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

SHAREHOLDERS' MEETING

6 April 2021 (single call)

EXPLANATORY REPORT BY THE BOARD OF DIRECTORS

CONCERNING ITEM 2) ON THE ORDINARY SESSION OF THE AGENDA

drawn up as set forth in article 125-*ter* of Legislative Decree 58 of 24 February 1998, and as amended, and as set forth in article 74 of the Regulations adopted by the Italian Securities and Exchange Commission with Resolution no. 11971 of 14 May 1999, and as amended.

PROVISIONS AS SET FORTH IN ART. 2446 PARAGRAPH 1 OF THE CIVIL CODE IN LIGHT OF ART. 6 OF DECREE LAW 8 APRIL 2020 NO. 23, TRANSPOSED WITH AMENDMENTS TO LAW 5 JUNE 2020 NO. 40, AS AMENDED BY LAW 30 DECEMBER 2020 NO. 178; RESOLUTIONS PERTAINING THERETO AND RESULTING THEREFROM.

REPORT BY THE BOARD OF DIRECTORS DRAWN UP AS SET FORTH IN ART. 125-TER OF LEGISLATIVE DECREE 24 FEBRUARY 1998 NO. 58 AND AS SET FORTH IN ARTICLE 74 OF THE REGULATIONS ADOPTED BY THE ITALIAN SECURITIES AND EXCHANGE COMMISSION WITH RESOLUTION NO. 11971 OF 14 MAY 1999, AND AS 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**") summoned you to the Ordinary and Extraordinary Shareholders' meeting in Siena on 6 April 2021, at 10:30 a.m., in a single call, to discuss and pass resolution, *inter alia*, on the following **item 2)** on the agenda of the Ordinary Session:

"Provisions as set forth in art. 2446 paragraph 1 of the Civil Code in light of art. 6 of Decree Law 8 April 2020 no. 23, transposed with amendments of Law 5 June 2020 no. 40, as amended by Law 30 December 2020 no. 178; resolutions pertaining thereto and resulting therefrom."

This explanatory report of the Board of Directors (the "**Report**") was drawn up as set forth in art. 2446 of the Civil Code, art. 125-*ter* of Legislative Decree no. 58/98 (the **"Consolidated Brokerage Act" or the "CBA"**) and of article 74, of the Regulation adopted with Italian Securities and Exchange Commission resolution no. 11971 of 14 May 1999, and as amended (the "**Issuers' Regulation**"), following the instructions in Diagram 5 of Annex 3A) of the Issuers' Regulation.

The Report also takes *into account the Italian Securities and Exchange Commission's letter of concern no. 1/21 of 16-2-2021, which among other things requires that "…the explanatory reports drawn up as set forth in art. 125-ter of the CBA and in the report on the financial position drawn up as set forth in art. 2446, first paragraph of the Civil Code, must include information on the circumstances the issuers find themselves in, the sum and nature of the losses accumulated over the course of the period, for which the suspension measures are deployed, the reasons for the decisions made concerning any deferments pursuant to articles 2446 and 2447 of the Civil Code, as well as the timing for settlement of the losses and/or replenishment of share capital.*"

The Report's goal is to illustrate, also in light of that submitted regarding the approval of the draft financial statements as at 31 December 2020: (i) the Bank's state of affairs as of 31 December 2020, approved by the Board of Directors on 25 February 2021 (the "**Financial Position**") and (ii) the motion that the Board of Directors brings before the Annual General Meeting regarding the losses for the year 2020 which, added to those from the previous years, decreased the share capital by more than one third.

1. Considerations on the results for the year 2020.

Below is the Bank's reclassified profit and loss account (in EUR/mln).

Reclassified Income Statement

MONTE DEI PASCHI DI SIENA BANK	31 12 2020	31 12 2019	Change Abs.	Change %
Net interest income	1,053.3	1,249.7	(196.4)	-15.7%
Net fee and commission income	1,353.8	1,388.7	(34.9)	-2.5%
Income from banking activities	**2,407.2**	**2,638.4**	**(231.2)**	**-8.8%**
Dividends, similar income	9.7	69.4	(59.7)	-86.0%
Net profit (loss) from trading, from financial assets/liabilities measuerd at fair value and Net profit (loss) on disposals/repurchases	138.3	295.7	(157.4)	-53.2%
Net profit (loss) from hedging	2.9	(6.2)	9.1	n.m.
Other operating income (expenses)	(27.9)	(60.9)	33.0	-54.2%
Total Revenues	**2,530.2**	**2,936.3**	**(406.1)**	**-13.8%**
Administrative expenses:	(1,924.7)	(1,974.7)	50.0	-2.5%
a) personnel expenses	(1,303.8)	(1,313.6)	9.8	-0.7%
b) other administrative expenses	(620.9)	(661.1)	40.2	-6.1%
Net value adjustments to property, plant and equipment and intangible assets	(117.5)	(127.9)	10.4	-8.1%
Operating expenses	**(2,042.2)**	**(2,102.6)**	**60.4**	**-2.9%**
Pre-Provision Operating Profit	**488.0**	**833.8**	**(345.7)**	**-41.5%**
Cost of customer credit	**(672.9)**	**(605.4)**	**(67.5)**	**11.2%**
Net impairment (losses)/reversals on securities and loans to banks	**(2.9)**	**(4.8)**	**1.9**	**-39.6%**
Net operating income	**(187.8)**	**223.6**	**(411.4)**	**n.m.**
Net provisions for risks and charges	(951.0)	(156.0)	(795.0)	n.m.
Gains (losses) on investments	(97.8)	(52.4)	(45.4)	86.6%
Restructuring costs / One-off costs	(151.6)	17.7	(169.3)	n.m.
Risks and charges associated to the SRF, DGS and similar schemes	(121.5)	(103.6)	(17.9)	17.3%
DTA Fee	(61.8)	(61.4)	(0.4)	0.7%
Gains (losses) on disposal of investments	40.2	2.8	37.4	n.m.
Profit (Loss) for the year before tax	**(1,531.3)**	**(129.3)**	**(1,402.0)**	**n.m.**
Tax expense (recovery) on income from continuing operations	(346.9)	(1,033.2)	686.2	-66.4%
Profit (Loss) after tax	**(1,878.3)**	**(1,162.5)**	**(715.8)**	**61.6%**
Profit (loss) for the year before PPA	**(1,878.3)**	**(1,162.5)**	**(715.8)**	**61.6%**
PPA (Purchase Price Allocation)	(4.3)	(11.9)	7.6	-63.5%
Net profit (loss) for the year	**(1,882.6)**	**(1,174.4)**	**(708.2)**	**60.3%**

As at 31 December 2020, the Bank achieved Total Revenues of EUR 2,530 mln, down 13.8% compared to the previous year.

This trend is attributable, in particular, to the decline in Net interest income, attributable to the sale of UTP loans and to the effects of the other actions implemented in 2019 and 2020 to comply with some of the *commitments* set forth in the Restructuring Plan, but also to the drop in short-term interest rates and sales volumes. Net fee and commission income, down slightly year on year, was affected by lower transactions during the months of *lockdown*, and by the reduced placement of consumer credit products. The Other revenues of financial management and the results from *trading* were also down, impacted by tensions in the financial markets linked to the COVID-19 emergency.

Taking a close look at the individual components of the 2020 aggregate compared to 2019, it becomes clear that:

- <u>Net Interest Income</u> amounted to EUR 1,053 mln, down 15.7% compared to 2019. The decline was driven by (i) the sale of *unlikely-to-pay* loans carried out in 2019 and the deconsolidation of the "Hydra M" portfolio, (ii) the return of the Bank to the institutional funding market, with significant volumes placed in the second half of the year 2019 and in 2020, and (iii) the decline in asset returns driven by the trend in interest rates combined with a restructuring of exposures with a reduction in demand and short-term components and growth in the medium/long-term component. Net Interest Income benefited from the positive effects of the access to the TLTRO3 auctions for a total of EUR 129 mln, although partially offset by the higher cost of deposits at central banks, equal to EUR 39 mln.
- <u>Net Fee and Commission Income</u>, amounting to EUR 1,354 mln, was down slightly compared to the previous year (-2.5%). A significant part of the reduction in commissions derives from the reduced placement of third-party consumer credit products and the reduction in commissions from services that were affected, in particular, by lower customer transactions following the COVID-19 emergency. Asset management fees, which were affected by the reduced operations of the Network during the lockdown months, were down by -1.1%. Other net fee and commission income instead improved, due to the lower cost of the state guarantee following the repayment of *Guaranteed Government Bonds* that took place in 1Q20.
- <u>Dividends, similar income and gains (losses) on equity</u> investments, amounted to EUR 10 mln, down EUR 60 mln compared to 31 December 2019, which recorded extraordinary dividends distributed by the subsidiary MPS Tenimenti S.p.A. for EUR 30 mln and dividends from the joint venture with AXA-MPS for around EUR 19.6 mln (no distribution was made by the insurance companies in 2020 in line with the recommendations divulged by the IVASS and EIOPA).
- <u>Net profit (loss) from trading, *fair value* measurement of assets/liabilities and gains on disposal/repurchase at</u> 31 December 2020 amounted to EUR 138 mln, a decrease compared to the values recorded in the same period of the previous year (-53.2%). The analysis of the main aggregates shows the following:
  - ✓ Net profit (loss) from *trading* of EUR +19 mln, down compared to 31 December 2019, also due to the elimination of the positive effects recorded in 2019 on derivatives hedging liabilities measured at *fair value*;
  - ✓ net profit (loss) from other financial assets/liabilities measured at *fair value* through profit and loss was negative for EUR 10 mln, a decline compared to the same period of the previous year (equal to EUR +119 mln), which had benefited from the positive effects (for more than EUR 150 mln) from the revaluation of

securities recognised in assets resulting from the debt restructuring transactions of Sorgenia Group and Tirreno Power;

- ✓ positive results from disposal / repurchase (excluding loans to customers at amortised cost) of EUR 129 mln, up by EUR 4 mln compared to the previous year.

Also contributing to the formation of the Total Revenues are: i) Net profit (loss) of the hedging activities equalling EUR +3 mln, on the rise compared to 31 December 2019 (equalling EUR -6 mln) and ii) Other operating income (expenses) amounting to negative EUR 28 mln, improved compared to 2019 (EUR -61 mln), which included the recognition of the indemnity linked to the exercise of the right of withdrawal from the agreement entered into with Juliet (EUR 49 mln).

Operating Expenses totalled EUR 2,042 mln, down 2.9% on the previous year. Specifically:

- Administrative expenses were EUR 1,925 mln, down by approximately EUR 50 mln from the previous year. A breakdown of the aggregate shows:
  - ✓ personnel expenses, equal to EUR 1,304 mln, fell 0.7% compared to 31 December 2019, benefiting primarily from the lower average workforce (in relation, in particular, to the departures for the Solidarity Fund recorded in 2019 and in 4Q20) and the reduction in expenses deriving from the extension of smart working as a consequence of the continuation of the COVID-19 emergency. This trend was only partially offset by the contractual increases/adjustments related primarily to the effects of the renewal of the National Collective Bargaining Agreement.
  - ✓ Other administrative expenses amounted to EUR 621 mln, down by 6.1% compared to the previous year. Despite the higher expenses required to handle the COVID-19 emergency (specifically to purchase personal protection equipment and for cleaning rooms), the aggregate benefited from the saving initiatives adopted, as well as the saving initiatives adopted, as well as the savings linked to branch closures in 2019 and reduced operations during the lockdown period.
- Net value adjustments to property, plant and equipment and intangible assets totalled EUR 118 mln, a deterioration of -8.1% compared to the same period of the previous year, principally due to lower amortisation of intangible assets and depreciation on property, plant and equipment.

As a result of these factors, the Bank's Gross Operating Income totalled EUR 488 mln (EUR 834 mln at 31 December 2019).

As at 31 December 2020, the Bank recognised a Cost of Customer Credit of EUR 673 mln, down by EUR 68 mln compared to 2019 (EUR -605 mln). Note:

- ✓ the 2020 figure includes roughly EUR 260 mln from the increase in adjustments deriving from the changed macroeconomic scenario due to the spread of the COVID-19 pandemic;

- ✓ the 2019 value instead mainly included a negative effect linked to the simultaneous revision of the NPE reduction strategy, which entailed acceleration in the 2019 disposal plan, and a net positive effect connected to the exercise of the right of withdrawal from the servicing agreement entered into with Juliet (which resulted in the elimination of forecasted costs for the agreement, reflected in value adjustments of the portfolio of reference).

Excluding these effects, the aggregate decreased mainly due to lower provisions on already impaired positions and lower transfers to default, which benefited from the effects of the moratoriums granted as part of the Government Decrees issued following the COVID-19 emergency, only partially offset by the lower benefit deriving from the return to performing of impaired positions.

Moreover, the aggregate also benefited from the positive effects generated by the acquisition of state guarantees on loans disbursed as part of the aforementioned Decrees.

The ratio between the Cost of customer credit and Loans to customers as at 31 December 2020 reflects a Provisioning Rate of 106 bps (90 bps as at 31 December 2019).

Value adjustments of impairment of securities and loans to banks amounts to EUR -2.9 mln (down compared to the EUR -4.8 mln recorded in late 2019).

As a result of the above, the Bank's Net Operating Income was negative for approximately EUR 188 mln, against a positive value of EUR 224 mln recorded in 2019.

The Result for the year before tax included the following items:

- net provisions for risks and charges in the amount of EUR -951 mln mainly allocated for legal risks, in particular on previous share capital increase transactions and risks linked to contractual agreements (at 31 December 2019 they amounted to – EUR 156 mln, mainly to cover the commitments taken up towards the compensation connected to operations in diamonds);
- losses on equity investments amounted to EUR 98 mln, against a loss of EUR 52 mln in 2019;
- restructuring costs/one-off charges, equal to EUR -152 mln, mainly relating to costs linked to the early retirement initiative through the activation of the Solidarity Fund and to expenses (interest, fees and commissions and other administrative expenses) relating to the non-proportional demerger plan with asymmetric option of a set of non-performing loans in favour of AMCO. At 31 December 2019, the aggregate was EUR +18 mln and included costs linked to project expenses and the price adjustment for the disposal of the subsidiary BMP Belgio S.A., the effects of the early retirements and the recoveries recognised by INPS (the National Social Security Institution) on previous early retirement/solidarity fund procedures;
- risks and charges associated with SRF, DGS and similar schemes, with a balance of EUR -122 mln consisting of the Bank's contribution due to the Single Resolution Fund (SRF) equivalent to EUR 47 mln, the additional

amount due to the National Resolution Fund (NRF) of EUR 15 mln and the total amount recognised to IDPF (DGS) of EUR 56 mln and the net loss on the exposure with the IDPF Voluntary Scheme (for the Carige intervention) amounting to EUR 3 mln.

The aggregate as at 31 December 2019 was EUR -104 million;

- DTA payment, equal to EUR -62 mln, after the shares recovered from the subsidiaries (EUR 9 mln).
- gains (losses) on disposal of investments of EUR 40 mln related to the sale of property (against the EUR 3 million positive results recorded in 2019).

Due to the changes discussed above, the Bank's Loss before tax for the period stood at EUR -1,531 mln, compared to 31 December 2019, when there was a loss of EUR -129 mln.

Tax expense (recovery) on income from continuing operations recorded a negative contribution of EUR 347 mln (against EUR -1,033 mln as at 31 December 2019) attributable nearly exclusively to the modification of the value of deferred tax assets (DTAs) recorded in the financial statements, carried out due to the update in long-term internal estimates of the income statement and balance sheet values to take into account changes in the macroeconomic scenario caused by the pandemic.

Considering the net effects of the PPA (EUR -4 mln), the loss for the year of Banca Monte dei Paschi di Siena amounted to EUR -1,883 mln, against a loss of EUR 1,174 mln in the same period of 2019.

2. Bank's Assets and Liabilities, Profit and Loss and net financial position as at 31 December 2020

For the assets and liabilities and the profit and loss, besides that stated in the paragraph above, please refer to the Draft Financial Statements for the year as at 31 December 2020, approved by the Board of Directors on 25 February 2021, which will be made available to the shareholders according to the law and submitted for approval at the Ordinary Shareholders' Meeting, with a motion to this regard.

For what concerns the financial position, in this case, too, please refer to the abovesaid Draft Financial Statements as at 31 December 2020, for more information; herein we wish to specifically point out that due to the health crisis, the Central Bank notified the banks – specifically for the LCR – that they could temporarily fall below the minimum threshold of 100%. Considering the solid liquidity position established in previous years and the satisfactory levels of its indicators, the Bank expects to be able to keep its targets higher than the minimum threshold, with an adequate buffer. At 31 December 2020, the consolidated LCR equalled 196.7%, the NSFR equalled 123.8% and the operating liquidity position was at a level of unallocated *Counterbalancing Capacity* equalling about EUR 33.1 billion.

3. Motions for provisions to take for the replenishment of the losses

As it became clear from the draft profit and loss as at 31 December 2020, (see paragraph one above and that stated in the Draft Financial Statements as at 31 December 2020) the Bank's losses for the year were EUR 1,882,682,981.

Moreover, the completion of the non-proportional partial demerger that entered into effect on 1 December 2020, with asymmetric option of a set of non-performing loans from MPS Bank in favour of AMCO, in terms of net worth, entailed a total reduction of EUR 963,718,818 (not including the valuation reserves under the demerger assets) of which EUR 1,133,606,063 representing the quota of Share Capital for the cancellation of no. 137,884,185 of the Bank's ordinary shares and EUR 169,887,245 representing the increase in the Reserves item (specifically, EUR 196,186,506 equal to variations in the demerger assets managed with the assets that were allocated, partially offset by EUR 26,299,261 which was left over from a cancellation linked to the proportional partial demerger of loans from the subsidiary MPSCS in favour of the parent company).

This is in addition to the accumulated losses in the approval of the financial statements as at 31 December 2019, totalling EUR 2,616,292,923.

Furthermore, to date the Bank possesses additional reserves available to cover the abovesaid EUR 130,573,382 in losses.

In brief, the net worth relevant for the purposes of art. 2446 paragraph 1 of the Civil Code is less than two thirds of the share capital of EUR 1,250,682,136.

In order to have an adequate capital structure and while waiting for viable options to be outlined and the related measures to strengthen the capital, essential elements in the DG Comp and European Central Bank ("**ECB**") authorisation procedures, in light of that set forth in art. 6 of Decree Law 8 April 2020 no. 23, transposed with amendments from Law 5 June 2020 no. 40, as amended by Law 30 December 2020 no. 178, we move to refer the decisions set forth in article 2446 paragraph two of the Civil Code related to the decrease in share capital to the Shareholders' Meeting that will be summoned to pass resolution on the capital strengthening measures, to take into account the previous losses and the loss for the year, and therefore to carry over the EUR 1,882,682,981 loss for the year.

4. These are initiatives that the Issuer intends to take up for turnaround and to maintain the status of going concern.

4.1 Initiatives underway for turnaround

On 17 December 2020, the Board of Directors preliminarily approved the 2021-2025 Group Strategic Plan. On the basis of the initial discussions with DG Comp following the submittal of the Group's new 2021-2025 Strategic Plan, the Bank is debating additional compensation measures for non-compliance with some *commitments* set in the 2017-2021 Restructuring Plan.

The Strategic Plan was prepared taking into account the commitments undertaken by the Italian Government in 2017 with reference to the Restructuring Plan mentioned above. The Government's commitments were recently confirmed in the Prime Minister Decree issued on 16 October 2020, which envisages "launching a process of disposal of the stake held by the Ministry of Economy and Finance ("**MEF**") in the share capital of BMPS, to be carried out using market methods and also through transactions aimed at consolidating the banking system." The Strategic Plan relies on the necessary dialogue with DG Comp concerning the commitments taken up in 2017 and with the ECB, also for the approval of the ideas envisaged for strengthening capital.

The Strategic Plan prioritised the initiatives capable of generating value as early as 2021, specifically:

- for the business model some opportunities were identified in repositioning the Bank's offer over the clientele segments, products and territories where the Group can compete most effectively, so as to regain the *market share* lost in the past few years and for which greater market growth is expected;
- for the cost base, for each central and network function, the freeable resources were measured against the current operative model and technological infrastructure following major organisational streamlining, rationalisation of the *footprint*, streamlining of the processes and adoption of smart work methods;
- for financial resources, the plan envisages keeping the capital and liquidity indicators well above the indications of the supervisor each year.

From an income standpoint, the Plan envisages net profit in 2021 impacted by restructuring costs and value adjustments on loans linked to the pandemic emergency, but with business in line with that observed in the second half of 2020. The Plan foresees the net profit breaking even in 2022 and realising a profit as of 2023.

Moreover, in late January 2021, the Board of Directors approved the Capital Plan which was submitted to the ECB, as required in the final decision of the ECB published on 28 December 2020 regarding the SREP capital requirements. The Capital Plan was prepared in view of the objective to find a potential structural solution for the Bank through an M&A transaction. If a structural solution does not come into play in the short/medium term, the Capital Plan envisages a EUR 2.5 billion capital strengthening that – in addition to prior authorisation from DG Comp and the ECB, within their area of responsibility – is supposed to take place (if done) at market conditions and with the pro-rata participation of the Italian state. The capital strengthening plan is subject to shareholders' approval.

The Board of Directors also granted Credit Suisse the position of financial advisor in order to aid Mediobanca in evaluating strategic alternatives available to the Bank and to screen the market interests of operators with a primary standing.

4.2 Going concern

See paragraph "Going concern" in the Draft Financial Statements.

5. Motion.

Dear Shareholders, we ask you to pass this resolution:

"The Annual General Meeting, ordinary item,

- *having reviewed and approved on today's date, the 2020 Draft Financial Statements of Banca Monte dei Paschi di Siena S.p.A.;*
- *having acknowledged the loss for the year 2020 equalling EUR1,882,682,981;*
- *having acknowledged that the net worth relevant for the purposes of art. 2446 paragraph 1 is less than two thirds of the share capital of EUR 1,250,682,136;*
- *having reviewed the report pursuant to articles 125-ter of Legislative Decree no. 58 of 24 February 1998, as amended, and 74 of the Regulations adopted by the Italian Securities and Exchange Commission with Resolution no. 11971 of 14 May 1999, and as amended, prepared by the Board of Directors;*
- *having taken into account the remarks of the Board of Statutory Auditors;*

RESOLVES

- in compliance with that set forth in art. 6 of Decree Law 8 April 2020 no. 23, transposed with amendments from Law 5 June 2020 no. 40, as amended by Law 30 December 2020 no. 178, to refer the decisions set forth in article 2446 paragraph two of the Civil Code related to the decrease in share capital to the Shareholders' Meeting that will be summoned to pass resolution on the capital strengthening measures, to take into account the previous losses and the loss for the year, and therefore to carry over the EUR 1,882,682,981 loss for the year."

Siena, 25 February 2021

For the Board of Directors
Maria Patrizia Grieco
Chairperson of the Board of Directors