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TECHNICAL NOTE ON BANKING REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

This Technical Note on Banking Regulation and Supervision of Less Significant Institutions for the Italy FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on July 2026.

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July 28, 2026

TECHNICAL NOTE

BANKING REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program (FSAP) in Italy. It contains the technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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APPENDICES

Glossary

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCBS	Basel Committee on Banking Supervision
BCC	Cooperative Credit Bank
BCP	Basel Core Principles for Effective Banking Supervision
BdI	Banca d'Italia
BoD	Board of Directors
CBG	Cooperative Banking Group
CCB	Cassa Centrale Banca
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1
CM	Council of Ministers
CONSOB	National Commission for Companies and the Stock Exchange
COVIP	Pension Fund Supervisory Commission
CP	Core Principle
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSRBB	Credit Spread Risk in the Banking Book
DGFSR	Directorate General for Financial Supervision and Regulation
DORA	Digital Operational and Resilience Act
EBA	European Banking Authority
EC	Essential Criterion
ECB	European Central Bank
EU	European Union
EVE	Economic Value of Equity
FATF	Financial Action Task Force
FHC	Financial Holding Companies
FSAP	Financial Sector Assessment Program
HI	High Impact
HQLA	High Quality Liquid Assets
HP	High Priority
HR	High Risk
ICAAP	Internal Capital Adequacy Assessment Process
ICCS	Inter-ministerial Committee for Credit and Savings
ICT	Information and Communication Technology
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IPS	Institutional Protection Scheme
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
ITRQ	IT Risk Questionnaire
IVASS	Institute for the Supervision of Insurance

JSC	Joint Stock Company
LCR	Liquidity Coverage Ratio
LSI	Less Significant Institution
MEF	Ministry of Economy and Finance
MoU	Memorandum of Understanding
MP	Medium Priority
NCA	National Competent Authority
NII	Net Interest Income
NPE	Non-performing Exposure
NPL	Non-performing Loan
NSFR	Net Stable Funding Ratio
OCR	Overall Capital Ratio
ODP	Online Deposit Platform
P2G	Pillar 2 Guidance
P2R	Pillar 2 Requirement
PPP	Periodic Penalty Payment
ROE	Return on Equity
SEP	Supervisory Examination Programme
SI	Significant Institution
SME	Small and Medium Enterprises
SQA	Supervisory Quality Assurance
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism
SupTech	Supervisory Technology
SyRB	Systemic Risk Buffer
TCB	Third-Country Branch
TLTRO	Targeted Longer-Term Refinancing Operations
TUB	Consolidated Law on Banking
TUF	Consolidated Law on Finance

EXECUTIVE SUMMARY

The Financial Sector Assessment Program (FSAP) undertook a targeted review of the banking regulation and supervision of Italy's Less Significant Institutions (LSIs). The review was carried out as part of the 2026 FSAP and was based on the regulatory and supervisory frameworks in place as of November 2025. Since the regulation and supervision of significant banking institutions (SIs), including Italian SIs, were extensively covered as part of the 2025 Euro Area FSAP, this note focuses on the prudential regulation and supervision of LSIs. In scoping this targeted review, the IMF team took into account the recommendations of the previous 2020 Italy FSAP, as well as relevant Euro Area and global regulatory and market developments.

Since the 2020 FSAP, Banca d'Italia (BdI) has made remarkable progress in strengthening the safety and soundness of the LSI sector. Key financial and prudential indicators of the LSI sector—profitability, capital and liquidity buffers, and NPL ratio—have significantly improved. This positive trend was supported not only by banks benefiting from the interest rate cycle but also by BdI's significant efforts to improve the resilience of the LSI sector. Reforms of cooperative and popolari banks were completed, and the first Italian Institutional Protection Scheme (IPS) was established. Significant supervisory work was done with fragile banks, including through the LSI sector consolidation involving restructuring and transformation of 30 percent of LSIs. Moreover, substantial efforts were dedicated to enhancing the regulatory and supervisory framework to reduce NPLs and improve corporate governance and operational resilience. Despite the overall strengthening of the LSI sector, pockets of risks persist in some LSIs, in addition to a new wave of 'challenger' banks.

Italy has a robust regulatory and supervisory framework, which is primarily based on the European Union (EU) framework with specific adjustments to address national needs. The enhancement of the regulatory and supervisory framework for LSIs has been driven by the evolution of EU regulations and supervisory approaches, alongside the Italian authorities' efforts to timely transpose these frameworks and upgrade their legal and regulatory infrastructure. BdI has also modernized its supervisory practices and processes and implemented key elements of the Single Supervisory Mechanism's (SSM) LSI supervisory methodology. Skilled and experienced BdI supervisors have chaired many SSM task forces and working groups. While significant progress has been made in addressing previous FSAP recommendations, some remain in the process of implementation (e.g., transactions with related parties), and certain recommendations have not been addressed (see Appendix V).

Prudential supervision of LSIs is high-quality and comprehensive, structured around the Supervisory Review and Evaluation Process (SREP). BdI's supervisory priorities and activities focus on relevant LSIs risks and vulnerabilities, such as governance, business models, IT/cybersecurity, and credit risk. Since the 2020 FSAP, significant efforts have been made to further enhance the effectiveness of LSI supervision, including reorganization by business models, establishing support and quality assurance units, and introducing innovative tools such as horizontal off-site reviews, benchmarking, proactive communication of supervisory expectations, and Supervisory Technologies (SupTech). In response to the 2020 FSAP recommendation, substantial measures have been taken to strengthen oversight of BdI branches, responsible for decentralized supervision of smaller LSIs. The SREP approach is applied proportionally, prioritizing High Impact (HI) and High Risk (HR) LSIs. BdI continues to devote significant resources to intensively supervise and resolve fragile and troubled banks.

It is crucial to continue increasing the coverage of on-site site inspections for the LSI sector and to further broaden the use of targeted, thematic, and follow-up inspections, supported by even more streamlined processes. In recent years, very deep on-site inspections, grounded in evidence, have been essential to assessing fragile and troubled banks, enabling early intervention, sanctioning, and other measures. On-site inspections represent a key supervisory tool for BdI to conduct in-depth assessments of weaknesses commonly observed in LSIs, particularly in corporate governance, and identify remaining legacy-troubled LSIs. The sector requires more on-site inspections to ensure adequate coverage of HI and HR LSIs, institutions after mergers, and those not inspected for extended periods and proactively identify vulnerabilities for timely remediation, in complementing institutional and horizontal off-site reviews. Given that there is high demand for on-site inspections, it is important to continue to increase resources allocated to the LSI sector. Expanding the use of targeted, thematic and follow-up on-site inspections with further streamlined processes could enhance the coverage of on-site supervision and allow for more efficient allocation of Inspectorate Directorate resources.

Over the last decade, significant corporate governance reforms in the LSI sector have progressively transformed the governance culture; yet further efforts are needed. Since the 2020 FSAP, one of BdI's main priorities has been to enhance LSIs' corporate governance through strengthening the regulatory framework, proactively communicating supervisory expectations, and conducting both off-site and on-site supervision, complemented by innovative horizontal reviews and SupTech tools. Today, Italy's LSIs operate under a robust corporate governance regulatory framework and, where needed, intrusive supervisory interventions are adopted. The significant enhancements in corporate governance regulation and supervision for LSIs, including the Ministry of Economy and Finance (MEF) Decree, have fundamentally reshaped governance structures and strengthened boards. Since corporate governance needs to be continuously strengthened and remains a point of attention for LSI sector, it is vital to continue prioritizing this area and intensify supervisory activities—both on-site inspections and horizontal off-site reviews—to reinforce LSI boards in their supervisory oversight responsibilities, enhance the proactive role of independent directors, and foster a stronger culture of control functions. BdI's sufficiently frequent prudential meetings with non-executive board members, including separate meetings with independent directors, could further support effective governance improvements.

BdI has increased the use of sanctioning and early intervention measures for fragile and troubled LSIs. It is important to keep the momentum by continuing to act early and decisively in strengthening preventive supervision, apply corrective powers at the first signs of deterioration and move swiftly up the escalation ladder, which leads to progressively stronger corrective measures and sanctions in case of material regulatory breaches. A more formalized escalation ladder process can expedite decision-making and enable the full and timely exercise of corrective and sanctioning powers, ranging from moral suasion to the imposition of Periodic Penalty Payments (PPPs) or other pecuniary sanctions. Following the LSI sector cleanup, it is essential to continue moving from reactive to preventive supervision through prompt deployment of these measures.

As credit risk remains the dominant financial risk for the LSI sector, BdI's focus on this area should continue, while its explicit powers for prudential purposes should be expanded. BdI has thorough requirements for LSIs on management of credit risk and treatment of problem assets. Although BdI expects to achieve similar results by moral suasion, requiring LSIs to revise its policies and imposing capital add-ons, it should, as recommended in the 2020 FSAP, be granted the explicit power to require LSIs to adjust their asset classifications and increase provisioning levels for prudential purposes. Majority of LSIs removed legacy non-performing loans (NPLs) from their balance sheets, while several LSIs are specializing in legacy NPLs management. As a supervisory priority, credit risk receives significant focus during off-site supervision, including horizontal reviews followed by BdI letters to the LSI sector, on-site inspections, and SREP activities. Efforts should continue to vigilantly supervise credit risk and problem assets—focusing on worst-performing loan portfolios and sectors exposed to geopolitical and tariffs risks as well as state-guaranteed loans—and keep an intense supervision on LSIs specializing in NPL management to timely identify vulnerabilities related to business model sustainability. While BdI still approaches concentration risk as a subset of credit risk, it is recommended that other dimensions of concentration risk are covered by Pillar 2. An explicit Pillar 2 add-on addressing sovereign concentration exposures could also be considered (sterilizing potential double-counting effects with the existing add-ons).

Since the 2020 FSAP, the regulatory framework and supervisory practices for LSIs' operational risk have been reinforced; however, continued initiatives are essential. This progress reflects the implementation of EU legislation and ongoing efforts to strengthen LSIs' operational resilience. Operational risk and resilience have been assessed during off-site and on-site supervision and SREP, with particular focus on IT risks, business continuity, and disaster recovery. BdI has intensified supervision of Information and Communication Technology (ICT) risk using innovative tools. As the majority of Italian LSIs have been outsourcing their IT functions to a small number of IT providers, BdI conducted seven on-site inspections of IT providers, and continued prioritization of this type of on-site inspections is essential. In 2022, a new Outsourcers and Third-party Supervision unit was established. Supervisory capacity related to IT and cyber risks has strengthened; however, ongoing initiatives are critical to further enhance this capacity in the rapidly evolving digitalization landscape.

It is crucial to strengthen legal protection for supervisors, including full coverage of defense costs for actions or omissions made in good faith during official duties, starting from the onset of proceedings. Currently, under Law no. 262/2005, BdI, as well as members of governing bodies and staff, are liable only for gross negligence or for intentional acts. However, the law does not include legal protection for professional service providers engaged in supervisory tasks, nor does it mention coverage of defense costs incurred during legal proceedings. BdI's internal rules allow reimbursement of legal expenses only after case closure and offer advance payments, but these measures provide insufficient timely support, leaving employees vulnerable during lengthy proceedings. To ensure legal certainty and effective protection, these safeguards should be enshrined in primary legislation, with conditions detailed in secondary legislation.

Table 1. Italy: Key FSAP Recommendations		
Recommendation	Responsible authority	Timeline[1]
Banking Regulation and Supervision of LSIs		
Institutional Setting		
Amend primary legislation to ensure that the BdI, its current and former staff, and professional service providers engaged in supervisory tasks are adequately protected from legal proceedings, including full coverage of legal costs from the onset.	MEF, BdI and other authorities	ST
Supervisory Approach and Tools		
Continue to increase coverage of on-site inspections for the LSI sector, focusing on the common weaknesses, proactively identifying vulnerabilities for timely remediation, and expanding the use of targeted, thematic and follow-up inspections, supported by further streamlined processes.	BdI	ST
Establish a more structured approach to prudential meetings, ensuring sufficiently frequent engagement—particularly with the LSIs' non-executive board members—and include separate meetings with the LSIs' independent board members.	BdI	MT
Continue strengthening preventive supervision by proactively applying corrective and sanctioning powers (in case of material regulatory breaches) at an early stage, along with the timely and more active use of the escalation ladder, which leads to progressively stronger interventions, to address unsound and unsafe practices,	BdI	ST
Promptly issue the MEF Ministerial Decree to reinforce the application of the suitability criteria for major shareholders, established in the primary Italian legislation.	MEF	ST
Regulation and Supervision of Key Risks		
Continue prioritizing corporate governance and intensifying supervisory activities—through on-site inspections and horizontal off-site reviews—focusing on strengthening oversight responsibilities of LSIs' boards in supervisory functions, enhancing independent directors' proactive role, and fostering a robust culture of control functions.	BdI	ST
Finalize the alignment of the regulatory framework on related party transactions to cover all elements of the revised 2024 BCP.	BdI	MT
Grant BdI the explicit power to require LSIs to adjust asset classification and provisioning for prudential purposes and continue prioritizing supervision of LSIs' credit risk and problem assets.	BdI, MEF and other authorities	ST

Table 1. Italy: Key FSAP Recommendations (concluded)		
Recommendation	Responsible authority	Timeline[1]
Further address digitalization-related challenges affecting LSI sector' liquidity and funding risks, particularly focusing on funding from online deposit platforms (ODPs) and hypothetical scenarios of sudden shifts in depositor behavior, such as social media-driven mobilization.	BdI	ST
Continue to proactively conduct supervisory work to strengthen LSIs' operational resilience and increase supervisory capacity for IT and cyber risks.	BdI	ST
Consider all forms of material concentration risk, when setting Pillar 2 capital add-ons, including an explicit add-on for sovereign concentration with safeguards against double-counting effects.	BdI	MT
[1] I Immediate (within 1 year); NT Near Term (within 1-2 years); MT Medium Term (within 3−5 years).		

INTRODUCTION[1]

A. Context and Scope

1. Since the 2020 FSAP, the EU regulatory framework and the oversight framework for euro area banks have been significantly strengthened. While there are some areas where the National Competent Authorities (NCAs) can adapt the framework to local circumstances, the wider EU legislation sets the main requirements for banks. The SSM assigns the European Central Bank (ECB) the responsibility to directly supervise SIs, whereas LSIs are placed under the direct supervision of NCAs, and the indirect oversight of the ECB. In view of these arrangements, the IMF and ECB/SSM have agreed to focus on regulation and supervision of LSIs as part of euro area member country FSAPs.

2. In this context, the FSAP conducted a targeted review of banking regulation and supervision of LSIs in Italy. In scoping this review, the 2020 FSAP recommendations as well as relevant euro area and global regulatory and market developments were taken into account. As a result, the review covered: (i) Institutional setting: BdI's supervisory powers, independence, accountability, and resources; (ii) Licensing, mergers and acquisitions: national criteria and other Italy-specific aspects; (iii) Supervisory approach, tools, and cooperation; (iv) Corrective actions and sanctioning; (v) Corporate governance; (vi) Transactions with related parties; (vii) Capital adequacy: Pillar 2; (viii) Supervision of LSI's key risks, including credit risk and problem assets, liquidity and funding risk, operational risk, interest rate risk in the banking book (IRRBB) and incorporation of anti-money laundering and countering the financing of terrorism (AML/CTF)-related considerations into prudential risk analysis and supervision. The review is based on the regulatory framework and supervisory practices that were in place by November 2025.

3. The findings of this review were guided by the 2024 Basel Core Principles for Effective Banking Supervision (BCP) and build on the most recent assessment of the euro area framework. This review also drew on areas of weakness previously identified by the 2025 EA FSAP, where relevant to the supervision and regulation of LSIs.[2]

4. The IMF team extends its sincere appreciation for the excellent cooperation provided by the Italian authorities and private sector participants. BdI provided a partial self-assessment of compliance with the 2024 BCP (building on the most recent euro area BCP self-assessment) and responses to a complementary questionnaire. The ECB also provided responses to a dedicated questionnaire. The authorities also provided examples of actual supervisory practices and assessments. The IMF team benefited greatly from the inputs received and exchanges of views during the meetings with BdI, MEF, ECB/SSM, banks, industry associations, audit firms, and other stakeholders and market

[1] This note was prepared by Aldona Jociene (IMF).

[2] The recent BCP Detailed Assessment Report of euro area bank regulation and supervision was published in September 2025 [Euro Area: Publication of Financial Sector Assessment Program Documentation-Detailed Assessment of Observance-Basel Core Principles for Effective Banking Supervision].

participants in Rome and Milan during November 2025. The IMF team sincerely thanks the authorities for their excellent arrangements, which greatly facilitated the mission's work.

MARKET STRUCTURE

5. As of March 31, 2025, Italy's banking sector comprised 12 SIs with total assets of €2.53 trillion, and 118 LSIs holding €338 billion in aggregated assets. The LSI segment included 112 banking groups and stand-alone banks, as well as six branches of third-country banks, together accounting for approximately 9 percent of the Italian banking system. There are 39 cooperative banks (Raiffeisen banks) operating under recently established IPS, 16 popolari banks and the remaining banks joint stock companies, which number is recently decreasing due to the consolidation in the sector. Table 2 shows the evolution of the number of LSIs and their assets since 2022.

Table 2. Italy: Evolution of LSIs in Number and Size

	2022	2023	2024	Q1 2025
Number of LSIs, *of which:*	127	123	120	118
- *JSC*	*62*	*60*	*58*	*57*
- *Popolari banks*	*18*	*16*	*16*	*16*
- *Cooperative banks*	*39*	*39*	*39*	*39*
- *Third country bank branches*	*8*	*8*	*7*	*6*
LSIs' Assets (in Euro billion), *of which:*	338	329	333	338
- *JSC*	*258*	*256*	*258*	*261*
- *Popolari banks*	*52*	*47*	*49*	*49*
- *Cooperative banks*	*17*	*16*	*17*	*17*
- *Third country bank branches*	*11*	*10*	*9*	*11*

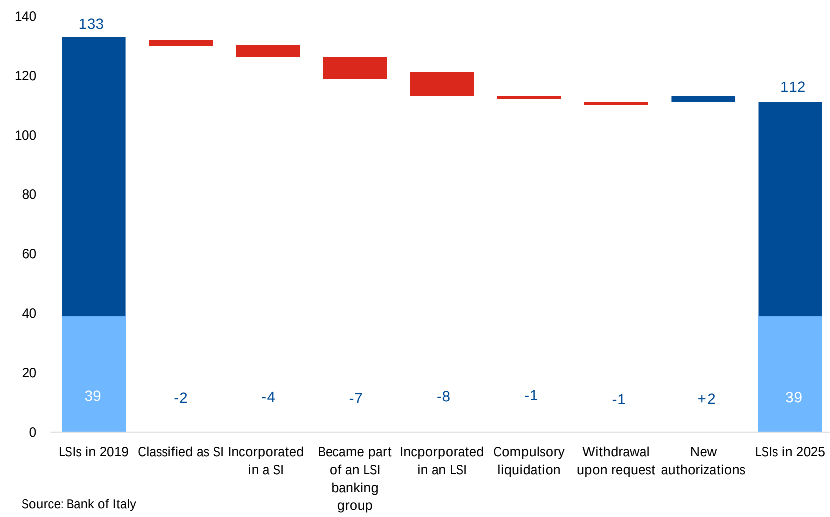
Source: Banca d'Italia.

6. Since the last FSAP, the number of LSIs has continued to decline, reflecting ongoing consolidation in the banking sector and an orderly exit from the market. Although the number of LSIs declined, total assets remained broadly stable. After the reform of cooperative banks, the two[3] Italian Cooperative Banking Groups (CBG) were classified as SIs and are now directly supervised by the ECB SSM, including both the parent companies and all 179 affiliated Cooperative Credit Banks (BCC)). Other LSIs have also transitioned to SI status or have been incorporated in SI. For the remaining part, the reduction of LSIs involved, and the degree of weaknesses declined following a series of mergers and acquisitions. Only in one case, BdI initiated a compulsory liquidation procedure. In addition, eight banks completely changed their business models due to changes in ownership and (often) capital injections. In BdI's view, the trend of declining numbers of LSIs also reflects one of the main challenges facing LSIs: the

[3] Istituto Centrale delle Casse Rurali ed Artigiane and Cassa Centrale Banca.

need to achieve i) economies of scale by leveraging size-related drivers to improve cost efficiency, and ii) economies of scope by diversifying sources of income, thereby reducing dependence on a single business line.

Figure 1. Italy: LSIs changes 2019-2025 (Q1)



Source: Bank of Italy

7. **The key financial and prudential indicators of the LSI sector have significantly improved.** The profitability of the LSI sector has reached its highest historical values, accompanied by a sizeable increase in capital ratios (see Table 3). Liquidity ratios—Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)—remain solid for the sector (LCR – 278 percent; NSFR – 151 percent), even after the full repayment of Targeted Longer-Term Refinancing Operations (TLTRO-III). Since the last FSAP, overall LSI sector asset quality has improved. Regarding credit risk indicators, it is important to distinguish between those of traditional LSIs and those of specialized LSIs: the latter have higher NPLs and lower coverage ratios, but mainly due to specific reasons related to their business model; traditional LSIs have much more similar indicators than SIs, with a residual gap that, regarding NPL levels, appears to be mainly related to the different customer base served and, with regard to coverage, is basically filled by considering the P2R add-on levels currently imposed by BdI for banks where potential under provisioning is detected[4]). Despite the overall strengthening of the sector, some LSIs continue to experience a number of idiosyncratic weaknesses. These challenges include small size, legacy of NPLs, low profitability, and weak capital ratios.

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[4] According to the Bank of Italy's Financial Stability Report, as of June 2025, Italian LSIs had an aggregate net NPL ratio of 4.7% and a coverage ratio of 27.9%; however, considering only traditional LSIs, the ratios are 2% and 48.4%, respectively. The low coverage ratio of specialized banks is primarily attributable to banks specializing in NPL management, but for these banks standard indicators for NPL coverage are not deemed useful because of the relevance of the features of the purchased credits and of the price discount (in fact, including the price discount applied at the purchase of the NPLs, the coverage ratios of these banks would be much higher). The increase in the NPL ratio among specialized banks in 2024-2025 reflects not only acquisition of NPL portfolios, but also the loan reclassification of three problem banks under intensive supervision, one of which was placed under temporary administration.

Table 3. Italy: Capital, NPLs and Profitability Ratios of the Italian LSI Sector
(in percent)

	2022	2023	2024	Q1 2025
CET1 Capital Ratio, of which:	16.5	17.4	18.1	18.7
• *Traditional banks*	*16.6*	*17.7*	*18.7*	*19.9*
• *Asset management banks*	*18.4*	*20.8*	*24.2*	*19.5*
• *Specialized credit banks*	*15.6*	*14.9*	*14.4*	*14.9*
NPL ratio, of which:	5.8	6.0	7.0	6.6
• *Traditional banks*	*4.3*	*4.3*	*3.9*	*3.9*
• *Asset management banks*	*1.9*	*2.3*	*3.2*	*2.5*
• *Specialized credit banks*	*12.3*	*12.3*	*17.1*	*18.4*
ROE, of which:	7.6	9.5	9.3	10.7
• *Traditional banks*	*6.0*	*7.9*	*8.1*	*9.9*
• *Asset management banks*	*8.5*	*15.3*	*16.1*	*16.6*
• *Specialized credit banks*	*13.1*	*12.4*	*9.6*	*9..6*

Source: Banca d'Italia.

8. The LSI sector is characterized by a significant diversity of business models, The majority of banks (81) are traditional banks—including 39 Raiffeisen banks—while the remainder specialize in areas such as asset management (15), the purchase and management of NPLs, leasing, factoring, small and medium enterprises (SMEs) lending, and consumer credit (see Appendix I). Traditional LSIs operate mainly through physical branch networks, which leads to higher fixed costs but stable client relationships and less sensitivity of funding costs to market changes. Specialized LSIs typically rely less on physical branches, gaining operational efficiency but facing higher funding costs.

9. A comprehensive reform of the popolari banks was completed in 2022. Legislation enacted in 2015 required the largest Italian popolari banks—with total assets exceeding €8 billion—to convert into joint stock companies (JSCs), as their cooperative structure was no longer suitable for institutions of such size and complexity[5]. Ten popolari banks above this threshold completed their conversion to JSCs, with the reform implementation finalized at the beginning of 2022. In 2024, the asset threshold was raised to €16 billion, though this amendment had no practical effect, as all remaining popolari banks were below the new limit. Currently, there are 16 popolari banks in Italy, with combined assets of €49 billion (15 percent of Italian LSIs total assets), mainly located in Southern Italy, with a focus on lending to local householders and SMEs. These institutions continue to operate according to a cooperative model, but the introduction of financing shares (with the first issuance in 2025[6]) is expected to significantly enhance their capacity to access capital markets and attract professional investors, as well as strengthen corporate

[5] Several popolari banks had significantly grown over time, expanding their operations from local to national and international levels and also being listed on the stock market.
[6] On May 2025, the European Banking Authority (EBA) assessed the first project of issuance of such instruments as compliant with the CET1 eligibility requirements.

governance. In recent years, a few of these banks have experienced difficulties due to idiosyncratic shortcomings in their corporate governance and internal controls, which prompted intervention by BdI.

10. After the reform of the cooperative banks, there are now 39 cooperative banks classified as LSIs, with Raiffeisen banks operating under a recently established IPS. As part of the broad reform of the BCC sector, two cooperative banking groups were formed and are now directly supervised by ECB SSM. The remaining 39 BCCs—Raiffeisen banks—are located in South Tyrol and have become part of Italy's first IPS, established based on Article 113 (7) of the EU Capital Requirement Regulation (CRR)[7]. The IPS has made the LSI segment more integrated and has strengthened its resilience, particularly by ensuring liquidity and solvency support where necessary to prevent potential failures.

11. A recent phenomenon in the Italian market is the rise of 'challenger banks', which are mostly digital banks offering innovative financial services and targeting niche segments. These banks have not aimed to challenge the dominance of traditional retail banks but have instead focused on specific market niches along the SME financing value chain, offering a narrow range of high-margin products. Examples include LSIs specializing in public sector factoring, SME loans backed by public guarantees, and NPL management. Some have also generated revenue by selling proprietary models or IT infrastructure. Despite differences in business models, these specialized banks typically operate without physical branches, rely on external agents and brokers, use innovative IT platforms, and often depend on online deposits, making their funding more sensitive to market fluctuations. 'Challenger banks' have grown rapidly and delivered strong returns, but some have struggled to scale up compliance and adapt to evolving regulations. Their unique business models and technical features have made them more exposed to macroeconomic shifts. In the recent macroeconomic and financial context, certain 'challenger' banks have experienced increased distress.

INSTITUTIONAL SETTING

A. Supervisory Responsibilities, Objectives and Powers

12. Since joining the ECB SSM in 2014, BdI has served as the NCA. In the SSM supervisory responsibilities are distributed between the ECB and the NCAs[8]. The ECB, working closely with NCAs, directly supervises the SIs (114 banking groups, including 12 Italian SIs, as of July 1, 2025), whereas the NCAs directly supervises the LSIs, under the oversight and indirect supervision of the ECB. For what relates to licensing, revoking the bank's license and authorization to acquire qualifying holdings in banks, the ECB is the competent authority for all banks: the NCA is the "entry point" of all notifications and is responsible for preliminary investigation phase, as well as for submitting to the ECB specific proposals regarding the possibility to grant authorizations or not. The NCAs plan and carry out their

[7] An IPS, within the sense of Article 113 (7) of the CRR, is a contractual or statutory liability arrangement that protects the participating institutions and, in particular, ensures their liquidity and solvency to avoid bankruptcy where necessary. As such, an IPS is not a legal entity but rather a contractual arrangement between distinct financial undertakings aimed at providing mutual support in financial stress situations.
[8] The SSM Regulation and the SSM Framework Regulation set out the fundamental principles governing collaboration within the SSM.

ongoing supervisory activities using their own resources and decision-making procedures. Additionally, NCAs perform supervision in areas that are not, or only partially, covered by the SSM Regulation. The ECB is entrusted with an oversight responsibility to ensure that the supervisory activities carried out by NCAs for LSIs supervision are in line with high supervisory standards, also with a view to fostering consistency of supervisory outcomes within the SSM.

13. BdI is the main competent authority for the prudential supervision of Italian LSIs. BdI supervises 112 LSIs and six third country (non-euro area) bank branches operating in Italy, which represent €338 billion aggregated assets, as of March 31, 2025. Other authorities are responsible for supervising other financial sectors, including the Italian securities and market regulator (National Commission for Companies and the Stock Exchange – CONSOB), the Italian insurance sector supervisor (Institute for the Supervision of Insurance – IVASS), and the Italian pension funds supervisor (Pension Fund Supervisory Commission – COVIP). BdI closely cooperates with all these authorities in supervising the LSI sector. Since the last FSAP, several Memorandum of Understanding (MoUs) have been signed or amended with these authorities (e.g., with CONSOB, related to issuers and the Markets in Crypto Assets Regulation).

14. The Consolidated Laws on Banking and Finance establish the framework for the prudential supervision of LSIs. BdI prudential supervision is carried out on banks and banking groups pursuant to the Consolidated Law on Banking (TUB, Legislative Decree 385/1993) and, when they provide investment services, pursuant to the Consolidated Law on Finance (TUF, Legislative Decree 58/1998). The TUB also determines how BdI exercises their powers within the context of the EU, including the SSM. Since the last FSAP, the TUB has been amended to implement the EU CRD V/CRR2 package (Legislative Decree No. 182/2021); the Digital Operational and Resilience Act (DORA, Regulation no. 2022/2554/EU) via the Legislative Decree no. 23/2025. The EU Directive 2024/1619 (so called CRD VI) is currently under transposition at the Italian level.

15. There have been no legislative initiatives to shift prudential powers from MEF to BdI and implement other 2020 FSAP Recommendations. According to the TUB (Article 2), the Inter-ministerial Committee for Credit and Savings (ICCS) [9] is designated as the authority responsible for 'high-level supervision', even though it can only adopt decisions based on proposals submitted by BdI (Article 4, Para 1, TUB). However, since 2014, the ICCS's role has been significantly reduced (the last meeting was held in 2016)[10]. The 2020 FSAP recommended amending the banking law to clearly define the ICCS's role and eliminate any overlapping supervisory functions that could conflict with the prudential mandates of BdI. Furthermore, banking law grants the MEF the authority: i) to issue

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[9] Based on the TUB (Article 2, Para. 1), the ICCS is composed of five Ministers: The Minister for Economy and Finance (Chairperson), the Minister of International Trade, the Minister for Agricultural, Food and Forestry Policies, the Minister for Economic Development, the Minister for Infrastructure, the Minister for Transport and the Minister for European Community Affairs. Meetings of the Committee are attended by the Governor of the BdI.

[10] The scope of the ICCS regulatory powers has been significantly revised on the occasion of the transposition of CRD IV and taking into account the SSM supervisory framework: the ICCS is not involved any longer in the regulation of prudential matters; as a consequence, the BdI is currently endowed with regulatory powers on prudential issues such as capital and liquidity, risk management, governance, and internal controls. Based on the TUB, ICCS mandate is limited to the issuance of guidelines, following a proposal by the BdI on non-prudential topics such as transparency and consumer protection and few other topics (*e.g.*, fund raising by non-bank institutions by means other than deposits).

ministerial decrees—in line with preliminary opinion of BdI—regarding the fit and proper requirements for major banks' shareholders, board members, and senior management[11]; and ii) to place banks and companies belonging to banking groups under compulsory administrative liquidation, acting on a proposal by BdI. Given the prudential nature of these responsibilities, the 2020 FSAP recommended that these roles and responsibilities be transferred to BdI. To maintain coordination, a thorough consultation process between BdI and MEF could be established to ensure relevant matters continue to be discussed with the MEF.

16. Recommendation: Consider the necessary amendments to primary legislation to implement the 2020 FSAP recommendations,[12] particularly those concerning the transfer of prudential powers under paragraph 15 sub i) from the MEF to BdI and clarify the exact role of the ICCS.

B. Supervisory Independence, Governance and Accountability

Objectives

17. The objective of banking supervision is defined in the primary legislation, with financial consumer protection responsibilities being coordinated with, and not conflicting with, it. The TUB stipulates that BdI exercises its powers with regard to: (i) the sound and prudent management of supervised institutions; (ii) the stability, efficiency, and competitiveness of the financial system; and (iii) the compliance of supervised institutions with laws and regulations. Regarding the provision of investment services, the TUF[13] assigns to BdI the responsibility for risk containment, asset stability, and the sound and prudent management of intermediaries, while CONSOB is assigned responsibility for transparency and correct conduct. TUB (Articles 5 and 127) tasks BdI with financial consumer protection responsibilities for banking and payment services that are complementary to and do not conflict with prudential supervision objectives.

Supervisory Independence

18. BdI's primary legislation includes robust safeguards to ensure operational independence in the exercise of its prudential supervisory responsibilities. The BdI statute explicitly stipulates that BdI and the members of its decision-making bodies shall act autonomously and independently in performing their functions and managing BdI's finances. They are prohibited from seeking or accepting instructions from any public or private sector entities. The statute clearly states that no public authority is empowered to influence, veto, override, or annul BdI's regulations or supervisory decisions. Additionally, no prior approval by any other public authority is required nor empowered to affect

[11] Authorities indicated that the adoption of a Ministerial Decree, which is subject to a preliminary review by the Council of State, is justified by the impact of the measure on individual rights.

[12] Italy: Financial Sector Assessment Program-Technical Note-Banking Regulation and Supervision and Bank Governance. The implementation of the 2020 FSAP recommendation on amending the banking law to shift the power of putting banks under compulsory administrative liquidation from the MEF to the supervisory authorities was reviewed by another 2026 FSAP workstream (Financial Safety Net and Crisis Management*)*.

[13] The TUF specifies the objectives of supervisory activities as: (i) safeguarding confidence in the financial system, its stability, competitiveness, and proper functioning; (ii) protecting investors; and (iii) ensuring compliance with financial regulations.

regulations or decisions made by BdI in its supervisory role. The sole exception is judicial review to ensure that any regulation or decision by BdI complies with the law, as provided under Article 24 of the Italian Constitution.

19. BdI's ownership structure reflects its past history, with the main shareholders primarily being banks and insurance firms. The amendments to the BdI Statute in the last decade set new rules for BdI capital and ownership structure. This resulted in broadening and redistributing the shareholder base and making the profit distribution process more transparent. In 2022, the cap on single institutions' stakes was raised from 3 to 5 percent (Law 234/2021[14]). Currently, the capital of BdI is held by 175 shareholders: 100 banks, 9 insurance firms, 43 foundations, 23 social security institutions, and eight pension funds. BdI has a Board of Directors (BoD) chaired by the BdI Governor and composed of 13 Directors nominated by the shareholders' meeting[15] held at the main branches of BdI. The BdI Statute allows Directors to serve 3 terms (15 years). According to changes in the Statute (2013 and 2022), the Board of Directors has no power of intervention with respect to the performance of BdI's institutional functions.

20. Since the 2020 FSAP, there have been no changes in the framework of appointments and removals within the BdI's governing bodies[16]. The Governing Board is the BdI's main supervisory decision-making body and consists of the Governor, the Senior Deputy Governor, and three Deputy Governors.

21. The requirement to publicly disclose the reasons for the removal of a member of the Governing Board is included in the recently adopted primary legislation. According to the general principles underpinning the public law, the formal decision on removal—adopted by the President of the Republic—shall acknowledge the reasons for removal. The decrees of the President of the Republic concerning the appointment, reappointment and removal of the Governor or other members of the Governing Board are published in the Official Journal of the Italian Republic. Furthermore, paragraph 7-bis of Article 19 of Law No 262/2005 – as recently amended on occasion of the implementation of CRDVI - explicitly provides that "where a member of the Governing Board of the Bank of Italy is

[14] The main changes: the raising of the threshold for participation in the BdI's capital, as per the 2022 Budget Law, from 3 to 5 per cent, as of 1 January 2022; the introduction of measures for a better functioning of the statutory organs; the removal of obsolete provisions; and a new division of the responsibilities for the control functions on the BdI's accounts between the internal audit board and external audit firms.

[15] A Nominations Committee composed of three Directors and two alternates shall select the candidates for nomination or reelection. Article 16 of the BdI Statute establishes some criteria for the position of Director. They should have significant experience in business, the professions, university teaching or high-level public management and should also meet requirements of integrity and independence. They should not hold and should not have held, within the two years preceding their nomination, positions with banks or companies operating in the financial or insurance sector or with other entities that by reason of their nature, activity or other circumstances, even contingent, are subject to the powers of control, supervision or authorization of the BdI.

[16] The Governor is appointed for a term of six years (possibly renewed only once) based on a decree issued by the President of the Republic, acting on a proposal from the President of the Council of Ministers, following the adoption of a resolution by the Council of Ministers (CM), after hearing the opinion of the BdI's BoD. The BdI's BoD, acting on a proposal from the Governor, appoints the Senior Deputy Governor and the Deputy Governors. The appointment, reappointment and removal of the Deputy Governors must be approved by a decree of the President of the Republic, acting on a proposal from the President of the CM in agreement with the MEF after consulting the CM.

dismissed, the reasons for dismissal shall be made public, unless the member concerned raises a justified objection."

22. It is crucial to strengthen legal protection for supervisors, including full protection against the costs of defending their actions or omissions undertaken in good faith while performing official duties, starting from the onset of such proceedings. According to Law no 262/ 2005, BdI, as well as the members of governing bodies and employees, are liable only for gross negligence and for acts committed intentionally. However, the Law does not include legal protection to professional service providers engaged in supervisory tasks, and protection against the costs for staff as well as former staff of defending their actions or omissions made while discharging their duties in good faith. BdI internal rules have provisions for the reimbursement of legal expenses incurred by the BdI's employees after the conclusion of the proceeding. An internal circular allows employees to request advance payments (loans) to cover the costs of defending their actions. As litigiousness is common in Italy and legal proceedings take several years, these provisions in internal rules leave employees vulnerable and do not provide timely financial support during lengthy legal processes. According to international standards and good practices, legal defense costs should be fully covered from the outset, ensuring complete indemnification for affected individuals and eliminating any requirement for upfront payments or personal expenses. To ensure the legal certainty, permanence, and enforceability of these safeguards, it is important to enshrine all these provisions in primary legislation to ensure adequate protection from legal proceedings. This includes full protection against the costs of defending actions or omissions undertaken in good faith while performing official duties, starting from the onset of such proceedings. Conditions and procedures for legal protection could be specified in secondary legislation. Legal protection for supervisors became even more important following the introduction of new provisions in law 21/2024[17].

23. Recommendation: Amend primary legislation to ensure that BdI, its current and former staff, and professional service providers engaged in supervisory tasks are adequately protected from legal proceedings. This includes full protection against the costs of defending their actions or omissions undertaken in good faith while performing official duties, starting from the onset of such proceedings.

Supervisory Governance

24. BdI has strengthened its well-established governance framework through recent organizational reforms and the introduction of innovative tools and practices. These changes are

[17] More recently, Law No. 21/2024 (see Article 20, paragraph 1) amended Article 24 (of Law 262/2005), adding there a new paragraph (6-ter), which states that: "*Without prejudice to what provided under paragraph 6-bis, anyone who has suffered damage as a result of an act or behaviour by an entity supervised by the Banca d'Italia may take action against the latter to obtain compensation, but only for damage that is the immediate and direct consequence of the violation of laws and regulations over which Banca d'Italia failed to exercise its supervision*". This rule refers to a different situation, in which the damage is caused by the supervised entities, and introduces an additional requirement that the damage is connected with the laws and regulations over which BdI failed to exercise its supervision. However, since this rule point to institutional liability, and protection does not explicitly extend to actions or omissions by BdI board members or staff, there is still a clear need to clarify the legal protection for BdI and supervisors, as prescribed in Basel standards. BdI submitted the Memorandum to the Senate (June 27, 2023) by pointing out the importance of introducing in primary law restrictions on the possibility for third parties to bring actions for damages directly against members of the BdI Governing Board and staff of BdI. ECB also issued opinion (December 2023) on this matter.

expected to improve supervisory effectiveness and align with evolving European standards. In particular, the Directorate General for Financial Supervision and Regulation (DGSFR) undergone through internal reorganization. Two divisions have been created: i) the Supervisory Quality Assurance (SQA) Division, for a second-line oversight of the adequacy of methodologies and procedures used in supervisory activities, and ii) the SSM Coordination Division, to support and strengthen the BdI participation in the decision-making processes of the SSM. In addition, an Anti-Money Laundering Supervision and Regulation Unit, which reports directly to the Board, has been established in order to enhance AML/CFT risk-based supervision and support preparations for the new European AML/CFT Authority (AMLA). Finally, also organizational changes were made in Banking Supervision Directorate 2 through i) the distribution of banks by business model among supervisory units; ii) the establishment of a Sector devoted to dealing with problematic banks and crisis management[18]; and iii) establishment of a Sector aimed at fostering the coordination of small banks supervision ruled by BdI branches[19] .

25. The newly established SQA Division plays a pivotal role in evaluating the effectiveness, efficiency, and consistency of supervisory processes. Serving as the second line of control within DGFSR, the Division reports directly to the Head of DGFSR, ensuring its independence and accountability. The SQA Division conducts comprehensive assessments aimed at enhancing the effectiveness of banking supervision, with particular focus on governance, risk oversight, and control of the supervisory process (see Appendix II). Notable thorough and valuable assessments have been conducted on several critical topics, including: the SREP process with a focus on governance and capital decisions; operational supervisory planning; on-site inspection planning; assessment of fit and proper requirements for LSI boards; updates to the Guide to Supervisory Activities; and follow-up letters addressing serious shortcomings identified during on-site inspections.

26. Significant supervisory decisions for the LSI sector are taken by the Governing Board, and the framework of delegation is clearly defined and publicly disclosed. The Governing Board is the main decision-maker for LSIs supervision. According to the BdI Statute, the Governing Board may delegate authority to BdI's management personnel to adopt measures and acts that do not require discretionary evaluation. For LSIs supervision, specifically for measures and acts involving the exercise of public power, the Governing Board granted delegation of authority to the heads of DGFSR and BdI Branch Managers through Resolution No. 426 of July 20, 2021. The level of decision-making authority delegated depends on three key criteria: simplification, proportionality to risk, and the complexity of the matter. Those with delegated authority may always refer particularly complex or sensitive decisions back to the Governing Board for consideration. The BdI's delegation of authority framework is publicly disclosed.

[18]This unit was established to leverage on a team of experts that supports the supervisory units in the management of these cases, to maximize the timeliness and effectiveness of interventions and minimize legal and execution risks.
[19] This unit aims to ensure homogeneity of approaches and supervisory actions through, inter alia, the joint definition of supervisory action and assessment in case of extraordinary measures or more complex issues and the oversight of the branches' related follow up activities.

Supervisory Accountability

27. Since the 2020 FSAP, BdI has further strengthened its accountability mechanisms, including related to LSIs supervision. BdI is accountable to Parliament and the Government, primarily through its annual "Report on operations and activities," as required by Article 19 of Law No. 262/2005. This report contains a specific section devoted to supervision of banks and non-bank intermediaries. The Governor presents the report to the joint parliamentary finance committees and testifies before Parliamentary Commissions when needed—there were 9 hearings in 2023, 5 in 2024, and 2 in 2025. The Governor may also consult the Committee for the Safeguard of Financial Stability[20] on financial system issues. BdI remains accountable to the financial community and the public through transparent decision disclosures and follows a "better regulation" approach, consulting stakeholders and conducting impact analyses before enacting new regulations. Moreover, to enhance public understanding of its actions and decisions, BdI regularly publishes financial stability reports, occasional papers, insights and clarifications on important topics on its institutional website[21]. This website serves as the primary communication tool with the public and fulfills BdI's legal obligations for transparency and publicity. BdI also published its BdI Strategic Plan 2023-25, which includes supervisory priorities, and the state of the plan is publicly disclosed twice a year.

C. Supervisory Resources

28. Since the 2020 FSAP, BdI has continued maintaining an overall steady level of supervisory staffing resources, including those dedicated to LSI supervision. In May 2025, there were 1,077 staff members employed in prudential supervision and regulatory activities of all supervised entities (663 at the Head Office and 414 in the Branches), including around 183[22] staff members for LSIs sector. The low turnover rate of 1.2 percent further indicates stability in supervisory staffing. BdI primarily hires young professionals at entry levels through competitive public exams, selecting from a large pool of highly qualified candidates. Due to the evolving nature of supervision activities, recent years have seen the addition not only of experts in banking, finance, law, statistics, and accounting, but also new professional profiles such as specialists in data science, IT security, and artificial intelligence.

29. BdI's competitive salary scales and other favorable employment conditions ensure it consistently attracts and retains highly qualified staff, demonstrating its strong position and reputation in the labor market. Employment conditions and salary levels are determined through bargaining agreements with trade unions. While public and banking sector salaries are considered, they are not binding benchmarks for compensation. BdI does not typically conduct specific salary surveys, although some information on public and banking sector salaries is publicly available. BdI's ability to

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[20] This Committee, established in 2008 following an EU recommendation, includes the Minister for MEF and the heads of the main financial regulatory bodies (BdI, CONSOB, IVASS).

[21] Banca d'Italia - Financial Stability Report; Banca d'Italia - Occasional Papers (Questioni di economia e finanza); Banca d'Italia - Notes on Financial Stability and Supervision (Notes on Financial Stability and Supervision , including dedicated research and policy papers on LSIs).

[22] Regarding Regulation and Macroprudential Analysis Directorate, the SSM Coordination Unit and Supervisory Quality Assurance Division, it was not possible to differentiate activities (in numerical terms) between LSIs and SIs.

attract and retain qualified staff indicates that its remuneration system and employment conditions are attractive compared to the external labor market. Continuous recruitment in the Banking Supervision Directorates helps prevent understaffing in key areas of expertise.

SUPERVISORY APPROACH AND TOOLS

A. Licensing, Mergers and Acquisitions

30. For what relates to LSIs licensing, revoking the bank's license and authorization to acquire qualifying holdings in banks, the ECB is the competent authority. BdI is the "entry point" of all notifications and is responsible for preliminary investigation phase, as well as for submitting to the ECB specific proposals regarding the possibility to grant authorizations or not. Since the 2020 FSAP, BdI has been involved in issuing three banking licenses, including one[23] for the first Italian fintech bank (2021), as well as in 44 qualifying holding acquisition procedures.

31. While general requirements for granting authorizations are included in EU legislations and guidelines, licensing criteria based on Italy's national legislation are also applicable in the licensing process of the SSM. The main provisions[24] of authorizations are reflected in the Italian TUB and implemented by BdI Circular 285/2013. This BdI Circular provides guidance on the administrative procedure the applicant needs to follow as well as on the content of the documents to be submitted to BdI, namely the Programme of operations and the description of the structural organization, internal controls and government arrangements. TUB lays down a specific condition for the authorization of cooperative banks[25], also specifies that BdI or the ECB denies applications for authorization when sound and prudent management is not ensured (Circular 285/2013 specifies provisions related to BdI powers), or ECB withdraws the license in case the authorization has been obtained by providing false information.

32. The MEF Ministerial Decree on fit and proper requirements for corporate officers was issued in 2020, while requirements for the suitability of major shareholders have not yet been updated. The MEF Ministerial Decree on fit and proper assessment of corporate officers (169/2020) replaced Decree no. 169/1998 to implement the new updated Article 26 TUB and ensure alignment with EU legislation and international standards (see the Corporate Governance section for more details). Another MEF Ministerial Decree (144/1998), regarding the suitability of major shareholders, has not yet been updated. The draft underwent public consultation in 2022. MEF mentioned that they are awaiting the revision of the Criminal Code. BdI indicated that the requirements established in the draft MEF Ministerial Decree are already used in practice, as they are included in the Questionnaire.

[23] Founders with banking experience acquired a lending firm and then sought authorization to expand its business. The bank focuses on lending to SMEs through a fast and digital processes.
[24] The authorization to provide investment services is regulated by Italy's Consolidated Law on Finance. National law also applies regarding authorization for the issuance of bankers' draft (Article 49 of the TUB and BdI's Regulation No 229/1999).
[25] All Italian cooperative banks must be part of a cooperative banking group.

33. Recommendation: Promptly issue the MEF Ministerial Decree to reinforce the application of the suitability criteria for major shareholders, established in the primary Italian legislation.

34. LSIs' shareholders must notify BdI of any information that may affect or change the assumptions and conditions on which the authorization was issued; however, there is no explicit requirement that LSIs themselves must notify BdI. The obligation for LSIs' shareholders to notify BdI is established in Article 20, paragraph 2-bis, of the TUB. Shareholders must also notify the bank of the same acts and facts. Under Article 21 TUB, BdI may require banks to provide, among other things, any communications received or data available regarding their shareholders. However, there is no explicit requirement, as prescribed by BCP (CP6 EC6)—that LSIs notify BdI as soon as they become aware of any material information that may negatively affect the suitability of a major shareholder or a party that has a controlling interest. The same shortcoming was noted in the euro area FSAP.

35. Recommendation: Establish the requirement that LSIs notify BdI as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or controlling parties.

36. In implementing EU legislation, reforms on qualifying holding discipline were undertaken, including requirements for major shareholders—beneficial owners and those acting in concert—and banking groups related to (mixed) Financial Holding Companies ((M)FHC). For acquisitions of significant ownership and controlling interest, the TUB was amended by Legislative Decree 182/2021 to align the national framework with EU requirements. These requirements were detailed in the 2022 BdI Regulation on the ownership structures of banks and other intermediaries. Supervisory Provisions on the information and documents to be submitted to BdI in the qualifying holding application were issued in 2021. As to banking groups, the current framework will soon be amended to transpose new provisions introduced by CRD VI with respect to (M)FHC.

37. Mergers and acquisitions have been used as an exit strategy for fragile banks. Since 2019, several fragile banks have been involved in mergers with other regulated entities (SIs, LSIs, or other financial intermediaries) or have undergone a change of control (with banks and pension funds acting as third-party investors). The restructuring of these banks was carried out through market-based solutions, including the orderly exit from the financial market of the weakest entities. The recently established voluntary fund by the Italian DGS has also started supporting the turnaround of fragile banks.[26] The same requirements are applied to mergers and acquisitions as for other authorizations (merger proceedings are often assessed together with the qualifying holding procedure), with specific recommendations and supervisory requests included in the decision.[27]

[26] This practice was reviewed by another FSAP workstream (Financial Safety Net and Crisis Management).
[27] These specific recommendations and supervisory requests must be carried out within pre-established timeframes and followed up by dedicated meetings with the board of directors, statutory auditors, and internal control functions. Examples of supervisory recommendations include prudent calibration of capital buffers (above the P2R and P2G) to be included in the Risk Appetite Framework , close monitoring of lending growth and the loan-to-deposit ratio, review and rebalancing of the funding mix, restrictions on profit and dividend distribution, and expected trends in the cost/income ratio.

38. BdI has ultimate responsibility for authorizing and supervising Italian branches of non-EU or the European Economic Area banks. There are six[28] such branches with total assets of €11 billion. The TUB and Circular 285/2013 set out the requirements for the authorization of third-country branches. The establishment of the first branch of a non-EU bank must be authorized by BdI, after consulting the Ministry of Foreign Affairs. The requirements include: i) a minimum capital requirement of €10 million; ii) submission of a program of activity to BdI; iii) fitness and propriety of the branch managers; iv) a group structure that does not hinder prudential supervision of the branch; v) a good standing letter issued by the home country authority; vi) the existence of adequate supervisory and AML/CFT frameworks in the home country; vii) a MoU for the exchange of information; and viii) the branch's commitment to join a depositor guarantee scheme. The implementation of CRD VI will bring changes to the authorization, regulation, and supervision of third-country branches.[29]

39. Current Italian legislation includes requirements related to the acquisition of material holdings in financial or non-financial sector entities; the implementation of CRD VI will bring certain changes. Italian legislation on major acquisitions by banks applies to holdings qualifying as direct equity investments (shares or capital units), indirect equity investments, and other types of investments entailing the assumption of equity risks. According to TUB and Circular 285/2013 banks shall comply with a general quantitative limit[30] and acquisitions in financial entities are subject to: i) prior authorization (holding exceeds 10 per cent of the acquirer's consolidated own funds or it involves control or significant influence over a non-EU entity with limited exceptions); ii) prior communication in case of acquisitions determining changes in the banking group's composition; iii) ex-post communication in case the holding exceeds 1 percent of the bank's own funds. Acquisitions of holdings in non-financial entities are subject to quantitative limits set forth under Article 89 EU CRR and banks shall comply with organizational rules to prevent the risk of conflict of interest between the financial activity carried out and the investment in non-financial entities. Furthermore, material investments—other than acquisitions or investments in equity holdings—made by banks are subject to national provisions on the transfer of assets and liabilities (including transfers of business, business units, assets, liabilities, and contracts identifiable as a block). Transfers must obtain prior authorization from BdI when the sum of the assets and liabilities involved exceeds 10 percent of the bank's own funds. Transactions (including intra-group) where the transfer price exceeds 5 percent of the transferee's own funds are subject to ex-post communication to BdI (TUB, Circulars 285/2013 and 269/2008). In implementing CRD

[28] There are six branches from third country groups (USA, UK, Japan, China and Iran).

[29] CRD VI has introduced: i) The obligation to establish a branch in each Member State where third-country institutions intend to provide "core" banking services (acceptance of deposits and other repayable funds, lending, issuance of guarantees, and undertaking of commitments), thereby prohibiting third-country banks from operating under the freedom to provide services (LPS) within the EU; ii) Minimum requirements for capital, liquidity, governance, financial statements, and reporting (see background) applicable to all third country branches (TCBs); iii) A distinction of TCBs based on whether the third country applies standards equivalent to the EU ones and it is not in AML grey lists (qualified vs non-qualified TCBs); and iv) A classification system for TCBs into two categories, with differentiated regulatory requirements: Class 1: higher risk, where the relevant third country is listed as high-risk third country that has strategic deficiencies in its AML/CFT regime in accordance with Directive (EU) 2015/849; Class 2: lower risk. Also, CRD VI establishes (Art. 48-bis par. 4) a national discretion mechanism whereby Member States may choose to apply to all TCBs, or to specific categories thereof, the same prudential requirements applicable to credit institutions (so called subsidiary-like approach), rather than the minimum harmonized standards.

[30] According to this limit, the book value of all real estate and equity holdings shall not be greater than the bank's consolidated own funds.

VI, BdI is preparing to adjust national requirements to new EU requirements related to acquisition and divesture of material holdings and material transfers of assets and liabilities.

B. Supervisory Approach, Tools and Cooperation

40. The BdI plans its supervisory activities over LSIs and allocates its resources on an annual basis according to a set of key priorities that take into account the main LSIs risks and vulnerabilities. The supervisory planning process is outlined in BdI Circular 269/2008 and the overall planning process is based on the ECB joint supervisory standard on supervisory planning. The BdI's supervisory priorities[31] for 2023-2025 were the following: credit risk; IT/cyber risk and impact of new technologies; profitability and sustainability of business models (including exposure to interest rate and liquidity risk); governance, climate risk, and updating the regulatory framework. The updated BdI supervisory priorities will be shared with the supervised entities after publication of the BdI Strategic plan 2026-2028. BdI has indicated that not all the priorities for the LSI sector will be explicitly mentioned in this plan. It is important to develop a procedure for the regular public communication of supervisory priorities, as required by BCP (E3 CP2) and already performed by BdI since 2023.

41. Recommendation: Develop a procedure for maintaining regular public communication of LSI supervisory priorities.

42. SREP process is fundamental to BdI off-site supervisory activities and outcomes. SREP is the key tool used by BdI off-site supervisors to assess LSI risks, determine capital requirements, and set up the supervisory program. See Appendix III for a diagram outlining the workings of SREP. The BdI risk assessment framework, compliant with the EBA Guidelines on SREP, is highly similar to the SSM approach, focusing on relevant risks and controls while allowing supervisory judgment in assigning risk scores. It is applied on solo LSIs and on LSI consolidated groups and includes the following areas of assessment: (i) business model and profitability, (ii) internal governance and risk management, (iii) capital adequacy and risks to capital, and (iv) liquidity and funding risks. The assessment of risks ranges from 1 (best) to 4 (worst). A recent innovation is the introduction of score qualifiers within the two middle categories: a plus (+) or minus (-). This delivers a system with eight gradings. The evaluation of net risk results from the combination of the assessment of risk exposures on one side and risk controls and mitigants on the other side.[32] The supervisory assessments are documented in the SIGMA procedure (BdI tool supporting the SREP).

43. A higher convergence with respect to the ECB SSM supervisory methodology was achieved. The BdI supervisory activity is based on the SSM-wide harmonized methodology developed

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[31] Supervisory priorities were included in the BdI Strategic Plan 2023–2025, which was published on its institutional website.

[32] The methodology relies on qualitative criteria for the assessment of governance and control systems and quantitative criteria for the assessment of capital adequacy and profitability. The scores assigned to risks to capital (credit risk, IRRBB, market risk, operational risk) and the capital adequacy score are combined to produce a single score for the element called "Capital Adequacy and risks to capital". Then the scores assigned to each of the four elements (business models and profitability, internal governance and risk management, capital adequacy and risks to capital, and risks to liquidity and funding) are finally combined based on a predefined mechanism, while allowing for a discretionary judgment (+/-1) to assign the final overall SREP score to each bank on a scale from one to four.

for LSIs, as prescribed in BdI Circular 269/2008. Since 2020, BdI has been updating this Circular annually to ensure broad alignment with the SSM LSI SREP methodology. For SREP 2024, the Business Model and Profitability, as well as the Credit Risk and Market Risk modules, were aligned with the updated SSM Manual for LSIs. Updates are ongoing for Operational Risk, IRRBB, and Governance and Internal Control Framework modules. The revision of the Liquidity Risk module in the ECB SSM Manual for LSIs has just begun, with BdI staff actively participating in the process.

44. Recommendation: Continue the update of Supervisory Guide (Circular 269/2008) to ensure consideration of changes in the LSI sector, recent regulatory and supervisory developments, and the alignment with the updated ECB SSM LSIs Manual.

45. Italy's SREP methodology for LSIs is slightly tailored to the national banking sector and tools. Currently, some elements of specificity compared to the SSM SREP methodology are foreseen, including: (i) the calibration of the indicator thresholds, carried out with respect to the Italian banking system; (ii) the crucial role played by on-site inspections outcomes in the SREP scoring phase of single risk profiles. For the determination of some SREP automatic scores, BdI also decided to make use of additional source of information, complementing the SSM approach in all the instances where the data reported and stored at national level (i.e.: data collected within the National Credit Register, maturity ladder reports for IRRBB, CSRBB) provide for additional and relevant information with respect to EBA harmonized reporting framework (COREP and FINREP). BdI indicated that such information is important for supervisors in assigning the final SREP scores. Supervisory judgment is applied at several phases of risk assessment. The indicators used to assess risks are often based on peer group analysis, which allows them to differentiate between banks with different characteristics (like business models, legal structure, size, etc.). In implementing 2019 recommendation, BdI increased supervisory judgement and flexibility in the SREP assessment to more accurately assess the risks of LSIs with specialized business models; furthermore, business models' peculiarities are considered both in the Pillar 2 capital add-on approaches and in the newly introduced annual benchmarking exercise.

46. The SREP approach is applied proportionally, prioritizing HI and HR LSIs. In 2022, the new ECB SSM classification for LSIs was established to prioritize HI and HR LSIs[33]. The process of updating the HI and HR classification[34] is managed by the ECB, in collaboration with the BdI. HI and HR LSIs are mainly functional to define the intensity of the supervisory activity and the information exchange regime between the ECB and NCAs on individual banks. BdI defines minimum engagement levels for its supervisory activities, setting minimum levels for frequency, scope, and granularity of control during its

[33] The definition of HI and HR LSI originates from the classification adopted by the ECB in its function of 'oversight of LSI supervision'. The SSM Framework Regulation states that "the ECB shall define general criteria, in particular taking into account the risk situation and potential impact on the domestic financial system of the less-significant supervised entity concerned, to determine for which less-significant supervised entities information shall be notified." These HI and HR LSIs definitions replaced the previous classification adopted by the ECB (according to which LSIs were divided into High Priority, Medium Priority and Law Priority).

[34] The process of assigning LSIs to the HI category is carried out annually and the outcome is then published. As of Dec. 31, 2024, there were 6 Italian LSIs in HI category – Banca Sella, Banco Desio, CR Bolzano, Banca Generali, MCC group, Cassa Centrale Raiffeisen- which represent the 28 percent of the Italian LSIs sector in terms of assets; 4 LSIs have exceeded the €15 billion threshold in total assets). The definition of HR LSIs occurs quarterly, and the outcome is not made available to the public.

assessment process. Supervisory activities are presented in annual supervisory examination programmes (SEP). In terms of frequency, SREP risk profiles are currently assessed every year by BdI supervisors, while capital decisions (i.e., Pillar 2 requirement (P2R) and Pillar 2 guidance (P2G)) are generally issued every two years, except for HI, for which they are issued annually. Nonetheless, supervisors are expected to update the assessment whenever it is warranted by new information, in order to adopt the appropriate actions.

47. BdI continues to devote significant resources to supervising and resolving fragile and troubled banks. Although supervisory methodologies ensure actions are proportionate to each LSI category's impact and risk, BdI's efforts on weak banks are steadily increased. BdI indicated that addressing issues in these banks is labor-intensive, requiring thorough assessment, strategy development, intervention preparation, risk monitoring, and close cooperation with stakeholders (including boards, auditors, authorities, i.e., ECB SSM and CONSOB, DGS, and internal units such as Legal and Resolution), along with frequent internal reporting. Regardless of size, troubled banks attract significant media and public attention, creating additional operational pressure, including handling complaints. They also often face substantial current or potential legal disputes, starting with the demanding process of responding to requests for supervisory documents and frequent exercises of rights of access by parties involved.

48. In recent years, the bank-specific SREP assessment is complemented by a structured horizontal analysis (so called "benchmarking"), both to the assignment of SREP scores and with reference to the quantification of the supervisory capital add-ons. In implementing the 2020 FSAP recommendation, a dedicated task force[35] started to conduct this benchmarking annually. The purpose of the benchmarking is to ensure the correct application of the principle of proportionality in terms of frequency and depth of analysis and the consistency of the assessments for LSIs with similar technical-managerial characteristics and risk exposures, as well as to verify the correct application of the methodologies. BdI indicated that such activity allowed both to detect in advance any signs of heterogeneity in the application of the margins of discretion provided by the methodology and to strengthen the results of SREP scoring and determining capital add-ons (P2R/P2G).

49. There was a remarkable increase in horizontal off-site reviews. These reviews covered many topics, including business model analysis, credit risk, board composition and functioning, fit and proper assessments, IT risks, ESG risks, state-guaranteed loans, online deposit platforms, IRRBB, and recovery plans. These reviews conclude with follow-up actions or recommendations addressed to all LSIs (or a subset of them), while identified vulnerabilities could be deeper assessed during on-site inspections. For each horizontal review, a task force is typically formed by experts with the most knowledge in the area; however, these processes are not formalized. Defining them would help ensure consistent execution of these activities going forward, with clear responsibilities, objectives, and outputs, while preserving flexibility.

50. Recommendation: Formalize supervisory procedures for horizontal off-site reviews and officially acknowledge the existing pool of specialized experts (e.g., IT/cyber, IRRBB, internal models, credit risk,

[35] This Task Force composed of experts from Supervision units (including BdI branches) and the Methodology unit.

liquidity risk, business models, corporate governance). This formalization should preserve flexibility by allowing dynamic task force composition based on emerging risks and review topics, enabling supervisors to draw expertise across units without rigid structures.

51. Existing deep and high-quality on-site inspections should be further increased for the LSI sector. Very deep on-site inspections, grounded in evidence, have proven essential to assessing the situation in trouble banks, enabling early intervention and sanctioning measures (Table 4). They remain a key supervisory tool for BdI to identify common weaknesses in LSI sector, particularly in corporate governance, and identify remaining legacy-troubled LSIs. Given LSIs sector vulnerabilities, more on-site inspections are needed to ensure adequate coverage of larger and more risky LSIs, and those not inspected for long periods, and proactively identify vulnerabilities for timely remediation. However, demand for on-site inspections is high (Inspectorate Department covers all BdI supervised entities[36]), making it critical to continue to increase the effort for these high-quality on-site inspections for the LSIs (in 2022-2023-2024 the resources allocated to LSI on-site inspections represent respectively the 22,2 percent, 22,6 percent and 29,2 precent of the total amount of available on-site resources).

Table 4. Italy: Planned Prudential On-site Inspections 2022-2025

Year	2022	2023	2024	Nov-2025
Number of prudential inspections	23	22	26	21
- Full scope	19	17	21	19
- Internal models	3	0	4	0
- Targeted, Thematic, follow-up	1	5	1	2

Source: Banca d'Italia.

52. Recommendation: Continue to increase the number of on-site inspections for the LSI sector, ensuring adequate coverage of inspections for HI and HR LSIs, including 'challenger banks', institutions following mergers and acquisitions, and those not inspected for long periods. These inspections aim to complement institutional and horizontal off-site reviews and proactively identify vulnerabilities for timely remediation. Particular attention should be given to weaknesses observed in the LSI sector, such as corporate governance shortcomings, unsustainable business models, credit risk exposures, and IT/Cybersecurity threats, and the identification of remaining legacy-troubled LSIs.

53. Full-scope on-site inspections remain the predominant supervisory tool; however, further expanding the use of targeted, thematic, and follow-up on-site inspections with even more streamlined processes is essential. BdI has indicated that full-scope inspections continue to be the most efficient and effective tool for prudential supervision, particularly for smaller banks. Only a few targeted prudential on-site inspections have been conducted recently (see Table 4). Currently, each full-scope on-site inspection is very resource-intensive, typically taking three months or more, with reports issued three months afterward. Further expanding the use of targeted, thematic, and follow-up inspections could enhance the coverage of on-site supervision and allow for a more efficient allocation

[36] This includes providing resources to the SSM and conducting on-site inspections of non-bank financial institutions, AML and conduct risk, payment institutions, and central counterparties.

of limited resources in the LSI sector. 2020 FSAP recommended looking into ways to reduce inspection durations and the time spent communicating supervisory findings. BdI has well-established on-site inspection processes which were recently updated[37], but there is room to further streamline these processes without compromising quality. As mentioned in 2020 FSAP, BdI teams still conduct all inspections on a surprise basis—with prior bank notification provided only 3–5 days before the kick-off meeting. The 2026 draft on-site inspection plan includes six topics for thematic inspections.

54. Recommendation: Enhance preventive supervision by expanding the use of targeted, thematic, and follow-up on-site inspections, supported by further streamlined processes.

55. BdI actively engages with LSIs on a range of topics; however, the interactions with non-executive board members could benefit from a more structured and frequent approach. BdI's engagement with LSIs takes various forms, including meetings, letters, SREP decisions, and informal contacts. Circular 269 requires that meetings with senior management or corporate bodies occur frequently for high-priority banks, while representatives of low-priority banks must be met at least once every three years. In practice, the number of prudential meetings yearly held during the last three years has exceeded the minimum level set forth in the Circular (see Table 5). BdI typically meets with representatives of LSIs, such as the CEO/General Manager and heads of control functions, with many meetings being reactive. Meetings also occur with the Statutory Audit's members who, according to Italian corporate law, are all independent and perform specific control functions, as well as with senior and middle managers. Though, a lower frequency has been observed in relation to meetings with individual and independent non-executive directors. During meetings held by the IMF staff with stakeholders, it was noted that these interactions with board members could benefit from a more structured approach in terms of frequency and nature. Significant benefits in this respect are expected from the regular recourse to a new tool recently introduced in Circular 269, specifically designed to support line supervisors in the performance of targeted deep dives, through the analysis of minutes and structured interviews with non-executive and independent directors. As required by BCP (CP9 EC7), supervisors need to engage sufficiently frequently with the bank's board, non-executive board members, and senior and middle management (including heads of individual business units and control functions) to gain timely insights into prudential issues; separate meetings with independent board members would also be beneficial to introduce (CP9 EC8).

[37] For on-site planning, the National Ranking Table was introduced and recently updated to better cover HI, HR, with greater use of judgement (4 -years cycle for higher priority LSIs); a more detailed pre-inspection note was launched to better focus the scope and the perimeter of the assessment; solid consistency check process; there is fast-track procedures for 'urgent case' to enable act promptly; new tools to support on-site activity and increase efficiency (Doriv, AI Sophia) were introduced.

Table 5. Italy: Prudential Meetings 2022-2024											
Meetings with LSI Boards members			Meetings with individual members			Meetings with independent directors[1]			Meetings with Statutory Auditors		
2022	2023	2024	2022	2023	2024	2022	2023	2024	2022	2023	2024
281	276	276	7	11	10	1	3	3	19	27	29

Source: Banca d'Italia.

[1] Figures do not include the approximately 30 meetings/interviews with independent directors that occurred in 2020/2021 in the context of the Thematic Review on governance, nor the frequent Bdi's staff calls with independent directors entrusted with the specific mandate of monitoring the turnaround process.

56. Recommendation: Establish a more structured approach to prudential meetings to ensure sufficiently frequent engagement—particularly with the LSIs' non-executive board members—and include separate meetings with the LSIs' independent board members.

57. BdI has made significant efforts to improve oversight and coordination of the supervisory activities carried out by its branches (except for the processes related to the SSM common procedures, such as the qualifying holdings assessment). Out of 112 LSIs, 70[38] decentralized smaller LSIs fall under the direct supervision of BdI branches. In response to the 2020 FSAP recommendation, substantial measures were taken to strengthen oversight of BdI branches and ensure maximum harmonization of supervisory processes and practices across all BdI locations. In 2022, a Coordination Unit was established within the Banking Supervision Directorate 2 to enhance supervisory coordination of these decentralized LSIs and ensure consistent application of supervisory approaches and procedures. Additional initiatives include periodic meetings between headquarters and branch supervisors, benchmarking activities on all LSIs regarding SREP scores and capital add-ons, and temporary staff exchanges. On-site inspections have been centralized, with mixed teams from headquarters and branches conducting these inspections. Ongoing reforms to consolidate BdI branches will reduce the number of branches responsible for prudential tasks—from 11 hubs supported by 16 collaborating branches to 8 branches—further enhancing focus on prudential supervision of LSIs.

58. The ECB SSM performs a risk-based oversight of LSIs mostly relying on information and views exchanged with the NCAs. The ECB SSM is provided with views on individual supervisory cases, through notifications of financial deterioration cases, and, for HI and HR LSIs, via notifications of BdI's material supervisory procedures and draft decisions. The ECB SSM also performs thematic reviews, mostly offsite, to identify different practices and promote high supervisory standards. Moreover, the ECB SSM conducts oversight via the interaction between the country desk and the BdI, senior management visits as well as bilateral technical calls or technical visits. In 2024, ECB SSM published a report on LSIs supervision[39].

[38] Including 39 Raiffeisen banks, supervised by the BdI Bolzano branch.
[39] ECB SSM LSI supervision report 2024.

C. Corrective Actions and Sanctioning Practices

59. **BdI has a wide range of corrective and sanctioning measures to address unsafe and unsound practices of LSIs.** As highlighted in the 2020 FSAP, the corrective and sanctioning powers of BdI have been significantly enhanced following the transposition of the CRD IV in the national legal framework. Implementation of CRD VI will introduce PPPs as an enforcement tool. The application of PPPs will enhance the current sanctioning regime—they act as an ongoing deterrent and incentive for a bank to quickly remediate the issue for which they are being penalized.

60. **BdI has undertaken remarkable supervisory work with problem banks, including measures that facilitated LSI sector consolidation.** BdI has put significant effort into addressing issues of problem banks, focusing on effective restructuring processes, capital strengthening initiatives, and market consolidation (e.g., 10 M&A were related to problem bank cases). Overall, restructuring and transformation have affected 30 percent of LSIs. BdI has increased the application of early intervention measures for problem banks[40], which was followed by sanctioning of certain LSIs and their natural persons.[41]

61. **Circular 269 provides criteria and procedures for corrective actions, allowing BdI to follow the escalation ladder and apply supervisory measures with flexibility and judgment based on individual circumstances.** In practice, the most intense use of corrective and sanctioning measures was mainly related to problem banks. Typically, the imposition of corrective measures is the result of negative SREP results (score of 3 or 4), critical on-site inspection findings, or other situations where the bank is in a deteriorating condition that reaches or is likely to reach levels that may require early intervention measures, mainly in relation to capital, liquidity, credit quality and profitability. There is an increased interaction with the ECB for problematic bank situations. For this purpose, financial deterioration reporting was set by the ECB whereby institutions that breach a fixed set of thresholds based on key solvency and performance indicators are being followed up and discussed more closely with the ECB.

62. **Application of corrective powers at an early stage, along with timely and more active use of the escalation ladder, which leads to progressively stronger corrective measures and sanctions in case of material regulatory breaches, remains essential.** After the LSI sector cleanup, it is important to strengthen preventive supervision where corrective measures should be used at an early stage and more decisively, up to the imposition of sanctioning measures in case of material regulatory breaches. To address each situation, BdI's approach is to initially explore possible moral suasion efforts and other informal supervisory measures, before escalating stronger interventions, if necessary. A more formalized escalation ladder process could expedite internal processes and decision-making and

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[40] Including 7 cases where banks were put under temporary administration (based on Article 70 of TUB); in 2 cases, the BdI appointed temporary administrators (Article 75 of TUB); 1 case where the BdI started directly the compulsory liquidation procedure.

[41] Financial penalties were applied to four LSIs in 2023 and another four in 2024. In 2024, financial penalties were also imposed on the natural persons of two of these LSIs (affecting 10 individuals in one LSI and 12 in the other). In 2025, financial penalties were applied to eight LSIs, including natural persons (limited to September 30, 2025).

facilitate the full and timely use of its corrective and sanctioning powers, ranging from moral suasion to the imposition of PPPs or other pecuniary sanctions. Some of these issues were already highlighted in the 2020 FSAP.

63. Recommendation: Continue strengthening preventive supervision by proactively applying corrective and sanctioning powers (in case of material regulatory breaches) at an early stage, along with timely and more active use of the escalation ladder, which leads to progressively stronger interventions, to address unsafe and unsound practices. This could include developing a more formalized escalation ladder process.

REGULATION AND SUPERVISION OF KEY RISKS

A. Corporate Governance

64. During the last decade, significant corporate governance reforms in the LSI sector have progressively transformed the governance culture in this area; however, further efforts are still needed to advance these changes. In 2014[42], the significant enhancement of corporate governance requirements for LSIs fundamentally reshaped governance structures. During the IMF staff's meetings with stakeholders, it was confirmed that LSIs separate the roles of Chairman of the Board and CEO, shareholders increasingly recognize the importance of independent directors, the largest LSIs have established board-level committees, and the composition of boards have been strengthened. Important structural reforms have also enhanced corporate governance across the Italian LSI sector, including the transformation of the largest popolari banks into JSCs, the cooperative banks reform with Raiffeisen banks now operating under an IPS, and the MoU signed by the Banking Foundations Association and the MEF[43].

65. Since the 2020 FSAP, one of BdI's main priorities has been enhancing LSIs' corporate governance through the regulatory framework, communication of supervisory expectations, off-site and on-site supervision, innovative horizontal analyses, and SupTech tools. The progress made by LSIs in implementing these proactive BdI initiatives has been recorded annually during the SREP. BdI has indicated that, through self-assessment and the implementation of remediation plans, LSIs have been gradually improving their corporate governance policies, processes, and practices.

66. Italy's LSIs are subject to a thorough corporate governance regulatory framework. In 2021, BdI regulation on banking corporate governance was updated to implement CRDV, to be fully in line with EBA Guidelines on internal governance (EBA/GL/2017/11)[44], with certain adjustments to meet

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[42] A first comprehensive and advanced BdI regulation on banks' corporate governance was introduced in 2008 (following a reform of the Italian company). In order to keep this regulation aligned with the international standards and compliant with the EU framework, it has been revised over time. BdI Circular 285 was significantly upgraded in 2014 on governance-related aspects.

[43] In October 2025, the MEF and Banking Foundations Association entered into an addendum to the protocol agreement to allow foundations to increase their holdings in banks up to 44 percent.

[44] In August 2025, a public consultation on the EBA Guidelines on internal governance was launched in order to implement CRD VI The EBA consults on revised Guidelines on internal governance | European Banking Authority

national needs. Two new national requirements were introduced: i) larger and more complex LSIs require to develop policy on the dialogue between the management body and shareholders; and ii) binding gender quota was increased from 20 to 33 percent female presence on the LSIs board of directors.

67. The adoption of fit and proper requirements and criteria through a MEF Ministerial Decree has significantly strengthened regulatory requirements in this area. The MEF Ministerial Decree[45] established comprehensive fit and proper requirements and criteria for LSIs' corporate officers and key function holders[46], including integrity, good reputation, professional experience and competence, independence requirements (for independent directors and independence of mind), time commitment, limits on multiple directorships positions and collective suitability. Following this, BdI issued provisions on the procedure for assessing the suitability of bank bord members[47]. In assessing the suitability of corporate officers BdI also utilizes the ECB Fit and Proper Handbook for Supervisors (internal SSM Guidance) and the ECB Guide to Fit and Proper Assessments[48] .

68. BdI published[49] further supervisory expectations on fit and proper assessments, highlighting good and bad practices. Two benchmarking exercises, covering 2,600 individuals (representing 67 percent of LSIs and NBFIs) helped identify market trends and key issues in addressing weaknesses, while promoting best practices. For example, in addition to mandatory time limits imposed by the CRD to banks, BdI recommended limiting LSIs board members' participation in multiple directorship positions to 10, with no more than three being executive roles. BdI recommended LSIs update their Fit and Proper assessment policies accordingly. A new Fit and Proper Assessment Manual was drafted to ensure consistent interpretation, enable horizontal analyses, and progressively enhance the overall supervisory approach to these assessments. This includes: i) an internal assessment methodology for supervisors to challenge LSIs' assessments, broadly aligned with the SSM Fit and Proper Guide; ii) a self-assessment ('checklist') for supervisors, also shared with LSIs; and iii) standardized note and feedback templates to ensure consistent supervisory dialogue with LSIs. This was followed by an industry workshop in June 2024 to support the effective implementation of these recommendations by LSIs. BdI plans to conduct further in-depth reviews, such as assessing the collective suitability of corporate bodies. These initiatives contribute to strengthening LSIs' boards and help guide shareholders' decisions regarding board renewals.

69. Innovative approaches and tools were used in BdI's horizontal off-site review to strengthen the composition and functioning of LSIs' boards. In 2020, a dedicated task force conducted horizontal analysis with the aim of: i) supporting the supervisory dialogue by complementing and strengthening the evidence stemming from bank-specific analyses with

[45] Requirements for board members are established in Article 26 TUB, and the fit and proper requirements were further specified in MEF Ministerial Decree.
[46] Suitability assessment of key function holders is conducted only for larger LSIs.
[47] BdI's provisions outline the procedural aspects for assessing the suitability of bank board members and highlight critical issues and good practices observed during these assessments. They are also based on Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body | European Banking Authority
[48]ECB Guide to fit and proper assessments (2021)
[49] Guidelines on the assessment of qualifications and criteria for suitability for the performance of the task

benchmarking exercises; ii) developing new approach to foster off-site supervision effectiveness, and, iii) identifying and promoting best practices. Based on a broad data gathering, an assessment of LSIs boards composition[50] performed against regulatory requirements and supervisory expectations. Also, the functioning of LSIs boards (22 percent of all LSIs) was scrutinized through examination of a large sample of minutes of the boards' meetings and related reports using SupTech tool (see Appendix IV), followed by targeted interviews[51] with board members, including independent directors. Good and bad practices identified were publicly communicated through the issuance of the Guidelines on the Composition and Functioning of LSIs Boards[52], followed by an industry workshop. LSIs' boards were requested to self-assess their alignment with the Guidelines and to draft action plans to address any gaps. This analysis ran in parallel with the SSM 'Thematic Review on LSI Governance Arrangements,' co-led by BdI and the ECB, during which BdI shared its overall experience and the specific tools developed at the national level.

70. On-site inspections represent a key supervisory tool for BdI to conduct in-depth assessments of corporate governance in individual LSIs. During these inspections, many corporate governance topics are reviewed, including the soundness of the overall governance system, board composition and functioning, the entire system of control functions, and the remuneration framework. BdI indicated that full-scope missions remain the primary tool for assessing governance profiles (e.g., the impact of board weaknesses on other risk profiles); in the last two years, one targeted and one follow-up inspections were carried out. Evidence-based findings from these on-site inspections, which broadly align with the results of horizontal off-site reviews, highlight the strong need to intensify supervision of corporate governance within the LSI sector.

71. It is important to continue prioritizing corporate governance and intensifying supervisory activities—both on-site inspections and horizontal off-site reviews—to strengthen LSIs' boards of directors' oversight responsibilities, independent directors' proactive role, and the culture of control functions. As highlighted above, significant efforts have been dedicated to strengthening LSIs' corporate governance; however, further progress is still needed to advance these governance reforms. Findings from on-site inspections and horizontal reviews highlight that particular attention should be given to enhancing the boards' oversight responsibilities, in particular in the specific cases where LSIs' shareholders prefer a dominant CEO, which weakens the boards in supervisory function authority and effective oversight. More focus is required on fostering the proactive role of independent directors and continuing to enhance the culture of control functions. These governance shortcomings were also highlighted during the IMF staff meetings with stakeholders.

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[50] Board diversification by age, gender, and professional background; adequate presence of independent and non-executive directors; and members' average tenure.

[51] These interviews, conducted by a panel of BdI supervisors, double-checked the results of document examinations, focusing on: a) the role played by the Chairman of the Board; b) the possible presence of dominant figures (typically the CEO or General Manager); c) the quality and intensity of internal debates (e.g., on strategic and/or risk-related topics); d) the ability of non-executive directors to properly challenge CEO/General Manager proposals; e) the quality of the analyses brought to the attention of the Board and its committees; and f) the interactions between the Board and the internal control functions.

[52] Bank of Italy Guidelines on the composition and functioning of LSI boards of directors

72. Recommendation: Continue prioritizing corporate governance and intensifying supervisory activities—through on-site inspections and horizontal off-site reviews—focusing on strengthening oversight responsibilities of LSIs' boards in supervisory functions, enhancing independent directors' proactive role, and fostering a robust culture of control functions.

B. Transactions with Related Parties

73. BdI is finalizing the update of the regulatory framework for transactions with related parties to cover all elements of the revised 2024 BCP (CP20), including definitions, limits or other mitigants, reporting on aggregate exposures, and public disclosure using prudential definitions. Italy's current regulatory framework in this area is comprehensive and incorporates many requirements from international standards, including governance-related requirements. BdI has postponed updating this framework while awaiting significant regulatory developments at both the revised 2024 BCP and the EU level. There is currently no EU-wide framework for regulating transactions with related parties. BdI's work on this update is ongoing and is expected to be finalized in 2026. The 2020 FSAP recommended[53] reviewing the definition of related parties and their connected persons to include directors, senior management, and key staff of a bank's affiliated companies, as required under BCP (CP20 EC1). The revised 2024 BCP introduced changes to requirements for transactions with related parties, including definitions, limits, and supervisory reporting. For public disclosure (BCP CP28 EC2), prudential definitions should be used[54]. BdI has been carrying out further assessments to update definitions of related parties to ensure full alignment between the scope of application of the national regulation and the BCP, also in light of the updated definition of related parties. BdI has already planned to update the current framework to also introduce an aggregate prudential limit, taking into account the revised 2024 version of BCP[55] . The introduction of the aggregate prudential limit for related parties' transactions will also include the relative reporting obligation towards the BdI.

74. Recommendation: Finalize the alignment of the regulatory framework for transactions with related parties to cover all elements of the revised 2024 BCP, including definitions, limits (or deductions from capital or collateralization) and reporting on aggregate exposures, and public disclosure using prudential definitions.

75. BdI Circular requires LSIs to implement thorough oversight processes for transactions with related parties, involving independent directors. These requirements empower independent directors of LSIs to play an important role in overseeing transactions with related parties. In practice,

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[53] 2020 FSAP also mentioned that the definition may need to be reviewed in light of the reform of the BCC sector (either in the form of CBGs or IPS) to ensure that it continues to properly capture all related parties across the group.

[54] To ensure appropriate transparency for stakeholders and the market, the BdI Circular requires each bank to publish on its website—without undue delay—its procedures for approving transactions with related parties and any amendments thereto (or, if unavailable, on the website of the relevant trade association or in the press). Concerning the accounting rules, the definition of related party and the related disclosure requirements in financial statements are governed by IAS 24 "Related Party Disclosures." CONSOB regulations on transactions with related parties are applied for listed companies, including certain largest LSIs.

[55] On aggregate limits, BdI had already initiated the preliminary analysis necessary to update the prudential regulation (in particular, the preparatory cost/benefit assessment required to evaluate the prospective impact of the aggregate limit on the banking sector).

larger LSIs have Board's Related Parties Committee, composed of non-executive and independent directors, responsible for overseeing these transactions. According to BdI procedure, independent directors should be involved in each transaction at both the preliminary stage and during the deliberative process, but their role is limited to issuing non-binding advice.

76. **BdI established limits on individual related parties, but there are no other mitigants for related party risk on an aggregate level.** As was indicated in the 2020 FSAP, the TUB provides the BdI with the power to set limits, including imposing more stringent prudential limits, limits on aggregate exposures, limits on a case-by-case basis, and conditions. BdI can also impose the application of the framework in situations not expressly mentioned to address conflict of interest risks emerging from the relationship between the bank and certain counterparties. BdI's individual limits vary depending on whether the related party is financial or non-financial[56]. Furthermore, the BdI regulation requires banks to adopt internal controls and policies to define their risk appetite regarding exposures to related parties, also in terms of the maximum amount of all related party lending deemed acceptable in relation to their own funds. While these limits have proven effective in mitigating risks at the level of individual related party and its related interests, they are not able to mitigate excessive related party risk at an aggregate level. For example, when exposures to individual non-financial related parties range from 5 to 15 percent, the aggregate exposure may become excessively high, and there are no other mitigants such as deduction from capital or collateralization.

77. **There is clear supervisory attention to related party transactions during off-site and on-site supervision, as well as SREP.** Circular 269 mandates the assessment of related party transactions with two main objectives: i) evaluate compliance with the regulatory framework through periodic monitoring (quarterly, based on supervisory reporting); and ii) assess potential adverse effects on LSIs' governance within the SREP. During ongoing supervision, particular attention is given to monitoring compliance with limits. If prudential limits (individual) on related party exposures are exceeded, the LSI must act swiftly to restore compliance; within 45 days from the breach the LSI must approve plan to bring back the exceeding exposure within the permitted limits and send it to the BdI within the following 20 days. In addition to a remediation plan, the LSI may be required to include excess capital in the Internal Capital Adequacy Assessment process (ICAAP). Governance requirements concerning related parties are also verified during ongoing supervision and Fit and Proper assessments, and findings included in SREP. Full-scope inspections thoroughly review related party transactions and their governance. No horizontal or thematic reviews of related party transactions have been conducted, as also noted in the euro area FSAP. Since the prudential regime's introduction in 2012, BdI reported that related party transactions have decreased by more than half, with only two breaches of individual limits reported by the end of 2024.

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[56] Exposures to each non-financial related party and its respective connected persons are limited to five percent of equity for banks' officers and shareholders with significant influence or control powers, 7.5 percent for other shareholders, and 15 percent in all other cases. For exposures to other related parties (financial), the limit varies from five percent to 20 percent of equity on each related party and its respective connected persons. Those limits are applied at the consolidated level for banking groups. In addition, for banks that are part of a banking group, they can have, on a standalone basis, a higher 20 percent limit toward a single group of related parties irrespective of their financial or non-financial nature.

C. Capital Adequacy: Pillar 2

78. Italian LSIs' capital requirements are based on the EU prudential framework. Capital requirements (Pillar 1) and regulatory own funds are established in the EU CRR and apply directly to the LSI sector. Capital buffers as well as Pillar 2 capital add-ons have been transposed into Italian legislation (BdI's Circular 285). BdI formulates a formal capital decision[57] for each LSI with frequency depending on the prioritization level of each institution (at least every year for HI LSIs, two years for remaining LSIs). Two capital buffers are designed to be released when adverse scenarios materialize: the Countercyclical Capital Buffer (CCyB), currently set at zero percent, and the Systemic Risk Buffer (SyRB), with an initial calibration of 0.5 percent and fully phased in at 1 percent since June 2025.

79. In implementing the 2020 FSAP recommendation, BdI's bank-specific SREP assessment has been complemented by a structured horizontal analysis, carried out on both SREP scores and Pillar 2 capital add-ons. This analysis (known as 'benchmarking') began with the 2020 SREP cycle, performed annually by a dedicated task force. The aim of this exercise is to enable comparisons of LSIs' risk profiles, foster consistency in assessment/outcomes across LSIs with similar business models and risk exposures, and ensure the uniform application of the SREP methodology. BdI indicated that benchmarking has contributed to strengthening the capital demand placed on LSIs, with particular attention given to the correlation between SREP scores and capital demand, as well as to the conservativeness of capital allocated to key Pillar 2 risks such as IRRBB, concentration risk, and under provisioning.

80. Since the 2020 FSAP, BdI has focused on strengthening supervisory methodologies and tools to make the determination of Pillar 2 capital add-ons more accurate and conservative. The P2R determination at BdI focuses on pure Pillar 2 risks, with the main components being IRRBB and Pillar 2 credit risk, while other Pillar 2 risks, such as sovereign and strategic risks, represent a very small portion (while having a more substantial impact on the P2G add-ons). The improvements include: i) risk-by-risk capital quantification for P2R, challenging ICAAP estimates with supervisory proxies and benchmarks; ii) a consistency check of the overall P2R quantification against the LSI's overall score (with a minimum add-on set for every score); iii) methodological improvements introduced in the proxies applied for relevant risks, such as IRRBB; iv) dedicated tools (e.g., ICAAP dashboards) provided to facilitate better horizontal comparisons; v) introduction of the EBA bucketing approach for P2G determination, increasing correlation between stress test capital depletions and imposed P2G, thereby limiting supervisory judgment; vi) a specific methodology introduced for determining P2R and P2G for excessive leverage ratio exposures (a number of capital decisions imposed within this framework).

81. The BdI still approaches concentration risk as a subset of credit risk; it is recommended that other dimensions of concentration risk are covered by Pillar 2. The 2020 FSAP recommended that BdI supervisory approach and requirements should incorporate all dimensions of concentration

[57] A formal capital decision for each LSI indicates: i) the Total SREP Capital Requirements (TSCR) ratio that includes Pillar 1 and Pillar 2 Requirements (P2R) and has to be met at all times; ii) the Overall Capital Ratio (OCR), that includes P1, P2R and the capital conservation buffer; and iii) in case needed a Total Capital Demand, that is equal to the sum of OCR and Pillar 2 Guidance (P2G), where the latter is a non-legally binding requirement.

risks, rather than focusing only on those linked to credit risk. In BdI's P2R, concentration risk is related solely to credit risk (Pillar 2 credit risk), covering single-name and geo-sectorial concentration risk. Concentration in other dimensions is not considered for Pillar 2 capital, and this potentially leaves some types of concentration uncovered. For example, the LSI sector holds more than 20 percent of sovereign exposures in its assets. BdI informed that, within SREP processes: i) the sovereign exposures are included within the P2R IRRBB framework, which is the main contributor to the overall LSI P2R. In addition, supervisory units may impose a specific P2R for sovereign exposures, on top of IRRBB add-ons (a number of LSIs have a specific P2R in force within this framework); ii) P2G – sovereign risk is one of the key factors in stress test capital depletion, contributing to the impact of credit spread risk. It is recommended that all dimensions of concentration risk, including related to sovereign exposures, are also considered when setting up Pillar 2 capital add-ons. Considering all the different components of the capital demand (i.e. P2R on IRRBB, explicit P2R on credit spread risk, and P2G), in practice, sovereign-related risks receive considerable coverage through capital add-ons; however, these do not directly address the concentration risk of sovereign exposures.

82. Recommendation: Consider all dimensions of material concentration risk, when setting Pillar 2 capital add-ons, including an explicit add-on for sovereign concentration with safeguards against double-counting effects.

D. Credit Risk and Problem Assets

83. BdI has thorough requirements for LSIs on management of credit risk and treatment of problem assets. Circular 285 and other BdI regulations set specific requirements for LSIs on identification, measurement, monitoring, and reporting credit risk and management of problem assets, mainly based on EU framework. Regarding loan classification and provisioning, Circular 285 has been updated through the years to transpose the EBA Guidelines on the application of the definition of default (EBA/GL/2016/07), defining technical criteria for the identification of defaulted exposures (past due and unlikely-to-pay) pursuant to Article 178 of CRR. BdI has also implemented EBA Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (EBA/GL/2017/06). In 2022, BdI attained full compliance with the EBA Guidelines on the management of non-performing and forborne exposures (EBA/GL/2018/06), as it was recommended in the 2020 FSAP.

84. BdI has robust requirements and processes for advanced internal rating-based (A-IRB) models for credit risk validation and monitoring. Recently, four larger LSIs have been authorized to use these models for prudential purposes, covering both corporate and retail portfolios. The validation process was in line with the best practices of Italian significant institutions. BdI indicated that these LSIs also benefited from upgrading and strengthening their credit risk management and internal processes. All these LSIs are subject to a floor on total consolidated RWA based on the corresponding RWA calculated under the standardized approach (ranging between 80 and 95 percent); add-ons at the parameter level (LGD) are also applied to the authorized models. After authorization, BdI intensively monitors each LSI, and the results are taken into account during the SREP process.

85. Credit risk remains the most important financial risk for LSIs and BdI's supervisory priority. Credit risk receives significant focus during off-site, on-site, and SREP activities. In recent years, BdI significantly increased the number of horizontal off-site reviews, partly in response to emerging risks stemming from shocks and uncertainties observed in the macro environment (e.g., COVID-19 pandemic, geopolitical risk). These reviews followed by BdI's letters to LSIs to raise a board of directors' awareness about the importance of proper credit risk management.[58] These initiatives also provided significant input for the BdI's periodic 'prioritization exercise' aimed at planning supervisory actions to be taken on problem banks (see Corrective and Sanctioning Powers section). Credit risk supervision conducted within the ongoing supervisory cycle reflected in SREP decisions with qualitative and quantitative supervisory measures. Credit risk was typically a core topic of full-scope on-site inspections, which uses a very intrusive approach, including an extensive credit file review. On-site inspection reports evidenced a comprehensive review of all relevant aspects of credit risk management and robust findings. Both off-site and on-site activities leverage the availability of granular data stemming from national reporting requirements, including from BdI's Central Credit Register.

86. BdI has increased its focus on supervision of LSIs public-guaranteed loans. In Italy, one quarter of corporate lending carries public guarantees with zero risk weight, a significant increase that occurred during the COVID-19 pandemic. BdI initiated the horizontal off-site review due to potential increase of residual, reputational, and credit risks. In June 2024, BdI issued a letter to LSIs regarding state-guaranteed loans, requiring[59] the internal audit function to conduct an in-depth assessment of PGS processes and a sample of credit files. Follow-up letters were sent in April 2025 with main recommendations including: i) the public guarantees cannot represent a derogation from the application of the general credit standards; ii) control measures for the entire commercial loan supply chain must strengthened; iii) the consistency between the declared purpose of the loan and the business activity must be assessed; and iv) robust AML/CFT systems and controls safeguards must be in place (for example, for transactions involving new customers). BdI also provided to LSIs other requests and expectations for strengthening oversight of this segment.

87. As recommended in the 2020 FSAP, BdI should be granted the explicit power to require LSIs to adjust their asset classifications and increase provisioning levels for prudential purposes. Currently, BdI does not have the power to require LSIs to adjust the classifications of individual exposures or impose provisioning levels for specific exposures for prudential purposes (BCP CP 18 EC7). Indeed, while, in principle, BdI has the power to require the application of a specific provisioning policy for prudential purposes, such a measure applies only to the methodology to be used by the supervised bank, while it does not entail the imposition of higher provisions on specific/individual exposures. BdI has indicated that banks usually take on board the findings related to loan classification and

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[58]Formal letters to LSIs sector: i) Letters on credit risk and business model sustainability, 2020-2021 (52 LSIs); ii) Letter on LSIs situation of September 2023 (80 LSIs); and iii) In June 2024, BdI issued a letter regarding state-guaranteed loans, requiring the internal audit function to conduct an in-depth assessment of PGS processes and a sample of credit files. Follow-up letters were sent in April 2025.

[59] BdI requested to conduct self-assessment by LSIs: i) to verify the overall process related to public-guaranteed loans, ii) credit file review to check possible need for reclassification and increase provisioning and any issues potentially affecting the enforcement of the guarantees and/or leading to legal and reputational risk; and iii) findings to be taken into account in the ICAAP, evaluating an appropriate quantification of capital

provisioning after BdI inspectors and supervisors review loan files[60]. This practice shows that supervisors broadly use moral suasion regarding LSIs' classification and provisioning levels. If banks do not comply, or more generally if the BdI deems a bank presents a potential under-provisioning of its portfolio, BdI has the power to impose a Pillar 2 capital add-on (P2R). BdI indicated that currently 30 percent of Italian LSIs have a specific P2R add-on for potential under-provisioning. Insufficient provisioning coverage may also lead to a poorer credit score and an overall weaker SREP score. Nevertheless, since the use of the P2R add-on could have limitations, it is important that BdI has the explicit power to take appropriate action through imposing the reclassification of NPLs and require increased provisioning levels for prudential purposes in order to ensure more effective supervision.

88. Recommendation: As recommended in the 2020 FSAP, the BdI should be granted the explicit power to require LSIs to adjust their asset classification and increase provisioning levels for prudential purposes.

89. Majority of LSIs removed legacy NPLs from their balance sheets; some LSIs specializing in legacy NPL management. Financial Stability Board concluded that the Italian authorities have achieved significant success in reducing NPLs on bank balance sheets[61]. LSIs sold their legacy NPLs to investors and firms specializing in NPL management. These NPLs have largely been securitized and are now managed by loan servicers. BdI actively oversees the securitization segment aimed at ensuring the traceability of the securitized assets even once they 'exit' the LSIs balance sheet[62]. Nonetheless, a substantial stock of NPLs remains in the system, held by investors and pending resolution, partly due to slow insolvency and foreclosure processes despite recent judicial reforms. LSIs focusing on NPL management[63] operate under a highly specific business model, heavily influenced by acquisition prices, recovery fluctuations, and a declining supply of NPL portfolios—factors that pose challenges for this activity. Some of these LSIs have started reviewing their business models by entering into other banking activities. It is recommended that BdI keep an intense supervision of these specialized banks—NPL management banks—to timely identify vulnerabilities related to business model sustainability. BdI continues reviewing the NPL strategies submitted by several high-NPL LSIs (NPLs >5 percent).

90. Recommendation: Keep intense supervision of LSIs specialized in NPL management banks to promptly identify vulnerabilities related to business model sustainability.

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[60] The BdI inspectors assess a sample of the bank's credit portfolio to verify whether the bank's classification and valuation comply with the applicable requirements. They then submit to the bank a list of loans containing the revised classification assessments and provision adjustments (Annex 1a/b). BdI expects banks to fully align their accounting with the valuations from the on-site inspections. BdI informed that this alignment occurs in almost all cases.

[61] Peer Review of Italy - Financial Stability Board (2024). Also, this topic was extensively discussed during the 2020 FSAP.

[62] In 2026, BdI is planning to conduct a thematic on-site inspection related to securitization transactions. The NPL securitization market is highly concentrated: approximately 93 percent of Gross Book Value is managed by six financial intermediaries and one specialized LSI. Between 2022-2005, BdI carried out an on-site inspection campaign on servicers, while a horizontal analysis is currently underway with the aim to identify strengths and weaknesses of the market and the opportunity of new supervisory measures.

[63] There are 16 specialized credit banks, including five that specialize in managing NPLs. These specialized banks hold 22 percent of LSI sector assets.

91. BdI is preparing to focus on a new initiative—the implementation of NPL calendar provisioning requirements for legacy NPLs. Recently ECB SSM launched a new initiative[64] for a harmonized supervisory approach to the coverage of non-performing exposures (NPE) held by LSIs for the exposures that originated before April 26, 2019. It is expected that this initiative can help reduce NPL-related risks, especially those arising from legacy NPLs, thereby making LSIs more resilient to potential adverse developments in the macroeconomic environment. Measures will apply starting from the end of 2025, but its introduction will be gradual, with full implementation starting at the end of 2028. BdI will use the outcomes of its assessments of LSIs' coverage of NPL exposures as part of the SREP, mainly through P2R add-ons.

92. Maintaining vigilant supervision of LSIs' credit risk and problem assets remains essential. Even though the level of NPL is lower compared to the past, the current macroeconomic environment requires that both off-site supervision—through bank-specific and horizontal analyses—and on-site inspections continue to be essential with continued focus on the worst-performing loan portfolios (e.g., commercial real estate), sectors impacted by geopolitical and tariff risks, and public-guaranteed loans.

93. BdI is proactively aiming to supervise the digitalization-related challenges faced by LSIs. BdI is planning thematic on-site inspections to assess how LSIs use new technologies and AI tools in the credit process, aiming to improve efficiency by shortening the time required for customer selection and evaluation, strengthening credit monitoring, and fostering innovation.

94. Recommendation: Continue prioritizing and vigilantly supervising LSIs credit risk and problem assets, focusing on worst-performing loan portfolios, sectors exposed to geopolitical and tariff risk, and state-guaranteed loans.

E. Liquidity and Funding Risk

95. LSIs in Italy are subject to the LCR and the NSFR as applied in the EU legislation[65]. Italian LSIs sector maintains sound liquidity buffers (LCR at 278 percent and NSFR at 151 percent as of June 2025; all LSIs reported these ratios well above minimum regulatory requirement). The NSFR[66] was introduced for Italian LSIs, as for the entire EU, in 2021. The BdI continues to exercise the options and discretions[67] available in the CRR and DA, which are aligned with the ECB SSM approach. Italian LSIs report LCR data on a monthly basis and NSFR data quarterly, using templates harmonized at the EU level.

96. BdI regulation for LSIs includes comprehensive liquidity risk governance and management requirements based on EU legislation. Circular 285 requires LSIs to have policies and systems in place

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[64] Public consultation on a draft Guideline for a harmonised supervisory approach to the coverage of NPEs held by LSIs

[65] The Euro Area 2025 FSAP found that the LCR and NSFR requirements continue to deviate from Basel standards Euro Area: Publication of Financial Sector Assessment Program Documentation-Detailed Assessment of Observance-Basel Core Principles for Effective Banking Supervision

[66] NSFR regulation (Circular 285) was updated in 2025 to establish the preferential required stable funding factors (RSF) currently applied to securities financing transactions.

[67] Regarding the LCR, BdI has opted to apply a 5 percent outflow rate to trade finance off-balance sheet items in accordance with Article 23 of the LCR Delegated Regulation (Circular 285, Introductory Provisions, Section V).

to prudently manage liquidity risk, including a clear definition of the roles and responsibilities of governing bodies, as well as processes for identifying risk factors, measuring exposure, conducting stress tests, implementing mitigation measures, preparing contingency plans, monitoring compliance with limits, and reporting to corporate bodies. BdI Circular 285 was updated in 2020 to incorporate certain EBA requirements on stress testing.

97. BdI has a long-standing practice of conducting weekly liquidity monitoring using a domestic template. Since the global financial crisis in 2007, BdI has been collecting extensive data[68] weekly from 72 LSIs to monitor ongoing liquidity risk in a business-as-usual scenario and to prevent potential shortcomings that could lead to idiosyncratic or systemic crises. LSIs can easily submit these data on a daily basis during times of systemic and idiosyncratic stress.

98. BdI increased supervisory focus on liquidity and funding risks related to TLTRO-III repayment by conducting a horizontal off-site review and thematic on-site inspections. Italian LSIs were among the most intensive users of TLTROs. A horizontal off-site review, covering 70 LSIs, focused on funding plans, verified banks' liquidity capacity to repay TLTROs using cash and highly liquid assets, assessed the reliability of these funding plans, and checked compliance with LCR and NSFR requirements during and after the phasing out of TLTROs. Thematic on-site inspections at three LSIs analyzed short-term funding (online and interbank), specialized business models, operational safeguards, and funding needs in light of the TLTRO-III reimbursement. BdI reported that LSIs successfully repaid TLTRO-III: a few used their excess liquidity to repay, while the majority increased their market access (mainly through unsecured debt issuance) or raised deposits from retail and corporate clients. Following the repayment of TLTRO-III, the amount of unencumbered assets increased, which could be used as collateral in repo and other markets.

99. BdI continues to assess LSIs' liquidity and funding risks and their management during SREP and on-site inspections. Since 2018, Italian LSIs have been submitting their Internal Liquidity Adequacy Assessment Process (ILAAP) reports annually. In implementing the 2020 FSAP recommendation on ILAAPs, BdI has consistently worked[69] to ensure that ILAAPs achieve an adequate level of quality and reliability. BdI's supervisory approach is based on the ongoing assessment of liquidity risk in both normal and adverse scenarios, and the ability of LSIs to govern, manage, and control this risk. BdI's stress tests on liquidity risk are used within the SREP Risk Appetite Statement and to identify banks that may be more exposed to certain risk factors. As a result of SREP liquidity and funding risk assessments, BdI typically conveys most recommendations and interventions to banks through formal SREP letters or discusses them during prudential meetings with LSIs. From the

[68] LSIs are required to report on a weekly basis of: i) counterbalancing capacity, together with projections of inflows and outflows over a three-month period, and detailed information about central bank eligible assets, including both on- and off-balance sheet items; and ii) on a fortnightly basis, additional information regarding further sources of liquidity, including on-demand funding composition, the fifty most relevant depositors, interbank positions, etc.

[69] Specific areas for improvement—often linked to stress test assumptions—are usually addressed after the SREP cycle through formal letters or prudential meetings, requesting the adoption of appropriate initiatives to resolve the deficiencies highlighted in the subsequent ILAAP.

perspective of on-site inspections, LSIs' liquidity and funding risk management practices are thoroughly assessed during full-scope inspections to obtain a holistic view, including interlinkages with other risks.

100. BdI has increased supervisory focus on the risks associated with LSIs collecting funding via online deposit platforms (ODP). In recent years, the collection of deposits through ODPs located in other EU countries, under a free provision of services regime, has emerged as a new trend for some Italian LSIs. BdI analyzed this phenomenon through horizontal off-site review and on-site inspections, participated in ECB SSM task force, and now has a comprehensive understanding of all related risks and these LSIs' business models.

Box 1. Italy: Collection of Deposits through On-line Deposit Platforms – BdI's View on Risks and Supervisory Response

Key Risks

In the last few years, the increasing collection of deposits through Online Deposit Platforms (ODPs) located in other EU countries, particularly by 'challenger banks' and some traditional banks interesting in funding diversification opportunities, has emerged as a new trend for some Italian LSIs. Although this kind of funding has proven its stability so far, the collection of ODP deposits entails some risks, mainly related to liquidity, business models, and operational/AML and ICT aspects. Key liquidity risks might arise from the potential volatility of ODP deposits, especially in light of depositors' behavior influenced by online banking and social media. Business model risks are notable for specialized banks heavily reliant on ODP funding. Operational risks include challenges in governance, compliance, and information security linked to the digital nature of these platforms.

Supervisory Response

In response, BdI has established a comprehensive supervisory framework to monitor and mitigate these risks. Prior to allowing ODP deposit collection, LSIs must submit detailed liquidity plans addressing ODP-specific characteristics and maturity mismatches. They are also required to conduct thorough risk assessments covering risk management, compliance, and AML/CFT functions. BdI evaluates these submissions and mandates corrective actions before operations commence if deficiencies are found. To ensure ongoing risk monitoring, BdI collects regular quantitative data on ODP funding through targeted reports integrated into LSIs' liquidity reporting, supplemented by periodic detailed surveys. AML/CFT risks linked to ODPs have been pragmatically assessed through on-site inspections . Building on accumulated data and supervisory experience, BdI actively contributes to ongoing work on this topic both at the EBA and ECB SSM levels

101. Digitalization-related challenges affecting liquidity and funding risks is an emerging topic at an international level and requires further attention. BdI could benefit from the empirical and academic studies on changes in depositor behavior[70], particularly on higher social media-driven mobilization of depositors. BdI noted, that currently Italian LSIs depositors tend to be more loyal to

[70] The 2023 banking turmoil illustrated the changing and increasingly volatile nature of depositors' behavior, where social media can be used to mobilize crowds to withdraw deposits. Moreover, online banking, digitalization, and the increasing role of non-bank competitors have a greater impact on depositors' behavior and, consequently, the stability of banks' liquidity and funding sources.

their banks, but the fast-changing environment could change depositor behavior, making it essential to prepare for various possible scenarios.

102. Recommendation: Further address digitalization-related challenges affecting the LSI sector's liquidity and funding risks, particularly focusing on funding from online deposit platforms (ODPs) and hypothetical scenarios of sudden shifts in depositor behavior, such as social media-driven mobilization. This could include setting up rapid outflow stress scenarios reflecting social-media dynamics, or contingency funding playbooks for LSIs with high reliance on ODP.

F. Operational Risk

103. Since the 2020 FSAP, the regulatory framework for LSIs concerning operational risk has been reinforced through the implementation of EU legislation, with ongoing efforts on strengthening LSIs' operational resilience. Since January 2025, all LSIs calculate operational risk capital requirements using the standardized approach (Pillar 1), following CRR 3 implementation of Basel III post crisis reforms in the EU. The Circular 285 has been updated in August 2025 implementing the revision of the CRR 3, including Chapter 8 on Operational Risk. The BdI regulation establishes thorough requirements for overall risk management, including for operational risk, and the role of board of directors in its supervisory function to define the risk tolerance threshold, the risk appetite framework, and the risk management policies. In updating BdI regulation, requirements for internal control systems, including operational risk, as well as operational continuity, were strengthened. Currently, Circular 285 also includes detailed requirements for LSIs on ICT and security risk management, under review according to applicable DORA, with ongoing efforts to strengthen LSIs' operational resilience.

104. Operational risk and resilience were assessed during off-site and on-site supervision and within SREP, with particular focus on IT risks, business continuity, and disaster recovery. As regards the on-site inspections, the supervisory activities have been intensified with respect to the LSI's operational risk management and operational resilience. In addition to the full-scope inspections on LSIs, inspections were carried out on the main LSIs IT service providers. These on-site inspections revealed over 100 findings of varying severity, primarily related to outsourcing management and oversight, security processes, governance and IT risk management, and business continuity tests and disaster recovery plans. The findings of on-site inspections were integrated into the supervisory process, with follow-up activities. In addition to on-site inspections, off-site supervisors used the IT Risk Questionnaire (ITRQ), within the annual IT Risk assessment under SREP, to gather data on ICT risk exposure and the related control environment. The assessment of operational risk[71], including ICT, is regularly performed within the SREP[72]. The main results and requested remedial actions are typically included in the formal SREP letters to LSIs.

[71] In BdI's operational risk assessment, reputational risk is also evaluated, with compliance and conduct risks incorporated, and the assessment of ESG factors taken into account.
[72] The integrated ICT risk and operational risk supervisory framework is undergoing a major overhaul (e.g., Circular 269/2008) and is now aligned with the methodological updates introduced by the ECB SSM LSI Manual, also reflecting the entry into force of CRR 3.

105. **Since the 2020 FSAP, BdI conducted five on-site inspections on IT providers, to which LSIs outsource their IT systems and services; continued prioritization of this type of on-site inspections is essential.** The majority of Italian LSIs have been outsourcing[73] their IT functions to a small number of IT providers, and the use of cloud services has increased. In implementing the 2020 FSAP recommendation, BdI started performing on-site inspections over these IT providers[74] to ensure they are subject to minimum IT security requirements and to assess their IT risk governance and controls. The main shortcomings identified during these on-site inspections relate to management of core IT and security processes, assessment of IT risks and completeness of the inventories regarding the IT systems and services provided to customers, and coverage and depth of business continuity and disaster recovery tests performed. BdI shared on-site inspections reports to these IT providers, and requested the remedial plans, which were monitored. At the same time, BdI shared summaries of the relevant on-site findings with LSIs, sent letters to remind them of their ultimate responsibility on outsourced functions (43 letters in 2024), and requested to assess and monitor the implementation of IT providers' remediation plans. Follow up inspections carried out at the main two IT providers in 2024 to verify how previous shortcomings were addressed.

106. **Recommendation:** Continue prioritizing on-site inspections of IT and cyber risk, including inspections of firms to which LSIs have outsourced their IT systems and services.

107. **BdI has intensified supervision of ICT risk using innovative tools; further efforts are needed to continue strengthening LSIs' operational resilience.** In SREP, ICT Risk is assessed as an integrated separate component of operational & ICT risk. BdI's supervisory methodology is comprehensive and annually updated to be aligned with the current ECB SSM LSI Manual. In the ICT risk assessment, BdI has been considering DORA provisions[75]. In a three-year period, all LSIs (excluding Raiffeisen banks[76]) have been subject to the ITRQ exercise in the context of annual SREP. Compared to the standard SSM LSI ITRQ, additional requests of information related to DORA, Risks controls on cloud, AI developments were integrated as well as on financial aspects of IT. Moreover, BdI has prepared an ITRQ assessment tools, providing an automated score to the analysis, that carry out an assessment also by using other available information (e.g. results of risk assessment on payment services, major incidents, benchmarking tools). This exercise revealed main points of attention: over-reliance on IT providers, need to strengthen controls on IT providers, and enhancement of ICT risk control functions. Another system-wide horizontal analysis[77] focused on major ICT incidents[78], which have shown an increase in reported cases over recent years. Operational incidents remain predominant, with a strong

[73] As of December 2024, 72 percent of LSIs, excluding the Raiffeisen banks belonging to the Raiffeisen IPS), have adopted IT models relying fully or extensively on outsourcers. On average, the main IT provider accounts for more than 75 percent of third-party IT services; in some cases, IT providers rely on specialized sub-providers for IT services such as supervisory reporting, cloud services, and AML/CFT. For LSIs' IT core banking, the market is highly concentrated, with two of the six main IT providers serving more than the half of LSIs.
[74]In addition to five direct on-site inspections of IT providers, other on-site inspections have been conducted indirectly during on-site inspections of banks that are customers of these IT providers.
[75] Eg: Threat Intelligence Based Ethical Red-Teaming (Tiber), Threat-Led Penetration Test (TLPT); and ESA recommendation on critical third parties (CTPP)).
[76] It was excluded Raiffeisen banks but the central body of the IPS Raiffeisen was included.
[77] Banca d'Italia - Supervisory Operational or Security Incident Reporting Framework - Horizontal Analysis 2024
[78] This horizontal analysis included many other topics such as self-assessment on DORA readiness, analyses on innovative technologies (e.g., biannual Fintech Survey, AI, and quantum computing).

involvement of third-party providers and a slight growth in the number of cyber incidents. On-site inspections also significantly focus on operational resilience – ICT risk assessment[79], and business continuity and disaster recovery[80] capabilities. This on-site assessment is integrated, if needed, with the evaluation of third-party management process; it can also leverage the outputs of inspections performed directly on IT providers. All these topics were covered during LSIs full scope on-site inspections and inspections of the main IT providers. Findings from intensive BdI supervisory work reveal that further efforts are needed to continue strengthening LSIs' operational resilience. BdI is planning to focus more on ICT risk management (governance and control system) and third-party risks. Depending on the results of the analyses, some LSIs may also be included in the perimeter of banks that will have to carry out TLPT according to DORA.

108. Recommendation: Further proactively conduct supervisory work to strengthen LSIs' operational resilience, with particular focus on effectiveness of the ICT risk management (governance and control system) and third-party risks.

109. Supervisory capacity related to IT and cyber risks has strengthened; however, continued initiatives are crucial to further enhance it in the rapidly evolving digitalization landscape. In 2022, a new Outsourcers and Third-party Supervision Unit dedicated to LSIs was established, with the aim of fostering a holistic approach[81] on third party risk and identifying IT service providers that require closer monitoring from a BdI perspective. Other IT experts are distributed in the Banking Supervision Directorate 2 and Regulation and Macroprudential Analysis Directorate divisions. The Statistical and ICT Support Division carries out horizontal analysis on ICT/cyber risks and provides specialized support to other units in the Banking and Financial Supervision DG. BdI also draws resources from its IT department when needed. Recently, BdI has activated several initiatives to strengthen its capacity in IT and cyber risk supervision. These include: i) promoting external (e.g., participation in the SSM ICT risk networks and other related workstreams and working groups) and internal synergies — such as an agreement with the IT Department for the exchange of resources; ii) specialized new hires to reinforce capacity; iii) implemented measures as focused training programs to enhance skills and effectiveness.

110. Recommendation: Continue increasing supervisory capacity for IT and cyber risks, with a particular focus on ensuring a capable and timely response in the rapidly evolving digital landscape.

[79] ICT risk assessment includes: the ICT security risk, ICT availability and continuity, ICT change risk, ICT third party risks, ICT data integrity risks; the adequacy of ICT governance, ICT risk management and control framework. The methodology embeds DORA provisions (e.g. Threat-Led Penetration Test (TLPT)). In such context, the identification, mapping and management of ICT systems supporting critical functions and processes is evaluated.

[80] Business Continuity (BC)-Disaster Recovery (DR) assessment includes: the adequacy of LSIs' BC and DR plans and the related definition and review processes (e.g. coherence with the group structure, strategy, resources, CIFs; triggers and owners; the completeness of the identified scenarios, internal findings stemming from TLPT exercises, adequacy of tests).

[81] The main activities of this unit include supporting on-site inspections (e.g., planning, follow-up with IT service providers) and requesting corrective actions from IT service providers when deficiencies are identified. In collaboration with other units within the Banking Supervision Department 2 (LSIs), the unit evaluates and monitors the implementation of remedial plans. It is also responsible for conducting horizontal analyses, collecting outsourcing registers, and supporting the supervision of LSIs in this area. Data collection of outsourcing registers began in 2023, involving both LSIs and NBFIs.

G. Interest Rate Risk in The Banking Book (IRRBB)

111. The regulatory framework for LSIs to assess and manage IRRBB is based on comprehensive European legislation, with certain adjustments to meet national needs. BdI's Circular 285 contains requirements for LSIs that are aligned with the EU CRR2/CRDV and EBA Guidelines; directly applicable EU legislation is also applied by LSIs. These include requirements for LSIs to have adequate systems to identify, measure, evaluate, monitor, report, and control or mitigate IRRBB. The framework also covers Credit Spread Risk in the Banking Book (CSRBB) in line with the EBA Guidelines on IRRBB and CSRBB. In June 2024, BdI updated the existing Italy-specific simplified methodologies for LSIs to calculate IRRBB exposure from both economic value of equity (EVE) and net interest income (NII) perspectives, aimed at reducing the compliance burden, particularly related to behavioral models, to integrate the new provisions from CRDV. These methodologies were updated through a technical dialogue between BdI and industry representatives and are used by LSIs on a voluntary basis. Furthermore, supervisory powers were further specified—currently, BdI has the power to require the use of the standardized methodology if a LSI's internal IRRBB systems are found to be unsatisfactory; this power has not yet been exercised.

112. BdI supervisors assess LSIs' IRRBB exposure as well as their governance and control arrangements during off-site and on-site supervision and within the SREP exercise. BdI continuously monitors IRRBB by comparing LSIs' internal metrics with the outcomes of the BdI regulatory metric, which is computed regularly for all LSIs (quarterly and semi-annually) based on EVE and NII. Alongside the regulatory metric results, data from LSIs' internal systems—both the ICAAP quantification (annually) and the outcome of the Supervisory Outlier Test (quarterly)—are also regularly collected and reviewed as part of the SREP. In line with the EBA EU-wide ST methodology, the BdI micro-prudential solvency stress test for LSIs includes stress projections on operating income, thus stressing out the net interest margin. The outcome of the stress test, combined with supervisory proxies, is used for capital add-ons related to IRRBB[82]. BdI's full-scope on-site inspections comprehensively assess the IRRBB component, with particular focus on verifying whether the LSI's strategy, policies, and processes for managing IRRBB/CSRBB are developed in a safe and sound manner and implemented effectively. For 2026, BdI is planning thematic on-site inspections focused on IRRBB.

113. Recently, BdI carried out horizontal off-site analyses to assess the soundness of internal behavioral models used by LSIs for managing and measuring IRRBB exposure. A first assessment in 2024 was carried out on a sample of LSIs, focusing on behavioral models for non-maturity deposits. In 2025, the analysis was then expanded to all LSIs using internal models for non-maturity deposits and loan prepayment risk. The analyses focused on three areas: i) governance and internal controls (e.g., IRRBB policy, internal audit, and validation activities); ii) behavioral models (e.g., segmentation of deposits by counterparty and account characteristics, key parameters of loan prepayment rates, historical databases used for estimates); and iii) model risk assessment (e.g., sensitivity and stress tests on key parameters and the use of results to support internal capital allocation decisions). The outcome of the analysis and the shortcomings identified during the exercise. contributed to the IRRBB SREP score and the capital

[82] Around 50 percent of Pillar 2 capital add-ons relate to IRRBB.

decision. The findings were communicated to banks through formal SREP letters or ad hoc communications, requesting the adoption of necessary remedial actions in the subsequent ICAAP. Looking ahead, BdI plans to continue monitoring the implementation of behavioral model-related requirements and adjust as necessary.

114. According to BdI monitoring, Italian LSIs' exposure to IRRBB—measured from both the EVE and NII perspectives—has remained generally limited over the past few years. Since September 2024, LSIs have been submitting new quarterly IRRBB reports (based on EBA ITS reporting), enabling BdI to increase monitoring compliance with the Supervisory Outlier Test IRRBB thresholds. On average, exposure is below 15 percent of Tier 1 capital for EVE and under 5 percent for NII. Based on this analysis, LSIs collectively exhibit a positive duration gap, meaning their assets typically have longer durations than their liabilities. The asset side primarily consists of loans to customers and securities, while liabilities are predominantly deposits. As a result of this balance sheet composition, LSIs are mostly sensitive to upward shifts in interest rates from the EVE standpoint, whereas from the NII perspective, they are more exposed to downward shifts in interest rates.

115. Since December 2022, BdI has been monitoring Italian LSIs' unrealized losses on amortized cost[83] assets on a semi-annual basis. This thematic review was launched following the increase in the Italian credit spread observed during the COVID-19 pandemic, with its importance further heightened after the 2023 banking turmoil. Between December 2022 and December 2024, the potential impact of unrealized losses on the CET1 ratio – with reference to the Italian banking system (SIs and LSIs) - decreased significantly from 200 bp to an average 61 bp[84]. Starting with the 2026 SREP cycle, BdI plans to integrate the quantitative assessment of unrealized losses into the SREP IRRBB&CSRBB methodology for LSIs, aligning with the ECB SSM approach[85]. It is important to continue carefully monitoring unrealized losses, as if assets need to be sold or market conditions deteriorate, these losses can quickly become realized, impacting regulatory capital ratios.

116. Recommendation: Continue carefully monitoring unrealized losses from held-to-maturity portfolios at amortized costs.

H. AML/CFT

117. Since the 2020 FSAP, BdI has made progress to improve technical compliance with the AML/CFT international standard (banking sector). The Financial Action Task Force (FATF) noted that Italy has made progress to improve its technical compliance with the AML/CFT international standard,

[83] The scope covers financial instruments held-to-maturity (HTC) at amortized cost. Exposure to unrealize losses is calculated using non-harmonized reporting data based on the fair value of the HTC financial assets.
[84] The decline of the impact reflects (i) a moderation of unrealized securities losses as long-term yields eased in 2024, reducing valuation pressures on banks' fixed-income portfolios, and (ii) intensified supervisory follow-up on IRRBB management and balance-sheet resilience, which encouraged corrective adjustments.
[85] At the ECB SSM level, no capital add-ons were envisaged for unrealized losses until now. From the 2026 SREP cycle onwards, the quantitative assessment of unrealized losses (ULs) and unrealized gains (UGs) will be included in the IRRBB & CSRBB SREP methodology for LSIs. Supervisory assessment of UL/UG will be based on: i) the current value and evolution of UL/UG over time, and ii) the ability of IRRBB metrics produced in the past to anticipate the current/observed level of UL.

notably strengthening risk-based supervision through a more structured risk-rating process that assesses both inherent ML/TF risks and the mitigating measures, as well as expanding supervisory powers and sanctions.[86] The broader FATF mutual evaluation that also looks at the effectiveness of Italy's AML/CFT framework is currently underway.[87]

118. BdI organizational reforms increased focus on AML/CFT supervision in the banking sector by establishing an independent unit reporting directly to the Governing Board. In 2021, an Anti-Money Laundering Supervision and Regulation Unit was established, independent from the Banking Supervision Department and reporting directly to the Governing Board. The main objectives of this reform were to address the increasing complexity of ML/TF risks, centralize AML supervisory and regulatory functions to ensure a unified approach, and facilitate effective coordination with the new European AML/CFT Authority (AMLA).

119. The approach to AML/CFT on-site inspections was amended, in alignment with the FSAP 2020 recommendation to conduct more targeted reviews or more prudential inspections over banks by deploying resources previously involved in inspections over banks' branches. On-site inspection efforts were indeed reallocated to full-scope AML/CFT assessments, targeted inspections of specific risk areas, and thematic inspections across banks and non-bank intermediaries, in line with a risk-based supervisory approach. In 2023 and 2024, particular emphasis was placed on thematic and targeted inspections, with eight and nine conducted respectively, along with several follow-up inspections addressing issues identified in previous investigations.

120. There has been an increase in cooperation and coordination between AML/CFT supervisors and prudential supervisors. Italy has significantly enhanced the integration of ML/TF risks into prudential oversight. The AML/CFT unit works in close and regular contact with prudential supervisors, with its assessments feeding directly into core prudential processes. The notes prepared for the BdI Governing Board related to various prudential assessments (e.g., authorizations for qualifying holdings) always include a section that describes the AML profile. AML/CFT considerations are embedded across all SREP areas—business model and profitability, governance, operational risk, liquidity risk, and credit risk—where they can influence the overall SREP score and capital requirements.

121. Prudential supervisors assess ML/TF-related vulnerabilities across multiple dimensions:

- *Governance and Internal Controls.* The presence of vulnerabilities in a bank's AML/CFT systems and controls could be an indicator of weaknesses in the broader organizational structure and internal control system; Evaluation of the effectiveness and involvement of Board of Directors and the Board Statutory Auditors in AML/CFT oversight; Use of Tableau de Board to understand their proactivity of control functions in addressing ML/TF risks.

[86] Financial Action Task Force 2019 Follow-Up Report Italy's progress in strengthening measures to tackle money laundering and terrorist financing
[87] Italy is currently undergoing assessment against the AML/CFT international standards, the conclusions of the assessment are scheduled to be discussed at FATF plenary meeting in February 2026.

- *Business Model.* Integration of ML/TF risk analysis into assessments of business model vulnerability and sustainability; Identification of prudential indicators to detect vulnerabilities linked to strategic choices, high ML/TF risk products and services, and exposure to higher-risk counterparties; sectoral benchmarking dashboards for comparative analysis.

- *Credit Risk.* continuous monitoring of ML/TF risks throughout the credit lifecycle; assessment of credit management policies for procedures addressing ML/TF risks at origination and repayment; consideration of customer types, products, geographic exposure, and funding legitimacy.

- *Operational Risk.* Recognition of reputational risks and adverse events stemming from AML/CFT weaknesses; Evaluation of IT system robustness and planning for ongoing upgrades to detect ML/TF transactions.

- *Liquidity and Funding Risk.* Analysis of funding structures for concentration in high ML/TF risk sources. Use of specific indicators to highlight vulnerabilities, such as deposits from high-risk jurisdictions or in high-risk currencies.

122. While cooperation between prudential and AML/CFT supervisors is strong, deeper coordination would further enhance the integration of ML/TF considerations into prudential work. The introduction of ML/TF triggers into supervisory processes is positive; these triggers integrate those already included in ML/CF unit's methodology. Those indicators are the ones defined by SSM. If the trigger exhibits an anomalous value that deviates significantly from the industry average, the supervisory unit shall undertake further in-depth analysis, with the involvement of the ML/CF unit.

123. Recommendation: Continue promptly integrating AML/CFT findings into the prudential assessments of LSIs and strengthening cooperation and coordination with AML/CFT supervisors.

Appendix I. Overview of the LSIs Business Models

1. Italian LSIs sector is characterized by a significant diversity of business models. For supervisory purposes, Italian LSIs are classified into the following business models:

Traditional LSIs

These banks primarily focus on deposit-taking and lending to households and businesses. They usually operate regionally serving stable local customers.

In BdI's view:

- *Main risks:* credit risk—due to high exposure to SMEs and real estate lending, which are particularly sensitive to economic downturns—and interest rate risk. They are sensitive to changes in net interest margins.
- *Main Challenges:* achieving business model sustainability and cost efficiency must remain central to intermediaries' strategic considerations, while preserving trust-based relationships with customers despite the gradual reduction in branch numbers. Ensuring continuous process and service renewal by harnessing rapid technological advancements, while simultaneously strengthening internal expertise, supporting effective governance, regulatory compliance, and a balanced reliance on external IT providers.
- *Supervision's focus:* quality of the loan portfolio, adequacy of classification and loan loss provisions; potential asset-liability mismatches.

Asset Management-Oriented LSIs

2. Focused on wealth management, investment services, and custody with limited lending activity, these banks generate most revenues from fees and commissions and have lower credit risk than traditional banks. However, they are more vulnerable to market volatility affecting assets under management and face higher operational and reputational risks due to dependence on IT systems, third-party providers, client trust, and regulatory compliance.

In BdI's view:

- *Main risks:* operational risk related to the management of financial advisor networks (compliance risk, AML risk, failing in IT systems supporting advisors); strategic risk: banks with limited size and a Private/HNWI client base often have a core business that is not fully economically sustainable, due to weak competitiveness in pricing and high operating costs; for some banks the risk stems from dependence on a small number of advisors when few of them generate a significant portion of revenues, in a high competitive environment.
- *Main challenges:* Leveraging technological tools to enhance investment performance; improving operational efficiency, including through the consolidation of market players, in order to achieve assets under management levels that ensure economic sustainability; business diversification through entry into new sectors (example: structured finance, alternative investment).

- *Supervision's focus:* business model's sustainability in terms of evolving volumes of assets under management and margin performances; monitoring of operational risk, with particular reference to control system on financial advisor networks; execution risk stemming from recent M&A operations and arising from entering new market to diversify the business.

NPL Management-focused LSIs

3. Specialized in acquiring and managing NPLs, often at significant discounts, these banks frequently operate within restructuring or resolution settings. Their activities and asset types vary widely. Many also engage in traditional lending activities. Their main risk is credit risk, particularly the risk of recovering less than expected from NPL portfolios. Key factors including higher interest rates and a slowing NPL market are reshaping their operations.

In BdI's view:

- *Main risk:* credit risk, namely the risk of obtaining from purchased NPLs lower recoveries than those estimated at the time of purchase. Indeed, for these intermediaries, the correct valuation and pricing of investment portfolios during the acquisition phase is key.
- *Main challenges:* dependence on a single/limited source(s) of income, shrinking and context-dependent NPL market (influenced, among other factors, by the macroeconomic environment), and significant impact of the regulatory framework on capital ratios (e.g., calendar provisioning).
- *Supervision's focus:* assessment of the purchased loans' value and capacity of recovery; operational/reputational risks typical of servicing activities; liquidity and interest rate risk (especially in case of no physical branches).

Specialized Lending LSIs

4. These institutions focus on niche credit activities such as leasing, factoring, consumer finance, and publicly guaranteed loans. They serve small and medium enterprises with a narrow range of products and typically higher margins. They usually avoid physical branches, relying heavily on external agent networks, which entail operational and reputational risks. Their funding sources are more volatile, less based on traditional current accounts. Credit risk varies depending on the loan type, with certain products (salary-backed loans, state-guaranteed loans, loans to public entities) mitigating risks effectively. They tend to have lower NPL coverage ratios than the broader banking sector.

In BdI's view:

- *Main risks:* credit risk, that varies significantly depending on the type of credit granted, and in some cases, it is mitigated by the specific type of credit offered; operational (also AML) and reputational risks arising from the external network of agents and brokers; liquidity risk that might be associated with the use of online funding platforms.
- *Main challenges:* ensuring the sustainability of the business model over the medium to long term, in light of a rapidly evolving economic and financial context.
- *Supervision's focus:* profitability and credit risk of the specific asset classes; governance and control systems that are often less structured than traditional banks.

Appendix II. Methodological Framework for Supervisory Quality Assurance

1. The BdI's SQA Function adopted procedures, tools, and methodologies to carry out its activities in order to ensure the effective and efficient performance of its duties. The Division independently plans and conducts oversight activities on supervisory processes falling under the responsibility of the BdI, while also conducting benchmarking with the approaches and guidelines defined within the SSM to identify relevant best practices for domestic supervision. The main activities of the SQA Function are the following:

- *Assurance Review:* This is an in-depth review of a supervisory process or activity that provides an impartial assessment of its organization (governance), management, and first-line controls. These are reviews aimed at ensuring the effectiveness, timeliness, and consistency of supervisory activities. These are examined, verifying the operational procedures and internal controls in place. Where deficiencies are identified, interventions aim to identify underlying root causes and formulate recommendations for possible remedial actions. In the presence of significant critical issues or if material challenges arise in implementing the action plans, the activation of a specific follow-up assessment may be envisaged.
- *Back-testing Analyses:* These ex-post analyses focus on specific events and/or cases that occurred in the past and aim to reconstruct the related supervisory actions and the underlying decision-making process. Conducted with a cross-functional approach, they are intended to identify areas for improvement in line with the "lessons learned" principle.
- *Desk Analysis:* Based on available data and sources, desk analysis seeks to identify phenomena or processes that deserve attention from a risk perspective. Drawing from existing analyses, it may result in proposals for intervention or suggestions.
- *Advisory:* These are ad hoc analyses to help improve the processes and activities of the Directorates by objectively evaluating their strengths, weaknesses, and progress, particularly with regard to ongoing activities, as well as specific projects (for example, related to IT infrastructure and internal communication). During advisory engagements, governance, risk management, and internal control issues may be identified in relation to processes, procedures, methodologies, and resources.

The methodological framework of SQA includes the following key components: planning, execution, monitoring, and review of the quality assurance process.

Planning

2. The approach adopted in the planning phase is risk-based and takes into account several factors such as: i) strategic priorities defined at the level of the SSM, BdI and DGFSR, ii) vulnerabilities identified in previous SQA and Internal Audit activities, iii) planning of internal audits concerning supervisory processes, in order to avoid overlaps, iv) the criticality assessment performed by the Operational Risk Management (ORM) Function and v) methodological and organizational changes related to supervisory processes and products.

3. The risk universe includes the processes, activities and products of DGFSR and is updated annually, enriching the ORM process map with additional information in order to arrive at a sufficiently granular and up-to-date definition of the analysis of objects.

4. The update of the risk universe is the prerequisite for the application of the inherent risk assessment methodology which, starting from the updated criticality assessment carried out by the ORM Function, incorporates the assessment of the factors described above and takes into account the coverage of supervisory processes by the second and third lines of defense.

Execution

5. Roles and responsibilities of the different actors involved in the assurance review process, both internal (Team Lead, Team members and Discussant) and external (Directorates of DGFSR and Branches), the operational procedures to be applied in the different phases of the investigation (from the definition of the work programme to the formalization of the results) as well as the assessment methodology are formalized in the operational manual of the SQA Function. This is ensuring standardization of the iter and outcome of the quality assurance activities, traceability of the process, and accountability towards relevant stakeholders.

Monitoring of Action Plans

6. The SQA Function verifies that the initiatives identified by the relevant Directorates and Branches in order to overcome the critical issues identified in previous assessments have been implemented or, if not, that the risk has been accepted at the relevant levels. In detail, starting from the action plans defined by the relevant stakeholders after the reviews, detailed information on the status of the expired initiatives is collected jointly with any relevant supporting documentation useful for assessing the implementation of remedial actions.

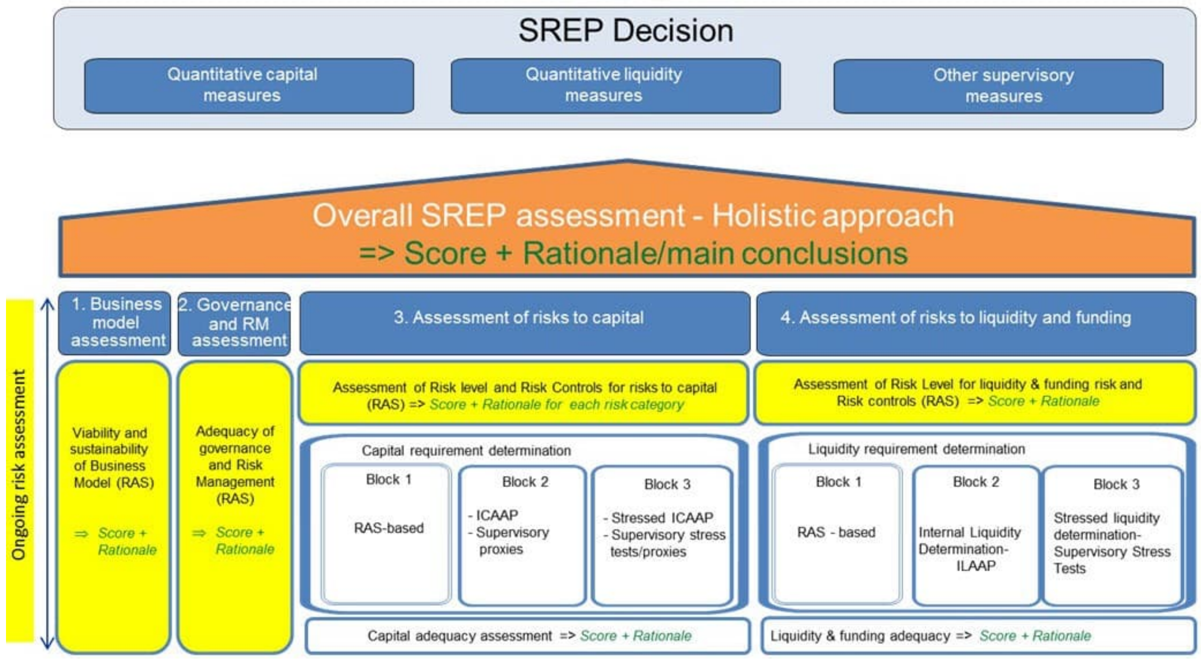
Review of the Quality Assurance Process

7. The quality assurance process is reviewed and updated annually with the ultimate goal of verifying its ability to fulfill the objectives of the SQA Function. The activity involves the ex-post analysis of the implementation phases of the assessments carried out during the year (reviews, follow-ups, and other analyses). Following the assessment, if changes are deemed necessary, specific improvement actions are defined and implemented in terms of revision of the methodological framework.

Appendix III. Overview of the SSM Supervisory Review Process

1. The SREP methodology relies on quantitative and qualitative assessments, overlaid with supervisors' expert judgement, to derive SREP decisions that are tailored to a bank's specific risk profile.

Structure of SREP



Source: ECB.

2. The methodology is built on four elements, which can be tailored for the specific situation of each institution:

- *Business model assessment* – including an assessment of business model viability and sustainability.
- *Internal governance and risk management assessment* – assesses group structure, internal governance framework, risk management framework, internal control environment and risk infrastructure.
- *Capital assessment* – includes a risk-by-risk assessment of risks to capital i.e., credit risk, market risk, operational risk and IRRBB. This assessment also includes an ICAAP outcome, encompassing ICAAP governance, capital planning, scenario design and stress testing, internal controls, independent reviews and ICAAP documentation, data and infrastructure, risk capture, management and aggregation.
- *Liquidity assessment* – includes a risk-by-risk assessment of risks to liquidity and funding, i.e., short-term liquidity, long-term funding sustainability and ILAAP reliability assessment, encompassing ILAAP governance, funding strategy and liquidity planning, scenario design, stress testing and

contingency funding plan, internal controls, independent reviews and ILAAP documentation, data and infrastructure, risk capture, management and aggregation.

3. Consideration is also given to developments in the sector and the wider economic environment that may have an impact on the longer-term risk profiles of the banks. This is achieved through quarterly risk analysis packs (analytical reports of supervision), financial stability reviews, quarterly bulletins, internal ‘policy bites’ information sessions, SSM priorities, and SSM horizontal assessments. Frequency of engagement with each LSI is based on the risk profile of the bank, business model changes, and the nature, scale, and complexity of the institution.

Appendix IV. Overview of BdI's SupTech Tools and Digitalization Initiatives

1. BdI has developed several SupTech tools and is finalizing other digitalization initiatives.

2. *First*, Findings Automation supports on-site inspection activities through two new SupTech tools designed to make drafting and reviewing findings. The first tool, NOR.R.IS (NORmativa Rilievi ISpettivi), provides a single access point for national and international regulations with advanced search and exploration features. The second tool, S.O.FI.A (System for Onsite Findings Automation), uses machine learning to assist drafting by suggesting similar findings, applicable regulations, and classifications. NOR.R.IS enables full-text searches of regulatory standards, integrates external alerting services to notify users of new regulations, processes these into elemental provisions, classifies them under predefined categories, and stores them in a dedicated database. S.O.FI.A helps inspectors by suggesting similar past findings and retrieving relevant regulatory standards via NOR.R.IS.

3. *Second*, Corporate Governance analysis is conducted, among other methods, through examining board meeting minutes to analyze interactions between board members. Traditionally, this manual analysis has been performed on an ad-hoc basis, particularly during on-site inspections. To improve this, the CGOV project developed an AI-powered tool to strengthen this analysis. This tool empirically assesses the relationships among board members and their functions, the board's actual functioning and autonomy, and member behaviors including the type and frequency of their interventions, depth of discussion, and topics addressed. The project aims to extract structured information automatically from minutes about who interacts, how, and on what topics, and these tools facilitate easy comparison based on the analyzed data.

4. *Third*, Fit and Proper Automation supports the annual fit and proper assessment process for approximately 3,000 candidates appointed to positions within supervised entities. This assessment covers reputation, experience, time commitment, collective suitability, independence of mind, and conflicts of interest. To reduce manual effort and operational risk on verifying candidates' self-declarations, the Fit and Proper Automation platform streamlines the process by enabling analysts to enter candidate names and trigger an extensive automated workflow. The platform integrates multiple internal data sources, such as the Italian Companies Register, sanctions archives, Central Credit Register, and supervisory reports, and external databases like Factiva, Worldcheck, and the European Fit and Proper System. The AI-powered Factiva integration scans thousands of sources to flag any news affecting a candidate's reputation, including judicial proceedings. The system applies business rules aligned with regulatory frameworks to generate alerts, providing analysts with structured, risk-focused support while leaving final judgments to them.

5. *Additionally*, BdI has developed a tool for mapping Ownership Structures using a Knowledge Graph as part of the VIG project. This tool reconstructs ownership structures of supervised intermediaries such as banks and other financial institutions by employing AI technologies, specifically Automated Reasoning applied to the Knowledge Graph. It integrates and visualizes data

from multiple sources and generates new insights beyond the original data scope, significantly enhancing the available information.

6. From September 2024, the Directorate General for Financial Supervision and Regulation, working with the IT Department, is implementing a multi-year program to modernize the IT architecture for banking and financial supervision. Approved by the Bank of Italy Board in 2024, this initiative aims to build an integrated IT platform to support core supervisory processes and ensure good governance over supervisory data using advanced technologies. The first phase, "Data Management and Analytics," is under feasibility study and will establish the architecture and target IT solutions to support the SREP for LSIs and non-banking financial institutions.

7. *Finally*, the BdI has introduced Microsoft Copilot to boost individual productivity, including among supervisory staff. Although current use is restricted to handling non-confidential data, ongoing evaluations are exploring extending its application to sensitive information and further understanding its capabilities.

Appendix V. Implementation Status of Key Recommendations in the 2020 Italy FSAP

2020 Recommendation[1]	Actions Taken
Powers, Independence and Resources Amend the banking law to shift the power of putting banks under compulsory administrative liquidation from the MEF to the supervisory authorities, with a proper consultation process with the MEF.	Not addressed. The implementation of the 2020 FSAP recommendation on amending the banking law to shift the power of putting banks under compulsory administrative liquidation from the MEF to the supervisory authorities was reviewed by another 2026 FSAP workstream (Financial Safety Net and Crisis Management). Italy's MEF indicated that the 2020 FSAP recommendation about transferring the compulsory administrative liquidation and resolution MEF's powers to the Bank of Italy is not reiterated. In this regard, it should be considered that both procedures can be activated only upon a BdI proposal. Furthermore, the Minister's involvement does not affect the operational role of BdI and the effectiveness and timeliness of its intervention: indeed, in concrete terms, BdI states that MEF has never rejected its proposals and the MEF's involvement is mainly related to the potential impacts of these decisions on third parties' rights. Along this line, the involvement of bodies different from supervisory and resolution authorities, namely the European Commission and the EU Council, is envisaged in the EU legislation—notably in the SRMR—as essential part of the process governing the commencement of the resolution procedure.
Supervisory Approach, Processes and Cooperation Further oversee the supervisory activities of BdI's branches to ensure maximum harmonization of supervisory processes and practices across all BdI's locations, leveraging on the reform recently launched.	Addressed. Substantial measures were taken to strengthen oversight of BdI branches and ensure maximum harmonization of supervisory processes and practices across all BdI locations. In 2022, a Coordination Unit was established within the Banking Supervision Directorate 2 to enhance supervisory coordination of these decentralized LSIs and ensure consistent application of supervisory approaches and procedures. Additional initiatives include periodic meetings between headquarters and branch supervisors, benchmarking activities on all LSIs regarding SREP scores and capital add-ons, and temporary staff exchanges.
[1] IMF Technical Note – Banking Regulation and Supervision and Bank Governance (2020)	

2020 Recommendation	Actions Taken
	On-site inspections have been centralized, with mixed teams from headquarters and branches conducting these inspections. Ongoing reforms to consolidate BdI branches will reduce the number of branches responsible for prudential tasks (from 11 hubs to 8 branches).
Perform more frequent deep dives and thematic and targeted inspections, particularly on key LSI weaknesses, including bank governance, credit risk, and business models	Partially addressed. Full-scope on-site inspections remain the main supervisory tool, focusing on corporate governance, credit risk, business models and other topics. BdI conducts 22–26 such inspections annually. The use of thematic, targeted, and follow-up inspections is still limited but increasing. Recently, some targeted and follow-up inspections have addressed governance, business models, credit risk, and liquidity risks related to TLTRO. The 2026 draft plan includes six thematic inspection topics. Off-site supervision of LSIs has expanded with horizontal reviews covering areas like business models, credit risk, board functioning, IT and ESG risks, state-guaranteed loans, and recovery plans. These reviews generally lead to follow-up actions, or further on-site assessments.
Enhance the interaction with CONSOB to discuss bank-specific issues as well as findings related to CONSOB's oversight of external auditors, building on the recent revision of the MoUs.	Addressed. Cooperation between BdI and CONSOB has significantly improved through reorganized Joint Committees (both at strategic and technical level) meetings, enhancing operational interaction on bank-specific issues. Several MOUs and bilateral working groups have been established to bolster collaboration on topics such as issuer supervision and MiCAR implementation. Findings from CONSOB's oversight of external auditors are addressed via collective and bank-specific dialogues, with the Bank of Italy holding mandatory meetings with auditors since 2023, increasing from 29 meetings in 2023 to 44 in 2024. Other issues are investigated jointly with CONSOB, and relevant information is incorporated into the BdI's supervisory activities. Since 2007, Bank of Italy, CONSOB, and IVASS have coordinated on IAS/IFRS application through a formal agreement to align positions on accounting standards impacting financial statements. This has led to the publication of joint guidance on systemic accounting issues. Additionally, a 2021 amendment to the Banking Law empowers the Bank of Italy to directly remove bank auditors in cases of serious reporting breaches, implementing a previous IMF recommendation.

2020 Recommendation	Actions Taken
Corrective Action and Sanctioning Consider timelier escalation of corrective measures for banks with unsustainable business models and those whose situation shows persistent deterioration (e.g., in relation to governance, asset quality, or capital levels).	Addressed. BdI has undertaken remarkable supervisory work with problem banks and decisive measures, including those that facilitated LSI sector consolidation. BdI has made significant efforts to address issues in problem banks, focusing on effective restructuring processes, capital strengthening initiatives, and market consolidation (e.g., 10 M&As were related to problem bank cases). Overall, restructuring and transformation have affected 30 percent of LSIs. BdI has increased the application of early intervention measures for problem banks, followed by sanctions against certain LSIs and their natural persons. These include seven cases where banks were placed under temporary administration (based on Article 70 of TUB); in two cases, BdI appointed temporary administrators (Article 75 of TUB); and one case where BdI directly initiated the compulsory liquidation procedure.
Capital Adequacy Review banks' pillar 2 process and capital requirements to ensure better consistency and horizontal benchmarking in applying P2R across all LSIs	Addressed. In recent years, the bank-specific SREP assessment is complemented by a structured horizontal analysis (so called "benchmarking"), both to the assignment of SREP scores and with reference to the quantification of the supervisory capital add-ons. In implementing the 2020 FSAP recommendation, a dedicated task force started to conduct this benchmarking annually. The purpose of the benchmarking is to ensure the correct application of the principle of proportionality in terms of frequency and depth of analysis and the consistency of the assessments for LSIs with similar technical-managerial characteristics and risk exposures, as well as to verify the correct application of the methodologies. BdI indicated that such activity allowed both to detect in advance any signs of heterogeneity in the application of the margins of discretion provided by the methodology and to strengthen the results of SREP scoring and determining capital add-ons (P2R/P2G).
Credit Risk Make the necessary refinements to align the BdI NPL guidelines to the EBA guidelines on the management of non-performing and forborne exposures.	Addressed. In April 2022, the Bank of Italy attained the full compliance with EBA Guidelines (GL) on NPE management (EBA/GL/2018/06), which replaced the national guidelines. Thanks to the high similarity between the two GLs, no material changes have been recorded for LSIs.
Grant the BdI the power to require banks to adjust their asset classification and increase provisioning levels.	Not addressed. BdI does not have the explicit power to take appropriate actions, for example through mandating LSIs to adjust the

2020 Recommendation	Actions Taken
	classifications of individual exposures or impose provisioning levels for specific exposures for prudential purposes. Indeed, while, in principle, BdI has the power to require the application of a specific provisioning policy for prudential purposes, such a measure applies only to the methodology to be used by the supervised bank, while it does not entail the imposition of higher provisions on specific/individual exposures. BdI has indicated that banks usually take on board the findings related to loan classification and provisioning after BdI inspectors and supervisors review loan files. This practice shows that supervisors broadly use moral suasion regarding LSIs' classification and provisioning levels. If banks do not comply, or more generally if the BdI deems a bank presents a situation of potential under-provisioning of its portfolio, BdI has the power to impose a Pillar 2 capital add-on (P2R). BdI indicated that currently 30 percent of Italian LSIs have a specific P2R add-on for potential under-provisioning. Insufficient provisioning coverage may also lead to a poorer credit score and an overall weaker SREP score. However, the use of the P2R add-on could have limitations.
Continue monitoring the implementation of banks' NPL plans and further scrutinize banks' NPL plans for reliability and ambitiousness.	Addressed. Credit risk remains the most important financial risk for LSIs and a key supervisory focus for BdI, emphasized in off-site, on-site, and SREP activities. Recently, BdI increased horizontal off-site reviews in response to macroeconomic shocks like COVID-19 and geopolitical risks. These reviews were followed by letters to LSIs to raise board awareness on credit risk management. The insights inform BdI's 'prioritization exercise' for supervising problem banks. Credit risk supervision also drives SREP decisions and is a core focus of full-scope on-site inspections, involving detailed credit file reviews. BdI continues reviewing the NPL strategies submitted by several high-NPL LSIs (NPLs >5 percent).
Other Risk Area Introduce an aggregate prudential limit for all related party exposures that is at least as strict as the single large exposure limit.	Partially addressed. BdI is finalizing the update of the regulatory framework for transactions with related parties to cover all elements of the revised 2024 BCP (CP20), including definitions, limits or other mitigants, reporting on aggregate exposures, and public disclosure using prudential definitions. Italy's current regulatory framework in this area is comprehensive and incorporates many international standards, including governance-related requirements. BdI postponed updating

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	this framework while awaiting significant regulatory developments in the revised 2024 BCP and at the EU level. Currently, there is no EU-wide framework regulating transactions with related parties. BdI's work on this update is ongoing and expected to be finalized in 2026. The update will also introduce an aggregate prudential limit in line with the revised 2024 BCP, including the related reporting obligation to BdI.
Increase the BdI's supervisory capacity in relation to IT and cyber risk.	Addressed. Supervisory capacity for IT and cyber risks has strengthened. In 2022, BdI established a new Outsourcers and Third-party Supervision Unit dedicated to LSIs to take a holistic approach to third-party risk and identify IT service providers needing closer monitoring. Additional IT experts are positioned in the Banking Supervision Directorate 2 and Regulation and Macroprudential Analysis divisions. The Statistical and ICT Support Division performs horizontal ICT/cyber risk analyses and supports other units within Banking and Financial Supervision. BdI also leverages its IT department resources when needed. Recent initiatives to strengthen supervisory capacity in relation to IT and cyber risk include: i) fostering external (e.g., SSM ICT risk networks) and internal synergies, such as resource exchanges with the IT Department; ii) hiring specialized staff; and iii) implementing focused training programs to enhance skills and effectiveness.
Perform inspections over IT outsourcing firms to ensure they are subject to minimum IT security requirements	Addressed. Since 2020 FSAP, BdI has conducted seven on-site inspections of IT providers used by LSIs. These inspections, part of implementing the 2020 FSAP recommendation, assessed IT security, risk governance, and controls. Key shortcomings found include management of core IT and security processes, IT risk assessments, incomplete inventories of IT services, and gaps in business continuity and disaster recovery testing. BdI shared reports with IT providers, requested and monitored remedial plans, and informed LSIs about their responsibility over outsourced functions through 43 letters sent in 2024. Follow-up inspections were carried out at the two main IT providers that year to verify remediation progress.
Revisit the approach to AML/CFT inspections conducted by the BdI over banks' branches and use these resources in doing more targeted AML/CFT reviews or more prudential inspections over banks	Addressed. AML/CFT inspections on banks' branches were conducted until 2021. Following the creation of the AML/CFT Unit, separated from the Banking Supervision department, the Unit decided to set aside this type of inspection and reallocate on-site inspection resources to conducting full-scope (entire spectrum of AML/CFT assessment), targeted (specific analysis of defined AML/CFT areas), and thematic (horizontal AML/CFT

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	assessments on specific areas across various bank and non-bank intermediaries) inspections, consistently with the risk-based approach used to assess this risk.
Bank Corporate Governance Quickly issue the draft Quickly issue the draft decree on the fitness and propriety of banks' corporate officers and revise the decree on the suitability of major shareholders.	Partially addressed. The draft Decree on the fitness and propriety of banks' corporate officers has been issued in 2020 (Ministerial Decree no. 169/2020). MEF Ministerial Decree (144/1998), regarding the suitability of major shareholders, has not yet been updated. The draft underwent public consultation in 2022. MEF mentioned that they are awaiting the revision of the Criminal Code.
Grant the supervisory authorities the power to issue such fit and proper requirements for banks' shareholders and corporate officers given the prudential nature of these requirements.	Not addressed. Provisions on board members' and shareholders' requirements directly impact, among others, on individual rights and for this reason, according to the Italian legal framework (Banking Law), the MEF shall issue them. In this perspective, it must be noted that the issuance of the Ministerial Decree is subject to a specific administrative procedure, which includes the prior advice by the Council of State; the involvement of this court reinforces the legal strength of the decree also considering the relevance of some matters dealt with (e.g. Constitutional principles on the presumption of innocence). In any case, the Bank of Italy is formally involved in the process of elaboration of the decree since the Banking Law requires that the Ministry shall obtain the prior advice of the Bank of Italy too. Finally, it is key considering that the ministerial competence does not extend to the policies and practices adopted by the Bank of Italy to assess the compliance with the Fit and proper requirements included in the decree itself. Such mandate has been implemented in 2021 through the issuance of the Bank of Italy Regulation on the procedure for assessing the suitability of banks' board member.
Complete the implementation of the reform of the large popolari banks (i.e., with total assets of more than Euro 8 billion) and continue to explore further ways to address problems and push for solutions for the smaller popolari banks	Addressed. Legislation enacted in 2015 required the largest Italian popolari banks—with total assets exceeding €8 billion—to convert into JSCs. Ten popolari banks above this threshold completed their conversion to JSCs, with the reform finalized at the beginning of 2022. In 2024, the asset threshold was raised to €16 billion. Popolari banks continue to operate under a cooperative model, but the introduction of financing shares—first issued in 2025—is expected to significantly enhance their capacity to access capital markets, attract professional investors, and strengthen corporate governance. In May 2025, the EBA assessed the first issuance project of such instruments as compliant with CET1 eligibility requirements. Bank corporate

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	governance is a priority for BdI supervision. Several horizontal off-site reviews have been conducted by BdI, including those focused on popolari banks.
Closely supervise the new CBGs during their first years of operations to ensure that the challenges associated with the reform are successfully overcome.	Addressed. After the reform of cooperative banks, the two Italian CBGs were classified as Significant Institutions (SIs) and are now directly supervised by the ECB SSM, including both the parent companies and all 179 affiliated BCCs. These groups have been subject to intense scrutiny through both off-site and on-site supervision. The early warning systems (i.e., internal risk-based evaluation processes aimed at assessing and monitoring the overall stability of the affiliated BCCs), through which the parent companies exercise their steering powers, have been regularly reviewed and upgraded, making them more robust and reliable tools for intervening with risky or weak BCCs. Additional supervisory efforts have focused on completing the integration of IT systems, achieving convergence toward common processes and standards. Finally, risk management functions and internal control systems have now reached a high degree of centralization.