

(in units of Euro)

	Balance as at 31 12 2016	Change in opening balances*	Balance as at 01 01 2017	Allocation of profit from prior year		Changes during the period							Total Equity as at 30 09 2017
				Reserves	Dividends and other payout	Changes in reserves	Shareholders' equity transactions				Total comprehensive income as at 30 09 2017		
							Issue of new share	Purchase of treasury shares	Extraordinary distribution of dividends	Change in equity instruments		Treasury shares derivatives	
Share capital:	7,365,674,050	-	7,365,674,050	-	-	-	8,327,125,301	-	-	-	-	-	15,692,799,351
a) ordinary shares	7,365,674,050	-	7,365,674,050	-	-	-	8,327,125,301	-	-	-	-	-	15,692,799,351
b) other shares	-	-	-	-	-	-	-	-	-	-	-	-	-
Share premium	-	-	-	-	-	-	-	-	-	-	-	-	-
Reserves:	1,322,720,205	(205,790,035)	1,116,930,170	(3,722,770,706)	-	(328,309,632)	-	-	-	-	-	-	(2,934,150,168)
a) from profits	-	(205,790,035)	(205,790,035)	(2,324,050,501)	-	(327,190,008)	-	-	-	-	-	-	(2,857,030,544)
b) other	1,322,720,205	-	1,322,720,205	(1,398,720,205)	-	(1,119,624)	-	-	-	-	-	-	(77,119,624)
Valuation reserves	(198,344,475)	205,790,035	7,445,560	-	-	-	-	-	-	-	-	(99,092,761)	(91,647,201)
Equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-
Treasury shares	-	-	-	-	-	-	(185,957,994)	-	-	-	-	-	(185,957,994)
Net profit (loss)	(3,722,770,706)	-	(3,722,770,706)	3,722,770,706	-	-	-	-	-	-	-	(2,506,030,923)	(2,506,030,923)
<b>Total equity</b>	<b>4,767,279,074</b>	<b>-</b>	<b>4,767,279,074</b>	<b>-</b>	<b>(328,309,632)</b>	<b>8,141,167,307</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(2,605,123,684)</b>	<b>-</b>	<b>9,975,013,066</b>	

\* The column "Change in opening balances" reflects the impacts of the early application of IFRS 9 with regard to the presentation of profits and losses on fair value option financial liabilities attributable to changes in own creditworthiness.

## Statement of Changes in Equity as at 30 September 2016

(in units of Eur)

	Balance as at 31 12 2015	Change in opening balances	Balance as at 01 01 2016	Allocation of profit from prior year	Changes during the period	Total comprehensive income as at 30 09 2016	Total Equity as at 30 09 2016
Share capital:	9,001,756,821	-	9,001,756,821	-	-	-	9,001,756,821
a) ordinary shares	9,001,756,821	-	9,001,756,821	-	-	-	9,001,756,821
b) other shares	-	-	-	-	-	-	-
Share premium	6,325,105	-	6,325,105	(6,325,105)	-	-	-
Reserves:	(736,320,326)	-	(736,320,326)	422,957,761	-	-	(313,362,565)
a) from profits	(619,232,917)	-	(619,232,917)	381,870,352	-	-	(237,362,565)
b) other	(117,087,409)	-	(117,087,409)	41,087,409	-	-	(76,000,000)
Valuation reserves	(173,401,127)	-	(173,401,127)	-	-	(54,606,467)	(228,007,594)
Equity instruments	-	-	-	-	-	-	-
Treasury shares	-	-	-	-	-	-	-
Net profit (loss)	416,632,656	-	416,632,656	(416,632,656)	-	(1,398,720,205)	(1,398,720,205)
<b>Total equity</b>	<b>8,514,993,129</b>	<b>-</b>	<b>8,514,993,129</b>	<b>-</b>	<b>-</b>	<b>(1,453,326,672)</b>	<b>7,061,666,457</b>



## EXPLANATORY NOTES



## Accounting Policies

### Statement of compliance with international accounting standards

The financial statements of Banca Monte dei Paschi di Siena as at 30 September 2017 were prepared in accordance with the IAS/IFRS international accounting standards issued by the International Accounting Standards Board (IASB) including interpretations by the IFRS Interpretations Committee, as endorsed by the European Commission and effective at the time this report was prepared, pursuant to EC Regulation no. 1606 of 19 July 2002.

The international accounting standards were applied following the indications set forth in the “Framework for the preparation and presentation of financial statements” (the Framework).

These financial statements were prepared for the purposes of the Board of Directors Report to the Shareholders’ Meeting called for 18 December 2017, *inter alia*, for the proposed reduction of share capital pursuant to art. 2446 to cover previous losses, the loss for the first nine months of the year and the other adjustments made directly to shareholders’ equity in application of the accounting regulations.

The financial statements as at 30 September 2017 comprise the Balance Sheet, Income Statement, Statement of Comprehensive Income, the Statement of Changes in Equity and the Explanatory Notes. The financial statement tables are denominated in units of Euro.

The layouts used and the rules for preparing the financial statements are consistent with the provisions of Circular no. 262 issued by the Bank of Italy by measure of 22 December 2005 as amended.

The accounting standards adopted for the preparation of the financial statements, with reference to the classification, recognition, valuation and derecognition of the various asset, liability and equity entries, as well as the methods for recognising revenue and costs, remained substantially the same as compared to the 2016 Financial Statements, to which the reader is referred for more detail, with the exception of the partial early adoption by the Bank, as of 1 January 2017, of IFRS 9, limited to the part regarding the accounting treatment of the profit/loss connected to own creditworthiness of fair value option (FVO) liabilities.

Indeed, the IFRS 9 standard allows for the early application before 1 January 2018 of only the provisions on the presentation of profits and losses on fair value option financial liabilities attributable to changes in own creditworthiness, without applying the other parts of the standard early. The Bank has decided to take advantage of this option.

These provisions establish that the amount of the change in the fair value that is attributable to changes in the credit risk of the liability shall be presented directly in other comprehensive income, unless this creates or increases an accounting mismatch in the profit (loss) for the year, in which case the entire change in fair value of the liability must be presented within profit and loss.

In this regard, the standard establishes that an accounting mismatch is created or expanded when the presentation of the effects of changes in the credit risk of the liability in other comprehensive income results in a more significant mismatch in profit and loss than that which would arise by recognising the entire change in the fair value of the liability in profit and loss.

The standard also establishes that the amount that is recognised in other comprehensive income is not transferred subsequently to profit and loss when the liability is settled or extinguished. At the moment of settlement or extinguishment, the cumulative profit (loss) may be reclassified to other components of shareholders’ equity.

On the basis of the facts and circumstances existing at the date of initial application, the effects of changes in the credit risk of the liabilities of the Bank are not offset in profit and loss by a change in the fair value of another financial instrument measured at fair value through profit and loss for the year; as a result, the presentation of changes in own creditworthiness in the Bank’s statement of comprehensive income does not create an accounting mismatch.





The Bank also relied on the right not to restate comparative data.

The impacts connected to changes in own creditworthiness which were attributed to profit and loss at 30 September 2016 and at 31 December 2016 were positive and totalled EUR 136.5 mln and EUR 108.7 mln, respectively.

The early adoption of IFRS 9 as at 1 January 2017 with reference to the presentation of changes in own creditworthiness of the fair value option liabilities entails:

- in terms of determining the retrospective impacts, the formation as at 1 January 2017 of a positive valuation reserve in the amount of EUR 205.8 mln as a balancing entry to retained earnings, net of the relative tax effect;
- the attribution as at 30 September 2017 of a gross negative effect of EUR 85.7 mln to shareholders' equity rather than to profit and loss.

Please note that in 2016 the IASB published several amendments to some international accounting standards, which must be applied as of 2017. The amendments, which are still awaiting approval from the European Commission, are not relevant for the Bank.

The preparation of the financial statements as at 30 September 2017 requires recourse to estimates and assumptions in the determination of certain cost and revenue elements and for the assessment of assets and liabilities. Please refer to the 2016 Financial Statements for a description. In addition, certain valuation processes, in particular those which are more complex such as the determination of any impairment of assets, are generally carried out in full when the yearly financial statements are prepared, except in cases in which there are relevant indicators of impairment which require immediate impairment testing.

The financial statements as at 30 September 2017 show, in addition to the amounts pertaining to the relevant period, also the corresponding comparison data as at 30 September 2016 for the income statement and 31 December 2016 for the balance sheet.



## Results in brief

Changes in the key items of the main aggregates of the Bank for the first nine months of 2017 are summarised below:

- a) The Bank recorded **Total banking income** of **EUR 3,058 mln**, in line with the same period of the previous year, with decreases in Net interest income and Net fee and commission income, mainly offset by the growth in item 100 “Gains (losses) on disposal/repurchase” (which was impacted by the positive effects of the burden sharing). The trend in Total banking income is affected by the performance of **Net interest income**, which amounted to approximately **EUR 1,241 mln** (-5.9% YoY), due especially to the negative performance of interest-bearing assets, particularly lending to commercial counterparties (decrease in average volumes and decline in the relative returns), the trend of which was only partially attenuated by the decrease in interest expenses following the reduction in the cost of commercial funding, the maturity of bonds issued with more costly conditions and the effects of burden sharing. **Net fee and commission income** as at 30 September 2017, totalling approximately **EUR 1,186 mln**, recorded a decline of 14.0% compared to the same period of the previous year, mainly penalised by the recognition of the cost of the guarantee on government issues and the definitive disposal of the merchant acquiring business on 1 July 2017. Item 100 “**Gains (losses) on disposal/repurchase**” came to approximately **Euro 610 mln** in the first nine months of the year (including the effects of the burden sharing operation), up on the previous year. Net of those effects, the aggregate decreased in any event on 30 September 2016, which was characterised by greater disposals/repurchases of securities.
- b) **Net impairment (losses)/reversals on loans, financial assets and other transactions** amounted to approximately **EUR 4,073 mln**, up by 2,281 from those recorded in the same period of the previous year. These include: i) the net adjustments on the scope subject to the transfer following the adjustment of their recoverable value (already recognised as at 30 June 2017), ii) the write-downs of several equity investments, including the investment in Atlante, and iii) the complete write-off of the share held in the Voluntary Scheme, as well as the partial write-down of the irrevocable commitments undertaken by the Bank in relation to the Voluntary Scheme - Caricesena/Carim/Carismi (recorded in 3Q17).
- c) **Operating expenses** amounted to **EUR 2,295 mln** (+12.1% YoY). **Personnel expenses**, which totalled **EUR 1,363 mln**, grew year on year by 20.0%, essentially attributable to the recognition of the charges allocated for the early retirement/personnel fund scheme (agreement signed on 3 August for 1,200 resources), net of which there would have been a reduction attributable to workforce downsizing (due in the first place to the roughly 600 Solidarity Fund exits on 1 May 2017), as well as lower provisions on the variable component in 2017 with respect to the same period of the previous year. **Other administrative expenses** ended the first nine months of 2017 standing at about **EUR 1,048 mln**, down by 8.1% from the same period of the previous year, mainly attributable to a lesser impact of DTA fees and the structural cost control measures that marked the first nine months of the year. **Net adjustments to (recoveries on) property, plant and equipment and intangible assets**, amounting to approximately **EUR 70 mln**, were higher than the values from the corresponding period of the previous year due to greater write-downs up to 30 September 2017 on property, plant and equipment (impairment on land and buildings of roughly EUR 12 mln).
- d) As a result of the trend of the above-mentioned economic aggregates and also considering the capital gain realised from the sale of the merchant acquiring business to CartaSi (recorded in June 2017 under “Gains on disposals of investments”) in addition to the partial reassessment of DTAs from tax losses accrued but not recognised in previous years, induced by the recent regulatory measure which ordered the reduction in the ACE benefit (cf. article 7 of Law Decree no. 50 of 24 April 2017), the Bank recorded a **loss of roughly EUR 2,506 mln** as at 30 September 2017, against a negative result of around EUR 1,399 mln in the same period of 2016.



## Going concern

These financial statements as at 30 September 2017 were prepared based on a going concern assumption. With regard to the indications contained in Document no. 4 of 3 March 2010, issued jointly by the Bank of Italy, Consob and IVASS, and subsequent amendments, the Bank reasonably expects to continue operating in the foreseeable future and has therefore prepared the financial statements as at 30 September 2017 under the going concern assumption.

To this end, the following are of particular importance:

- approval of the Restructuring Plan of the BMPS Group by the European Commission on 4 July 2017;
- finalisation on 11 August 2017 of both the conversion of AT1 and T2 financial instruments into ordinary shares of the Parent Company in compliance with what is set forth in art. 23, paragraph 3 of Decree 237, as well as art. 2 of the Burden Sharing Decree and the capital increase of the Parent Company servicing the subscription of shares by the MEF, for EUR 4,473 million and EUR 3,854 million, respectively;
- the recording of a CET1 Ratio and TC Ratio exceeding the SREP thresholds currently in force.

As regards the liquidity position, after the significant deterioration in 2016, the Bank obtained the State guarantee on financial liabilities to be issued for a total of EUR 15 bn (for a maximum duration of three years). To date, the Parent Company has carried out three issues of government-backed securities for a total of EUR 11 bn, which were used in full in sales transactions in the market and as collateral to back funding transactions. As a result of these transactions, the recovery of commercial funding and the financial contribution of the capital increase subscribed by the MEF, liquidity indicators returned to ordinary levels.

Therefore, in light of what is noted above, as it is deemed reasonable that the Bank will continue operating in the foreseeable future, the financial statements as at 30 September 2017 have been prepared on a going concern basis.

It should, however, be noted that owing to the loss for the period, as well as the previous losses carried forward and the other adjustments made directly to shareholders' equity in application of accounting regulations, the Bank falls within the conditions provided for by article 2446 of the Italian Civil Code, since BMPS's share capital, amounting to EUR 15,692,799,350.97, as at 30 September 2017, had decreased by more than one third.

## Risks and uncertainties relating to the use of estimates and significant accounting choices

In accordance with the IFRSs, management is required to formulate assessments, estimates and forecasts which may have an influence on the application of the accounting standards as well as on the amounts of assets/liabilities and costs/revenues recognised in the financial statements. Estimates and related forecasts are based on past experience or other factors deemed reasonable in the specific circumstances and were made to estimate the book value of assets and liabilities that cannot be easily inferred from other sources. In particular, estimates were used in support of the book value recognised for the most significant items posted in the financial statements as at 30 September 2017, in accordance with the afore-mentioned accounting standards and regulatory provisions. Production of these estimates involves the use of available information and adoption of subjective assessments. By their nature, the estimates and assumptions utilised may vary from one period to another and, therefore, it cannot be ruled out that in subsequent periods the actual amounts stated in the accounts may differ, even to a significant extent, as a result of changes in subjective assessments made. These estimates and valuations are thus difficult and bring about inevitable elements of uncertainty, even in stable macroeconomic conditions.

For details about risks and uncertainties related to the use of estimates, see the 2016 Financial Statements.



## Other matters

The Restructuring Plan approved by the European Commission on 4 July 2017 includes a doubtful loan disposal transaction which envisages the transfer of a portfolio of doubtful loans with a gross book value as at 31 December 2016 of roughly EUR 26.1 bn at Group level, through a securitisation transaction. The transaction contemplates the intervention of the Atlante II Fund (managed by Quaestio Capital Management SGR S.p.A.), with which, on 26 June 2017, a binding agreement was signed for the acquisition of 95% of the junior and mezzanine notes.

The doubtful loans included in the transferred portfolio were therefore classified in Asset item 150 “Non-current assets held for sale and discontinued operations” as the transfer transaction satisfies the requirements laid out in IFRS 5 (non-current assets which are highly likely to be sold within the next 12 months). Furthermore, the impairment losses on the scope of transferred positions were adjusted so that the net book value of such doubtful loans would reflect the conditions set forth in the term sheet signed with Quaestio. Indeed, the Plan commitments and the agreement with Quaestio feature an amendment of the management strategy for such assets, the recovery of which depends no longer on ordinary activities (enforcement of guarantees, participation in bankruptcy proceedings, etc.) but rather on assignment to third parties. The net book value of the doubtful loans was therefore reduced to reflect the cash flows expected from this transaction, as set forth in par. 63 of IAS 39. The resulting additional adjustments, equal to EUR 3.3 bn, were recognised in the first half of 2017 in the income statement under Item 130 a) “Net impairment losses/reversals on loans”.

The binding agreement also envisages that the Bank will need to bear some additional charges. Of these, the income statement item 130 d) “Net impairment losses/reversals on other financial transactions” includes EUR 65 mln connected to the commitment undertaken to cover the vehicle hedging costs to be borne by the transferor.

This recognition also takes account of the valuation of the overall set of conditions contained in the agreement with Quaestio.

On 1 August 2017, in compliance with what is set forth in art. 23, paragraph 3 of Decree 237, as well as art. 2 of the Burden Sharing Decree issued on 28 July 2017, the AT1 and T2 financial instruments indicated therein were converted into newly issued ordinary shares of the Parent Company at the unit price of EUR 8.65. As a result, 517,099,404 shares were issued for a total value of EUR 4,473 mln, of which 21,511,753 also recorded as treasury shares (for a total value of EUR 186 mln), as they derive from the conversion of the shares of securities held by the Bank.

Pursuant to the combined provisions of IFRIC 19 “Extinguishing Financial Liabilities with Equity Instruments” and IAS 39, the difference between the book value of the converted bonds and the fair value of the shares assigned to the bondholders was recognised in the income statement. In particular:

- the subordinated liabilities were derecognised for a book value of EUR 4,711 mln;
- the share capital increase of EUR 4,473 mln was recognised and treasury shares were posted as a decrease in shareholders' equity, for EUR 186 mln;
- the negative difference of EUR 371 mln between the fair value of the shares assigned to the bondholders and the book value recorded in shareholders' equity net of treasury shares was charged to the item “Reserves”;
- an overall positive effect of EUR 631 mln was recognised in the income statement (+ EUR 56 mln in interest expense, + EUR 14 mln as gains on the reimbursement of repurchases by the Bank recognised under financial assets available for sale, EUR 559 mln as gains on the repurchase of financial liabilities and + EUR 2 mln as gains on the repurchase of financial liabilities designated at fair value).

Please also note that on 7 June 2017 the Bank received the final results of the on-site inspection conducted by the supervisory authority from May 2016 to February 2017. The inspection concerned the classification of loans, the levels of coverage and the valuation of collateral for non-performing loans, as at the date of 31 December 2015. The Bank, also as a result of the discussions with the



inspection team, made assessments and analyses in 2016 which led to changes in the methodologies and parameters used for the valuation of non-performing loans, in accordance with the rationale and with the impacts described in Part A - Information about changes in accounting estimates in the 2016 financial statements.

Following the assessments conducted, in the 2016 financial statements the Bank recognised higher impairment losses on some positions subject to analytical assessment by the ECB inspectors (credit file review) on the basis of the position deterioration events that took place in 2016 and in compliance with the Group's accounting policies.

The ECB recognised that the additional valuation differences, also caused by the use of statistical methods for the projection of the results obtained, overlap in large part with the impairment losses recognised by the Bank in the past year, as well as with the losses deriving from the disposal of the doubtful loan portfolio, with the estimated effects of the transition to IFRS 9 and with the operations for the reduction of non-performing loans set forth in the Restructuring Plan.

Although the supervisory authority acknowledged this overlap, taking account of what was recorded in the first quarter of 2017, it expects the residual difference from the credit file review, equal to EUR 250 mln, net, that is, of the above-mentioned overlaps, to be reflected in the accounting by the end of 2017 and the residual difference deriving from the use of statistical projections, equal to EUR 185 mln, again net of the above-mentioned overlaps, to be adequately evaluated.

The Bank classified and evaluated the loans in accordance with the reference accounting regulations and therefore the above-mentioned provisioning differences have been and will be reflected in the accounting to the extent to which they are confirmed in credit events that will entail the reduction of expected cash flows for the exposures and/or portfolios subject to the inspection.

## Prospects and outlook on operations

The economic growth which accelerated at a pace greater than expected in the first half of 2017 continues to be sound and generalised over various countries and sectors. At the same time, the recent volatility in the exchange rate is a source of uncertainty to keep under observation due to its possible implications on the medium-term outlook for price stability. Global trade trends improved significantly, driven primarily by the increase in trade of emerging economies. In general, the financial markets showed signs of stability and low risk aversion. Financial conditions in emerging economies are also benefitting from improved outlooks for global growth, with a recovery of capital inflows.

Looking forward, economic activity in Eurozone countries should also gradually strengthen, with a view to moderate growth which should continue to benefit from the support of expansive monetary and budget policy.

After the Governing Council's monetary policy meeting held in June 2017, yields on Eurozone government bonds remained substantially unchanged, while spreads on corporate bonds reduced slightly and remain at levels lower than the beginning of March 2016, when the corporate sector bond buying programme was announced (Corporate Sector Purchase Programme, CSPP).

The ECB's monetary policy measures continued to preserve very favourable lending conditions, which are necessary to ensure the long-lasting convergence of inflation rates towards levels lower than but close to 2 percent in the medium term. This is demonstrated by the continuation of very low bank interest rates. Likewise, the issue of monetary policy measures continues to provide significant support to loan conditions for businesses and households.

As regards the Bank, following the approval of the 2017-2021 Restructuring Plan by the European Commission on 4 July 2017, activities began for the implementation of the main initiatives set forth in the Plan.

In this regard, as concerns the disposal of the platform of doubtful loans, a binding agreement was reached with Cerved Group S.p.A. and Quaestio Holding SA. The transaction envisages the disposal to





a company established *ad hoc* by Cerved and Quaestio of the platform for the collection of doubtful loans of BMPS and the subscription of a long-term servicing agreement for the outsourced management of future flows of doubtful loans of all of the Group's Italian banks. The consideration of the disposal is EUR 52.5 mln, in addition to a possible earn out of up to EUR 33.8 mln, based on the achievement of economic results in the timespan until 2025. The closing of the transaction, expected to take place by the end of the first quarter of 2018, is subject to the approval of the supervisory authority as well as the completion of the securitisation of the doubtful loans of BMPS, with the subscription of mezzanine notes by funds managed by Quaestio.

On 3 August 2017, an agreement was signed with the trade unions with regard to the "Solidarity Fund for professional retraining and requalification, for the support of employment and the income of credit personnel", which envisages the exit of a further 1,200 resources at Group level in 2017, in addition to the 600 exits already completed as at 1 May 2017, in line with the targets of the Restructuring Plan, which requires, *inter alia*, a headcount reduction across all of the Group's organisational structures by around 5,500 resources, to be carried out primarily through exit support measures (roughly 4,800 through the activation of the "Solidarity Fund"). The period for joining the Solidarity Fund ended on 16 September, with the Group fully reaching its target set for 2017.

Moreover, on 24 October 2017 Consob approved the document concerning the voluntary public offering for exchange and settlement to holders of ordinary shares of the Bank arising out of the conversion of the subordinated bond loan "Floating Rate Subordinated Upper Tier II 2008 - 2018".

On 24 October 2017 Consob also issued a judgment of equivalence in relation to the disclosure requirements concerning the senior debt securities offered in exchange by BMPS as part of the offering.

On the same date, Consob approved registration document concerning the Issuer, the securities note and the summary note concerning the admission to trading of the Bank's ordinary shares on the Electronic Stock Market organised and managed by Borsa Italiana S.p.A. The Registration Document, the Securities Note and the Summary Note constitute the prospectus for the admission to trading of the New Shares on the Electronic Stock Market (MTA). Consob also ordered the withdrawal of Resolution 19840 of 23 December 2016 concerning the temporary suspension from trading on Italian regulated markets, multilateral trading facilities and systematic internalisers of the securities issued or guaranteed by the Parent Company and the financial instruments whose underlying assets are securities issued by the Parent Company. Therefore, the Bank's shares were re-admitted to trading on the Electronic Stock Market (MTA) on 25 October 2017.

On 30 October 2017 the decree of the Italian Ministry of the Economy and Finance was issued concerning the purchase by the Ministry of the shares that are the subject of the voluntary partial public offering for exchange and settlement targeted by BMPS to holders of ordinary shares of the Bank (ISIN IT0005276776) arising out of the conversion, following the application of burden sharing measures pursuant to article 22, paragraph 2 of Law Decree no. 237 of 23 December 2016 (as converted, with amendments, into Law no. 15 of 17 February 2017 and subsequently amended) - of the subordinated bond loan "EUR 2,160,558,000 Floating Rate Subordinated Upper Tier II 2008 - 2018".

The tender period for the Offering will therefore begin on 8:30 a.m. of 31 October 2017 and will end at 4:30 p.m. on 20 November 2017 (inclusive), unless extended. The settlement date of the Offering shall be 24 November 2017 (the "Exchange Date").

Lastly, with regard to future impact on equity deriving from the Bank's exposure to non-performing loans, note that on 4 October 2017 the ECB launched a consultation process relating to an addendum to its guidance to banks on non-performing loans of 20 March 2017. In particular, the addendum requires that all loans classified as non-performing starting in 2018 must have full coverage within two years at the latest for unsecured loans and within seven years for secured loans. The effects on the capital adequacy ratios may be determined once the definitive regulations are issued.



This information is also provided in compliance with Consob's request of 8 November 2016, pursuant to art. 114, paragraph 5 of Legislative Decree 58/1998, asking the Bank to provide the status of implementation of the Plan, with proof of the deviations of final data compared to the forecast data.

## The doubtful loan disposal transaction

Among the initiatives to improve credit quality, the Restructuring Plan approved on 4 July 2017 envisages the transfer of a portfolio of doubtful loans to Atlante II.

This project envisages the transfer of a portfolio of doubtful loans with a gross book value (GBV) as at 31 December 2016 of roughly EUR 26 bn at Group level through a securitisation transaction and through the intervention of the Atlante II Fund (managed by Quaestio Capital Management SGR S.p.A.), with which, on 26 June 2017, a binding agreement was signed for the acquisition of 95% of the junior and mezzanine notes.

The scope of the securitisation includes MPS Group loans that were classified as doubtful as at 31 December 2016 (EUR 28.6 bn excluding positions which due to certain characteristics could not be transferred, for roughly EUR 0.8 bn), net of a portfolio of EUR 2.5 bn consisting of unsecured loans with a gross unit value of less than EUR 150,000 and lease receivables.

The expected transfer price of the entire Group portfolio is expected to be around EUR 5.5 bn, equal to 21.0% of the GBV at the cut-off date of 31 December 2016, against a net book value as at 31 December 2016 of around EUR 9.4 bn; the difference between the transfer price and the net book value for the Parent Company, equal to approx. EUR 3.3 bn, was accounted for in the first half of 2017 and the securitised portfolio is expected to be deconsolidated by the end of June 2018.

The portfolio will be transferred to a vehicle company established for this purpose and will be funded through the issue of the following securities:

- (i) Senior A1 tranche equal to 12.5% of the GBV;
- (ii) Senior A2 tranche equal to 1.9% of the GBV;
- (iii) Mezzanine tranche equal to 4.0% of the GBV;
- (iv) Junior tranche equal to 2.6% of the GBV.

During the period between the transfer of the securitised portfolio and its deconsolidation, the Senior A1, Senior A2 and Junior notes will be held by originator.

For the Senior A1 notes, there will be a request for the "GACS" guarantee scheme, to be obtained by the end of June 2018, after the assignment of an investment grade rating by at least two rating agencies; after which time, they may be placed in the market with institutional investors.

The Securitisation envisages the following phases:

- (i) by the end of December 2017, the transfer of the portfolio to the vehicle company, the issue by it of all securities that will be initially subscribed by the originator and the transfer to Atlante II of 95% of the mezzanine notes;
- (ii) by the end of June 2018, with the assignment of the investment grade rating to the Senior A1 notes and after obtaining the GACS, the placement on the market of such notes along with the Senior A2 notes and the transfer to Atlante II of 95% of the Junior notes, with the simultaneous deconsolidation of the portfolio.

An earn out is established in favour of the Group equal to 50% of the excess profit if the profit realised on the Junior notes exceeds 12% per annum.

For the entire duration of the securitisation, the Group will in any event maintain a net economic interest of 5% of the nominal amount of each class of notes so as to remain in compliance with the retention rule, in keeping with regulations in force.

**OBSERVATIONS BY THE BOARD OF STATUTORY AUDITORS REGARDING THE PROPOSAL FOR A SHARE CAPITAL REDUCTION PURSUANT TO ART. 2446 OF THE ITALIAN CIVIL CODE, TO BE SUBMITTED TO THE SHAREHOLDERS' MEETING CONVENED FOR 18 DECEMBER 2017**

The Board of Statutory Auditors has received the Board of Directors' Explanatory Report on item no.1 of the agenda of the extraordinary session of the Shareholders' Meeting convened for this coming 18 December, prepared in accordance with Article 125-ter of Legislative Decree no.58 of 24 February 1998, as consequently amended and supplemented(CFA), and with Articles 72 and 74 of the Regulation adopted by Consob resolution no. 11971 of 14 May 1999, as subsequently amended(the Issuers' Regulations).

The purpose of this Report is to illustrate the bank's financial statements for the period ending 30 September 2017, approved today by the Board of Directors, as well as a proposal to be submitted to the Shareholder's Meeting regarding the adoption of appropriate measures following losses that have reduced share capital by more than one third.

That being stated, it is the intention of this Board to provide Shareholders with its observations regarding the Board of Director's Report on the Company's Financial Statements as at 30 September 2017, in accordance with Article 2446, paragraph 1 of the Italian Civil Code.

The Report primarily examines the soundness of the reasons which resulted in the losses, the nature and characteristic of the losses themselves as well as the evaluation criteria adopted.

Having examined all the documents submitted by the Board of Directors, the Board of Statutory Auditors hereby notes the following:

- a) the financial statements as at 30.9.17 registered a loss of approximately €M 2,506 in the first nine months of the year, largely due to:
  - net impairment losses on loans, financial assets and other transactions amounting to €M 4,073, which include: i) net losses booked since the start of the year on loans subject to disposal following adjustment to their realizable value (already booked as at 30 June 2017), ii) the write-down of certain shareholdings, including Atlante, and iii) the full write-off the stake held in the Voluntary Scheme in addition to the partial write-down of the irrevocable commitments towards the Voluntary Scheme - - Caricesena/Carim/Carismi (registered in 3Q17) assumed by the Bank;
  - the increase in personnel expenses which amounted to €M 1,363, registering a year-on-year growth of 20% primarily due to the provisions recognised for the early-retirement scheme/funds;
- b) moreover, with the approval of the financial statements as at 31.12.2016 the Shareholders' Meeting of 12 April 2017 passed resolution to carry forward losses in the amount of €M 2,324;
- c) further net losses were posted to net equity under applicable accounting regulations (mainly the application of IFRIC 19 to the conversion of subordinated bonds as well as the earlier application of IFRS 9 limited only to the treatment of the credit standing of financial liabilities utilising the Fair Value Option) for approximately €M 534;
- d) total losses registered as at 30.9.17 amounted to €M 5,364 and, at present, the Bank does not have any reserves available to cover the losses;
- e) The Board of Directors proposes to approve covering the aforementioned loss by reducing share capital by the corresponding amount, thereby bringing the share capital to € 10,328,618,260.14, with no cancellation of shares, since they have no par value.



The Board of Statutory Auditors also notes that:

- The Restructuring Plan approved on 4 July 2017 by the European Commission aims for the Bank's and the Group's return to an adequate level of profitability with a target ROE of >10% in 2021. The Plan is based on 4 key pillars, briefly described as follows:
  - 1) full leveraging of Retail and Small Business customers thanks to a new, simplified and highly digitised business model;
  - 2) renewed operating model, with a continuous focus on efficiency, which will result in a cost/income ratio of below 51% in 2021 and the reallocation to commercial activities of resources employed in the administrative area;
  - 3) radically improved credit risk management, with a new Chief Lending Officer ("CLO") organisational structure that will make it possible to strengthen the Bank's early detection processes and improve the recovery rate, and which will bring the cost of risk to below 60 bps and the gross NPE ratio to below 13% in 2021;
  - 4) strengthened capital and liquidity position, with targets at 2021 that include a CET1 of >14%, a Loan to Deposit Ratio of <90% and a Liquidity Coverage Ratio (LCR) of >150% with, at the same time, a significant decrease in the cost of funding.
- The Restructuring Plan includes the transfer of almost the entire doubtful loans portfolio as at 31 December 2016 for a gross value of EUR 28.6 billion;
- In particular, the Restructuring Plan is consistent with the commitments undertaken with DG Comp (the "Commitments") and reflects the parameters of the 2017 SREP Decision received in June 2017. In this letter, the ECB required the Bank to maintain a Total SREP Capital Requirement ratio of 11% at consolidated level as of 2018, which includes a minimum Pillar 1 requirement of 8% and an additional Pillar 2 requirement of 3% (P2R), entirely in terms of Common Equity Tier 1 capital.
- In assessing the ability of the Group to continue to operate as a going concern, the following hold particular importance:
  - i. approval of the Restructuring Plan by the European Commission;
  - ii. the completed conversion of AT1 and T2 instruments into ordinary shares of the Parent Company and capital increase of the Parent Company with subscription of capital by the MEF for €M 4,473 and €M 3,854 respectively;
  - iii. return of capital ratios to above the SREP thresholds currently in force and those established for 2018.

The Board of Statutory Auditors is of the view that:

- a) the proposed resolution that will be submitted to the Extraordinary Shareholders' Meeting does not trigger the shareholders' right of withdrawal pursuant to Article 2437 of the Italian Civil Code;
- b) the Board of Directors' Report and the financial statements have been prepared on the basis of statutory rules governing the preparation and drafting of the financial statements; the latter abide by the tax and accounting principles applicable for the financial year in which the loss was incurred;
- c) the Board of Directors' proposal for a share capital reduction has been guided by the principles of sound management and is compliant with the limits of the law and the Articles of Association.

The Observations contained herein, along with the Board of Directors' Report, will be filed, under the terms of Article 125 ter, paragraph 2 of the CFA, with the Company's registered office and published on its corporate

website. They will also be made available to shareholders through the other means established by Consob Regulations.

Siena, 7 November 2017

THE BOARD OF STATUTORY AUDITORS