



ITALY

December, 2013

DETAILED ASSESSMENT OF OBSERVANCE OF BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision on Italy 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 in January 2013. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Italy or the Executive Board of the IMF.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>

Price: \$18.00 per printed copy

**2013 International Monetary Fund
Washington, D.C.**



ITALY

DETAILED ASSESSMENT OF OBSERVANCE

January 2013

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in Italy during January 2013, led by Dimitri Demekas, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at:

<http://www.imf.org/external/np/fsap/fssa.aspx>.

CONTENTS

GLOSSARY	3
SUMMARY, KEY FINDINGS, AND RECOMENDATIONS	5
A. Introduction	7
B. Information and Methodology Used for Assessment	8
C. Institutional and Macroeconomic Setting and Market Structure—Overview	11
D. Preconditions for Effective Banking Supervision	12
E. Summary Compliance with the Basel Core Principles	18
DETAILED ASSESSMENT	27
RECOMMENDED ACTIONS AND AUTHORITIES COMMENTS	173
A. Recommended Actions	173
B. Authorities' Response to the Assessment	175
BOX	
1. The 2012 Revised Core Principles	10

Glossary

ABI	Italian Banking Association
AC	Additional criteria
AMA	Advanced measurement approach
AML/CTF	Anti-money laundering/counter terrorism financing
BCBS	Basel Committee for Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BI	Banca d'Italia
BIA	Basic Indicator Approach
BL	Banking Law (Legislative Decree 385/1993 and subsequent amendments)
CAL	Compulsory Administrative Liquidation
CEBS	Committee of European Banking Supervisors
CCR	Central Credit Registry
CFL	Consolidated Financial Law (Legislative Decree n. 58/2008)
CONSOB	Companies and Stock Exchange Commission
CRA	Credit Rating Agencies
CRD	Capital Requirements Directive
DGF	Deposit Guarantee Fund
EBA	European Banking Authority
EC	European Community
ECB	European Central Bank
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pension Authority
ELMI	Electronic Money Institutions
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
FSB	Financial Stability Board
FATF	Financial Action Task Force
FITD	<i>Fondo Interancario di Tutela dei Depositi</i> —Fund for interbank deposits
FIU	Financial Intelligence Unit
FGDCC	<i>Fondo di Garanzia Depositanti BCC</i> —Deposit insurance agency for mutuals
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
IAD	Internal Audit Department
ICAAP	Internal Capital Adequacy Assessment Process
ICCS	Interministerial Committee for Credit and Savings
IFRS	International Financial Reporting Standards
IVASS	Insurance Supervisory Authority
IRB	Internal Ratings Based
MEF	Minister of Economy and Finance
NPL	Non-performing Loan

ITALY

RAS	Risk Assessment System
RRD	Bank Recovery and Resolution Directive
RRP	Recovery and Resolution Plan
RWA	Risk weighted asset
SA	Special Administration
SIFI	Systemically important financial institution
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism

SUMMARY, KEY FINDINGS, AND RECOMENDATIONS¹

1. **The core supervisory process at the Banca d'Italia (BI) is strong, and it has a well-defined and integrated supervisory approach.** BI is well regarded both in terms of independence, professional qualification and integrity. The various components of its supervision are integrated in the Supervisory Review and Evaluation Process (SREP). Key pillars of the approach are offsite analysis, onsite inspections and analytical data.
2. **The authorities have made progress in addressing the recommendations of the 2006 FSAP, although some issues remain.** Regarding legal protection of supervisors, the legal framework was amended in 2005 and 2006, establishing that staff are not legally liable for actions taken or omissions made while discharging their duties in good faith; regarding loan loss provisioning, the rules were modified in 2012 to consider as non-performing loans past due from 90 days (instead of previously 180 days), the Banking Law (BL) was amended in 2008 to allow the regulation of related party lending limits and procedures. Some issues previously identified remained: the procedure for covering legal costs of supervisors, the lack of power to remove members of the board and senior officials of banks, and the power to remove external auditors of banks.
3. **Italy is the first country to be assessed under the revised Basel Core Principles approved by the Basel Committee in September 2012. It is also the first country to be assessed and rated not only on the essential criteria but also on the additional criteria.** It is important to note that since last assessment conducted in 2005/2006, the bar of the standards has been raised twice by the BCBS (the BCP methodology was revised in 2006 and again in 2012). This assessment, consequently, is not directly comparable with the previous assessment or across countries. More is expected of supervision and regulation, and much that before the revision was considered "desirable" is now considered essential, with the lessons of crisis and evolution of financial markets and international standards. The assessment also brings a new relevance to observed implementation and practices.
4. **Therefore, even in the presence of strong regulatory framework and robust supervisory practices, there are areas requiring attention so that Italy can meet the highest standards of supervisory effectiveness.** For instance, the lack of powers to suspend and remove directors and senior managers continues to negatively affect BI timely corrective action capacity, and is not conducive to good corporate governance, in particular given the narrow definition of fit and proper existent in legislation. Similarly the lack of power to remove external auditors can be a significant limitation in an environment where the supervisor is not capable of issuing or interpreting accounting standards.

¹ The assessment team comprised Fabiana Melo (IMF, former Central Bank of Brazil) and José Tuya (consultant, former OCC).

5. The Bank of Italy collects and analyzes a wide range of banking information. The information ranges from detailed credit records to feed the credit registry to broader risk management overview contained in the ICAAP. Through the in-house tool SIGMA, the data is accessible to the offsite unit and analyzed. Based on results and risks identified, onsite inspections are scheduled to supplement the offsite observations. As a result of SREP, banks receive risk assessment grades. Key risk areas (credit, financial, operational, profitability, capital, strategic and governance) are risk-graded and an overall risk grade is assigned to the bank. The risk ratings are the foundation for determining the scope of the supervisory plan for each bank.

6. The supervisory coverage of the bank is comprehensive and the follow-up process is intensive. Through reviews of inspection reports, bank communications and SIGMA screens a picture of the bank-specific risk develops. The BI takes supervisory action on quantitative issues such as credit risk, loan classifications and capital adequacy but also on judgmental issues such as the adequacy of corporate governance and internal controls.

7. Deficiencies in the legal and regulatory framework are largely mitigated by intensive and intrusive supervisory action on and off site, on a bank-by-bank basis. Nevertheless, in such cases it is recommended that the regulatory framework is completed so it is clear to the market what the supervisory expectations are. A good example is the framework for management and control of country and transfer risk. While the regulatory framework is not adequate, BI addresses the risk, when considered material, on the largest internationally active banks. However, other Italian banks have active exposures to country risk, and the regulatory framework is too general to be conducive to good management of country and transfer risk. BI is strongly recommended to issue guidance that can be understood and applied to all banks, in particular, banks need to be made aware that an overall deterioration of credit risk in a country can lead to many private contracts not being observed, independently of sovereign risk or currency risk.

8. In the same spirit, the regulatory framework for concentration risk is mostly focused on large exposures and management of name risk, while the revised CP has been considerably expanded from the previous methodology, and the focus has shifted from “large exposures” to “risk concentration”—which includes not only name risk but by industry, economic sector, geographic region, and by market (for instance, when banks are exposed to particular asset classes, products, collateral, or currencies). Supervisory practice, however, does consider such concentrations on a case by case review. The regime for large exposures should be revised, as there are exceptions to the limits that reduce its prudential effect, such as risk-weighting of exposures for the application of large exposure limits to some asset classes—although the BI’s scope for revision may be limited by EU legislation on the issue.

9. The new framework for related party lending has come into force in January 2013, and therefore assessors could not observe implementation. A review of the regulation, however, showed that some deficiencies may reduce its effectiveness. Besides exceptions to the limits and enhanced procedures, some exposures are risk weighted for the calculation of limits, there is no explicit requirement that the board member or persons involved are excluded for decision making process, and no requirement that all related party lending should occur in no more favorable terms

than those to non-related party. The definition of connected parties for this legislation is different from that used to define connected parties in the large exposures regime: in the case of related parties, the economic dependence is not considered. The BI is empowered to impose stricter definitions of connected parties by judgment other than control, and to intervene in situations when economic influence is the real element connecting the related parties in transactions which may be detrimental to the bank. Therefore, supervisory practice may mitigate the issues raised above, but since implementation is its infancy that could not be observed.

10. Loan loss provisioning, practices are heavily influenced by fiscal and judicial requirements over prudential considerations. On the fiscal side, banks are allowed to deduct losses resulting from circumstances of legal certainty and accuracy of loss amount. These circumstances have so far been met by declaration of insolvency and court judgments; the judicial process is lengthy and ranges from 6 to 11 years depending on the region. Without the legal certainty support, write downs can only be deducted within 0.30 percent of the overall book value of the loans, with a deferred tax asset arising from the excess, which is amortized in 18 years. As banks structure their provisioning/write-offs also trying to avoid problems with the “Agenzia delle Entrate,” the result is a longer timeframe for loan workouts. In June 2012, a decree (Growth Decree) was issued to encourage banks to open some lending capacity by writing off or selling NPLs. The Growth decree provides for the tax deductibility of losses resulting from small loans delinquent for over six months and for losses resulting from the sale of assets or, more in general, from derecognition according to IAS 39, for IAS-adopting companies. However, the banks are awaiting further interpretation of the decree.

11. The NPLs may remain on the books for years and include interest, according to IAS 39, based on bank management’s estimation of collectability and collateral support. The latter is valued taking into account costs for obtaining and selling the collateral. Onsite inspections sample the loan portfolio and review loan classification and practices to ensure IFRS compliance. Valuation of real estate collateral is hampered in the current environment of declining prices and low turnover volume. Provisioning practices are assessed to ensure compliance with prudential rules. In response to the deterioration of the macroeconomic conditions as well as of the credit quality, at the time of the assessment the BI was performing a broad horizontal monitoring activity at the main medium-large banking groups, aimed at checking their coverage ratios against those observed immediately before the financial crisis (2007) and at assessing the robustness of the provision criteria and practices.

A. Introduction

12. This assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in Italy has been completed as part of a FSAP update undertaken by the International Monetary Fund (IMF) during January 2013. It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to assess the merits of policy and implementation issues regarding European Union (EU) regulatory framework. In addition, it is not intended to represent an analysis of the state of the banking sector or crisis management framework, which are addressed in the broader FSAP exercise.

13. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and detailed examination of the policies and practices of the institutions responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on the BI as the main supervisor of the banking system, and did not cover the specificities of regulation and supervision of other financial intermediaries, which are covered by other assessments conducted in this FSAP. The assessment did not cover issues related to the newly agreed Single Supervisory Mechanism² in the Euro Area, as at the moment of the assessment the operational and regulatory details of the structure were not fully defined. It is important to note, however, that even in the envisaged structure local supervisors will retain direct oversight responsibilities regarding a large number of banking institutions, and will continue in many levels to be involved in the supervision of the institutions that will be under direct ECB supervision. Therefore, the assessment of banking supervision in Italy should provide a useful picture of current supervisory processes applicable to Italian banks.

B. Information and Methodology Used for Assessment

14. The Italian authorities agreed to be assessed according to the Revised Core Principles (BCP) Methodology issued by the BCBS (Basel Committee of Banking Supervision) in September 2012. The current assessment was thus performed according to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2006. It is important to note, for completeness' sake, that the two assessments will not be directly comparable, as the revised BCP have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority, raising the bar to measure the effectiveness of a supervisory framework (see box for more information on the Revised BCP).

15. The Italian authorities also chose to be assessed and rated against not only the Essential Criteria, but also against Additional Criteria. To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The essential criteria (EC) were usually the only elements on which to gauge full compliance with a CP. The additional criteria (AC) are recommended best practices against which the Italian authorities have agreed to be assessed and rated. This option was not available to assessed countries before the 2012 Revised BCP; in fact, Italy is the first country being rated also against ACs. The assessment of compliance with each principle is made on a qualitative basis. A four-part grading system is used:

² In summer 2012 the European Council launched a project for the set-up of an integrated system of bank supervision at European level. In September 2012 the EU Commission issued proposals for a single supervisory mechanism (SSM) for banks in the euro area as an important step in strengthening the Economic and Monetary Union (EMU). In the proposal of the new single mechanism, ultimate responsibility for specific supervisory tasks related to the financial stability of all Euro area banks will lie with the European Central Bank (ECB). National supervisors will continue to play an important role in day-to-day supervision and in preparing and implementing ECB decisions. The Commission also proposed to have the SSM in place by January 1, 2013. To allow for a smooth transition to the new mechanism, a phasing-in period is envisaged. As a first step, as of January 1, 2013, the ECB will be able to decide to assume full supervisory responsibility over any credit institution, particularly those which have received or requested public funding. As of July 1, 2013 all banks of major systemic importance will be put under the supervision of the ECB. The phasing-in period should be completed by January 1, 2014 when the SSM will cover all banks. Discussions to finalize the proposal are underway at the European level.

compliant; largely compliant; materially noncompliant; and noncompliant. This is explained below in the detailed assessment section. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

16. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with officials of the BI, and additional meetings with auditing firms, and banking sector participants. The authorities provided a self-assessment of the CPs rich in quality and comprehensiveness, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff and systems.

17. The team appreciated the very high quality of cooperation received from the authorities. The team extends its thanks to staff of the authorities who provided excellent cooperation, including extensive provision of documentation and access, at a time when staff was burdened by many initiatives related to the European and global regulatory changes.

18. The standards were evaluated in the context of the Italian financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

19. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. The Italian and European banking systems in general were undergoing a period of volatility and stress when the assessment took place, as well as deep changes in the European banking supervision and regulatory structure. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Italian authorities with an internationally consistent measure of the quality of its banking supervision in relation to the CPs, which are internationally acknowledged as minimum standards.

Box 1. The 2012 Revised Core Principles

The revised BCPs reflect market and regulatory developments since the last revision, taking account of the lessons learnt from the financial crisis in 2008/2009. These have also been informed by the experiences gained from FSAP assessments as well as recommendations issued by the G-20 and FSB, and take into account the importance now attached to: (i) greater supervisory intensity and allocation of adequate resources to deal effectively with systemically important banks; (ii) application of a system-wide, macro perspective to the microprudential supervision of banks to assist in identifying, analyzing and taking pre-emptive action to address systemic risk; (iii) the increasing focus on effective crisis preparation and management, recovery and resolution measures for reducing both the probability and impact of a bank failure; and (iv) fostering robust market discipline through sound supervisory practices in the areas of corporate governance, disclosure and transparency.

The revised BCPs strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks. The supervisors are now required to assess the risk profile of the banks not only in terms of the risks they run and the efficacy of their risk management, but also the risks they pose to the banking and the financial systems. In addition, supervisors need to consider how the macroeconomic environment, business trends, and the build-up and concentration of risk inside and outside the banking sector may affect the risk to which individual banks are exposed. While the BCP set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.

The number of principles has increased from 25 to 29. The number of essential criteria has expanded from 196 to 231. This includes the amalgamation of previous criteria (which means the contents are the same), and the introduction of 35 new essential criteria. In addition, for countries that may choose to be assessed against the additional criteria, there are 16 additional criteria.

While raising the bar for banking supervision, the Core Principles must be capable of application to a wide range of jurisdictions. The new methodology reinforces the concept of proportionality, both in terms of the expectations on supervisors and in terms of the standards that supervisors impose on banks. The proportionate approach allows assessments of banking supervision that are commensurate with the risk profile and systemic importance of a wide range of banks and banking systems

20. To determine the observation of each principle, the assessment has made use of five categories: compliant; largely compliant, materially noncompliant, noncompliant, and non-applicable. An assessment of "compliant" is given when all EC and ACs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the principle and there is clear intent to achieve full compliance with the principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented). A principle is considered to be "materially noncompliant" in case of severe shortcomings, despite the existence of formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle is assessed "noncompliant" if it is not substantially implemented, several ECs are not complied with, or supervision is manifestly

ineffective. Finally, a category of “non-applicable” is reserved for those cases that the criteria would not relate the country’s circumstances.

C. Institutional and Macroeconomic Setting and Market Structure— Overview³

21. The structure of the Italian financial system (Central Bank, banks, financial companies, asset management companies, insurance companies and pension funds) has not changed substantially since the 2005–06 FSAP. Banks remain the most important part of the financial sector (75 percent of total system assets, or 256 percent of GDP) followed by the Central Bank (9.8 percent of total system assets, or 34 percent of GDP) and insurance companies (9.7 percent of total system assets, or 33 percent of GDP). The system expanded by more than 50 percent in asset size since 2005. Excluding the Central Bank, whose increase in assets was concentrated in 2011 following extraordinary monetary policy interventions, the greatest increase was recorded by pension funds (74 percent) as well as banks (53 percent). By contrast, insurance sector assets have not grown in size relative to GDP since 2005. Overall, the institutional investment sector (insurance companies, investment funds, pension funds, and individually managed portfolios) remains small by international standards.

22. Total lending to GDP stood at 125 percent at end-2011, compared to 131 percent in the Euro area. This relatively low ratio can be attributed mainly to Italian households’ low financial debt, particularly in the form of mortgages. The size of corporate debt to GDP is comparable to regional peers, although it is relatively shorter-term and more concentrated in the variable rate component.

23. In the banking sector, the wave of mergers and acquisitions that began in the late 1990s continued to increase concentration, albeit from a low base. By the end of 2011, the top two and five banking groups held 31 percent and 49 percent respectively of the system’s total assets. Nonetheless, the banking sector landscape is characterized by a large number of small cooperative and regional banks operating under different local economic environments.

24. At the end of 2011 there were 740 banks in Italy, 188 of them were part of one of the 77 banking groups. More than 70 percent of the banks not belonging to banking groups are small mutual banks.

25. There are currently six financial conglomerates in Italy. Three are primarily involved in banking or finance (Intesa Sanpaolo, Carige and Azimut), while the others are mostly active in insurance (Generali, Unipol and Mediolanum). Given the typical structure of these groups, in which

³ This section draws from other documents produced for the FSAP, some of which at the time of this assessment were not yet finalized. A complete analysis of the macroeconomic framework is contained in Article IV reports. Figures used in this section refer to December 31, 2011.

one of the two sectors (banking or insurance) clearly dominates, the risk factors are not substantially different from those for financial groups that are not conglomerates.

26. Major asset management companies, investment firms, and finance companies are mainly controlled by banking groups that follow the universal banking model. At the end of 2011, there were 24 banking groups or solo banks listed on the stock exchange. Eight of the top twenty groups by consolidated assets were not listed. The listed groups and banks held 61 percent of system assets. The shareholders of the main five groups are banking foundations (around 30 percent of voting capital), banks (mainly foreign) and insurance companies (around 7 percent), while non financial companies and institutional investors play a modest role. The internationalization of the banking sector increased significantly, with foreign lending by Italian banks representing 24 percent of their total lending in 2011, primarily in Germany, Austria, and other Central and Eastern European countries. Foreign banks operating in Italy in the form of branches and subsidiaries accounted for 18 percent of system assets.

27. Under the Consolidated Law on Banking the Bank of Italy exercises powers of supervision over banks, banking groups, financial companies, electronic money institutes and payment institutions. Hence the scope of supervision is wide when compared to other jurisdictions. Supervisory activity is directed to ensuring the stability, efficiency and competitiveness of the financial system as a whole, the sound and prudent management of intermediaries, the enforcement of credit and financial law and regulations, and transparency and fairness in bank/customer relations. The Consolidated Law on Finance specifies the purposes of supervision over intermediaries engaged in investment services and asset management as safeguarding confidence in the financial system, protecting investors, ensuring the stability, orderly functioning and competitiveness of the system, and enforcing financial legislation. In this sphere the Bank of Italy is responsible for controls on intermediaries' risk containment, capital soundness and sound and prudent management.

D. Preconditions for Effective Banking Supervision⁴

Soundness and sustainability of macroeconomic policies

28. Starting from mid-2011 the propagation of the European sovereign debt crisis posed challenges to financial stability in Italy. The interventions of the European Central Bank and the measures decided at both European and national level have allayed fears in the euro area. In Italy, the fiscal consolidation measures taken since mid-2011 and reforms to raise the economy's growth potential have reduced concerns about the sustainability of the public finances. In 2012, a structural balanced budget rule was approved and in 2013, Italy exited the EU's Excessive Deficit Procedure.

⁴ This section draws from other documents produced for the FSAP, some of which at the time of this assessment were not yet finalized. A complete analysis of the macroeconomic framework is contained in Article IV reports.

29. While the household sector's financial situation remains balanced, thanks to their relatively modest debt and large proportion of financial wealth held in the form of real estate and low-risk assets, the recession continues to affect the profitability and self-financing capacity of firms. At the time of this assessment, there were signs that after eight quarters of GDP contraction the economy might be stabilizing, such as improving business confidence, stabilizing production, and higher tax receipts.

The framework for financial stability policy formulation

30. The current legal framework assigns responsibilities in the area of financial stability to three entities (BI, IVASS, and Consob) although in practice BI, being the prudential regulator, plays a leading role. BI's financial stability mandate covers a broad scope of financial institutions, including banks and non banks credit institutions, investment services providers and market infrastructures. Several divisions/units within the BI contribute to financial stability analysis, and a Financial Stability Committee within BI assists in integrating views on systemic risk.

31. According to the law, all regulators have to act in a coordinated way and to share all information which is material for their respective tasks. Co-operation normally takes place on the basis of MoUs; a Committee for the safeguard of financial stability (CSSF), chaired by the Ministry for economy and finance, has been set up in 2008 with the objective of ensuring cooperation as well as sharing of information and assessments among supervisory authorities and the Ministry (the Committee was not established by law but by means of a MoU and has no powers of direct intervention). The existing authorities are mandated and empowered to co-operate and exchange information with other authorities cross border, including EU agencies and the ESRB, according to the relevant EU legislation

32. To monitor systemic risk, the BI makes use of a wide range of analytical tools, including a number of early-warning indicators of financial stability and stress tests to assess the resilience of the banking system. The BI also monitors shadow banking and non-banking institutions and is working to enhance its toolkit, in particular metrics of risk concentration within the system. For the insurance sector, macroprudential analysis has only recently been incorporated into IVASS work. IVASS conducts system-wide analysis of the insurance sector using several tools, many of them in coordination with ESRB/EIOPA. IVASS annual industry-wide stress test has been replaced by the EIOPA stress tests. Some prudential tools have already been used in the banking and insurance sectors to mitigate systemic risk, such as limits on maturity mismatch, loan-to-value limits below which more favourable risk weightings are attributed to mortgages secured by residential real estate. Additional instruments will be put in place and assigned to the BI in the context of Basel III and CRD-IV, including a countercyclical capital buffer, capital surcharges for systemic institutions, and new liquidity requirements

33. In December 2012, the ESRB recommended Member States to specify their ultimate objective of macroprudential policy, designate an authority entrusted with the conduct of macroprudential policy, and entrust it with sufficient tools to pursue its mandate. In the case of Italy, two options were under discussion at the time of the assessment: establishing BI as the

macroprudential authority, or establish a new macroprudential committee, where the BI should maintain a leading role.

A well developed public infrastructure.

34. Italy has a long established and well developed legal system belonging to the civil law legal tradition. The judicial system is still characterized by extremely lengthy civil procedures, due to both excessive litigation (demand) and inefficient courts (supply). Recent measures provided for the merger of very small courts into larger ones, the creation of specialized courts for company law matters, the introduction of a filter for appeals should affect both demand and supply.

35. Since 2005–2006 Italy adopted the International Financial Reporting Standards for financial reporting for banks and supervised financial intermediaries both on solo and consolidated basis. Reliability of accounting data for the banking system is ensured by the external auditors that apply the national auditing standards, which are derived from International Standards on Auditing. They are subject to Consob oversight and must notify to the Banca d'Italia any acts or facts that may constitute a serious breach of the banking law, affect the bank's ability to continue as a going concern or result in an adverse or a qualified opinion on the financial statement or a disclaimer ("duty to report").

36. As for banks trading activity on liquidity and sovereign bonds markets, including the post trading custody, guarantee and settlement phases, the law assigns to Banca d'Italia and Consob supervision powers on trades executed in regulated secondary trading venues and on the post trading financial infrastructures (central counterparties, central securities depositories, securities settlement systems). Moreover, Banca d'Italia is also responsible for the safety, smoothness and efficiency of the payment system.

37. The Cassa di Compensazione e Garanzia (CC&G), the Italian central counterparty (CCP), is systemically important for the Italian market, and through the link with the French CCP also relevant for cross-border financial stability. CC&G is the only CCP that clears the cash and derivatives markets operated by Borsa Italiana and it shares the clearing activities of electronically traded Italian government securities operations (cash and repos) with the French CCP, LCH Clearnet SA. Through the link with LCH Clearnet SA, a substantial amount of cross-border transactions is handled and large credit exposures have built between both CCPs.

The framework for crisis management, recovery and resolution

38. The Italian legal framework is based on a wide range of tools that allow the authorities to intervene to address crisis situations. The resolution framework and toolkit have been used to resolve successfully small banks and one banking group during the crisis. The regime already

extends to parent banks, banking groups,⁵ insurers, and investment firms, and has two main sets of powers typically (although not necessarily) deployed sequentially.

39. The framework includes well-specified resolution powers. A special administrator can be appointed by the BI when a bank has suffered serious capital losses or if there are repeated serious irregularities or violations of the law or regulations.⁶ The administrator assumes the powers of the managers but cannot take decisions pertaining to shareholders. If the special administrator is unable to restore the bank to viability, a CAL can be triggered⁷ based on the same grounds as an SA, if of an exceptionally serious nature. These powers can be used to suspend payments,⁸ and in the case of CAL, trigger liquidation and DGS payouts, as well as to transfer assets and liabilities (P&A powers). For the period commencing from 2009 to March 25, 2013, 31 small banks and one banking group had been placed into SA. These banks had a median size of assets of approximately EUR190 million, of which 10 subsequently went into CAL.

40. The resolution powers were used effectively to preserve depositor confidence but may increase the cost to the DGS. In very few recent resolution cases have losses been shared with uninsured creditors, e.g., in one case, out of 31 recent resolutions, DGS funds were used to pay out insured depositors in liquidation. In most resolutions, DGS funds were instead used to support the recovery or merger of the bank (so called “open bank assistance”) or to fund the transfer of all creditors, not just deposits, to a purchaser in CAL.

The adequacy of systemic protection (or public safety net)

41. The Italian deposit guarantee scheme consists of two schemes, banks incorporated as joint-stock companies and cooperative banks are covered by the FITD and mutual banks are covered by the FGDCC. The DGSs are required to comply with EU DGS Directives⁹. Both DGSs are private-law consortia among banks administered by representatives of member banks and supervised by the BI. They are primarily entrusted with depositor payout in liquidation but have a broad mandate to provide guarantees, credits and acquire equity and fund P&A transactions, provided that it is less costly than a payout. Such interventions are subject to the approval of the BI. Both DGS are able to obtain information from their member banks, for the purposes of carrying out risk assessments.

42. Membership is compulsory. As of December 31, 2012, there were 241 member banks in the FITD and 398 in FGDCC. Members include Italian banks and their branches in EU countries, Italian branches of EU banks adhering to the fund on a voluntary basis, and non-EU banks. In line

⁵ Articles 98 to 101 BL.

⁶ Article 70 BL.

⁷ Article 80 BL. The CAL can also be triggered independently, without the need to go through SA first.

⁸ Article 74 BL.

⁹ EU DGS Directive 94/10/EC of 30 May 1994, amended by Directive 2009/14/EC of 11 March 2009.

with EU DGS directives, coverage is EUR 100,000 per depositor per bank and payout has to be made within 20 working days. The total value of covered deposits as a percentage of eligible deposits covered by the FITD is 68.7 percent, while that of the FGDC is 65 percent. The FITD and the FGC have had to make very few cases of payout, as most cases are resolved using the transfer of assets and liabilities, with DGS support. The DGSs are both ex-post funded. Contributions are provided by participants as and when required. Member banks are committed to making available to the DGSs the amount of resources required for interventions.

43. The BI as a member of the Eurosystem may provide emergency liquidity assistance (ELA) within the constraints of the system. While granting ELA remains a decision of the national central bank (NCB), undertaken at risk and cost of the NCB, ELA is subject to oversight by the Governing Council of the ECB. In order to ensure that ELA operations do not interfere with the Eurosystem's monetary policy and to assure a level playing field between the euro-area counterparties, the ECB provides guidance on the main features of ELA operations. The possible recipients are systemic banks that are solvent, but which face a temporary liquidity shortage and which are able to provide adequate collateral. ELA in excess of EUR 2 billion requires approval by the ECB's 23-strong governing council and can be stopped if two-thirds of the council opposes it. The BI has the power to provide ELA on the basis of Article 35 of its Statute, which endows a broad provision to take all the actions and operations necessary to perform the BI's tasks not related to the European System of Central Banks.

Effective market discipline

44. Corporate law is provided for by the Civil Code and it has been deeply reformed in 2004. Listed companies are also subject to the Consolidated Law on Financial Intermediation that provides for specific rules on transparency, governance and investors protection. The current bankruptcy law framework for business, that has been substantially reformed in 2005–06, entails reorganization procedures (in-court and out-of-court) and liquidation procedures, ensuring wider restructuring possibilities and a streamlined liquidation. Recently Law decree n. 179 of October 18, 2012 introduced in the Italian legal framework a set of provisions devoted to personal bankruptcy. The law decree establishes a reorganization procedure and a liquidation procedure (at the end of which discharge may be granted) for consumers and small firms that were excluded from the existing legislation.

45. Issuers of public offerings and products admitted to trading on regulated markets are subject to robust disclosure obligations at the moment of registration and on a periodic and on-going basis—although the deadline for submission of annual audited statements appears long. In addition, there is a framework of ongoing and periodic disclosure for issuers of financial instruments that are widely held among the public. Consob has developed a robust program to monitor issuers' compliance with their disclosure obligations. Basic rights of shareholders are embedded in company law, and additional protections exist in connection with issuers listed in a regulated market, including the obligation to launch a mandatory tender offer. There are also notification obligations for substantial and insider holdings.

46. Auditors of Public Interest Entities are subject to oversight by Consob. Such oversight is mainly exercised through a quality control review, conducted via on-site inspections that are carried out on a three year cycle. The inspections program appears robust. Credit Rating Agencies (CRAs) that provide services in Italy have been subject to a thorough registration process by cross-European colleges of supervisors. They are now under the supervision of ESMA, which is in the process of implementing its supervisory program for CRAs. There is a framework in place for all persons who provide recommendations, which is based on fair disclosure; in addition regulated entities are subject to organizational requirements to minimize potential conflicts of interest.

47. The consumer protection regulatory framework for banking services is based on provisions issued by the EU institutions (among the others, the so-called “Consumer credit” directive, the “Consumer rights” directive, the “Payment Systems Directive,” and the “Unfair commercial practices” directive) that contribute to depict a strong pro-consumer scenario, complemented by extensive national rules in areas which are not harmonized at EU level. Along with these provisions, a key role is played by the Italian Competition Authority which is in charge of protecting consumers against unfair commercial practices and unfair contract terms. The availability of information to consumers has considerably increased over the years. This trend can be traced back to a number of EU directives as well as to national rules that have gradually increased and refined the intermediaries’ disclosure duties and the duty to “assist” the clients in their decision-making process. The law embeds a number of consumer protection devices such as: the cost of credit is limited by caps to interest rates that banks and non-banking institutions can charge to their clients (according to anti-usury legislation); comparative shopping is made easier in that clients are given the right to move their existing mortgages to banks other than the one which has first extended credit; no switching cost can be imposed to clients by banks and charges on overdraft facilities and overrunning are allowed only when they respect strict regulatory requirements .

48. The Italian credit reporting system has a dual nature due to the coexistence of a public central credit register (CCR), managed by BI, and several independent credit bureaus (CBs), private owned and regulated by voluntary agreements and by a “code of conduct with regard to consumer credit, reliability, and timeliness of payments” approved by the Data Protection Authority, all registers comply with the general principles fixed by Italian Data protection law¹⁰ The most important private credit register is CRIF that manages EURISC, a credit information system which collects data related to lending operations from the member financial institutions. The Italian Data Protection Authority has general powers to control the compliance of data treatments with the Data protection regulation.

¹⁰ Legislative Decree n. 196/03, art. 12 and “code of conduct” published in the Official Journal no. 300 dated December 23, 2004 and subsequently amended per the notice published in the Official Journal no. 56 dated March 9, 2005.

E. Summary Compliance with the Basel Core Principles

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	Responsibilities, objectives and powers are clearly defined. Powers seem to be mostly adequate and used in practice, according to evidence presented to assessors. The BI, although responsible for initiating procedures for the revocation of license, depends on the final decision on liquidation, which is issued by a MEF decree. There are some limitations on powers for corrective actions that were not considered for the rating of this CP, but were included under CP 11.
2. Independence, accountability, resourcing and legal protection for supervisors	LC	In particular given the changes in the legal framework since 2005, the BI has governance framework conducive to independence of supervisory decisions, and adequate transparency and accountability. Interviews with external parties confirm the BI is currently well regarded both in terms of independence, professional qualification and integrity. Resources, including for recruitment and training, seem to be adequate for the conduction of supervisory activities. The legal protection of supervisors, although improved since 2005, may still be an issue, since reimbursement of legal costs only after the end of judicial proceedings means employees need to bear all the costs of defending their actions and decisions taken in good faith in the exercise of their supervisory functions. The Board of BI has made a decision, on December 18, 2012, to allow the anticipation of reimbursement to staff in cases of legal suits. The assessors welcome the developments, and the effectiveness of the measures will likely be fully observable when the next BCP assessment takes place
3. Cooperation and collaboration	C	
4. Permissible activities	C	
5. Licensing criteria	LC	The criteria and assessment process for licensing applications is clearly established in laws and regulations and involve the assessment of

Core Principle	Grade	Comments
		<p>ownership structure, governance, and fitness and propriety of board members. The licensing framework and practice, although well established, needs to be enhanced for full compliance with the revised principles: regarding EC 2, BI cannot revoke the license if it finds it was granted based on false application if the bank has already started operation; regarding EC 5, BI does assess the sources of initial capital, but initial capital can be mostly subscribed with assets (up to 7/10), and shareholders are allowed to use borrowed money for the initial subscription. The BI can apply stricter conditions and refuse the operations, however there is no legal restriction to shareholders being leveraged or borrowing money to finance capital subscription or increases, therefore the regulatory framework does not seem supportive to denials based on the BI's assessment of shareholders being able to provide "additional financial support". Regarding EC 7, the responsibility of assessment of fitness and propriety of the board and senior management lies with the bank's board itself; the BI does not systematically perform its own verification, although in practice it does conduct ad-hoc investigations. In addition, the integrity requirements laid down in Ministerial Decree No. 161/1998 are narrow, in the sense they do not include adverse regulatory judgments. In other words, the adverse judgment and sanctions by regulatory agencies, including Consob and BI, if are not related to criminal activities, may not be grounds for denial based on fitness and propriety. The BI can deny a license and "disqualify" a board member when it finds the appointed person lacks one of the integrity requirements listed in the Ministerial decree No. 161, but cannot otherwise remove or mandate the removal of a member of the board (see CPs 11 and 14 These deficiencies are mitigated by a very well structured licensing procedure and good quality of analysis. Some occur very rarely in practice (for instance, subscription of initial capital with assets), and BI actively imposes conditions on authorizations that although strictly meeting legal requirements may not be seem sound enough</p>

Core Principle	Grade	Comments
		<p>based on BI's judgment.</p> <p>A draft amendment to the regulation (posted for consultation until 14.1.2013) seeks to enhance requirements concerning initial capital, organization, governance and program of the activities.</p>
6. Transfer of significant ownership	C	
7. Major acquisitions	LC	<p>EC 1 requires that cases for which notification after the acquisition or investment is sufficient should be primarily activities closely related to banking and where the investment is small relative to the bank's capital. However, bound by the EU legal framework, acquisitions for non financial investments do not need prior approval or prior notification. Acquisitions of financial firms below 10 percent of regulatory capital in EU and G-10 countries, even if such level means control, do not require approval, only notification. In the first case, the deficiency is mitigated by the limits, but these limits would still allow for a significant participation in industrial and other non-financial business that can bring additional risks to the enterprise. In the second case, the ex-ante notification of 30 days provides a very limited timeframe for BI to assess the suitability of financial, managerial, and organizational resources involved in the acquisition. In the EU environment, it is unclear whether in such situations the BI would be able to exercise the power conferred to it by Art. 53 BL to suspend or prohibit the acquisition. Therefore, the regulatory framework permits some situations where acquisitions may imply control of the acquired undertaking and the BI would not be able to make a throughout ex-ante analysis of the quality of supervision in the host jurisdiction, nor assess possible hindrances to effective implementation of corrective measures in the future, nor adequately consider the risks the non-banking activities will bring to the group, or assess that the bank has sufficient financial, managerial and organizational resources to handle the acquisition from the outset. If an undesirable situation occurs, BI would need to rely on its correct and remedial powers—however, divestment procedures may</p>

Core Principle	Grade	Comments
		<p>take long and risks brought to the bank may have already festered. It is recommended that prior notifications are extended to all cases where acquisition will imply control, (even if the investment is within limits—for instance, 15 percent on non-financial enterprises). For the cases where authorization is needed, given the structure of the judicial system in the country, in cases where the acquirer bank meets all quantitative regulatory requirements but the supervisor may not be fully confident on the financial sustainability of the investment, it is possible that no legal grounds for rejection are found. BI has then to rely on its powers to approve with conditions. BI has actively used its powers to impose conditions to make sure all criteria are met and effective supervision is not hindered. Assessors were shown evidence of such supervisory action.</p>
8. Supervisory approach	C	
9. Supervisory techniques and tools	C	
10. Supervisory reporting	C	
11. Corrective and sanctioning powers of supervisors	LC	<p>BI has several powers and tools to apply early corrective measures to address unsafe and unsound practices and activities. The assessors were given access to many examples when such actions were taken, and market participants confirm a very active mode of supervision to curb practices and management which are considered unsound. In particular, BI attributes significant importance to the SREP process and adjustments to the capital. It lacks, however, the important capacity to remove—or even suspend—administrators and members of the board. Unsuitable administrators are often removed by moral suasion but formal powers only exist when the narrow experience and integrity requirements defined by Ministerial Decrees are not met anymore or under crisis procedures. BI believes the issue will be solved when the CRD IV is transposed into Italian law, as it should provide the supervisor the power to temporarily ban the bank’s managers from exercising functions in financial institutions.</p>

Core Principle	Grade	Comments
		Another issue which BI believes will be solved at EU level is the capacity to impose pecuniary sanctions not only on individuals, but on the entity. Currently, such sanctioning is only possible for AML breaches.
12. Consolidated supervision	C	
13. Home-host relationships	LC	The ability of the BI to develop resolution plans and set in motion early coordination to address evolving bank problems and possible resolution on a cross-border basis is limited. The current legislation provides for information exchanges by the BI with foreign ministries and resolution within the scope of liquidation or insolvency proceedings. A proposed directive: will resolve the confidentiality issues that current limits the ability of EU bank supervisors to share confidential information with foreign MEF and Resolution Authorities other than bank supervisors. Additionally, the BI is actively implementing the FSB crisis management and resolution recommendations.
14. Corporate governance	LC	BI lacks authority to remove directors (see CP 11). The BI has issued significant guidance on corporate governance. A proposed guidance for which the consultation period has just concluded would strengthen the corporate governance framework.
15. Risk management process	LC	The BI has set in place an extensive risk management regulatory and supervisory compendium of requirements. Some of the guidance is principles-based and/or deficient in certain areas as noted in the CPs addressing operational, credit, country/transfer and concentrations risk
16. Capital adequacy	C	
17. Credit risk	LC	There is no requirement that large exposures or highly risky and complex operations be approved by the Board nor is there a requirement that lending transactions be on market terms (arm's length).
18. Problem assets, provisions, and reserves	LC	Loan provisioning and write-off is heavily influenced by the judicial and fiscal framework.

Core Principle	Grade	Comments
		This results in NPLs remaining on the books for years. While the current practice is accommodated by the flexibility of IFRS, the prudential aspects are not sufficiently reflected resulting in highly aged NPLs.
19. Concentration risk and large exposure limits	LC	BI has a wealth of information to monitor and analyze concentration risk in banks portfolios, in particular in the loan portfolios, and has conducted such analysis on a bank by bank basis within the SREP process and system-wide. Although monitoring of concentration risk in the broader sense of the revised CP is conducted occasionally, based on general guidelines for credit risk and market risk evaluation, there is not systematic guidance or review beyond name risk/large exposures. However, even the case of large exposures, there are exceptions to the limits that reduce its prudential effect. Contrary to the definition the Methodology, limits are imposed on a risk-weighted basis for some exposures, and exposures in the trading book are not included in the limit but are covered by a separate capital charge. Also, the same limits do not apply on both solo and consolidated basis—banks in a group are subject to larger solo limits than other banks calculating the limit on a solo basis, provided that the consolidated limited is complied with. The authorities have explained that the framework is given by EU level legislation and a different treatment would be an infringement of EU Law. The deficiencies in this CP are somewhat mitigated by evidence of strong supervisory action in many instances. In the case of large exposures, assessors were presented several examples of supervisory action. Assessors were also shown examples where, even in absence of specific regulation on concentration on sector or market products, strong supervisory action was taken to curb such types of concentration.
20. Transactions with related parties	MNC	Italy's framework for related party lending was majorly deficient before the amendments to the BL in 2006 and to Circular 263 in 2011. At the time of this assessment, however, the new framework had just entered into force, and there was no sufficient evidence available to assess implementation, as required by the

Core Principle	Grade	Comments
		<p>methodology. For that reason, compliance could not be verified and will need to be reviewed in future assessment updates. In addition, the regulatory framework has some deficiencies. In particular, the various exceptions to the limits may affect their effectiveness (exposures are risk weighted, as in the large exposures regime, intra-group exposures, including cross border, if between the parent and wholly owned subsidiary, are not only exempt from the limits but also of the approval and monitoring procedures). Although the new procedures represent a large improvement compared to the previous situation, there is no specific requirement that the board member or persons involved are automatically excluded for decision making process, or that all related party lending should occur in no more favorable terms than those to non-related party. The regulation allows the BI to impose case-by-case stricter definition, therefore the capacity of BI to impose definitions of connected parties by judgment other than control remains to be determined in practice, as well as its capacity to intervene in situations when economic influence is the real element connecting the related parties (noting that the definition of connected parties for this legislation is different from that used to define connected parties in the large exposures regime: in the case of related parties, the economic dependence is not considered)</p> <p>These deficiencies might be mitigated by the specific procedures for related party transactions approval and disclosure, active enforcement of risk management procedures by BI and by the use of its powers to require consolidation, and other corrective measures under its power. As mentioned above, however, the regulatory framework only came into full force in December 31, 2012; there is not yet evidence of implementation that could be presented to assessors. Authorities are ready to re-assess the appropriateness of some of these elements based on factual evidence of the significance of the exempted transactions. To this aim they are asking banks to report, at least at the aggregated level, any transaction with related parties, including those that are partially</p>

Core Principle	Grade	Comments
		exempted.
21. Country and transfer risks	MNC	<p>There are no specific requirements for management of country risk and transfer risk. The general risk management and internal control regulations apply (see CP 15). According to the Circular 269, Part I, Section III, Chapter 4, country risk is considered as components of credit risk. Regulations do not define transfer risk. BI assesses the appropriateness of banks' practices regarding country risk on a case by case basis, through off-site and on-site analysis, as part of the annual SREP. In practice, it only happens when country risk is considered material. Assessors were shown evidence that BI does review country risk in depth in the large internationally active banks.</p> <p>However, the regulatory framework is too general to be conducive to good country and transfer risk management in the banks not using IRB. Also, the guidance seems to overlook country risk derived to exposures within the EU, as if the only sources of country and transfer risk were availability of Euro and sovereign risks.</p> <p>Italian banks are active in exposures abroad, and not only the largest. BI is strongly recommended to issue guidance on country and transfer risk that can be understood and applied to all banks; in particular, banks need to be made aware that an overall deterioration of credit risk in a country can lead to many private contracts not being observed, even when not linked to any specific restrictions imposed by governments. In another words, country risk may be linked to the possibility that political and/or economic events occur and influence the quality of the banks portfolio.</p>
22. Market risk	C	
23. Interest rate risk in the banking book	C	
24. Liquidity risk	C	
25. Operational risk	LC	AMA and TSA banks comprise some 90 percent of the Italian banking system, as measured by the banks total assets. For all banks, the BI calculates, under RAS, a score for operational

Core Principle	Grade	Comments
		<p>risk, which uses both quantitative assessment and qualitative. It is clear that requirements for operational risk management are much more detailed and stringent for TSA and AMA banks. Guidance for BIA banks on operational risk monitoring and control is at very high level, in fact, the regulatory basis for action is derived from the general internal controls framework. There is no specific requirement that an operational risk management policy is approved by the board, or that all banks have adequate channels of information of operational risk data and events to boards or the supervisor. The regulation does not properly guide BIA banks on how to identify, assess, evaluate, monitor, report and control or mitigate operational risk. Furthermore, the regulatory framework, even for the more sophisticated banks lacks guidance on IT and outsourcing. However, in spite of the deficiencies in the regulatory framework, assessors were presented evidence, both from the supervisor and from market participants, that actual supervision of operational risk, in particular for TSA and AMA banks, is intensive and intrusive, and supervisors have actively required corrective actions related to operational risks. Capital add-ons are often imposed based on weaknesses of management (even for BIA banks) or relevant findings in AMA frameworks. Market participants confirm the technical quality of the BI team involved in the supervision of operational risk is high and that analysis conducted by BI both onsite and offsite constantly challenges and questions the bank's adequacy of operational risk management and quantification. The supervisory guide contains more details on BI's approach to management of operational risk, including IT and outsourcing, but these are contained in the non-public part of Circular 269. BI has already identified the need to provide more specific requirements, and has included these elements in the draft regulation on internal controls. The BI is encouraged to provide further guidance and requirements applicable to banks and banking groups of all sizes and profiles.</p>
26. Internal control and audit	C	

Core Principle	Grade	Comments
27. Financial reporting and external audit	LC	The BI lacks authority to require banks to replace an external auditor and also lacks the authority to review the work papers of external auditors.
28. Disclosure and transparency	C	
29. Abuse of financial services	C	

DETAILED ASSESSMENT

Supervisory Powers, Responsibilities And Functions	
Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ¹¹ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ¹²
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ¹³ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	The Banking Law (Legislative Decree 385 of 1 September 1993 and subsequent amendments) contains the general rules on the activities and the supervision of banks and banking groups. It identifies three “credit authorities”: the BI, the Interministerial Committee for Credit and Savings (the ICCS), and the Minister of Economy and Finance (the MEF), and specifies their related tasks and responsibilities (articles 2, 3 and 4 of the BL). BI is the authority responsible for bank supervision, including licensing, supervising, application of corrective actions and sanctions, and broad prudential regulatory powers. The ICCS is a Committee composed of five Ministers: of Economy and Finance (Chairperson), for Agricultural, Food and Forestry Policies; for the Economic Development; Infrastructure; European Affairs. The BL gives it responsibilities for “high level oversight.” It is responsible for issuing general guidelines on the basis of which BI is to develop and issue prudential

¹¹ In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

¹² The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

¹³ Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

	<p>regulation. In fact, Art. 4 establishes that on such guidelines the ICCS cannot act by its own initiative, since it can issue regulatory guidelines only upon specific proposals developed by the BI.</p> <p>The MEF can act in the place of ICCS in cases of emergency. The MEF has no actual supervisory powers over banks, but is responsible for issuing decrees on fit and proper requirements for major shareholders and managers, and is responsible for approving the BI's proposals developed for the special administration and compulsory administrative liquidation of banks and banking groups.</p> <p>The Consolidated Financial Law (legislative decree n. 58 of February 24, 2008, the "CFL") states that the BI and the Consob (the securities and markets supervisor) share their supervisory responsibilities on banks performing investment services. Article 5 determines that the BI is responsible for prudential regulation and supervision, while the Consob is responsible for issues relating to fairness and transparency vis-à-vis investors and financial markets.</p>
EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	<p>Art 5 of the BL defines the objectives of banking supervision, determining that the "credit authorities" exercise their powers considering: (a) the sound and prudent management of the supervised institutions; (b) the overall stability, efficiency and competitiveness of the financial system; (c) compliance of supervised institutions with laws and regulations.</p> <p>The BI is also responsible for transparency of banking services and consumer protection (articles 115–128 of the BL). In addition, the BI also has attributions under the legal framework on anti money laundering (AML) and combat to terrorism financing (CTF), and the law entitles the BI extensive powers (see CP 29) to ensure integrity of banking business and avoid misuse of financial services for criminal purposes.</p> <p>The objectives of transparency and consumer protection are considered complementary to the "prudent management" of the banks.</p>
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ¹⁴ and systemic importance. ¹⁵
Description and findings re EC3	The BI is empowered to issue regulations on capital, prudential requirements, risk containment, permissible holdings, governance, organization and internal controls, remuneration policies, and connected lending (art 53 for banks, 67 for consolidated banking groups). BI issues prudential regulation through circulars and supervisory instructions which are legally binding for the supervised entities. It must be noted, however, that as a member of the EU the regulatory capacity of BI is bound by the EU legal framework, where it has been harmonized through EU-wide Directives (that need to be transposed into national

¹⁴ In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

¹⁵ In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	<p>legislation/regulation) and Regulations (which are directly applicable in EU member states).</p> <p>Art 53 (3) (d) allows for the application of more stringent prudential requirements to banks/banking groups. BI has in practice used the article to impose Pillar 2 requirements, in particular capital add-ons and target ratios (article 53 (3) (d) of the BL).</p>
EC4	<p>Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.</p>
Description and findings re EC4	<p>Rulemaking by the BI follows EU-harmonized standards that involve impact assessment of regulations and public consultation (as set out by legislative Act. 28 November 2005, n. 246, and more specifically to the BI in art. 23 of the Savings Protection Act). BI further increased transparency in its regulatory process by issuing in 2012 Regulation 277, which established the public disclosure on a yearly basis of the planned Regulatory Activity; and the extension of the consultation process and the impact assessment to any regulatory proposals to be issued by the ICCS upon the specific input by the BI. Both the impact assessment and the result of the consultation process are made public and are available on the BI website.</p> <p>Although these procedures take a toll in terms of timeliness, as the legal framework (BL Articles 2, 3, 4, 53) empowers the BI to adopt the bulk of prudential regulation these can be more easily updated than if a parliamentary or political/executive proceeding was needed. The BL itself has been amended as necessary to reflect evolution of international standards and EU legislation.</p>
EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) Supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	<p>On a) and b) Arts 51 and art. 66 of the BL mandate banks and banking groups to provide the BI with any information needed for supervision. Articles 54 and 68 of the BL entitle the BI full access to inspect banks and entities belonging to banking groups for the purposes of the consolidated supervision (also see CP 12). On cross border operation of Italian banks and banking groups, BI (i) is responsible for supervision of branches established in other EU Member States (home country control); with the same rights of access and inspection as for domestic branches, (ii) full access to the information and premises at subsidiaries of Italian banks established in other EU Member State, once proper cooperation with the home member state should occur according to EU legislation (see CP 3 and CP 13) and (iii) only authorizes the establishment of branches and subsidiaries in non-EU Member States if the foreign regulatory framework does not present any legal or factual obstacles to the access to the information and premises by BI, the parent bank, and the parent bank internal audit. Information sharing and cross-border inspections are normally based on cooperation agreements with the supervisors of the host country. (See CP 3 and CP 13).</p> <p>On c), the supervision of branches of EU banks is the primary responsibility of the home competent supervisory authority, according to the EU principle of the "home country control". Some controls are exercised by the host authority, e.g., liquidity risk and AML/CFT, and any aspects that has not been subject to EU harmonization (e.g., transparency of banking services) (article 29 and 41 of the CRD). Subsidiaries of EU banks are subject to authorization and supervision of the host Member State. Powers and access, in this case, are the same as</p>

	for domestic banks. Branches and subsidiaries of banks/banking groups from non-EU Member States are subject to the prior authorization by the BI. Supervision and access, in this case, is also the same as for domestic banks.
EC6	<p>When, in a supervisor’s judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank’s license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	<p>The main reference for BI powers is article 53 of the BL. More specifically, 53.3 establishes that BI has early intervention capacity, with tools such as the capacity for convening the board to examine the bank’s solvency and liquidity situations and identifying the appropriate solutions ; convening a general meeting of shareholders, the board of auditors, the board of directors, for the discussion of specific proposals; apply specific prudential measures such as restriction of activities or suspension of operations, restriction on payments of dividends and on remuneration; imposition of capital add-ons.</p> <p>The BI is empowered to apply pecuniary administrative sanctions where any bank does not comply with the relevant supervisory provisions. In particular, article 144 of the BL states that the BI may apply fines on banks’ corporate officers for non compliance with any applicable law, regulations, and specific measures set out by the BI. The AML/CFT Law allows the BI to impose sanctions on legal entities for the violations of anti-money laundering legal and regulatory obligations.</p> <p>Other tools are possible under the crisis regime (Title IV of the BL). Of them, only the “temporary administration” under art. 76 and “extraordinary procedures” under art 78 are available directly to the BI. According to art. 76, in the case of extreme urgency (when there is no extreme urgency, the adequate procedure would be the “special administration,” described below) the BI may suspend the banks’ board and appoint one or more temporary managers, for a period of maximum two months. The measures under article 78 include the capacity to close branches of Italian banks and non-EU branches in Italy, as well as to prohibit them to conduct any new transactions. The two other mechanisms (special administration and compulsory administrative liquidation) need to be proposed by the BI to the MEF, who cannot initiate them but is responsible for the final decision. Under the <u>special administration</u> (SA), there is a temporary dissolution (normally up to one year) of the governing bodies and their replacement with one or more special administrators (and an oversight committee) appointed by the BI (art. 70 ff of the BL). Under the <u>compulsory administrative liquidation</u> (CAL), the bank’s license is withdrawn and resolution starts (art. 80 ff of the BL).</p> <p>These are crisis measures: SA can be ordered in case of severe administrative irregularities and violations of laws, regulations or bylaws and/or in case of significant expected losses; same conditions, when exceptionally serious, trigger the CAL.</p> <p>BI is the resolution authority for banks and banking groups (articles 80 ff and 99 and 101 of the BL). Besides being responsible for proposing the liquidation to the MEF, the BI appoints the liquidators and the oversight committee; oversees the liquidation procedure, and can authorized liquidators to conduct “en bloc” sales of assets. Under FSB’s SIE recommendations, the BI is currently negotiating with foreign (in particular EU) authorities specific agreements</p>

	to ensure proper cooperation for the purpose of crisis management of Italian systemically important banks (SIBs) on a best effort basis. (See also description of CP 13, EC. 5 and 6).
EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	<p>The BL establishes the general regulation on banking groups and consolidated supervision (Articles 60–68). The BI is empowered to set prudential requirements on a consolidated basis to banking groups; exercise both off site and on-site supervision with respect to all the entities belonging to a banking group, including the financial holding company (see CP 12 for definition of banking group). The perimeter for consolidated supervision for the purpose to collect information and carry out on-site examinations is wider than that of the banking group. It includes also banking, financial and instrumental companies not included in a banking group but controlled by a natural or legal person who controls a banking group or an individual bank; companies which control at least one bank; companies other than banking, financial and instrumental companies where they are controlled by an individual bank or by companies or persons belonging to a banking group, or who hold, jointly or otherwise, a controlling interest.</p> <p>The holding company is required to transmit information and statistics covering the entire conglomerate (Articles 65 and 66 of the BL). As regards those companies that are not included in the group but are included in the perimeter of the consolidated supervision, the BI may require, via the holding company, the same information as it is the case for banking groups. According to Articles 66, 67 and 68 of the BL, the BI may include the operations of such companies in the calculation of capital requirements on a consolidated basis and require their accounts to be included in the consolidation if they are material for the purposes of the stability of the banking group. To this end, the BI is empowered to carry out on-site inspections (Art. 68 of the BL).</p>
Assessment of Principle 1	Largely compliant
Comments	<p>Responsibilities, objectives and powers are clearly defined. Powers seem to be mostly adequate and used in practice, according to evidence presented to assessors (for example, at the time of the assessment 64 banks were under specific capital add-ons imposed by the BI). The BI, however, cannot revoke a banking license based on its own judgment, as required by EC 6, since the final decision on license revocation rests with the MEF, who is responsible for issuing the decree that starts liquidation procedures.</p> <p>There are other limitations on powers for corrective actions that were not considered for the rating of this CP, but were included under CP 11.</p>
Principle 2	Independence, accountability, resourcing and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and

	banking groups under its supervision.
Description and findings re EC1	<p>Independence, accountability and governance of BI are established by legal framework, mainly the BL, the CFL, and the Statute (which is established by Presidential decree), Legislative Decree 43/1998 (incorporating the provisions of the EC Treaty on Monetary Policy and the European System of Central Banks), Law 262/2005, and Legislative Decree 303/2006.</p> <p>BI is a public law entity with private and public shareholders. The ownership structure of the BI reflects its past history and the evolution of the Italian banking regulation. It was established, under the 1893 Banking Law, as a private company as a result of the merger of three institutions. Afterwards, the 1936 Banking Law explicitly declared the public nature of the BI, defining it "a public law institution." Shareholdings were expropriated and equity was reserved to financial institutions of public relevance (banks, insurance firms and social security institutions). Since then, a high number of mergers and acquisitions within the Italian banking system has led to the current distribution of shares. Its capital (amounting to EUR 156,000 and divided into 300,000 registered shares with a par value of EUR 0.52 each) is held by 54 privately-owned banks, 5 insurance firms, the National Social Security Agency and the Italian Workers' Compensation Authority. The Statute establishes that the distribution of shares among the shareholders must be balanced and the power exercised in voting cannot exceed certain limits: the votes any shareholder may cast in a shareholders' meeting are limited to a maximum of 50 (out of a total, as of 8.2.2013, of 535), regardless of the number of shares held, in order to prevent individual shareholders from exercising a preponderant influence (article 9(3)). The scope of issues under the decision/intervention of shareholders is rather limited. They approve the annual accounts; the allocation of profits, the distribution of the income earned on the reserves, and appoint the members of the Board of Directors.</p> <p>The Board of Directors is charged with the general administration, management, supervision and internal control of the Bank, but is explicitly excluded by article 5(1) of Legislative Decree 691/1947 from all tasks relating to banking and financial supervision. Besides deciding on the dividends to be paid to shareholders, the Board approves the budget, internal regulations, and determines the staffing levels.</p> <p>The Directorate is the governing body of BI. It is composed of the Governor, the Director General and three Deputy Directors-General. Appointment and dismissal, conflict of interest features are established in law (see EC 2 and 4) and in the Statute. Art 19 (4) of Law no. 262/2005 establishes that the BI has autonomy to take supervisory actions or decisions, and increased the level of accountability and transparency of decisions thus taken. As a result, the Statute was deeply amended by Decree in December 2006, with the specific aim of enhancing independence. In particular, article 1 established the principle of independence from "public or private-sector entities". Articles 24, 25 and 26 established fixed terms of office for Directorate members, specific procedures for appointment, reappointment and dismissal of the Governor (Article 17). The amendments also introduced the principle of collegiality in the decisions taken by the Directorate, and improved accountability measures.</p> <p>Assessors saw no evidence of government or industry interference in supervisory actions and decisions.</p> <p>For accountability, see EC 3. The BI is accountable for its activities to both Government and Parliament.</p>
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the

	role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	<p>The Directorate is chaired by the Governor and includes the Director General and three Deputy Director- General. The procedures for the appointment and removal of the members of the Directorate were modified as follows according to Articles 19(7) and 19(8) of Law no. 262 of 28 December 2005 and to Article 17 of the Statute of the BI and largely drawn on the prescriptions of the Statute of the European System of Central Banks (ESCB).</p> <p>The appointment of the Governor, his/her reappointment and his/her removal from office must be enacted by means of 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, after hearing the opinion of the BI's Board of Directors.</p> <p>The Governor proposes the appointment of the other members of the Directorate to the Board of Directors. The appointment, reappointment and removal must also be approved by a decree of the President of the Republic acting on a proposal from the President of the Council of Ministers in agreement with the Minister for the Economy and Finance after consulting the Council of Ministers.</p> <p>Pursuant to article 24 of the Statute of the BI the Governor's term of office shall be six years; it may be renewed only once. Same rules apply to the other members of the Directorate.</p> <p>According to the statute of the BI (article 17.3) the reasons for removal of the Governor or other members of the Directorate are those provided for by Article 14(2) of the statute of the ESCB, i.e. only if they no longer fulfill the conditions required for the performance of their duties or if they have been guilty of serious misconduct. According to the principles of Italian public law, the formal decision by the President of the Republic, which is published as described above, must acknowledge the reasons for removal. No member of the Directorate has been removed under this framework, so far. In the last five years, three members of the Directorate, including a governor, resigned before their term, in all cases to assume presidency positions in Italian or European public entities.</p>
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ¹⁶
Description and findings re EC3	<p>The BI is accountable for its activities to both Government and Parliament.</p> <p>The main tool for accountability is the Annual Report to Government and Parliament, required by article 19 of law no. 262/2005. Furthermore the Governor, other members of the Directorate and managers of the Bank deliver their testimony before Parliamentary Commissions in the framework of parliamentary fact-findings when required to do so.</p> <p>The Governor may also refer to the ICCS and to the "Comitato per la salvaguardia della stabilità finanziaria" (Committee for the safeguard of financial stability) on issues related to the stability of the Italian financial system.</p> <p>The Committee for the safeguard of financial stability has been set up in 2008 pursuant to an EU recommendation. It is composed by the Minister for economy and finance and the heads of the main financial supervisors (Banca d'Italia, Consob, Ivass). Its main task is to examine issues related to financial stability.</p> <p>In addition to these forms of accountability vis-à-vis political bodies, the BI is accountable</p>

¹⁶ Please refer to Principle 1, Essential Criterion 1.

	towards the financial community and the public at large through disclosure of the main reasons underlying its decisions (individual measures as well as regulations), according to the general principles of public law (articles 4 and 8 of the Banking Law) and articles 23 and 24 of law no. 262/2005. As far as regulation is concerned, every new regulatory measure is enacted by the BI after consulting stakeholders and on the basis of an impact analysis whose results are made public (see also description of CP 1, EC 4).
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	<p>See EC1 on governance structure. The internal governance of the BI was substantially changed by the reform of the Statute approved in 2006, in the light of Law 262/2005. It establishes that acts and measures with an external relevance—such as the supervisory measures—have to be adopted by the Directorate acting as a collegial body (art. 21). Internal organization (“General Regulations” n. 1 of December 21, 1989 updated October 4, 2011) were approved by the Board pursuant to Article 18 of the Statute.</p> <p>The Directorate takes decisions on a collective basis. The meetings are chaired by the Governor, and the minimum required quorum is three members. The decisions are adopted by the majority of the votes of those who are present. In the event of a tie, the Governor has the casting vote (Statute, art. 22). As a general rule, the Directorate holds weekly meetings, subject to any other institutional engagements of its members. Proposals of the staff may be accepted, rejected, modified or sent back to staff for reconsideration. Prior the formal decision, the Directorate usually hears the Managing Director responsible for Supervision and the General Counsel (Head of the Legal Research and Services Area). The minutes of the Directorate’s meetings are available to the parties concerned upon request.</p> <p>Within the supervision structure, to ensure coordination and consistency within the organization, reports and proposals from the organizational units and local branches are conveyed through an ad hoc unit to the Managing Director responsible for Supervision, for submission to the Directorate. Proposals relating to enforcement actions (such as bank’s resolution) are implemented through inter-departmental procedures.</p> <p>The law on transparency of administrative procedures (law 241/1990) requires that BI discloses the reasons underpinning its decisions. It also determines the general rules on the timeframe for administrative proceedings. The BI, through its own regulation, also (Regulation of 25.6. 2008) sets the time limit for each supervisory proceeding and the adoption of the relevant decision (e.g. authorization), and the organizational departments that are responsible for each. Other BI internal rules (Circular n. 177/1993 updated 9.10.2006) also define in which circumstances the responsible person can delegate part or the entire proceeding to another manager. The list of administrative procedures and decisions delegated by the Directorate is available on the web site of BI. For instance, 56 out of 214 supervision proceedings have been delegated to the Managing Director responsible for Supervision; the heads of departments and branches; or unit managers, to provide timeliness of decision making. In addition, According to the Statute (art. 22), in case of necessity or urgency, decisions may be taken by individual members of the Directorate. Any such decision shall be endorsed by the Directorate at its first next meeting. Another feature for flexibility and timeliness of decision making is that some measures can be adopted through written procedure within the five days following the day of the proposal, but this procedure has not yet been used.</p> <p>A code of conduct for members of the Directorate was introduced in May 2006. It relates to</p>

	<p>the standards for conduct of personal affairs, the conflicts of interest, the disclosure of conflicts of interest and the definition of circumstances that require any member of Directorate to abstain from voting.</p> <p>Art. 6 of the code of conduct for members of the Directorate states that situations of potential conflicts of interest must be brought to the attention of the other members of the Directorate.</p> <p>According to art. 10 of the same code, members of the Directorate must inform the Board of Directors of facts or situations involving them that could impair or merely appear to impair the independence and impartiality of the BI, and any related initiative.</p>
EC5	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>
Description and findings re EC5	<p>For rules regarding the governing body, see EC 4. Conflicts of interest and business secrecy are ruled by articles 12/I and 17/II of the Conditions of employment that prescribe specific duties of reporting and refraining. Violation of the Conditions of employment can involve disciplinary sanctions. These provisions are enhanced by the Code of conduct, which establishes that employees shall avoid any situation liable to give rise to any type of conflict of interest; any potential conflict of interest shall be reported to the employee's direct superiors; employees shall neither use, nor disclose confidential information for the purpose of gaining an advantage for themselves, the members of their families or any other individuals. Failure to comply with business secrecy and any violation is punished as a crime (article 7 BL).</p> <p>The staff of BI is generally regarded as professionally skilled and with integrity by market participants and respected by international supervisors. Professional skills are sought in the recruitment process, which is based on a technical-only selection (selection tests). All management is composed of career members of staff, and traditionally also members of the Directorate are professionals with BI career experience.</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g. supervisory colleges).
Description and findings re EC6	<p>(a) Staff requirements are reviewed each year in terms of dimension and professional profiles. The requests from the supervision departments are provided to the BI's Human Resources</p>

	<p>(HR), and can be satisfied by either internal mobility or new recruitment (a recruitment plan is developed annually). As at September 9, 2012, there were 1.168 resources employed in supervision activities (705 in the Head Office and 463 in the Branches; professionals were 542 and 313 respectively). Since 2008, resources employed in the Banking and Financial Supervision Area have increased by 190 units, mainly professionals, even though the overall staff has been steadily decreasing (from 7,400 at the end of 2007 to 6,990 at the end of 2011). Heads of department and units stated to assessors staffing levels are currently adequate, although intensively used. Implementation of the European SSM may occasion a revision of staffing and expertise in the future.</p> <p>(b) The salary scale seems to be attractive for entry level staff, and BI has had no difficulties attracting skilled professionals. BI also promotes training and secondment with international institutions. Turn-over rate is low, about 7 percent. In the last 5 years, 18 people resigned to take positions in the private sector.</p> <p>(c) The BI can commission external experts for particularly qualified tasks that cannot be carried out by internal human resources. Through fixed-term contracts the Bank defines confidentiality restrictions to conduct supervisory tasks. In accordance with article 53 of Legislative Decree 165/2001, the list of the external consultancy and collaboration contracts assigned by the Bank is published on the Bank website. For supervisory tasks, BI relies mostly on its own personnel.</p> <p>(d) There is a centralized budget assigned to the HR Department, which covers expenses of internal training for all the staff members and of external training for staff members of branches. These expenses are estimated on the basis of the training policies and programs defined each year. In addition, there are decentralized budgets assigned to each department, to cover participation fees to external events. The BI's financial budget, including for training, is approved by the Board. During the year the financial budget can be adjusted. There is an annual training program agreed between the supervision departments and the HR department. Training budget has been stable in the last 5 years, and supervisors report training has been sufficient and of good quality. It includes not only supervisory skills but also language, online tutorials, etc.</p> <p>(e) The BI's technology budget is centralized and managed by specialized departments. The financial resources needed for technological equipment and assets are planned on a yearly basis, but supervision departments have the responsibility of defining all the business/technology needs. IT projects are generally subject to feasibility and cost benefit analysis, but the supervision departments have not reported any impediments to their work in that sphere.</p> <p>(f) Travel expenses are estimated every year on the basis of the information collected from the market (i.e., hotel and travel fees) and on the basis of the estimated travel needs of the departments (no. of business travel to be made and days spent out of office). The expenses are estimated not only for the annual on-site inspections plan but also meetings and training. During the year the supervision departments are autonomous in implementing their travel plans. Staff has not reported any impediments to the work in that sphere.</p>
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	The HR Dept. implements on a yearly basis the decisions of the ad hoc Advisory Committee named "Comitato Consultivo per gli organici" on the overall Bank's staffing. The planning

	exercise starts with the staff requirements sent by the Heads of Department to the HR Function. the Advisory Committee evaluates for each business unit staff requirements (e.g., staff dimension, professional profiles); workload indicators; demographic and organizational data; impact analysis of innovations in rules, technology, organization and procedures; Internal Audit evaluations.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	<p>The process for determining supervisory programs and allocating resources is set out in the Guide to supervisory activities (Part I). The risk profile and systemic importance of individual banks and banking groups are used to organize banks in groups and tailor the allocation of supervisory resources. BI describes its supervisory approach (see CP 8) as <i>consolidated</i> (to detect and address risks regardless of organizational and corporate structure); <i>risk-based</i>, targeted at assessing all relevant risks, and <i>proportional</i>, directed at graduating controls in proportion to the size of supervised entities, their systemic relevance and specific problems. To address proportionality, banks are grouped into five macro-categories, which affect resources and supervisory programs:</p> <p>“Intermediaries having a significant international presence;”</p> <p>“Domestic systemically-important banks” D-SIBs</p> <p>“Medium-large intermediaries”: entities—not falling within macro-categories 1 and 2—characterized by at least one of the following conditions: - total assets between EUR 3.5 and EUR 20 billion; assets under management exceeding EUR 10 billion (intermediaries mainly involved in asset management); annual turnover—dealing for own account or for the account of a third party—exceeding EUR 150 billion (intermediaries mainly involved in dealing for own account or for the account of third parties);</p> <p>“Minor intermediaries”: entities characterized by at least one of the following conditions: - total assets of EUR 3.5 billion or less; assets under management of EUR 10 billion or less (intermediaries mainly active in asset management); annual turnover—dealing for own account or the account of third parties—of 150 billion euro or less (intermediaries mostly involved in dealing for own account or for the account of a third party);</p> <p>Entities subject to specific regulations.</p> <p>In order to ensure efficiency as well as to promote more direct relations with supervised entities, the supervisory tasks concerning local minor intermediaries are fulfilled by the BI local Branches. The branches are grouped into five regional areas. Frequency and type of controls are adjusted to the intermediaries' size and problems. These are normally based on an annual planning that takes into account bank's features, the need for in-depth controls emerged while performing supervisory tasks and the (macro- and micro-prudential) risks highlighted in the Financial Risk Outlook (FRO).</p> <p>The FRO is the final output of the activity of the dedicated Risk Task Force, to which all the main Supervisory Departments (Regulation and Macroprudential, Banking Supervision, Financial Intermediaries Supervision, Inspectorate, Coordination Unit) participate. It analyzes and prioritizes the main risks to which the Italian financial system is exposed, and therefore it represents a guide for approaching the individual analysis of financial institutions.</p>
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions

	made while discharging their duties in good faith.
Description and findings re EC9	<p>According to Article 24, paragraph 6-bis, of Law no. 262 of 2005, the BI, the components of its governing bodies and its employees, in the exercise of supervisory functions, are responsible only for gross negligence and for acts committed intentionally.</p> <p>However, the conditions of employment in the BI states that employees are to be reimbursed for costs incurred for legal assistance in lawsuits related to the exercise of their functions, after the final judgment which decides the innocence of the employee.</p>
Assessment of Principle 2	Largely compliant
Comments	<p>In particular given the changes in the legal framework since 2005, the BI has governance framework conducive to independence of supervisory decisions, and adequate transparency and accountability. Interviews with external parties confirm the BI is currently well regarded both in terms of independence, professional qualification and integrity. Resources, including for recruitment and training, seem to be adequate for the conduction of supervisory activities.</p> <p>However, the legal protection of supervisors, although improved since 2005, may still be an issue, given the fact that measures adopted by the BI are not rarely challenged in court (from 2007 to 2011, BI was subject to 447 appeals or litigation, 23 were ruled against the institution, and 23 partially against.)¹⁷ Reimbursement of legal costs only after the end of judicial proceedings means employees need to bear personally all the costs of defending their actions and decisions taken in good faith in the exercise of their supervisory functions. In a country where litigiousness is common and such legal proceeding may take several years, this deficiency could be particularly material. The Board of BI has made a decision, on December 18, 2012, to allow the anticipation of reimbursement to staff in cases of legal suits. The operational details of this staff benefit are still to be fleshed out. The assessors welcome the developments, and the effectiveness of the measures will likely be fully observable when the next BCP assessment takes place.</p>
Principle 3	Cooperation and collaboration. Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. ¹⁸
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	The BI, Consob, ISVAP/IVASS, COVIP and FIU actively exchange information (BL, art 7). The CFL requires BI and Consob to share supervisory responsibilities regarding financial intermediaries that provide investment and asset management services, namely: banks, investment companies, asset management companies, collective investment funds, and

¹⁷ These cases refer to decisions adopted by the BI and not all are legal suits against staff.

¹⁸ Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13) and "Abuse of financial services" (29).

	<p>open-end investment companies. In particular: (a) the BI is responsible for risk containment, assets stability, and sound and prudent management of financial intermediaries and (b) Consob is responsible for issues relating to transparency and conduct (CFL, article 5, paragraphs 2 and 3).</p> <p>In October 2007, the BI and Consob signed an MOU addressing the main aspects of supervision: licensing, information exchange; on-site inspection; communication of findings as a result of the respective supervisory activities, and consultation on significant decisions. In addition the MOU established two permanent committees: 1) the strategic committee to discuss and exchange information on major issues and 2) the technical committee that deals with operational aspects and implementation of guidance issued set by the strategic committee.</p> <p>The BI, Consob and ISVAP in 2006 concluded a Coordination agreement concerning: (a) the identification of financial conglomerates and the authorities responsible for coordinating supplementary supervision, and (b) the methods for determining capital adequacy. There are six financial conglomerates; BI is coordinator for three and ISVAP/IVASS for the others.</p> <p>In March 2008, the Ministry of the Economy and Finance, the BI, Consob and ISVAP signed a cooperation agreement that set up the Committee to safeguard financial stability. The Committee is a permanent forum for discussion of issues affecting financial stability. The MEF chairs the meetings; the CSFS meets at least twice a year.</p> <p>Coordination has been effective, joint examinations have taken place and the insurance supervisor (former ISVAP, now IVASS) shares its governance bodies with the BI, which will further enhance cooperation.</p>
EC2	<p>Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary</p>
Description and findings re EC2	<p>The CRD and EU Regulations provide that supervisors must cooperate with each other; EU bank supervisors must also cooperate with other EU non-bank supervisors and EU supervisory authorities. The exchange of information cannot be impeded or impaired by the imposition of confidentiality obligations (professional and/or bank secrecy). Articles 6 and 7 of the BL outline the BI duties to cooperate with EU supervisors and EU authorities. Specific provisions of the CRD regulate cooperation and collaboration between supervisors involved in the supervision of cross border groups and, in particular, within the colleges of supervisors.</p> <p>Cooperation and information exchange may occur with non-EU supervisors, even in the absence of a cooperation agreement, provided that the conditions for an effective mutual cooperation are met. Such conditions refer to: (i) absence of obstacles to the exchange of information between the BI and the non-EU supervisor, and between the parent bank and its foreign subsidiaries; (ii) confidentiality requirements; (iii) access for the BI to conduct inspections of branches/subsidiaries in the non-EU country; (iv) cooperation on AML/CTF.</p> <p>The arrangements have been effective for the BI, resulting in joint supervisory activities with home/host authorities, coordinated follow-up on corrective action resulting from cross-border onsite inspections, sharing reports of inspection and shared websites with supervisory assessments of individual banks. Host supervisors have informed the BI of issues in local operations and coordinated action, involving various hosts and the BI, have been implemented.</p>
EC3	<p>The supervisor may provide confidential information to another domestic authority or foreign</p>

	supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	<p>The BI exchanges information with other domestic and EU supervisors to facilitate the performance of their supervisory tasks. In these occurrences the receiving supervisors and authorities are, under Italian and EU law, subject to stringent confidentiality requirements. The BI may exchange information with national and foreign deposit guarantee schemes on condition that confidentiality is ensured.</p> <p>The BI may also exchange information with supervisors of non-EU countries provided that such supervisors are subject to confidentiality requirements equivalent to those provided by the EU law and the Italian implementing provisions (BL, article 7). Therefore, before exchanging information, the BI ensures that the non-EU supervisor is able to meet equivalent confidentiality requirements.</p>
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information
Description and findings re EC4	<p>The BI is required to observe professional secrecy obligations that are meant to protect the confidentiality of supervisory information. These obligations are laid down by the BL (article 7). The BI may use confidential information only for the performance of supervisory tasks, (article 5 of the BL).</p> <p>The confidentiality requirements apply both to information acquired by the BI in the course of the supervisory activity and to information received from another supervisor or authority. As to the information provided by EU supervisors, pursuant to the EU law the BI is bound to seek the consent of the supervisor that provided the information before forwarding to third parties other than EU supervisors and EU authorities, and in particular to non EU supervisors (article 46 of the CRD).</p> <p>Regarding information provided from non-EU supervisors, the BI always informs the supervisor providing the information of a request from a third party and seeks to obtain the consent of this supervisor to the onward disclosure. Where such consent is denied the BI: either a) refrains from the onward disclosure or, b) when it cannot oppose professional secrecy (e.g. in the case of a request from the judiciary), undertakes every legal means to resist the request for onward disclosure.</p>
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	The BI is the national resolution authority for banks and banking groups (articles 70, 80, 98 and 99 of the BL) and may request the MEF to issue a decree authorizing the special administration and/or the compulsory administrative liquidation of a bank or a banking group. Furthermore, the BL provides for the legal gateways that permit the BI to cooperate

	with the other national supervisors to manage a bank crisis.
Assessment of Principle 3	Compliant
Comments	
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	Article 10 of the BL defines the banking business as the entrepreneurial activity constituted by fund-raising on a public basis and the granting of credit. Banking is restricted to banks.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	Article 10 of the BL defines activities to which banks are entitled to engage, including other financial business and in related or instrumental activities, provided that the law does not reserve the performance of such business to other intermediaries. For instance, banks cannot engage in collective asset management—which the law reserves to asset management companies (SGR) and open-ended investment companies (SICAV), and in insurance business—which the law reserves to insurance companies.
EC3	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	Article 133 of the BL prohibits the use by any legal entity and persons other than banks of the words “banca”, “banco”, “credito”, “risparmio” or other words or expressions in Italian or in a foreign language likely to deceive as to the authorization to engage in banking. Violators are punished with administrative sanctions. In addition, Circ. No. 229/99, Title I, Chapter 4, provides explanations and limited exceptions to the above prohibition, when the use of the protected words by any legal entity or persons other than banks is justified, for instance, legal entities and persons performing no financial activity, when the protected words come along with other expressions that avoid any confusion (e.g., “blood bank”).
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ¹⁹
Description and findings re EC4	Fund-raising (which includes deposit-taking) on a public basis is prohibited for legal entities and persons other than banks (Article 11 of the BL); any relevant breach is punished with criminal sanctions (article 130 BL). Whereas deposit-taking (intended as the raising of proper bank deposits, as defined in article 1834 of the Civil Code) is strictly reserved to banks, article 11 does allow fund-raising (acceptance of repayable funds) in some precise situations. More specifically, some activities

¹⁹ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

	such as issuing of “e-money” to be stored in payment accounts are not considered “fund-raising; whereas some public fund-raising is allowed to some non-bank institutions, such as sovereigns, international organizations, regional and local authorities. BI further detailed the conditions of such exceptions in Circ. No. 229/99 Title IX, Chapter 2. In any case, non-bank institutions cannot engage in the raising of sight funds nor in any form of fund-raising related to the issue or administration of generally spendable means of payment (Article 11, para. 5, of the BL)
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	According to Article 13 of the BL, the BI manages and updates the public register of banks and makes it available on its website (http://siotec.bancaditalia.it/sportelli/main.do?function=language&language=ita) a search engine to allow anyone to consult the register of banks, including branches of foreign banks, authorized in Italy.
Assessment of Principle 4	Compliant
Comments	
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ²⁰ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	Article 14 of the BL establishes that that the BI is both the authority responsible for banking licensing and supervision. Under its supervisory capacity, BI has the power to impose

²⁰ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms “board” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	<p>limitations or additional requirements.</p> <p>Withdrawal of license depends on the MEF. Although BI is the resolution authority, it needs to propose to the MEF a compulsory administrative liquidation (CAL) procedure (art 80ff, 900 and 101 of the BL). The withdrawal of the licence is declared by the MEF within the same decree as the CAL. The MEF cannot act withdraw a license on its own initiative, see CP 1. The BI can revoke the license if the bank has not started its operations, see EC2.</p>
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	<p>The criteria for licensing are set both in Law and in supervisory instructions set by the BI. Art 14 of the BL establishes requirements regarding the legal form, the initial paid up capital, requirements for business plans, and that shareholders and senior management must comply with suitability requirements.</p> <p>Applications can be rejected if the BI understands there are shortcomings that may jeopardise the sound and prudent management of the bank (such as inadequate capital, deficiencies in the proposed business, plan, and unsuitability of major shareholders). If the license is found to have been granted based on false information, the procedures for revocation will differ if the bank has already started operations or not. If the bank has not started operations, the BI can revoke the license on its own accord, by invoking the general principles of administrative procedure. Law n. 241/1990 (the general law on administrative procedure), Article 21-quinquies provides for the power to revoke administrative measures "for subsequently arising reasons of public interest or in cases where concrete situations change or the original public interest is re-assessed," and Article 21-nonies states that "an administrative measure that is unlawful in accordance with Article 21-octies may be annulled ex officio." BI understands a license granted on the basis of false information is a case of unlawful administrative measure according to Article 21-octies, which may be therefore annulled ex officio according to Article 21-nonies of Law n. 241/1990.</p> <p>If the bank has already started its business and there is the need for a compulsory winding-up, the usual procedures for CAL apply, and The withdrawal of the licence is declared by the MEF within the same decree as the CAL. The new Supervisory Instructions (amending Circular 229 Title I Chapter I), which were under public consultation at the time of the assessment, that will explicitly mention the case of false information being given by the applicant to BI as an example of withdrawal by BI of the banking license</p>
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	Licensing criteria (such as capital and suitability of senior management and shareholders) are consistent with ongoing supervision and need to be met throughout the life of the bank.
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ²¹ The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.

²¹ Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003.)

Description and findings re EC4	Circular 229, Title I, Chapter 1, Section IV specifically establishes that group structure must not prevent the effective exercise of its supervisory functions. The application assessment verifies the proposed legal, managerial and operational structure of the new bank, the group's configuration and the location of its components, the transparency of its ownership structure, the adequacy of the supervision on its foreign components and the ability of the BI to perform adequate consolidated supervision. Although there is no specific discussion on hindrance to corrective measures, it is considered part of the assessment of "effectiveness of supervision", as Circular 229, Title II, Chapter 1, Section 5.2) subsequently states that: "If a bank belongs to a group that does not fall into the definition of a banking group, the BI evaluates that the group structure does not hinder the implementation of Supervisory measures. Where the group consists also of firms with head-quarters and incorporated abroad, the BI assesses whether the geographical location or the activities performed in foreign countries can guarantee the exercise of effective Supervision"
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	<p>Circular 229 establishes that BI must ensure the suitability of major shareholders. Integrity requirements are defined in Article 25 of the BL, and in the Ministerial Decree 144/1998. There are also requirements concerning the quality and financial soundness to hold qualified shares of banks (Article 19 of the BL and Credit Committee Resolution 27 July 2011).</p> <p>In the application process, to assess the suitability of qualified shareholders, BI assesses their business reputation, including any record of criminal conviction or investigation, their experience and their financial soundness. Documentation required include:</p> <ul style="list-style-type: none"> • the list of the persons who directly or indirectly participate in the capital of the bank, with an indication of the shares held; for indirect holdings, the person by means of which the capital is held; • information on the provenance of the funds; • documentation showing that persons directly or indirectly holding a qualifying share of the capital or control of the bank satisfy the integrity requirements. <p>The BI also takes into account other information in its possession—such as supervisory records and the Central Credit Register (CCR)—and may request information from other public authorities or from the competent supervisory authorities of the foreign countries concerned. The BI seeks to identify links of whatever nature, including family or associational ties, between shareholders and other persons whose situation is likely to jeopardize the sound and prudent management of the bank. The subscribers to the capital must also provide documentation showing the origin of the funds used as initial capital.</p> <p>For the assessment of the transparency of the ownership structure the shareholders must provide a mapping of the holdings concerned; the BI also takes into account the significant influence exerted by shareholders or others persons, and the existence and content of shareholders' agreements aimed at controlling the management of the bank. The evaluation must find that the ownership structure will not jeopardise the exercise of effective supervision.</p> <p>A shareholder can borrow the funds to make the initial subscription of capital, in this case the amount and the conditions of the loan are analyzed under the information on the sources of funds to be used as capital. This verification is conducted to preserve the quality of the initial capital and to prevent shadow shareholders hiding behind a loan. According to Circular 229,</p>

	Title I, Chapter 1, Section 4 and Title II, Chapter 1, Section 2–5, the BI may “require shareholders to make specific statements of commitment with the aim of safeguarding sound and prudent management.”
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	Initial paid-up capital, which must be at least EUR 6.3 millions for banks adopting the legal form of <i>società per azioni</i> and for all <i>banche popolari</i> and EUR 2 millions for <i>banche di credito cooperativo</i> . The BI may require a higher level of initial capital where the bank’s own funds are inadequate in relation to the planned scale and scope of business or in case the capital adequacy ratios are likely to be breached in the future. A shareholder can borrow the funds to make the initial subscription of capital. In addition, under the current regulation, assets other than cash are allowed up to the 7/10 of the total initial capital. The BI informed that in practice, the provision has never been used by new applicant banks in recent years. A draft amendment under consultation proposes a new maximum of 3/10, to make sure that most of the initial capital must be in cash and liquid.
EC7	The licensing authority, at authorization, evaluates the bank’s proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank. ²² The licensing authority determines whether the bank’s Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.
Description and findings re EC7	<p>The persons performing administrative, managerial or control functions (which include board members and senior managers) must satisfy the experience and integrity requirements established by statutory and regulatory provisions (Article 26 of the BL and Ministerial Decree 161/1998). The requirements for integrity and experience are detailed in the Decree of the Minister of the Treasury n. 161/1998. Board members and senior managers are required to prove specific experience deriving from managing functions, academic teaching, professional career or civil servant career. Minimum required experience is: three years (five years for the chairman) for banks in the form of <i>società per azioni</i> and for all <i>banche popolari</i>; at least one year for chairmen, and two years for general managers of mutual banks, ie <i>banche di credito cooperative</i>. The general manager and the managing director of <i>società per azioni</i> and <i>banche popolari</i> must in all cases satisfy a specific minimum requirement of five years of managerial experience in the fields of banking, finance, securities and insurance.</p> <p>Integrity requirements refer to criminal proceedings: corporate offices may not be held by persons who, for example, have been subjected to preventive measures by the judicial authorities or sentenced definitively to a term of imprisonment of at least one year or two years for the specific crimes indicated in Ministerial Decree 161/1998. Integrity requirements provided by the Decree are narrow, in the sense they do not include adverse regulatory judgments. In other words, the adverse judgment and sanctions by regulatory agencies, including Consob and BI, if are not related to criminal activities, are not grounds for denial based on fitness and propriety.</p> <p>The legal framework attributes the major responsibility for compliance with all requirements to the bank’s corporate bodies. Pursuant to Circular 229 Title II, Chapter 2, Section 2, the</p>

²² Please refer to Principle 14, Essential Criterion 8.

	<p>banks need to transmit to the BI a copy of the minutes of the meeting in which the verification of suitability took place. When evaluating the minutes and their content, the BI can require the original relevant documentation (including extracts of official criminal records) to be submitted in order to verify the information provided.</p> <p>The BI evaluates the minutes and may conduct its own investigation; if the requirements are not satisfied by all the board members of the new banks the BI can deny the licence. The quality of corporate officers, like that of shareholders, is evaluated by the BI not only on the basis of the information provided by applicant banks but also in light of other sources of information available, such as the CCR.</p> <p>The BI may meet with the proposed board directors and managers to ascertain their knowledge of the activities and the organization, and the associated risks.</p> <p>In addition, the BI (Supervisory Instructions on Corporate Governance of Banks, 4 March 2008) requires some directors to be independent, as to reduce the scope for conflict of interest. The inter-locking limitation among board members of different banks, introduced by art. 36, law 201/2011, is required for new banks, and has been explicitly included in the draft amendment of licensing requirements, under consultation.</p>
EC8	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.²³</p>
Description and findings re EC8	<p>According to art. 14 of BL, a business plans must be submitted, together with the instruments of incorporation and the bylaws. Title I, Chapter 1, Section III of Circular 229 provides the guidelines of the business plan that the bank is to present to BI's evaluation. In particular, the plan must indicate:</p> <ul style="list-style-type: none"> • the sectors of activity, operations and services in which the bank intends to engage in; • the bank's technical, organizational and geographical structure, its procedures for internal controls and the characteristics of its information system; • the budgets for the first three years of business operation. <p>The new bank's proposed corporate governance is assessed on the basis of the company law rules, supervisory regulations, and bylaws (shareholders' agreements will be considered too, if in place). See CP 14 and 26.</p> <p>The BI evaluates the consistency of the banks' technical, organizational and geographical structure with its intended internal controls system. In particular, the internal control system must be consistent with the complexity, specific operations and scale of the activities to be carried on.</p> <p>The IT system that the bank will use must be adequate to control the bank's business and satisfy the supervisory reporting requirements. Banks can outsource functions, depending upon their operational complexity, but the outsourcing contract must identify the minimum guaranteed level of services and the possibility for the supervisory authority to access the</p>

²³ Please refer to Principle 29.

	<p>outsourced's systems.</p> <p>Banks should also ensure compliance with the anti-money laundering provisions adopted in line with the international standards and regulations</p>
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	<p>See EC 8. Title I, Chapter 1, Sections III and VI of Circular 229 establishes that BI must evaluate the bank's ability to reach and maintain profitability and to comply with the prudential rules during the start-up of operations. Applicant banks are requested to provide a technical report containing the forecast budgets for the first three financial years. The BI assesses the viability and sustainability of the proposed business plan, having regard to the amount of the investment to create the technical and organizational structure and volumes of business that the bank proposes to achieve and the expected outturn.</p> <p>As indicated under EC 5, the BI may require, where appropriate, the shareholders to offer specific financial commitments intended to safeguard the sound and prudent management of the bank. The origin of the resources used for the acquisition also comes under scrutiny.</p>
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	<p>According to article 15 of the BL, and Title I, Chapter 1, Section VIII of the Supervisory Instructions, the BI must consult with the home-country authority before authorizing the branch or licensing the subsidiary of a foreign bank to be established in Italy. In the case of foreign banks incorporated in EEA countries, the BI complies with the notification procedures of Directive 2006/48/EC related to the exercise of the right of establishment and the freedom to provide services. In the case of a branch of a non-EU bank, the BI verifies that the home-country supervisor has given prior consent to the establishment abroad. General licensing criteria are the same as new banks, although the assessment takes into particular account the fact that the bank's home-country has adequate regulations on supervision and that there are agreements in place with the supervisory authorities of the bank's home-country, in order to ensure the exchange of information; that there are no obstacles to such exchange of information; that the home country supervisory authorities have certified the soundness of the adequacy of the organizational, administrative and accounting structures of the parent bank, both on a solo and a consolidated basis.</p> <p>The BI gathers information on the adequacy of non-EU bank supervision, with particular regard to consolidated supervision, from public reports such as those of the IMF/WB (FSSA, DA), when available and up-dated. This screening is backed by a more detailed assessment based on the answers to a questionnaire sent to the foreign supervisor, which includes questions on the absence of obstacles to the transmission of information between Home and Host authority and between the parent and the subsidiaries (e.g., bank secrecy) and on confidentiality obligations.</p>
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.

Description and findings re EC11	The Supervisory Guide (part. I, section III, Ch. 9 and 10) provides some specific criteria regarding the risk assessment and evaluation of new entrants; within this framework, the implementation of the banks' three year program of initial operations and the fulfilment of supervisory requirements are regularly monitored. When a newly licensed bank belongs to a banking group, the BI requires the controlling entity to closely follow the performance of the new bank in meeting the supervisory requirements and implementation of the business plan.
Assessment of Principle 5	Largely Compliant
Comments	<p>The criteria and assessment process for licensing applications is clearly established in laws and regulations and involve the assessment of ownership structure, governance, and fitness and propriety of board members. BI received 42 applications from 2008 to 2012, of which 9 were rejected. From foreign entities, two were received and approved. The licensing framework and practice, although well established, is not fully compliant with the revised principles: regarding EC 2, BI cannot revoke the license if it finds it was granted based on false application if the bank has already started operation; regarding EC 5, although BI does assess the sources of initial capital, initial capital can be mostly subscribed with assets (up to 7/10), and shareholders are allowed to use borrowed money for the initial subscription. The assessment of the financial suitability of shareholders, most of the cases, focuses on the sources and the identification of possible shadow ultimate beneficial owner, but it seems the inability of shareholders to provide "additional financial support, where needed", as required by the EC, could not in practice be used to justify authorization denial, since there is no legal restriction to shareholders being leveraged or borrowing money to finance capital subscription or increases, although the BI has the power to apply stricter conditions. Regarding EC 7, the responsibility of assessment of fitness and propriety of the board and senior management lies with the bank's board itself; the BI does not systematically perform its own verification. Although in practice it does conduct ad-hoc investigations when the documentation received from the bank seems to warrant a further level of investigation, this is not systematically expected from the licensing analysts. In addition, the integrity requirements laid down in Ministerial Decree No. 161/1998 are narrow, in the sense they do not include adverse regulatory judgments. In other words, the adverse judgment and sanctions by regulatory agencies, including Consob and BI, if are not related to criminal activities, may not be grounds for denial based on fitness and propriety. The BI can deny a license and "disqualify" a board member when it finds the appointed person lacks one of the integrity requirements listed in the Ministerial decree No. 161, but cannot otherwise remove or mandate the removal of a member of the board (see CPs 11 and 14). Given this, it is all the more important that BI conducts its own verification as part of its normal assessment of licensing application.</p> <p>These deficiencies are somewhat mitigated by a very well structured licensing procedure and good quality of analysis. Some occur very rarely in practice (for instance, subscription of initial capital with assets), and BI actively imposes conditions on authorizations that although strictly meeting legal requirements may not be seem sound enough based on BI's judgment.</p> <p>A draft amendment to the regulation (posted for consultation until 14.1.2013) seeks to enhance requirements concerning initial capital, organization, governance and program of the activities. When approved, it will introduce specific provisions explicitly mentioning the case of false information being given by the applicant as an example of withdrawal of the banking license; require a higher initial capital requirement of at least EUR 10 millions for banks in the forms of <i>società per azioni</i> and for all <i>banche popolari</i> and EUR 5 millions for mutual banks (<i>banche di credito cooperativo</i>); and require that 7/10 of the initial capital is to</p>

	be subscribed in cash.
Principle 6	Transfer of significant ownership. The supervisor ²⁴ has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings re EC1	<p>The BL (articles 19-24) and a BI Communication issued in May 2009 (Annex I, par. 1, lett. a) and b)) define “significant ownership” and “controlling interest.” More specifically, a “significant ownership” is any participation in the share capital of a bank (acquired directly, indirectly or in concert) that provides its holder with:</p> <ul style="list-style-type: none"> • an interest equal or higher than 10 percent of the institution’s share capital or voting rights; or • the power to exert a significant influence over the institution. For example, among the criteria the BI considers there is the power to participate in the financial and managerial activities of the bank (e.g., appointment of members of the management or supervisory boards) even in the absence of controlling interests. <p>Arts. 19, (1) and (3), and 23 of the BL define as a “controlling interest” any holding in the share capital of a bank (acquired directly or indirectly) that provides its holder with the control of the bank regardless of the size of such holding. In particular, control exists in the cases provided by the Civil Code (article 2359) or pursuant to contracts or provisions of the bylaws that effectively entail the power to exercise management and coordination functions. Unless otherwise proved by the bank, control is deemed existing in the form of dominant influence in any of the following situations:</p> <ul style="list-style-type: none"> • where a person, pursuant to agreements, is entitled to appoint or remove a majority of the directors or the members of the supervisory board or controls alone a majority of the voting rights for the purposes of adopting specific resolutions (e.g., appointment of members of the board of directors, board of auditors); • where a person owns holdings which would allow him/her to appoint or remove a majority of the members of the board of directors or the supervisory board; • where there exist financial or organizational relationships, including those between members, which are likely to produce one of the following effects: <ul style="list-style-type: none"> ○ the transfer of profits or losses; ○ the coordination of the management of an undertaking with that of other undertakings for the purpose of pursuing a common objective; ○ the attribution of powers greater than those deriving from the holdings owned; ○ the attribution of powers in the choice of directors, members of the supervisory board or managers of undertakings to persons other than those entitled to exercise such powers on the basis of ownership of holdings; • where undertakings are subject to common management arising from the

²⁴ While the term “supervisor” is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

	composition of the administrative bodies or other concurrent factors.
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	<p>Art 19 and 22 of the BL and Annex I, par. 1 of the May 2009 Communication establish the requirement for prior authorization for “any natural or legal person intending to acquire, directly or indirectly or acting in concert, a significant ownership or controlling interest in an institution”. When the significant ownership or controlling interest is acquired indirectly, the request for authorization must be made by the company at the top of the shareholding chain and by the ultimate owner that directly holds the significant ownership or controlling interest in an institution. It is also mandatory to notify the BI of agreements that may give rise to the concerted exercise of voting rights in a bank (or in a company that controls it) or in a holding company. Where the agreement gives rise to a concerted exercise of voting rights such as to jeopardize the sound and prudent management of the bank or holding company, the BI may suspend the voting rights of the parties to the agreement (BL, Art. 20(3)).</p> <p>BL art 19 also establishes that prior authorization of the BI is also required in case of further increases in holdings resulting in an interest equal or higher than 20, 30 and 50 percent of the institution’s share capital or voting rights.</p>
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	<p>The May 2009 Communication sets out (as per EU directive no. 2007/44), the <u>evaluation criteria</u> and the <u>procedural rules</u> for the prudential assessment that the BI has to conduct in order to grant (or oppose to) the acquisition. The BI must be provided with sufficient information to ascertain:</p> <ul style="list-style-type: none"> • the integrity, experience and business reputation of the proposed acquirer; • the integrity and experience of any person who will direct the business of the bank as a result of the proposed acquisition; • the financial soundness of the proposed acquirer, in particular in relation to the type of business pursued and envisaged in the bank in which the acquisition is proposed; • whether the bank will be able to comply and continue to comply with the prudential requirements and, in particular, whether the group of which it will become a part has a structure that makes it possible to exercise effective supervision; • whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing is being or has been committed or attempted, or that the proposed acquisition could increase the risk thereof. <p>If necessary, the BI may request any further information deemed necessary to complete the assessment. The BI may also require the proposed acquirer specific commitments in order to ensure the sound and prudent management of the bank or its holding company even after the acquisition is completed.</p> <p>BL, Art. 19 establishes that if one or more of the conditions required are not met the BI can reject the proposed acquisition.</p>

	<p>Voting rights and other rights acquired without the BI's prior authorization or acquired on the basis of an authorization that has been suspended or revoked may not be exercised. Likewise the voting rights and other rights for which the notification requirements have not been met may not be exercised. Decisions that may have been taken by the exercise of such voting rights may be challenged under the provisions of the Italian Civil Code. The challenge may be initiated by the BI within the terms identified in the BL. (BL, Art. 24, (1) and (2)). BL. Art. 24, (3) also specifies that holdings for which the prior authorizations have not been obtained or have been revoked must be divested within the time limits established by the BI.</p> <p>The BI has also the power to impose administrative pecuniary sanctions for breaches of the authorization and notification requirements. Moreover, unless the act constitutes a more serious offence, any person who makes false representations in applications for authorization or notification may be punished by imprisonment for a term of up to three years (BL, Arts. 139 and 140).</p> <p>On an on-going basis, if the requirements and conditions on the basis of which the authorization was granted are not met anymore, the BI suspends and, where necessary, revokes the authorization (BL, Art. 19, (5)).</p>
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	<p>Holding companies and banks, except for cooperative banks (<i>banche popolari</i>) and mutual banks (<i>banche di credito cooperativo</i>), transmit every year to the BI a list of shareholders owning more than 2 percent of their voting share capital. According to art. 120 of Legislative Decree n. 58/1998 CFL, persons owning above 2 percent of the share capital of a listed bank must notify it to the bank and CONSOB (Italian Companies and Stock Exchange Commission). The same information must be provided with reference to the identities of beneficial owners of shares being held by nominees, custodians and through vehicles. If the mentioned notification requirement is not met, the related voting right cannot be exercised (BL, Art. 21(1), (3) and (4)).</p> <p>As mentioned in EC 2, shareholders have to notify to the Banca d'Italia, within 10 days of the operation, their holding stake in the following cases:</p> <ul style="list-style-type: none"> • operations subject to authorization (or decision not to perform the authorized operation); • increase in the holdings resulting in an interest higher than 25 percent, 40 percent, 45 percent and 55 percent of the institution's share capital or voting rights, or when the holding exceeds the latter by multiples of 5 percent (60 percent, 65 percent...95 percent) or 100 percent is reached; • reduction of the holding below each of the thresholds for which authorization and/or communication is needed.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	See EC 3.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a

	major shareholder or a party that has a controlling interest.
Description and findings re EC6	The BI requires banks to verify, before the shareholders' meeting, that the relevant shareholders and the parties owning a controlling interest have the power to exercise their votes (<i>i.e.</i> that they still meet the criteria required by law or regulation). In addition, the audit committee must inform the BI about every act or fact that may constitute a violation of the banking regulation. (BL, Art. 52, (1). That would include regulations concerning the suitability of major shareholders, but there is no specific requirement on that aspect.
Assessment of principle 6	Compliant
Comments	
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define: <ul style="list-style-type: none"> (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.
Description and findings re EC1	<p>According to Article 53 of the BL; ICCS Resolution no. 276 of July 29, 2008; and Circular no. 263, Title V, Chapter 4, requirements for authorization or notification depend on the nature of the companies to be acquired.</p> <p>Prior authorization is needed for acquisitions involving banks, electronic money institutions (ELMI), financial and insurance companies, if:</p> <ul style="list-style-type: none"> a) the investment exceeds 10 percent of the investor's regulatory capital, or; b) the acquisition involves control or significant influence <u>and</u> the target entity, in which the bank intends to acquire the holding, is settled outside EU area, G10 area or a list of countries published by the BI according to Circular no. 263, Title I, Chapter I. <p>Equity investments in instrumental companies (non-financial undertakings that perform activities of an auxiliary nature to that of the controlling bank or banking group) are subject to prior authorization in the case <i>sub b</i>).</p> <p>Holdings in non-financial companies may be acquired without authorization, but are subject to quantitative limits: each of such investments may not exceed 15 percent of the investor's supervisory capital; and the total of such investments is limited to 60 percent of supervisory capital.</p> <p>Acquisitions of holdings not subject to authorization but that determine changes in the composition of the banking group must be communicated to the BI 30 days before the closing of the transaction (e.g., purchase of a controlling interest in a financial institution that does not exceed 10 percent of the parent company's supervisory capital). After receiving the communication and within the 30 days period, the BI may suspend or prohibit the acquisition</p>

	<p>(see also EC3).</p> <p>Acquisitions of holdings in banks, ELMI, financial or insurance companies that are not subject to prior authorization or communication but that exceed 1percent of the supervisory capital must be communicated to the BI within 30 days of the closing of the transaction.</p> <p>If, for reasons beyond the control of the bank or the parent company (e.g., reduction of capital for losses, mergers between participated companies) the holdings exceed the limits, investments must be brought back within prudential limits as soon as possible. Until then the excess are to be equally deducted from Tier 1 and from Tier 2 capital.</p> <p>Banks must also comply with a general quantitative limit whereas the book value of real estate and participations may not be greater than the bank's regulatory capital.</p> <p>Circular 263 Title V, Chapter 4, Sect. VI, applies specifically to indirect investments realized through "interposed entities" (such as private equity funds, investment vehicles, etc.). BI understands this kind of investments also exposes banks to the same risks inherent in a direct investment in equity, and therefore the regulation provides for indirect investment in equity to comply with the same prudential limits.</p>
EC2	Laws or regulations provide criteria by which to judge individual proposals
Description and findings re EC2	<p>For transactions that need prior authorization, see EC 1. The criteria are established in Circular no. 263, and detailed in Circular No. 269/2008, Part II, Section II, Chapter III, implementing art. 53 BL. The BI assesses the proposal considering (i) observance of prudential requirements and rules, (ii) impact on the technical and organizational situation of the acquiring bank or banking group; (iii) appropriateness of the Supervisory systems in the acquired company's jurisdiction.</p> <p>According to Circular no. 263, Title V, Section V Chapter 4, the BI has the power to prohibit acquisitions of holdings in banks, financial companies and insurance companies if, as a result of the deduction of those holdings from supervisory capital or as a consequence of the consolidation of the acquired company, the bank doesn't meet the total capital requirement. Authorization must be also refused if, taking into account the regulations and supervisory controls of the country of establishment of the acquired company, the acquisition may arise obstacles to consolidated supervision.</p>
EC3	<p>Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.²⁵ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.</p>
Description and findings re EC3	<p>Not all major acquisitions are subject to prior analysis, see EC 1. Circular no. 263/2006 (Tit. V, Cap. 4, Sez. V) establishes that the BI has the power to prohibit acquisitions of holdings in banks, financial companies and insurance companies if such initiatives are likely to limit or</p>

²⁵ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

	<p>impede the effective performance of supervision on a consolidated basis. BI must assess the possibility for the acquiring bank to obtain information deemed necessary for determining prudential requirement on a consolidated basis; for consolidation of financial statements; for the effective exercise of the Internal Audit function; and possibility for the BI to perform on-site inspections, also in conjunction with national supervisors.</p> <p>There is no specific requirement regarding corrective actions, it is considered part of the assessment of "effectiveness of supervision" and "obstacles to consolidated supervision (see EC 2).</p>
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	<p>Not all major acquisitions are subject to prior assessment, see EC 1. Circular No. 269/2008 (Part II, Section II, Chapter III) determines that BI must evaluate acquisition applications based on: (i) availability of the necessary financial resources, (ii) organizational resources, and (iii) the existence of a system of internal controls able to ensure the correct management of the proposed acquisition. The supervisory guide details that the BI must consider: the impact of new risks (considering also strategic, reputational, legal risks) involved in the operation, in particular arising from investment in new markets or from developing new products; the impact on technical situation with specific regard to the current and future financial situation, the profitability, the risks of the investment, in particular if the bank already shows some weaknesses; the adequacy of the organizational structure and the control units to manage efficiently strategic risk connected to the investment.</p> <p>In approving banks' investment proposal, the BI requires commitments especially when the acquiring entity will become part of the banking group: for example the BI has required banks to strengthen the internal controls systems and IT systems or the maintenance of an adequate organizational structure, also in terms of human resources.</p>
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	<p>Acquisitions in non-banking activities are not subject to prior assessment see EC 1. According Circular no. 263, Title V, Chapter 4, holdings in non-financial companies may be acquired without authorization, but are subject to quantitative limits.</p> <p>There are some provisions regarding the internal control framework to manage potential conflict of interest that may rise from such situation (Section VII and Title V, Chapter 5), in particular the policy regarding acquisitions in non-financial companies must be approved by the board. The BL art 53 does give general powers to adopt specific measures regarding individual banks, and the BI could ultimately prohibit new operations of acquisitions of non financial entities and order to sell the holdings acquired. This hypothetical situation has not yet arisen.</p>
Assessment of Principle 7	Largely compliant
Comments	EC 1 requires that cases for which notification after the acquisition or investment is sufficient should be primarily activities closely related to banking and where the investment is small relative to the bank's capital. However, bound by the EU legal framework, acquisitions for non financial investments do not need prior approval (or prior notification). Acquisitions of financial firms below 10 percent of regulatory capital in EU and G-10 countries, even if such level means control, do not require approval, only notification. In the first case, the deficiency

	<p>is mitigated by the limits, but these limits would still allow for a significant participation in industrial and other non-financial business that can bring additional risks to the enterprise (for instance, an industrial participation comprising 14.9 percent would not be ex-ante assessed by BI). In the second case, the exemption of prior approval for acquisitions of control of financial firms abroad is hardly justified. The ex-ante notification of 30 days provides a very limited timeframe for BI to assess the suitability of financial, managerial, and organizational resources involved in the acquisition. In the EU environment, it is unclear whether in such situations the BI would be able to exercise the power conferred to it by Art. 53 BL to suspend or prohibit the acquisition.</p> <p>Therefore, the regulatory framework permits situations where acquisitions may imply control of the acquired undertaking and the BI would not be able to make an ex-ante analysis of the quality of supervision in the host jurisdiction, nor assess possible hindrances to effective implementation of corrective measures in the future, nor adequately consider the risks the non-banking activities will bring to the group, or assess that the bank has sufficient financial, managerial and organizational resources to handle the acquisition from the outset—as required by the CP. If an undesirable situation occurs, BI would need to rely on its correct and remedial powers—however, divestment procedures may take long and risks brought to the bank may have already festered. The materiality of the deficiencies has been mitigated by the requirements for minimum periods of prior (instead of ex-post) notifications for some cases, as described in EC 1. It is recommended that prior notifications are extended to all cases where acquisition will imply control, (even if the investment is within limits—for instance, 15 percent on non-financial enterprises).</p> <p>Denials of major acquisitions need to be substantiated (motivated) in a way that can be sustained in case of court proceedings. In this legal environment, and given the structure of the judicial system in the country, in cases where the acquirer bank meet all quantitative regulatory requirements but the supervisor may not be fully confident on the financial sustainability of the investment, it is possible that no legal grounds for rejection are found. BI has then to rely on its powers to approve with conditions. It is important to note that for transactions that require prior authorization, BI actively uses its powers to impose conditions to make sure all criteria are met and effective supervision is not hindered. In that sense, of 145 applications from 2008 to 2012, 69 were approved with conditions. Assessors were shown evidence of such supervisory action.</p>
Principle 8	<p>Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable</p>
Essential criteria	
EC1	<p>The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks:</p> <ul style="list-style-type: none"> (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system. <p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant</p>

	<p>comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>
Description and findings re EC1	<p>The BI annually performs a Supervisory Review and Evaluation Process (SREP) to assess whether banks and banking groups have appropriate capital and organizational safeguards relative to their risk profile. The SREP comprises a set of actions to evaluate the current and future situation of intermediaries and, in the presence of significant deficiencies and/or anomalies, lead to the adoption of appropriate corrective measures.</p> <p>The supervisory approach outlined in the Supervisory Guide is:</p> <ul style="list-style-type: none"> • “risk-based,” targeted at assessing all relevant risks and risk management; • conducted at the consolidated and solo levels; • proportional since supervisory activities are graduated in relation to risk, size, systemic relevance, complexity and specific problems. <p>Consistent with the Supervisory Guide, all risks characterizing the banking and financial activities are examined and assessed: strategic, credit, market, interest rate, liquidity, operational, and reputational risk. For each bank and banking group analysts assign a score to each risk (from 1, indicating low risk, to 6, indicating high risk). The assessment entails combining the quantitative analysis of risk exposure with a qualitative judgment on risk mitigation measures and the internal control system. To complete the analysis, a specific assessment and a score attribution process—based on the same scale—is performed on cross-cutting profiles: (i) governance and control system, (ii) capital adequacy, (iii) profitability.</p> <p>Supervision is conducted on a consolidated basis from a top-down approach including the parent company and all entities belonging to the group. In addition, for significant subsidiaries, a more in-depth analysis is performed on a solo-basis to assess the impact that entity may have on the group’s stability (example of entities that may be considered relevant and subjected to closer scrutiny are: listed companies, companies in which minority shareholders have significant interests, companies which absorb consolidated capital requirement beyond a pre-established threshold, firms which perform specific processes or business activities for the group as a whole or at which critically important functions are concentrated).</p> <p>The banking and financial intermediaries have been split into five macro-categories: (1) cross-border banking groups; (2) other systemically important banking groups; (3) regional and large specialized intermediaries; (4) small cooperative banks; (5) other intermediaries which are not subject to the three-pillar regulation. The SREP main steps (risks analysis, onsite examinations, ICAAP review) reflect the systemic relevance and soundness of the bank. For banks belonging to macro-category 1 inspections are performed more frequently and targeted, while for macro-category 4 inspections are less frequent and have a more general scope.</p> <p>The SREP is performed annually; with a semi-annual frequency for higher risk banks, typically risk scores from 4 to 6.</p>
EC2	<p>The supervisor has processes to understand the risk profile of banks and banking groups and employs a well defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis</p>
Description and findings re EC2	<p>The methodologies for analysis and evaluation standards used by the BI are detailed in the Supervisory Guide which describes the underlying logic and the evaluation sequence of the</p>

	<p>Risk Assessment System (“RAS”) used as the main SREP instrument.</p> <p>The RAS is focused on the seven relevant risks, with a grade attributed to each based on results from the combination of a quantitative analysis and of qualitative judgments: (a) analysis of the risk exposure; (b) bank’s ability to identify, measure or evaluate, monitor, control, mitigate and report that risk. The final score for each risk profile is mainly based on the quantitative analysis performed off-site, whereas in the on-site inspection, supervisory judgment determines the weight of the qualitative analysis, which can be better assessed through methodologies and techniques performed on-site. The single scores are combined to produce the final Total Score for the bank. The quantitative part of each scheme (single risk profiles and cross-cutting profiles) used for the assessment is mainly based on prudential data reported by banks, and used to produce indicators that are often evaluated through peer-group analysis.</p> <p>In the assessment of risk profiles stress tests are performed to gain a forward-looking view, while in the assessment of capital buffers and their composition account is taken of reported data at a given date and in a forward-looking perspective including the ICAAP assessment.</p> <p>The RAS results form the basis for subsequent supervisory actions; these range from routine supervision to corrective measures.</p>
EC3	The supervisor assesses banks’ and banking groups’ compliance with prudential regulations and other legal requirements
Description and findings re EC3	<p>Within the SREP a regular assessment of the banks’ compliance with prudential rules and the other regulatory requirements is performed. Such an assessment covers compliance with regulations on: capital requirements, large exposures, connected lending, limits to shareholdings and to real estate investments; financial statements; Pillar 3 disclosure. Compliance reviews with prudential rules and other operational limits is performed quarterly both on a consolidated and an individual level. Reviews of financial statements and disclosure are performed annually.</p> <p>The verification on public disclosure requirements is carried out as follows:</p> <p>verification of the existence of organizational arrangements ensuring a reliable preparation, processing and disclosure of information; this activity—mainly performed during onsite inspections—entails the evaluation of the independence and qualification of the function responsible of internal controls;</p> <p>examination of the public disclosures envisaged in the prudential regulation, performed together with the analysis of financial statements, including those necessary for the use of internal risk measurement systems for calculating capital requirements and risk mitigation.</p>
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	<p>The analysis of individual banks and banking groups is complemented by the macro-prudential analysis that is performed at the BI by a dedicated unit inside the Regulation and Policy Department, and by a special independent unit responsible for the analysis of financial stability. Such a macro-prudential analysis has preventive purposes, aiming at finding vulnerabilities in the financial system which might take on systemic proportions and affect the real economy.</p> <p>Dialogue and cooperation among the various Departments involved in supervision foster the</p>

	<p>ability to evaluate the trend of systemic risks when performing the SREP. For example: (1) Exchange of information between those in charge of macro-prudential studies and analysts/examiners (such as the participation of the macro-prudential experts in the meetings with corporate officers or in inspections on matters of common interest with possible systemic relevance). (2) A specific risk task force including staff from Policy, Off-Site, On-site departments is in charge of identifying the main systemic risk drivers—and bringing them, through the “Financial Risk Outlook,” to the attention of the supervisory area.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, identifies, monitors, and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks’ problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability</p>
Description and findings re EC5	<p>The BI identifies the build-up of risks and the other sources of systemically relevant vulnerabilities both at a micro and macro level through a comprehensive and integrated process: results of off-site analysis and onsite inspections, information provided by the banks, monitoring of markets, sector analysis, ad-hoc inquiries, and data obtained from other supervisory authorities, the judicial authority or customers through complaints. Trends in the quality of banks’ assets and problems in the sources of liquidity are duly investigated and described in the Financial Risk Outlook, but also—at a micro level—within the SREP and the RAS.</p> <p>The supervisor incorporates the result of this analysis into the bank and banking group assessment and addresses proactively any serious threat to the stability of the bank/banking system.</p> <p>Significant trends or emerging risks identified in the process are communicated to banks and banking groups either individually (in ordinary meetings) or collectively (through letters or special events arranged to exchange views on current issues).</p>
EC6	<p>Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank’s resolvability where appropriate, having regard to the bank’s risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.</p>
Description and findings re EC6	<p>Although the BI is the resolution authority, it must request the MEF for a decree declaring a bank insolvent and in need of resolution. The BI has crisis management tools (special administration—SA and compulsory administrative liquidation—CAL) to intervene and liquidate. The BI plans to implement the FSB recommendations on recovery and resolution as provided in the “Key Attributes for effective resolution regime for financial institutions (2011)” and the recovery and resolution planning activities are proceeding according to the priorities and the timeline set by the FSB. Also the RRD will upgrade the framework for the recovery and resolution planning activities.</p> <p>The BI has the authority to require a banking group to restructure to address impediments to orderly restructuring/liquidation.</p>

EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	As deteriorating trends are identified or concerns arise on the level of risk, the supervisory department in charge of that bank intensifies its monitoring activity and can adopt corrective measures, perform an on-site inspection and, if needed, call for the involvement of the high-level committee, which decides the further measures to apply (including, if needed, SA and CAL). The SA and the CAL are started by a decree from the MEF acting on proposal of BI.
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	Unauthorized banking activities are prohibited; violators are punished with penal sanctions, pursuant to articles 130, 131 and 132 of the 1993 BL. Where there is a well-founded suspicion that a company engages in banking or financial activity in violation of articles 130, 131 and 132, the BI may file a report with the public prosecutor for the purpose of the adoption of the measures provided for in Article 2409 of the Civil Code or may require the Court to adopt the same measures. The BI has authority to force changes in banking groups' structures, as was demonstrated to assessors during a review of supervisory actions.
Assessment of Principle 8	Compliant
Comments	
Principle 9	Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site ²⁶ and off-site ²⁷ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and	The BI employs a mix of off-site and on-site supervision. Off-site analysis is systematic,

²⁶ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

²⁷ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

<p>findings re EC1</p>	<p>carried out at set intervals, and based on analysis of data and information that banks report to the BI.</p> <p>Based on the off-site analysis results, inspections are planned and carried out. Inspections may be: full scope, targeted (business areas, specific risks, operational profiles, corrective action follow-up) and thematic. Currently, the BI is conducting a thematic review on provisioning. Inspections focus on exposure to significant risks and risk management: adequacy of structural and functional components of governance and control systems as well as economic and capital safeguards; the reliability of data and information given to the BI; the compliance with the regulatory framework with particular attention to prudential requirements.</p> <p>Off-site supervision focuses on quantitative analyses, while on-site visits focus on qualitative assessments (internal procedures and control systems, reliability of data and IT systems, management soundness and properness), and also on a detailed and in depth analysis of risks (especially credit risk) based on samples extracted from the banks' loan portfolios</p> <p>On-site/off-site integration is achieved by::</p> <ul style="list-style-type: none"> • coordination between the onsite and offsite staff during SREP; • prior to the inspection, the on-site and off-site analysts set the inspection scope based on the bank's risk profile; • involvement on inspections by off-site analysts; • coordinating inspection and post-inspection communications. <p>Annually, the units responsible for off-site and on-site work, under the coordination of Methods and Procedures Unit review the supervisory framework and update as needed.</p>
<p>EC2</p>	<p>The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.</p>
<p>Description and findings re EC2</p>	<p>A process for planning on-site and off-site activities—outlined in the Supervision Guide—is carried out on an annual basis. Planning identifies: the scope of evaluation (risk profiles, business lines, legal entities to be assessed); the instruments to be used (off-site assessments, meetings with corporate officers, on-site inspections); the time references for the “evaluation cycle” of the SREP; and the timing of the analysis to be performed. The evaluation cycle is normally completed in 12 months. However, in the case of complex banks the evaluation cycle may be longer (up to a maximum of 36 months for banks with a significant international presence), to be determined also considering the distribution of tasks in the colleges of supervisors and the time necessary for the foreign supervisory authorities to perform their respective duties. During the overall evaluation cycle, all main risk-related areas are analyzed. If the evaluation cycle will exceed 12 months, some risk reviews are completed in the 12-month timeframe by analyzing the scores automatically generated by the models; including review of the ICAAP.</p> <p>Annual planning of inspections is based on the priorities identified by the off-site supervision units (with problematic banks put on top of the list), the sources of systemically relevant vulnerabilities detected by the unit in charge of macro-prudential analysis and the availability of resources in the Supervision Inspectorate. Consequently, inspections annual planning takes into account the banks' risk profile.</p>

EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable ²⁸ and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	<p>All banks, banking groups and the other regulated financial entities file prudential reports (e.g., composition of regulatory capital, RWAs, solvency ratios, large exposures) and statistical returns (e.g., balance sheet and income statement, credit quality, securities holdings, residual maturities, etc.) in accordance to the relevant regulations. All banks and banking groups also send to the BI the official financial statements prepared in accordance with the International Accounting Standards and compiled according to the format requested. Supervisory information includes also Pillar 3 disclosure.</p> <p>The quality of information is tested through automated procedures developed by the Statistical Department (RES) and through the day-by-day reviews by the off-site line supervisors. During inspections, the reliability of data and information provided by banks and groups to the BI is further reviewed.</p> <p>The BI also reviews public available data and meets with market participants.</p>
EC4	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC4	<p>In line with the risk-based approach, analysis is focused on the bank risk profile and risk management, organizational safeguards set for governing, managing and controlling the risks. Bank specific financial indicators are compared with those of its peers; capital requirements are re-calculated under stressed conditions and the bank's situation is revalued accordingly.</p> <p>The RAS results are the basis for the subsequent supervisory actions; these actions vary, ranging from an ordinary oversight action to corrective measures. Such actions might be directed to specific/system risk profiles or to the general situation of the bank.</p> <p>Once the corrective actions have been formalized, including the deadline for implementation and the reporting to the supervisor, the analysts monitor the banks' activities.</p> <p>The "follow-up" stage is essential to:</p>

²⁸ Please refer to Principle 10.

	<ul style="list-style-type: none"> • determine whether the banks implement the actions required and if these are consistent with what indicated by the supervisor • assess, if appropriate, the possible termination of corrective actions once the resolution of problems is checked. <p>Business models are analyzed in the RAS to evaluate the exposure to strategic risk. The analysis, strictly connected to the bank’s profile and complexity, is divided in two phases: the first one is qualitative and deals with how the strategic targets are set and turned into both consistent actions on the organization and adjustments in case of adverse events; the second one is mainly quantitative and concerns the features of the supply strategy, the variability of profit and the evolution of market shares; special attention is given to the strategies to entry new markets or launch new products.</p> <p>Stress tests undertaken by the banks are reviewed in the ICAAP examination which is an important phase of the SREP. The methodological design and the underlying assumptions are assessed by off-site analysts to detect the reliability of stress tests. Furthermore, inspections enable verification of the quality of the databases supporting the stress tests and methodologies applied.</p> <p>Communications with the bank are frequent and range from analyst contact to review of onsite inspection results with management and the Board.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC5	<p>Analysis of individual banks is complemented by macro-prudential analysis. The macro-prudential analysis aims to identify vulnerabilities in the financial system, which might take on systemic proportions.</p> <p>The process of identifying the sources of potential systemic vulnerabilities is implemented through:</p> <ul style="list-style-type: none"> • identification of risks and vulnerabilities that may affect the financial system as a whole or some specific segments; • analysis of shock transmission mechanisms; • assessment of the importance of potential vulnerabilities, in terms of both event probability and possible impact, also by means of stress tests, both top-down and bottom-up; • possible substantiation of the results of the previous analysis by means of specific/targeted inspections or off-site controls; • taking supervisory action to mitigate the potential impact of the vulnerability factors (e.g., through recommendations to the system). <p>The BI, in line with most EU countries, performs stress tests on a regular basis, both on the whole banking system and on individual banks. The results are used also as inputs for planning supervision activities. They help to assess the robustness of the self-evaluation process of capital adequacy (ICAAP) performed by intermediaries. Moreover, they represent a benchmark for bottom-up stress tests conducted by Italian banks, also under EU-wide</p>

	<p>coordination.</p> <p>Macro conditions are reported to the market through the financial stability report.</p>
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk
Description and findings re EC6	<p>During the SREP the BI evaluates the work and adequacy of the bank's internal audit function as a component to the assessment of the governance and controls system and the evaluation of individual risks.</p> <p>As appropriate, inspectors meet with bank personnel involved in the internal audit and may carry out a targeted inspection to determine if the BI may rely on the internal auditors' work.</p>
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models
Description and findings re EC7	<p>Interaction with the banks arises through requests for information and meetings with bank representatives. Meetings are used to get to know the management and gather information on the bank's strategies and activities, as well as to complement and cross-check the data used in the supervisory process. Meeting with the bank is a critical component of the off-site process to discuss strategic planning.</p> <p>A top-level meeting is held with heads of the supervisory and/or management and/or risk managers to discuss the bank's condition, its strategic and operational perspectives, governance issues and the business policies (also with reference to specific sectors), with particular regard to risk management, capital and organizational safeguards related to risks, and internal controls. The BI may challenge the adequacy of the bank's strategies and business model and request further information from the Board and senior management.</p> <p>Meetings are also held with mid-level management and are technical and operational in nature focusing on areas, such as risk management methodologies, self-assessment of capital adequacy, and the control systems.</p>
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary
Description and findings re EC8	<p>The results of the off-site analyses are discussed with bank management. When the results of the analysis do not disclose serious areas of concern, they are discussed in meetings with the bank's executives and attention is drawn to the major issues concerning the bank to assess management awareness, examine the current or planned initiatives, and ask for operational adjustments.</p> <p>When off-site analysis results highlight areas of concern, the findings are communicated to the bank in a letter and the bank is asked to propose and put in place the most appropriate actions to remove the causes of anomalies and prevent further deteriorations or the</p>

	<p>emergence of new problems.</p> <p>The findings of the on-site activity are always communicated to the bank with a written report called "Inspection Report" that is typically divided into "Remarks and Observations," addressed to the corporate bodies, and "Confidential Information," reserved to the Supervisor.</p> <p>The presentation of the "Remarks and Observations" section, including its annexes, is performed by the inspector in charge of the on-site visit and takes place during a meeting—usually at the bank premises—the members of the Board, as well as the senior management and managing director. Depending on the relevance of the bank, the meeting can also be attended by the Central Manager for Banking and Financial Supervision, the Head of the competent Supervision Department, the Head of the Unit responsible for off-site supervision on the bank concerned. During the meeting, the inspector in charge explains the remarks and clarifies any controversial issues.</p>
EC9	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and findings re EC9	Once the type of supervisory action has been formalized (e.g., recommendations, meetings, corrective actions—see EC 8) and the deadline for implementation and the reporting to the Supervision established—the analysts monitor the bank's progress. The enforcement process is under the coordination of the offsite staff that monitors the bank on a continuous basis ensuring timely follow-up. Assessors were presented with enforcement cases documenting the process. All actions taken on banks through formal communication are endorsed by the BI's Board or by a member of the Board, by delegation.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements
Description and findings re EC10	<p>Banks regularly send information about their activities and other information requested by the BI. They also promptly submit to the Supervisor each change in their activities and structure (i.e., ownership structure; branches structure; change in the banks' Board, non-executive Board members and senior and middle management; group structure; etc.).</p> <p>The internal audit informs the BI of any act or fact it becomes aware while performing its duties and that may represent a potential irregularity and/or a violation of the provisions governing the banks activity by the management.</p>
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties
Description and findings re EC11	Although the BI has authority to contract external experts, it tends to not make use of external experts or third parties to carry out supervisory tasks including on site examinations. The BI has been provided with adequate resources in terms of staff and professional capacity not to need to delegate supervisory tasks to external expert.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas

	requiring follow-up action
Description and findings re EC12	<p>The Statistical Department is responsible for processing prudential and statistical information and ascertaining its quality (prompting banks to correct and send data again, when needed). The monitoring and analysis of such information is performed by the Supervision Departments.</p> <p>In their activity, on-site and off-site analysts are supported by an internally developed computer procedure called SIGMA that: (i) allows structured inquiry of the BI data-base; (ii) calculates automatic scores (as prescribed by the Guide) for the evaluation of bank condition (quantitative evaluation); (iii) allows “what if analysis” and the ability to simulate mergers; (iv) stores information about bank analyses, controls and evaluation activities.</p>
Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate
Description and findings re AC1	<p>The supervisory activities provided by BI are subject—as every other activity performed by the BI—to an independent review by the Internal Audit Department (IAD).</p> <p>No limitations exist for the auditors to ensure wide, effective controls on the supervision activities.</p> <p>The Departments which have been audited receive a report from the IAD, addressing weaknesses identified and prompting management follow-up.</p>
Assessment of Principle 9	Compliant
Comments	
Principle 10	Supervisory reporting. The supervisor collects, reviews, and analyzes prudential reports and statistical returns ²⁹ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power ³⁰ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	Articles 51 and 66 of the BL provide the BI with the power to collect (on a solo basis and a consolidated level) periodical prudential and statistical returns as well as any additional information needed, which can be collected on demand. BI determines procedures, modalities and deadlines for receiving such information. Main regulations in this respect are

²⁹ In the context of this Principle, “prudential reports and statistical returns” are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

³⁰ Please refer to Principle 2.

	<p>Circular n. 115—"Instructions for preparing supervisory reports on a consolidated basis", Circular n. 154—"Credit and financial institutions' supervisory reports: preparation and transmission", Circular 155—"Instructions for preparing reports on regulatory capital and prudential ratios", and Circular n. 272—"Matrix of account," which contain the reporting instructions and regulate the procedures and timing with regard to consolidated and solo reporting.</p> <p>The banks regularly transmit to the BI a comprehensive set of information about on and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentration (including by economic sector, geographical area and currency), asset quality, loan loss provisioning, interest rate risk, market risk, and also other information (e.g., specific distribution channels). From December 2012 onwards a periodical supervisory reporting dealing with related party transactions will be available.</p>
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	<p>For regulatory framework, see EC 1. Since 2005 on a consolidated basis (and 2006 on a solo basis) banks submit supervisory information based on IAS/IFRS. Regulation EU no. 1606/2002 sets out the provisions to adopt the IASs to consolidated annual reports for listed banking groups. Legislative Decree no. 38/05 extended the application of IASs to non listed banking groups and all individual banks (solo annual reports).</p> <p>BI circulars clearly set out the reporting instructions and the accounting standards to be used in preparing supervisory reports. See EC 1.</p>
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	<p>For regulatory framework, see EC 1 and 2. According to the Italian regulatory framework, the BI requires banks to adopt sound governance structures and effective control processes for methodologies on valuations. Valuation processes and methodologies must be reliable and integrated with the risk management process; separated units must be entrusted with the design of the methodologies and their validation. Valuation methodologies must be robust, tested under stress scenario and not rely on only one information source. Internal auditing must check adequacy and the correct functioning of valuation processes and methodologies, but compliance is mostly assessed through on-site inspections. More specifically Circular 269 Part III, III/I, Chapter II, establishes that BI must assess if evaluation framework and the related processes embedded in the overall governance structure:</p> <ul style="list-style-type: none"> • are coherent with the desired risk profile, preliminary determined by the governing body and cover all the identified relevant risk factors; • are applied consistently (across similar instruments, risks and business lines) at firm wide level and integrated with risk measurement and management processes and with the assessment of bank's capabilities to comply with both regulatory accounting provisions. Detailed analyses are to be carried out on any differences arising from the categorization

	<p>for the regulatory purposes and the applicable accounting framework;</p> <ul style="list-style-type: none"> • include well documented policies effectively used (i.e., use test), reviewed and approved by the competent bodies when necessary and at least annually; • are supported by valuation adjustment processes; • include an appropriate segregation of duties and ensure review by appropriate levels of management. The valuation framework and control procedures should be subject to adequate independent internally or externally validation and verification; • are supported by mechanisms to cross-check valuations; • are based on reliable (single or multiple) information sources or inputs (i.e. especially when valuing complex and illiquid products). In assessing these items during inspections, frequency, availability of prices, and transparency are taken into consideration. As far as illiquid financial instruments, BI verifies the existence of a hierarchy of either external (e.g. comparables, providers, bid/ask prices, etc.) or internal information sources (methods for breaking down risk factors and valuation methodology) in connection with the nature of financial instruments. <p>Especially for illiquid financial instruments, e.g., structured products included in the level two or three categories (where inputs are unobservable) the relevance and reliability of valuations are directly related to the quality and reliability of inputs. As far as the reliability of supervisory reporting the BI assesses whether the valuation used for regulatory purposes is consistent and prudent: significant differences between fair values included in financial reporting and those used in risk management or regulatory reporting should be appropriately reported to the competent functions. BI verifies if reporting is performed on regular basis in aggregated and understandable form. Where valuations are not sufficiently prudent banks are mandated to make adjustments to its reporting for capital adequacy or regulatory reporting purposes. Different organizational, accounting and risk factors are also to be taken into account:</p> <ul style="list-style-type: none"> • the latest activities carried out by the supervisory and control boards of the bank with respect to their general and periodical assessment of operations as well as the establishment of accounting principles and evaluation criteria; • the reports submitted to the Supervision on the organizational structure and the reconciliation between internal accounting and statistical returns; • the methodology of recording, classification and monitoring of exposures. <p>After the analysis inspectors need to form an opinion on supposed reliability of the returns submitted to the Supervision Authority, classifying it as high, intermediate, or poor.</p> <p>BI does not have the power to make accounting adjustments, but may and frequently does make adjustments for capital adequacy purposes.</p>
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	For regulatory framework, see EC 1 and 2. BI collects information from all banks on monthly and quarterly basis and from banking groups on semi-annual basis. Financial statements data are required on semi-annual basis. Since December 2008 BI has started collecting consolidated information based on FINREP (EU uniform template for financial reporting) with quarterly frequency limited to the four largest banking groups. Since December 2011, this template has been extended to the largest 35 banking groups.

	<p>Capital requirements data (aligned to COREP, EU uniform template for prudential reporting) is collected, at both solo and consolidated level, with quarterly frequency. In particular, on consolidated level quarterly frequency came into effect in December 2008 (before that date the frequency was semi-annual).</p> <p>When necessary, BI can require all information needed to have an updated situation of the entity supervised especially with regard to the capital adequacy, liquidity, and exposure to the different type of the risk.</p>
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	<p>For regulatory framework, see EC 1 and 2. BI collects stock data and flow data from all banks and banking groups based on standardized schemes and with the same predetermined periods. The reporting instructions of the above data (stock and flow) are the same and are based on IAS/IFRS rules, for statistical data, and on supervisory rules, for capital requirements data.</p> <p>The standardized schemes and the same frequency of survey allow the BI to make comparisons between banks and banking groups.</p>
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	For regulatory framework, see EC 1 and 2. BI has the power to request data and documents deemed relevant and necessary for supervisory purposes. It can require all information deemed material, including management information, for supervision and assessment of their risks. This may be used to support resolution planning. In addition, BI can decide, on an ad-hoc basis, to bring into the perimeter of consolidation any small investment of the bank, which will then be consolidated proportionally or fully for supervisory reporting.
EC7	The supervisor has the power to access ³¹ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	<p>For regulatory framework, see EC 1 and 2. According to the art. 51 of the BL, the BI may ask banks any data or information required to perform its activity. This power allows supervisor to supplement periodic structured reports with information arising from other sources (for instance data and files used in the risk management process) in order to improve the quality of off-site analyses.</p> <p>Also, within its on-site inspection powers BI can access any banking documents, data and, more generally, information needed to assess the entity under inspection. That includes access to records, bank's Board, management and staff.</p>
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank's senior management is responsible for the accuracy of

³¹ Please refer to Principle 1, Essential Criterion 5.

	supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	For regulatory framework, see EC 1 and 2. The competent bodies of the banking groups and the banks are responsible for the accuracy and fairness of the information delivered and for the adequacy of the procedures to develop and check supervisory reporting. BI requires banks to amend inaccurate information. The BL empowers the BI to issue administrative sanctions to individuals in charge with administration and direction functions (e.g., Board of Directors, General Manager, CEO) and to persons with control functions (e.g. Board of Auditors), as a consequence of breach of BL 51 and 66.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ³²
Description and findings re EC9	For regulatory framework, see EC 1 and 2. BI utilizes internal checks to determine the validity and integrity of information collected, periodical analysis and double checks with annual accounts (financial statements). The statistical Department (outside the Supervisory Area) conducts offsite data quality checks before making banks' supervisory reporting available to the line supervisors. In particular, during the annual off-site financial statement analysis, supervisors verify the consistency of supervisory returns (especially those concerning supervisory capital) with disclosed financial data. Periodic verification of supervisory returns is conducted on-site (see EC 3).
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, ³³ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	This EC is not applicable. BI does not rely on external staff for supervisory tasks.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	This EC is not applicable. BI does not rely on external staff for supervisory tasks.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	BI periodically reviews the information needed for supervisory activities and the process is coordinated by specific interdepartmental Committees (with representatives from different departments), that define data sources to address use needs, endorse new reporting

³² May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

³³ May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	instructions, endorse the annual planning of new informative requirements and IT projects, related to supervisory reporting. As part of the EU, Italy also needs to comply with regulations and implement directives and guidelines issued by the European bodies (Commission, EBA) concerning statistical and prudential reports. There is consultation with the industry, when appropriate.
Assessment re Principle 10	Compliant
Comments	
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	<p>The BI has the power to raise its concerns about the bank's situation with bank's managers, board members and auditors (Article 53 of the 1993 Banking Law). The Guide to the Supervisory Activity sets criteria and procedures for conducting the interaction with bank's representatives and adopting preventive and corrective interventions (Part 2, Section I, Chapter II).</p> <p>At any time, as result of ongoing supervision, and in particular at the end of the annual SREP or of the on-site visits, if issues are detected, BI engages bank's representatives through different instruments (letters, ad hoc-meeting, additional inspections), depending on the seriousness of deficiencies found. When issues are discussed in ad-hoc meetings, minutes are taken and filed. For the most significant deficiencies, the BI sends written communications to the governing bodies of the bank, where the measures are requested or specified. Banks have to present action plans with timetables, which need to be approved by BI. Written progress reports are requested from banks, and BI also conducts follow up inspections. Assessors saw several examples where such an exchange and follow up occurred, including as result not only of breaches of regulation or law but correction of conduct or compliance with supervisory guidance.</p>
EC2	The supervisor has available ³⁴ an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and	See CP 1. Art 53 of the BL establishes the range of tools BI can use to address non-

³⁴ Please refer to Principle 1.

findings re EC2	<p>compliance with laws, regulations, and BI instructions. BI is entitled to act not only regarding capital adequacy, but also to, impose prudent corporate governance, regulate shareholdings and participations, internal controls, remuneration, reporting and disclosure, and broadly “limit risks in its various forms.” For tools, see EC 4. Circular 269 sets up the general guidelines for supervisory actions. It establishes that the chosen tool must be linked to the supervisory evaluation of the bank, its risk profile and internal control system, the severity and persistence of deficiencies; awareness, competency and reliability of managers; availability of financial, technological and human resources; appropriateness of actions already performed or planned by the bank.</p>
EC3	<p>The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.</p>
Description and findings re EC3	<p>See above, and also CP 16. Capital adequacy is understood not only as regulatory minimum requirement, but the Pillar 2 minimum established by BI for each bank, based on the supervisory review of the internal capital adequacy assessment. More specifically, for each bank, the BI sets an expected capital level, aimed to cover both Pillar 1 and Pillar 2 risks, higher than minimum regulatory requirements. Banks are required to achieve (target ratio) or maintain (trigger ratio) this given level of capital. In the former case (target ratio), banks have to draw appropriate capital management plans, with consequent actions able to satisfy the supervisory expectations in a given time horizon. As for the trigger ratio, banks are required to continuously monitor their capital stance, in order to maintain the capital base above the identified floor. If the BI is not satisfied by banks’ action plans, it can impose the measures described in EC 4. For instance, in the course of the monitoring of the EBA recommendations on capital strengthening (above the regulatory minimum), the BI called the banks on to allocate the entire profit for the year to reserves and to limit or eliminate the variable component of staff compensation. Assessors saw several examples of BI interaction with banks with regards to capital.</p> <p>Corrective measures and sanctions are initiated by the head of the service (or BI branch) responsible for the ongoing supervision of the bank, with the approval of the Director for Banking Supervision. Appeals and further investigation are conducted by the General Affairs and External Relations Service, which is responsible for the overall procedures for the application of sanctions. Complex, novel or systemic cases may be submitted to a Commission for Examination of Irregularities, which gathers the heads of the different supervisory departments.</p>
EC4	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>

Description and findings re EC4	<p>See CP 1. Article 53 of BL and Circular 269 empower BI with a broad range of measures against the banks, graduated to the gravity of the situation. More specifically:</p> <p>Strengthening of the systems, procedures and processes concerning risk management and ICAAP</p> <p>Limitations of risk exposure</p> <p>Prohibition of certain categories of transactions</p> <p>Restrictions on operations or structure of branches, dismissal of participations</p> <p>Prohibition to distribute profits or other elements of capital</p> <p>restrictions to compensation and remuneration policies</p> <p>Request of higher capital than pillar 1 minimum</p> <p>In the event of violation of law or regulatory provisions or of management irregularities, including failure to implement corrective measures indicated by the BI, it can also prohibit the bank from engaging in new business or order the closure of branches (article 78, 1993 Banking Law). These are “extraordinary measures” tools under the crisis regime (Title IV of the BL), which the BI may adopt in case of urgency outside formal crisis procedures and therefore without the need of a MEF decree.</p> <p>The current legal framework limits the powers of the BI to adopt measures in respect to board members and managers. Beyond moral suasion, pursuant article 53 of the BL the BI may require a bank to convene or directly convene the general meeting to decide on the dismissal of board members. Other actions against the board occur within crisis management procedures which depend on formal initiation by the MEF (SA and CAL—see CP 1). Under the special administration (SA), there is a temporary dissolution (normally up to one year) of the governing bodies and their replacement with one or more special administrators (and an oversight committee) appointed by the BI (art. 70 ff of the BL). There is also one provision according to which in the case of extreme urgency the BI may suspend the banks’ board and appoint one or more temporary managers, for a period of maximum two months (art. 76).</p> <p><i>Administrative pecuniary sanctions</i> are applicable to individuals responsible for the legal/regulatory breach. According to the BL, fines range between 2,580 and 258,228 euro for every breach of law;³⁵ the actual amount is determined by the BI according to the: (i) nature, duration and seriousness of the breach; (ii) cooperation of the offender with the supervisory authority; (iii) reiteration of infringements (fines can be tripled in some cases; iv) financial strength of the bank involved in the infringement; (v) impact of the violation on the market/consumers. Fines are cumulative, so their total amount also depends on the number of violations committed. In addition, according to the AML Law BI may impose sanctions for breaches of AML/CFT obligations. In the case of AML/CFT breaches, the fines are applied to the institution responsible for the breach.</p> <p>If the infringement relates to the disclosure of the contract terms or to the fairness in relationships with customers, in addition to the pecuniary sanctions addressed to individuals the BI may adopt against the bank a number of other measures, such as: suspension or prohibition of certain activities, order to repay consumers, publication of the measures</p>
---------------------------------	--

³⁵ The maximum amount set by the AML Law is EUR 500,000. Similar provisions apply in case a bank does not comply with the laws and/or regulations concerning investment services (see Article 190 of the legislative decree no. 58/98, envisaging pecuniary sanctions up to EUR 250.000).

	<p>imposed (Article 128-ter of the BL).</p> <p>BI does not have the power to revoke license (see CP 5). It can propose the two mechanisms described in CP 1 to the MEF. As described, the MEF cannot initiate them but is responsible for the final decision. Under the special administration (SA), there is a temporary dissolution (normally up to 1 year) of the governing bodies and their replacement with one or more special administrators (and an oversight committee) appointed by the BI (art. 70 ff of the BL). Under the compulsory administrative liquidation (CAL), the bank's license is withdrawn and resolution starts. (art. 80 ff of the BL).</p> <p>BI is the resolution authority for banks and banking groups (articles 80 ff and 99 and 101 of the BL). Besides being responsible for proposing the liquidation to the MEF, the BI appoints the liquidators and the oversight committee; and oversees the liquidation procedure. It authorizes the most important transactions carried out by the liquidators, such as sale <i>en bloc</i> of assets. . The main goal of the SA is to eliminate irregularities and to promote outcomes of the crises that are in the interest of the depositors; this may include selling the business activity to (or a merger with) another healthy institution, and/or a composition with creditors for a moratorium or a cut of their credits. As a general rule, in both cases, an approval from the general meeting is required. If viable economic conditions can be restored through a sale of a few assets which implies a restructuring (as in the case of the sale of some branches) but not a complete business activity dismissal, those operations can be put in place autonomously by the Special administrators; even in these cases a final decision by the general meeting of shareholders is necessary to appoint the new governing bodies. In the case of CAL, there is the dissolution of the bank as a legal entity and its orderly resolution. Once CAL is started, the general meeting of shareholders has no power, so the Liquidators and the Oversight Committee are charged of the sales of assets and allotment of revenues to creditors, respecting their priority ranking.</p>
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	See EC 4. Sanctions are applicable to all responsible individuals (BL Article 144). Not all sanctions are applicable to the bank as institution. Only fines regarding AML breaches are applied against the institution, rather than individuals only. The BI understands that when the CRD IV is transposed into Italian law, it will have the capacity to impose pecuniary sanctions not only on individuals, but also on the entity.
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	Articles 53 and 67 of the BL empower the BI to take all the measures necessary to protect banks and banking groups from risks arising from entities with which they have structural links (articles 53 and 67 of the BL). In particular, to ensure the safety and soundness, the BI has the right to take against the parent company measures concerning the group as a whole or its individual components (see EC 2). Although ring fencing is in theory a part of the toolkit, BI has not taken ring fencing measures as a matter of policy. It considers its given capacity to determine the scope of consolidated supervision, which can be broadened on a case by case basis (see CP 12), encompassing not only the parent company—which may be either a bank or a financial holding company—and its subsidiaries (banks, non-bank financial entities as well as companies providing ancillary services to the group), but also 'sister' companies (entities controlled by the same persons controlling the bank or the group), the BI should be in a position to know and monitor risks arising from entities with which a bank

	have structural links.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	<p>See CP 1 and CP 3. BI cannot formally initiate resolution, but is the resolution authority for banks and banking groups (articles 70, 80, 98 and 99 of the BL), and in this capacity submits to the MEF proposals for CAL. Cooperation with the other national and international supervisors occurs when necessary within the general framework of cooperation described in CP 3.</p> <p>However, cooperation with central banks, ministries of finance and resolution authorities of foreign countries, especially of non-EU member states, is constrained by the absence in the EU and Italian laws of appropriate legal safeguards to secrecy. Pending the approval of the proposal for an EU directive on recovery and resolution, which will introduce the appropriate provisions, the BI works on a case by cases basis. In particular, in respect to Unicredit group (UCG) the BI is working with the relevant host supervisors. A Crisis Management Group has been set up; the high level strategy was delivered to meet the December 2012 deadline, and the draft-Cooperation Agreement (CoAG) is scheduled to be finalized by the first half of 2013 (see description of CP 3, EC 4 and CP 13, EC 5 and EC 6).</p>
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	In accordance with the laws on administrative and sanctioning procedures (Laws no. 241/90 and 689/81), the BI's Regulation of June 25, 2008 established the deadlines and the units of the Bank responsible for each administrative procedure. More formalized prescriptions apply to procedures for pecuniary sanctions.
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	Article 6(3) of the Legislative Decree 142 of 2005 on financial conglomerates requires that financial supervisory authorities communicate to each other any serious sanction or corrective action taken for violation of sectoral legislation or the Legislative Decree itself. A Protocol agreed in October 2007 between the BI and Consob provides, inter alia, that the two authorities exchange on a timely basis information on measures and actions taken against the financial entities respectively supervised. In particular, such information relates to: the order to convene the institution's board of directors; the restrictions imposed on services or activities; the suspension of the issue or of the repayment of UCITS' units or shares; the injunctions; the suspension of the management bodies; the proposal of special administration or compulsory administrative liquidation. Moreover, the BI and the Consob should timely inform each other about any significant irregularities found in the exercise of their supervisory powers. The 2011 Memorandum of Understanding between the BI and the Anti-Trust Authority provides for the exchange of information on the sanctions or sanctioning procedures respectively opened against supervised entities.
Assessment re principle 11	Largely compliant
Comments	BI has several powers and tools to apply early corrective measures to address unsafe and

	<p>unsound practices and activities. The assessors were given access to many examples when such actions were taken, and market participants confirm a very active mode of supervision to curb practices and management which are considered unsound. In particular, BI attributes significant importance to the SREP process and adjustments to the capital.</p> <p>It lacks, however, the important capacity to remove—or even suspend—senior management and members of the board. Unsuitable senior management are often removed by moral suasion but formal powers only exist under crisis procedures, and in even in the case of SA this depends on shareholders agreement. BI believes the issue will be solved when the CRD IV (at the moment of the assessment, the latest draft available was of May 2012) is transposed into Italian law, as it should provide the supervisor the power to temporarily ban the bank’s managers from exercising functions in financial institutions. BI is advised to monitor the matter closely, and if the CRD IV final text does not address the deficiency authorities should take the necessary steps to amend BL independently of EU legislation.</p> <p>Another issue which BI believes will be solved at EU level is the capacity to impose pecuniary sanctions not only on individuals, but on the entity. Currently, such sanctioning is only possible for AML breaches.</p> <p>The regulatory framework for sanctioning procedures was reviewed in 2012, and internal procedures at the BI have recently been changed to make action speedier.</p>
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ³⁶
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p>The 1993 BL and its regulations define banking group. According to art. 60 of BL, banking groups are composed of banks, financial companies and affiliated companies; pursuant to article 64 of BL, banking groups must be registered with the BI. The BL (Art. 21) empowers the BI to require detailed information about the ownership structure of all the companies/organizations that participate in the capital of a bank. The BI’s Circular 229 requires that any plan to modify the structure or the composition of the group must be previously submitted to the BI which assesses whether the proposed changes would permit the effective exercise of supervision on a consolidated basis.</p> <p>If the holding company is a financial company it is treated from a regulatory point of view as a bank and therefore it is also subject to all the requirements applicable to banks with regard to the protection of ownership structures and the requirements of independence, experience and integrity of the members of the governing bodies. The BI may also inspect nonfinancial companies included in the consolidated supervision sphere to verify the accuracy of information and data provided to the BI for supervisory purposes. All Italian banks and</p>

³⁶ Please refer to footnote 19 under Principle 1.

	<p>financial intermediaries (investment firms, investment fund management companies, and nonbank financial companies size and/or operational features thresholds) belonging to banking groups are subject to BI supervision on an individual basis.</p> <p>Pursuant to Art. 66 of the BL, the holding company is required to submit information and statistics covering the entire group. The BI keeps regular contact with other supervisory authorities to carry out a comprehensive assessment of the entities under its supervision.</p> <p>The assessment of banking groups' risk profiles and of the functioning of their risk management systems is reviewed through the SREP. The aim of the SREP is to ensure that banking groups have a capital base and an organization consistent with the risk profile and risk appetite and adopt appropriate corrective measures, should any significant deficiency and/or anomaly be detected.</p> <p>BI approval is required for banks to establish significant cross-border operations in non EU and non G-10 countries to ensure that the acquisition or investment will not impede consolidated supervision. Cross-country contagion risk due to the interconnectedness between the different components of a cross-border banking group is taken into specific consideration within the framework of the recovery and resolution planning activities.</p> <p>The BI makes extensive use of information sharing and collaboration with domestic and cross-border supervisors to identify and monitor conglomerate risks.</p>
EC2	<p>The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.</p>
Description and findings re EC2	<p>Pursuant to Art. 67 of BL the BI has the authority to issue regulations covering the parent and the group on a solo and consolidated basis:</p> <ul style="list-style-type: none"> • capital, • limitation of risk taking in its various forms, • permissible holdings, • governance, • organization and internal controls, • remuneration systems, connected lending, • information to be publicly disclosed . <p>Art. 66 of the BL empowers the BI to require all information deemed to be relevant for supervisory purposes (periodical prudential and statistical returns as well as any additional information needed) from all banks and intermediaries included within the scope of the consolidated supervision. The holding company is required to transmit information and statistics covering the entire group. Regarding companies related but not included in a banking group the BI may: (i) require, via the holding company, information; (ii) carry out on-site inspections to verify the data transmitted; (iii) require an audit of annual accounts.</p> <p>Also with regard to companies not included in a banking group, when calculating capital requirements on a consolidated basis, the BI may consider business operations of such companies and require their consolidation if they are deemed to be material for the stability of the banking group.</p> <p>To ensure the compliance with the above mentioned provisions, persons in administrative,</p>

	<p>managerial or control functions at companies within the scope of consolidated supervision who misrepresent or conceal facts concerning such companies' economic condition are subject to monetary penalties.</p> <p>Supervisory reports provide a wide range of information regarding on- and off-balance sheet assets and liabilities, profit and losses, capital adequacy, liquidity, large exposures, risk concentration (including by economic sector, geography and currency and towards related parties), asset quality, loan loss provisioning, interest rate risk, market risk, and also other information on the organizational structure (e.g., specific distribution channels).</p> <p>Often periodic supervisory reporting is complemented with additional information related to managerial aspects; the frequency with which such information is submitted to the supervisor is related to the relevance of the information provided (e.g., weekly reporting on liquidity and internal data on market and interest rate risks).</p>
EC3	<p>The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>
Description and findings re EC3	<p>The effectiveness of supervision conducted in host countries is a key factor when assessing banks' acquisitions/branching out. In general, when hindrances in host countries affect the parent bank access to all the material information from their foreign branches and subsidiaries, the BI prevents banks or banking groups from entering those countries and, in case of branches of subsidiaries already established, has the power to order the closure of the branch subsidiary.</p> <p>Holding companies are required to maintain compliance and risk systems that meet not only the local requirements but also Italian supervisory regulation.</p> <p>Compliance by individual legal entities with decisions adopted by the parent is verified by the internal audit function that performs regular on-site audits at the group's subsidiaries, considering the relevance of the various risks taken by legal entities.</p> <p>The effectiveness of the parent company's oversight on the whole group (including foreign operations) is assessed both from an off- and on-site perspective, being a key component of the "governance and control system" evaluation. In addition, as part of full-scope and targeted inspections of banks, the BI may extend/carry out on-site examinations at foreign establishments.</p>
EC4	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.</p>
Description and findings re EC4	<p>Cross-border operations of banks or banking groups are included within the general inspection scope when warranted.</p>

	<p>Inspections are carried out in cooperation with the host supervisory authorities:</p> <p>Host Supervisory Authorities are asked to provide information regarding the local operation and economic environment to facilitate scope-setting;</p> <p>On-site examinations are planned on the basis of size, with a focus on thematic areas or specific profiles, such as liquidity, finance, ALM. Ex-ante agreements are reached with local supervisors concerning scope of the inspections and host participation.</p> <p>The BI is allowed to request data and information over and above what is ordinarily requested to banks, whenever the situation so requires. Cooperation agreements have been entered into with a large number of countries addressing information sharing, periodic meetings and supervisory activities.</p> <p>The bulk of cross-border operations of Italian banks are in continental Europe or the U.K., as a result monitoring is facilitated by supervisory colleges and frequent interaction with host supervisors minimizing the need for cross-border inspections.</p> <p>The BI has conducted four inspections in the 2011/2012 period to address risks requiring onsite documentation. As a result of its reviews of bank management oversight of foreign activities, the BI required significant improvements to controls in a foreign branch to achieve a more balanced asset/liability mix. Another onsite inspection of a foreign branch resulted in requirements for the branch to revise its trading strategy and improve controls.</p>
EC5	<p>The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.</p>
Description and findings re EC5	<p>The SREP is the process by which the BI reviews and assesses the ICAAP, analyses the supervised entities' risk profile, assesses the corporate governance system, the performance of the governing bodies, the organizational framework and the internal control system, and verifies overall compliance with prudential rules.</p> <p>For cross-border groups, the SREP is performed in cooperation with foreign Supervisory Authorities within the Colleges of Supervisors. The home supervisor is responsible for consolidated supervision and plays a coordinating role on all the activities performed by the college with the aim to gather an overall and comprehensive picture of:</p> <ul style="list-style-type: none"> • the total risk profile of the group, by drawing a group "mapping" (type of risks taken, business lines, legal entities and countries of establishment), by identifying the relevant components and the related host supervisors and by carrying out a first assessment of risk; • information on the internal methodologies used to measure risks on a consolidated basis is shared on the most significant projects of common interest that are being implemented at the consolidated level (internal risk measurement systems for calculating the capital requirements and on the ICAAP are key areas). This information mainly pertains to the methodological choices made, to the progress of their implementation, to roll-out developments and to the connected impact on operations and organization. <p>The BI can adopt measures directed at preventing the deterioration of the corporate situation or any of its aspects, require the corporate bodies to maintain or restore normal conditions, promote the reorganization of deteriorated businesses, and ensure compliance with rules and regulatory requirements.</p>
EC6	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it</p>

	<p>determines that:</p> <p>(a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed;</p> <p>(b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or</p> <p>(c) the exercise of effective supervision on a consolidated basis is hindered</p>
Description and findings re EC6	<p>All plans to significantly modify the structure of a group have to be approved in advance by the BI, which assesses whether the new structure would hinder the conduct of consolidated supervision.</p> <p>The BI assesses any expansion project submitted for authorization considering the capital strength of the banking group and the reliability of its organization and internal control system.</p> <p>The BI can prohibit the setting up of new cross-border branches and subsidiaries or can set limits on the business of those whose organization appears inadequate in terms of risk control and management and/or where the host country's application of the internationally-agreed principles for the supervision of international banking groups appears inadequate or the host country does not offer adequate guarantees of transparency and access to information. In particular, the BI does not allow new establishments to be set up in jurisdictions considered uncooperative by the Financial Stability Board or the Financial Action Task Force (FATF).</p> <p>Establishments in off-shore centers have been permitted in the past provided their transactions were recorded in the accounts of other on-shore branches or the parent bank itself.</p> <p>The BI has the authority to prohibit cross-border establishments from taking on new business or ordering their closure. Annually, parent companies must report on visitations/audits conducted on cross-border operations.</p>
EC7	<p>In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.³⁷</p>
Description and findings re EC7	<p>The BI supervises—on an individual basis—all banks and financial intermediaries, regardless of the fact that they may be part of a banking group.</p> <p>Pursuant to the principle of proportionality, non-significant group entities may be subject to a less intensive supervisory approach. A group entity is deemed significant if it is listed, or its minority shareholders have significant shares, or absorbs a high percentage of the consolidated capital requirements, or if it performs specific processes or business activities for the whole group.</p>
Additional criteria	
AC1	<p>For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent</p>

³⁷ Please refer to Principle 16, Additional Criterion 2.

	companies.
Description and findings re AC1	<p>Any natural or legal person that directly or indirectly acquires the control (or even a qualifying holding) of a bank must file an application with the BI. In assessing the acquisition, the BI conducts an in-depth prudential assessment of the proposed acquirer.</p> <p>The potential purchaser must meet the fit-and-proper requirements additionally; his/her integrity and professional competence is evaluated. If the potential buyer is a legal entity, the fit-and-proper requirements must be met by the owner of the legal entity and by all the persons who effectively direct its business (i.e., board of directors and senior managers).</p> <p>The BI keeps the power to revoke or suspend the authorization if the prescribed requirements cease to be met. (see CP 1 and CP 5 on legal powers) On an ongoing basis, specific attention is devoted to changes in the governing bodies of the parent institution or in its owner.</p>
Assessment of Principle 12	Compliant
Comments	
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	<p>The BI has set up a supervisory college for each of the 10 banking groups with cross border operations of which BI is the home supervisor.³⁸</p> <p>Home-host cooperation and, in particular cooperation within colleges of supervisors, is addressed by BL (articles 6, 7 and 69); the BI enhanced and detailed the framework for such cooperation in its Supervisory instructions (Circular 263, Title III, Chapter 1, Section III, paragraph 3).³⁹</p> <p>The organizational structure is based on a mapping exercise to include within the perimeter of the college activities subsidiaries and branches having significance for the group operation and/or for the country in which they are established. This mapping exercise is carried out on an annual basis. The BI has established fully-fledged colleges for the two major cross border banking groups (Unicredit Group-UCG and Intesa Sanpaolo-ISP), while a simplified structure was established for the other Italian cross-border groups and agreed with the relevant host</p>

³⁸ Unicredit, Intesa Sanpaolo, Monte dei Paschi di Siena, Banco Popolare, Banca Popolare dell'Emilia Romagna, Unione di Banca Popolari Italiane, Credito Emiliano, Mediobanca, Banca Leonardo and Banca Mediolanum.

³⁹ http://www.bancaditalia.it/vigilanza/normativa/norm_bi/circ-reg/vigprud/Circolare_263_2006.pdf.

	<p>supervisors.</p> <p>Planning and performance of supervisory activities as well as communication and exchanges of information within the colleges that the BI coordinates are timed and scaled in accordance with the group operations, the group risks jointly assessed by the college members and the expectations of these members, especially in term of information. Furthermore, the BI colleges activities and information exchange thoroughly take into consideration the markets and system developments.</p>
EC2	<p>Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group⁴⁰ and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.</p>
Description and findings re EC2	<p>As home supervisor, the BI has signed bank-specific Multilateral Agreements regulating the colleges' functioning and information exchange. Similarly, as host, the BI signed MOUs for colleges in which it participates. The BI provides, according to agreed timetables, the requested information to the host authorities on the Italian parent companies and the domestic components of the banking groups falling under its supervision. As a general practice, bank-specific risk assessment reports, drafted according to EBA guidelines, are circulated with an annual frequency to the host supervisors, thus providing a deep and unrestricted view on risks, governance and management practices of the banking group; in addition, other ad-hoc (e.g., in case of major organizational changes) or structured (e.g., liquidity newsletter, stress testing outcomes) reports are shared within the college.</p>
EC3	<p>Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups</p>
Description and findings re EC3	<p>Annually, during the meeting of supervisory colleges devoted to the analysis of a group's risk assessment report and joint decision on capital adequacy, a list of priorities/supervisory actions is agreed upon and defined among college members. Group-specific action plans are subsequently drafted (on-site, off-site, validation, etc.) to be carried out in the coming year with a proposed distribution of tasks; against this backdrop, joint inspections may be proposed on given issues (e.g., IT, governance, credit risks).</p> <p>Another area in which collaborative work has been experienced is model validation; upon receipt of the application for the roll-out of internal model, intense supervisory action plans are defined, under the co-ordination of the BI, including meetings among authorities and/or with the parent company/the subsidiaries involved, and targeted inspections.</p>
EC4	<p>The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.</p>

⁴⁰ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

Description and findings re EC4	<p>The general practice is to provide a full, unrestricted view on risks, governance and management practices of the cross-border banking group. The communication strategy is flexible and adjusted if conditions change as occurred at the outbreak of the crisis which resulted in frequent conference calls regarding the evolution of groups' liquidity positions, which, in the case of some major European groups were held on a weekly basis.</p> <p>Quantitative information is regularly posted on the colleges secure websites.</p> <p>In cases of joint activities being undertaken by the college members, communication to the parent company and the relevant subsidiaries is coordinated both in terms of timing and content. Examples include internal model validation, where the joint decisions, once discussed and agreed by home and host authorities, have been forwarded to the parent company and the subsidiaries in a synchronized manner, to ensure consistency of messages and avoid misunderstanding.</p> <p>Other examples may be found in the field of joint decisions on capital adequacy: every year, upon completion of the joint risk assessment process by the College of Supervisors, the contents of the communication to the bank are discussed; a copy of the formal letter addressing the main issues stemming from the risk assessment is circulated among college members.</p>
EC5	<p>Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.</p>
Description and findings re EC5	<p>The ability of the BI to develop resolution plans and set in motion early coordination to address evolving bank problems and possible resolution on a cross-border basis is limited. The current EU framework on confidentiality obligations of bank supervisors limits the possibility for the BI to cooperate in RRP activities concerning cross-border banking groups, in particular to exchange information with foreign MEF and Resolution Authorities other than bank supervisors.</p> <p>Improvements to cooperation and coordination with foreign authorities in crisis management and resolution are expected with the approval of the resolution directive. The directive will upgrade the framework for information exchange with non-EU authorities, as well as with EU resolution authorities that are not supervisory authorities and foreign Finance Ministries.</p> <p>The RRD will fully implement the framework for cooperation and exchange of information set in the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. In particular the directive will resolve the confidentiality issues that current limits the possibility for EU bank supervisors (including the BI) to share confidential information with foreign MEF and Resolution Authorities other than bank supervisors. In particular, the directive:</p> <ul style="list-style-type: none"> • will introduce legal gateways allowing disclosure of confidential information to EU MEF and EU Resolution authorities; • will establish confidentiality obligations for EU MEF and EU Resolution authorities in order to protect the confidentiality of supervisory information from onward disclosure; • will set the conditions for sharing confidential information with resolution bodies of non-EU countries.
EC6	<p>Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities,</p>

	develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	<p>The BI, as the home supervisor of UCG and resolution authority established the UCG Crisis Management Group (CMG) with the relevant host authorities (German, Austrian and Polish supervisory authorities and central banks) since 2010.</p> <p>A preliminary framework for resolution assessment has been established and shared with host authorities. Should it become necessary to take any recovery or resolution measures, the BI would alert and consult relevant authorities and supervisors (both home and host) promptly, on the basis of the commitments that will be made official within the firm-specific COAGs.</p>
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	The BI is empowered to exercise over foreign banks the same powers it exercises over domestic banks. The BI may impose to these entities prudential requirements; require them to submit prudential reports and to carry out on-site inspections.
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	Home supervisors of groups having relevant Italian subsidiaries and/or significant branches are given, with a preliminary notice, access to the Italian offices and subsidiaries in accordance with the BL (Articles 54 and 68), the EU law and the terms of the MOU. Such terms provide that advance notice be given to the BI and the modalities of cooperation with the home authority. On this basis, in some cases, and under request of the home supervisor, BI inspectors join the inspection team of the home Authority to support their work.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	The Italian legislation and the BI do not allow the establishment of booking offices and/or shell branches in Italy. Likewise Italian banks are not allowed to set up shell branches abroad.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action
Description and findings re EC10	The BI, when undertaking action on the basis of the information received from another supervisor, generally requests ex-ante the consent from that supervisor. This is generally done within the framework of colleges of supervision in which the BI participates, as provided for by the principles laid down by CEBS. In general, the terms of the MOUs agreed by the BI provide that the home and host authority should inform each other of any measure regarding cross-border establishments especially when such measures may be relevant for the exercise of the respective competences.
Assessment of Principle 13	Largely Compliant

Comments	The ability of the BI to develop resolution plans and set in motion early coordination to address evolving bank problems and possible resolution on a cross-border basis is limited. The current legislation does not provide for information exchanges by the BI with foreign ministries and resolution authorities prior to the declaration of bank insolvency. A proposed directive: will resolve the confidentiality issues that current limits the ability of EU bank supervisors to share confidential information with foreign MEFs and Resolution Authorities other than bank supervisors.
Prudential regulations and requirements	
Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management, ⁴¹ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance
Description and findings re EC1	<p>Under the 2008 Governance Instructions, Directors are responsible for approving overall governance. Pursuant to circulars 229 and 263 the board must approve the strategies and policies for the management of the bank's business, maintaining a holistic view of the activities and related risks for its risk management and control duties. As noted in other CPs, corporate governance guidance issued by the BI should be enhanced in certain areas to achieve compliance with the BCPs, for example: fit and proper requirements enhanced to include disciplinary action from regulators as a cause for disqualification, require that lending be made at arm's length, including related party lending, include as related party those created by economic links, require that directors recuse themselves when a proposal benefiting them is being voted to avoid conflict of interest.</p> <p>Senior management is required to ensure the existence and functioning of an adequate internal control system. To this end, senior management has to: define control policies and practices, verify the effectiveness of the internal control system, identify perspective risks, assign competences among operational units in charge of control functions, and identify the needs for information flows.</p> <p>The BI meets, formally and informally, with banks' board members and senior management to discuss the bank's corporate governance policies and practices.</p>
EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	BI monitors policies and procedures adopted for: appointing members of the governing bodies and for removing directors in charge of the strategic supervision as well as members of the internal control committee; ensuring the interaction among governing bodies and their

⁴¹ Please refer to footnote 27 under Principle 5.

	<p>internal committees; delegating powers.</p> <p>During off-site and on-site supervision, the BI assesses whether the bank faces risks that stem from inadequate governance arrangements; and how corporate governance works with respect to the management of the credit institutions' specific risks. The analysis closely considers the governance system (the ownership structure, the supervisory, management and control bodies), the organization (macrostructure, planning and control systems, information and IT systems) and the control functions (internal audit, risk management and compliance functions). Requirements for banks include: the separation of responsibilities between operating and control personnel; the existence of risk-mapping procedures; the existence of a system for integrated management of the different types of risk, the effectiveness of the risk-control unit.</p> <p>Corporate governance policies and practices, and their implementation, are evaluated as part of the analysis the BI performs in the RAS that is the main SREP instrument. The evaluation cycle usually has an annual frequency. The assessment is performed by means of an examination of all the documentation concerning controls (bylaws, organization chart, corporate governance project, internal rules, and the corporate governance relation for listed companies). The assessment of the quality of the governance translates into a score that impacts the bank's overall assessment.</p> <p>The adequacy of structural and functional components of the corporate governance and control systems is evaluated during on-site inspections; it can also be the objective of a "targeted inspection." The assessment is conducted by both analysing corporate documents and exchanging information with directors and senior management. Particular attention is devoted to the adequacy of the organization and the governance structure with respect to the ICAAP process, and the successful integration of this process with company decisions.</p> <p>The governance analysis and evaluation is a specific sub-section of the inspection report and there is a close relation between the score given to such section and the final, overall, score.</p> <p>Where breaches are detected, credit institutions are required to adopt corrective actions, which vary depending upon the type and intensity of the problem. The BI can also issue administrative sanctions against those who perform management and control functions for violation of the applicable rules and regulations. In addition, it can require: banks and banking groups to modify bylaws or the board model; governance bodies to discuss certain issues it deems important for the safe and sound management of the institution; submit the need for appointing new directors to the attention of the general meeting. BI can also prohibit the accomplishment of certain transactions or the performance of certain activities, as well as, in extreme cases, suggest that the Finance Minister dissolve the board.</p>
EC3	<p>The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members</p>
Description and findings re EC3	<p>The Civil Code lays out the rules on nomination and appointment of board members. Also, it provides rules for the direction and coordination of subsidiaries, which aim at protecting minority shareholders' and creditors' rights and that subsidiaries are properly managed.</p> <p>The 2008 Governance Instructions require bylaws to regulate, in a clear and transparent manner, the composition of the Board and the mechanisms for appointment and removal of their members. The bank holding company should ensure the overall consistency of the group's governance structure and, in particular: the effective interaction between the</p>

	<p>governing bodies, units and functions of the different components of the group; a unitary approach to the risk management and control; group-wide compliance with the prudential requirements.</p> <p>The BI's regulations emphasize the role of the non-executive directors. A sufficient number of non-executive directors, with well-defined roles and duties, should actively contribute to the board discussions, challenge the management, have a say every time conflicts of interest may arise.</p> <p>Board committees are considered a crucial corporate governance tool for ensuring safe and prudent management of the credit institutions. The setting up of remuneration, nomination, and internal control and risk committees is required for large and complex banks. Members shall be non-executive and, at least some, independent.</p>
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty." ⁴²
Description and findings re EC 4	<p>Under the fit and proper requirements established by law and the BI's regulations, the duties and the expertise are specific, and commensurate to the size and operational complexity of the bank. Also, under the 2008 Governance Instructions, directors are required to devote sufficient time and resources to discharge their duties; banks' by-laws shall set limits to multiple directorships.</p> <p>The financial markets' supervisory authorities (BI, Consob, and ISVAP together with the Antitrust authority) have adopted Guidelines for the application of the statutory anti-interlocking rule. Under this regulation, the same person cannot hold managerial (including senior management and board) positions in two or more competing financial firms.</p> <p>The Civil Code prohibits directors from acting in their own interest. To this end, the Code provides that directors disclose their own interests; the decision adopted with the casting vote of the director interested—shall it damage the company—can be challenged in court. The director is liable for any damage caused to the company from his act or omission; criminal sanctions are also provided for in this case.</p> <p>There is no requirement for directors to recuse themselves when voting on issues affecting them directly; nonetheless, if the CEO has an interest in an operation that would be under its competence to conduct, he or she cannot act, and shall remit the decision on that operation to the board as a whole</p>
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite ⁴³ and strategy, and related policies, establishes

⁴² The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables," 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

⁴³ "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

	and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment
Description and findings re EC5	<p>Regulations emphasize the role of the Board in setting strategies and require that risks be managed in an effective, unitary, and coherent way. The Board and management contribute, in line with their duties and responsibilities, to define the risk management and the control policies, as well as to oversee their proper implementation. Directors have to be aware of the risks faced by the credit institution and have a holistic view thereof; the risk appetite shall be accurately pre-determined in a way that is appropriate, sustainable, and in line with the strategic planning.</p> <p>The management body in its supervisory function shall establish strategic risk management guidelines and policies, and periodically review them in order to ensure their enduring effectiveness. This body acts as the point of reference for the corporate internal control functions and units. The management body in its managing function shall verify on an on-going basis the overall efficiency and effectiveness of the risk management and control system, taking remedial action to correct any shortcomings or irregularities and adapting the system to relevant changes (business environment, bank's operations). The compliance, risk management and strategic planning functions shall also be closely involved in the setting up and maintenance of a strong control environment. To this end, they shall take part to the board meetings and, where set up, to the works of the internal committees.</p> <p>Conflicts of interest policies are required with respect to related party transactions (where applicable, a policy shall also be adopted for the proper provision of investment services to investors).</p> <p>Listed companies are bound, on a comply-or-explain basis, by industry code of conduct, lastly amended in December 2011. In line with the international best practices, the code: requires the board to set the strategic objective and the risk appetite of the listed company and the group it belongs to; streamlines the control system (the focus being the clear allotment of tasks and responsibilities among the corporate bodies); emphasizes the role of non-executive directors where conflicts of interests may arise.</p> <p>In September 2012, the BI published for consultation a document enhancing the corporate governance/internal control requirements for banks. In particular, the consultation paper: (i) recasts the currently in force regulation; (ii) better clarifies and strengthens high level principles already provided for by the current legal framework; (iii) introduces some new rules in order to update the regulation</p> <p>Enhancements cover: (1) Establishment of policies on human resources management and prevention of conflicts of interest. (2) Define assessment processes and methodologies that are integrated with the risk management process. (3) Requirement to define the level of risk tolerance or risk appetite. (4) Establish a Code of Ethics. (5) Detail the process for the approval of new products. (6) Establish the process for the nomination and removal of the managers for the control functions. The consultation period has closed and the BI is reviewing the comments received.</p>
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and	According to the BL, the persons performing administrative, managerial and control functions have to satisfy the experience and integrity requirements identified by the Ministerial Decree

findings re EC6	<p>161/1998. In order to fulfil the integrity requirement, these persons shall not have committed one of the criminal offenses listed. Under the experience requirement, board members and senior managers shall be knowledgeable in the field of financial markets and/or have previously held managing positions. The experience requirement is proportionate to the type of bank—its management and operating needs—and to the role performed by the director concerned.</p> <p>The experience requirements have been tightened by the BI's 2008 Governance Instructions (as clarified by subsequent Communications, adopted in 2009 and in 2012), following which governing bodies shall: identify their desirable composition in terms of skills and experience of their members; be satisfied that the candidates for any position match the required profile. Under this regulation, the nominating committee (or the independent directors, where the complexity of the institution does not justify the setting up of such a committee) should collaborate in these evaluation exercises: express its view as to the desirable composition of the bodies and as to the CVs of the candidates that might take up positions in the bank's governance.</p> <p>The adequate composition of the governance bodies shall be evaluated on an on-going basis, in order to ensure that the profiles of those who hold the offices be at all times in line with what needed. In case deficiencies are detected under this regulation, corrective actions shall be adopted as deemed appropriate by the credit institutions.</p> <p>Pursuant to the Civil Code, the board appoints the senior management and has the duty to monitor it. The management body in its supervisory function sets the overall strategic programs and plans, and the risk management policies. The management body in its managing function shall implement such programs, plans and policies, and ensure that the risk management and control functions are directed by qualified personnel, with adequate independence of judgement, experience and knowledge commensurate with the tasks to be performed. With its on-site evaluations, the BI ascertains, among other things, that the board duly supervises the senior management.</p> <p>The supervisory instructions stress the role of information flows, which ensure effective oversight of senior management's execution of board strategies. Such flows shall be sent to the bodies charged with the functions of strategic supervision, management and control and should pertain, at a minimum, the level and trend in the bank's exposure to all the main types of risk (credit, market, operational, reputational), and types of innovative transactions and their risks.</p> <p>The persons responsible for the internal control functions must report directly to the control, management, and strategic supervision bodies, which shall verify, on an on-going basis, the overall efficiency and effectiveness of the risk management and control system, and take remedial action to correct any shortcomings.</p>
EC7	<p>The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies</p>
Description and findings re EC7	<p>The BI, in 2008, issued a regulation on the remuneration policies and practices in the credit institutions. The aim was to ensure that such policies: be consistent with banks' sound and prudent management, as well as their long term strategies; properly take into account the whole range of current and potential risks.</p> <p>On the matter of processes and governance: the board shall define, with the collaboration of</p>

	<p>relevant internal functions (human resources, risk committee), the remuneration policy; moreover, under the law, the remuneration policy must be approved by the general meeting. Some types of remunerations are considered not adequate for a proper risk management and, hence, are prohibited (the remuneration of the control functions shall not be linked to the bank's performance; the audit committee shall not receive variable remuneration).</p> <p>The review of banks' compensation policies is an integral part of on-site and off-site supervision of the BI. During the supervisory assessment, particular emphasis is given to: the role and involvement of the corporate bodies; the performance indicators used; etc.</p> <p>The BI can require banks and banking groups to correct deficiencies in a timely manner. In particular, it can: limit the variable part of the remunerations when necessary to strengthen the capital basis; require banks to disclose (in accordance with the Pillar 3 requirements) their remuneration policies and practices; impose capital add-ons in case the remuneration policy is inconsistent with a sound capital base and the liquidity of the institution.</p>
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (eg special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>The BI's regulation focuses on the role of the Board and of the senior management in the identification and implementation of the banks' strategies, in light of the risk appetite of the credit institution.</p> <p>The supervisory activities (both on- and off-site) also consider the way in which governance arrangements face the challenges and the risks posed by the operational structure of the bank and the banking group.</p> <p>The Consultation Paper on Internal control system explicitly requires banks' Board of directors to have an in-depth knowledge of their business model, and to ensure that the organisational structure is coherent with such model; to this end, the setting of overly complex and unjustified structures shall be avoided.</p>
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria
Description and findings re EC9	<p>The BI does not have the power to remove individual directors. It can disqualify directors who do not meet the requirements of the Ministerial Decree. If directors contravene laws and regulations, or safety and soundness principles, the BI can impose administrative sanctions. Also, it can convene the corporate bodies and put on the agenda the renewal of the board. As a consequence, single members might end up being removed. Nonetheless, the decision rests with the shareholders' meeting.</p> <p>Under the special administration procedure, the BI can prompt the Finance Minister to remove the members of the governing bodies, and can replace them with specially appointed commissioners.</p>
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.

Description and findings re AC1	<p>Where the board members or the senior management ceases to comply with the fit and proper requirements, article 26 BL, as implemented by Ministerial Decree 161/1998, calls upon the directors to correct the situation, remove the person concerned, and inform the BI thereof. Shall the board refrain from acting; the disqualification is declared by the BI.</p> <p>A number of other provisions ensure that the BI receives information concerning the governance of the firm (directors' and senior management fitness and propriety included): under article 52 the control body shall inform the supervisory authority without any delay of those circumstances that might amount to a breach of the applicable laws and regulations; also, under Regulation 229 banks shall send to the BI, upon its request, any other information or documents.</p>
Assessment of Principle 14	Largely Compliant
Comments	<p>BI lacks authority to remove directors. The BI has issued significant guidance on corporate governance. However, guidance on a number of key areas is required to achieve compliance. The deficiencies in governance policies relate to fit and proper requirements, related party transactions, lending on market terms, reducing conflict of interest by requiring a director to reclude himself when Board is voting on his transaction. These deficiencies are fully discussed in the relevant CPs.</p> <p>The BI published for consultation a proposed regulation to enhance the guidance to Boards of Directors on corporate governance and risk management. The consultation period has concluded and the BI is encouraged to implement the regulation in an expedient manner.</p>
Principle 15	<p>Risk management process. The supervisor determines that banks⁴⁴ have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate⁴⁵ all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.⁴⁶</p>
Essential criteria	
EC1	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines

⁴⁴ For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

⁴⁵ To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

⁴⁶ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	<p>that the Board ensures that:</p> <ul style="list-style-type: none"> (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management take the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite
Description and findings re EC1	<p>The BI regulations (Circular 263) require that the board play a key role in an effective and efficient risk management and control system, establish the level of risk appetite and promote internal controls.</p> <p>Moreover, the Board has to: (i) define the strategies and the risk management policies and periodically review them with respect to changes in activities and external environment; (ii) define the system of internal controls and assess its consistency with the established risk appetite and strategies and with the evolution of the firm's risk profile and the interaction among the firm's risks; (iii) establish exposure limits, notably in the case of uncertainty in the valuation of financial instruments; (iv) be informed by competent internal function in case of uncertainty in the measurement of the risk exposures (model risk); (v) approve the risk management process, which is defined by the management body, and verify its consistency with strategies and risk governance policies.</p> <p>The management body is required to set operational limits to risk exposures—taking into account the results of stress tests and the economic context—and clearly define the responsibilities and the tasks of the functions involved in the risk management process, and prevent conflicts of interest.</p> <p>The risk management function is involved in the definition of the bank's risk appetite and in the formulation of the risk management policies and process as well as in the identification of operational limits to the different risk exposures, consistently with the nature, size and complexity of the bank's activities.</p> <p>Through the on-site supervision the BI assesses bank compliance.</p>
EC2	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ul style="list-style-type: none"> (a) to provide a comprehensive "bank-wide" view of risk across all material risk types; (b) for the risk profile and systemic importance of the bank; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.
Description and findings re EC2	<p>According to Circular 263 Banks must have in place risk policies and a risk management process to identify measure, evaluate, monitor, mitigate and communicate risks.</p> <p>Banks shall establish appropriate corporate governance arrangements and adequate management and control mechanisms in order to control all the risks to which they are</p>

	<p>exposed. These arrangements—disciplined also by the more general regulation on banks’ organization and internal control systems— have to ensure that operations are managed efficiently, effectively and with integrity. The above-mentioned arrangements cover all forms of risk in a manner consistent with the characteristics, size and complexity of the business conducted by the bank.</p> <p>The internal control system must measure, evaluate, monitor, mitigate and communicate at any appropriate organizational level all risks incurred or which are likely to be incurred (strategic, credit, market, concentration, interest rate, operational, liquidity, and reputation) on a bank- and group-wide basis, also in an integrated manner and capture the interrelation with the external context and the macroeconomic scenario.</p> <p>Circular 263 requires banks to establish procedures and tools for determining the adequate internal capital level (ICAAP). The supervisory board shall, with regard to the ICAAP, establish and approve the general structure of the process, ensure its prompt adaptation to significant changes in strategic policies, organizational arrangements and the business environment and take steps to ensure the full use of the results of the ICAAP for strategic and decision-making purposes. Through on-site supervision, the BI assesses that banks comply with the abovementioned regulation.</p> <p>The proposed internal controls regulation makes specific the link between changes in the external environment and the need to review strategic plans, risk appetite.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ul style="list-style-type: none"> (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank. <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank’s Board where necessary</p>
Description and findings re EC3	<p>Banks are required to establish formal risk management policies and to periodically review them—in order to ensure their continuing effectiveness—and to monitor the actual operation of risk management and control processes.</p> <p>The risk management function is required to: (i) verify the adequacy of the risk management policies, process and limits on an on-going basis; (ii) develop, validate and adapt risk measurement and control systems, which must be subject to back testing, analyzed in an adequate number of scenarios, built upon conservative assumptions with respect to correlations and dependencies.</p> <p>The internal control system must ensure that any breach be communicated in a timely manner to any appropriate level with the organization and to the supervisory and management board if significant; specific procedures must be incorporated in the system to cope with any breach of established limits.</p> <p>Through the on-site supervision the BI assesses that banks comply.</p>
EC4	<p>The supervisor determines that the bank’s Board and senior management obtain sufficient information on, and understand the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and</p>

	limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings re EC4	<p>The board is required to ensure the establishment of a system suitable to provide for accurate, complete and timely information concerning risk management and control. Besides, the Board ensures that the functionality, efficiency and effectiveness of the risk management and control system are periodically reviewed and it has to be periodically informed of the findings of such review; where shortcomings or irregularities are found, the board adopts appropriate remedial measures.</p> <p>The management body: establishes the internal reporting flows necessary to ensure the governing bodies and control functions have the information necessary to fully understand and govern risk factors; ensures that capital and liquidity positions are consistent with the overall risk appetite framework. The regulations also emphasize the importance of an effective system of information reporting with respect to the assessment of capital adequacy and liquidity risk. Furthermore, the risk management function is required to take account of the model risk and the uncertainties attached to risk measurement models.</p> <p>Through the on-site supervision the BI assesses that banks comply with the regulation.</p>
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	<p>The supervisory board has to ensure that the level and the allocation of capital and liquidity are consistent with the established risk appetite and risk management policies and processes.</p> <p>Banks must develop strategies to be pursued and tools and procedures for determining the adequate capital—in terms of amount and composition—to cover all risks to which they are or could be exposed, including risks not subject to specific capital requirements. The risk management function is required to monitor on an on-going basis the evolution of the bank's risks and the respect of established limits to risk exposures.</p> <p>The ICAAP is based on appropriate risk management systems and requires adequate corporate governance mechanisms, an organizational framework with clear lines of responsibility and effective internal control system. The strategic supervisory board defines and approves the ICAAP process, while the executive body is required to implement it.</p> <p>The BI reviews and assesses the ICAAP, analyzes the bank's risk profile, assesses the corporate governance system, the performance of the governing bodies, the organizational framework and the internal control system, and verifies overall compliance with prudential rules. These activities are conducted through the use of a system that defines general criteria and methodologies for analyzing and assessing banks (the RAS—Risk Assessment System). This system enables the BI to identify the material risks faced by banks and to assess their management and control systems, including for the purposes of reviewing the internal capital calculation they produce. If the overall analysis reveals deficiencies, the BI requests the adoption of appropriate corrective measures in the form of organizational or capital adjustments. The actions shall be proportionate to the scale of the anomaly: additional capital requirements shall be imposed if the application of organizational measures appears insufficient to ensure the removal of the problem within an appropriate timeframe.</p> <p>With respect to liquidity risk, regulations require that the supervisory board formalize the liquidity strategic policies and establishes an effective liquidity risk management system. In particular, the supervisory board defines the maximum acceptable exposure to liquidity risk</p>

	<p>and it is responsible for monitoring compliance. In addition, the board approves: (i) the methodologies used to measure the liquidity risk exposure; (ii) the main assumptions underlying the stress scenarios; (iii) the early warning indicators and the contingency funding plan.</p> <p>The liquidity risk management system must be consistent with the characteristic, the size and complexity of the banks' operations and it includes, among other things, the procedures to: (i) identify the risk factors; (ii) measure the risk exposure, also in a forward-looking perspective; (iii) identify the mitigation tools; (iv) implement the Contingency Funding Plan; (v) report to the board. Roles and responsibilities within the liquidity risk management process must be clearly defined and the liquidity risk management system has to periodically be revised to check its validity over time.</p> <p>Banks have to regularly carry out stress test in order to assess the impact of negative events on the liquidity risk exposure and quantitative and qualitative liquidity buffers adequacy. However, stress tests to address risks from foreign currency operations are not required.</p>
<p>EC6</p>	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models. <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
<p>Description and findings re EC6</p>	<p>Regulations require the banks' supervisory board to approve the development and validation process of internal models for the measurement of risks and periodically verify their correct functioning. The management body must understand all the risks to which the bank is exposed, including the possible model risks, as well as all the interrelations among risks and with the evolution of the external environment. The risk management function is responsible for the development, validation and maintenance of the risk measurement and control systems and makes sure that: (i) these systems are subject to periodic back-testing; (ii) an appropriate number of scenarios are analyzed; (iii) conservative assumptions are made on dependencies and correlations; (iv) model risk and uncertainties attached to financial instruments are adequately taken into account.</p> <p>The BI authorizes the use of internal systems developed by banks for calculating capital requirements for credit, counterparty, market and operational risks subject to compliance with the organizational and quantitative requirements envisaged for each of such systems. The BI examines the application, verifies its compliance with the organizational and quantitative requirements provided for in the regulations for each internal system. The salient aspects of the plan may be examined in greater detail with the corporate officers of the applicant, including through on-site verifications. The BI verifies the continuing compliance with the requirements for the adoption of internal risk measurement systems for prudential purposes.</p> <p>Through the on-site supervision the BI assesses that banks comply with the abovementioned regulation.</p> <p>The BI has not issued requirements for banks to independently test and validate models that are not used for regulatory purposes, but has made a recommendation in that sense in its communication of March 19, 2010)</p>

EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use
Description and findings re EC7	The BI reviews Board minutes and reviews reports to the Board and management during onsite inspections. The scope of the onsite inspections involves a detailed analysis of the information provided to management to ensure that decisions are made with timely and comprehensive information. The review is also part of the detailed ICAAP process.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, ⁴⁷ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board
Description and findings re EC8	<p>Regulations require banks to assess the implications deriving from entering new markets or operational sectors and from the offering of new products. In particular, before carrying out such new activities banks are required to identify the relative risks and to define adequate control procedures. Those procedures need to be approved by the Board. It is also important that Boards approve new products such as complex structured financial products and significant new activities directly.</p> <p>The proposed internal Regulations requires that the supervisory board ensure that the definition of the approval process for entering new products, services, activities and markets as well as the criteria for the identification of the major activities to be subject to the prior assessment of the risk management function. The Board must establish policies and procedures addressing the development of new markets, products and services and significant changes to existing ones.</p> <p>The process must ensure: an appropriate assessment of impacts on organizational structure and on risk profile and their consistency with the risk tolerance; the availability of adequate resources, tools and expertise to understand, manage and monitor the associated risks; the identification of corrective measures, if needed, which must be adopted in internal control system.</p> <p>Currently, the BI expects banks to establish a New Product Committee – comprised of the top management, the relevant business functions, the accounting function, the market risk management function and the internal audit – responsible to formally authorize the commercial functions to deliver a new product. In case of particularly complex or innovative products, the supervisory board should be directly involved in the approval procedure. Through the on-site supervision the BI assesses that banks comply with the abovementioned regulation.</p>
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to

⁴⁷ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	<p>The risk management function must have access to the firm's data and capacity to resort to external consulting if necessary. To make sure its personnel is adequate, both in qualitative and quantitative terms, (continuous) training and job rotation schemes have to be used. The organizational arrangements may vary according to the size and complexity of the bank as long as the risk management function is separated from the business functions and its role and responsibilities are clearly formalized.</p> <p>Regarding the segregation from risk-taking functions, the Supervisory instructions require that the head of the risk management function: (i) meets professional qualification requirements and is placed in an appropriate hierarchical position; (ii) neither has direct responsibility of operational functions under his/her control nor is subordinate to the people in charge of them; (iii) directly reports to the bank's bodies. The internal audit function is required to periodically assess the adequacy of the risk management function.</p> <p>The BI assesses that banks comply with the abovementioned regulation.</p>
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	<p>The head of the risk management function must be appointed and removed by the management body, in agreement with the board and with opinion of the audit committee (removal must be justified). In order to enhance the independence of the function, the risk manager may report directly to the risk control committee, if established, or to the supervisory board. In the larger and more complex banks, specific risk committees might be established; in such cases the different responsibilities as well as the participation scheme must be clearly defined. The set-up of such committees must not erode the powers and the authority of the risk management function. In addition, whatever the organizational structure of the latter, an integrated vision of all the relevant risks as well as of their interactions must be ensured. Moreover, in the largest and complex banks the chief risk officer must be put directly under the risk committee (if it has been set up) or the supervisory board.</p> <p>Banks of limited size and complexity can outsource internal control functions. Banks must notify in advance their intention of outsource (outsourcing generally is done by smaller institutions), providing all the information necessary to verify the compliance with supervisory requirements. BI may decide to prohibit the outsourcing of internal control functions.</p>
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	Regulations establish requirements and standards that banks must comply with respect to measurement, management and oversight of all those risks. Also the Guide to Supervisory Activities provides guidance for supervisors both in the off-site and in the on-site analysis, on the evaluation of risk management and organizational safeguards with respect to each main risk type. Guidance on operational, concentrations, country/transfer, and credit risk is deficient in areas that are fully addressed in the relevant CPs.
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral

	<p>part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.</p>
Description and findings re EC12	<p>By means of both off and on-site supervision, BI makes sure that banks have established appropriate contingency plans, in order to preserve an adequate level of capital and liquidity even in stressed conditions.</p> <p>With respect to capital contingency plans, BI is currently working on the definition of the recovery and resolution plans for Unicredit Group, which is the only Italian G-SIB. The correspondent crisis management group has already been established.</p> <p>With respect to liquidity, the contingency funding plan must be approved by the strategic supervisory board and the underlying procedures must be verified and updated on a regular basis, also in the light of the stress testing results. The plan must: (i) identify all the relevant liquidity risk factors, both systemic and idiosyncratic; (ii) define roles and responsibilities of the bank's bodies and functions in case of emergency; (iii) include back-testing liquidity estimates; (iv) allow for interaction mechanisms between the banking group's legal entities, especially in case of constraints to the transfer of funds; (v) define an effective reporting flow, especially when the results of the stress test indicate an exposure close or above the liquidity risk tolerance threshold.</p>
EC13	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> (a) promotes risk identification and control, on a bank-wide basis (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process.</p>
Description and findings re EC13	<p>Banks are required to conduct stress testing of their risk mitigation and control systems and, where necessary, the adequacy of their internal capital, currently and prospectively, in order to enhance the assessment of their risk exposure; through stress testing banks must evaluate their vulnerability in case of severe and exceptional but plausible events. The BI reviews and provides scenarios for banks to conduct stress tests. The strategic supervisory board defines and approves the overall ICAAP process, which includes stress testing of capital and risk exposures. The management body defines the risk management process and establishes</p>

	<p>operational limits to the various risk exposures taking into account, among other things, the results of the stress tests.</p> <p>The principle of proportionality applies to the type and nature of the stress tests adopted. In order to facilitate the implementation of the principle of proportionality, banks are divided into three classes that, in general, identify banks of differing scale and operational complexity.</p> <p>Stress testing enables banks to: (i) use “what-if” analysis to assess risk exposures under adverse circumstances; (ii) determine the internal capital needed to cover such exposures or identify other actions to be taken to reduce or mitigate the risk; (iii) verify the results and accuracy of risk assessment models. Banks perform stress tests consistent to each risk factor material to their operations and they take account of the relative costs and benefits of constructing especially detailed and complex scenarios in which there are numerous correlation effects among risk factors.</p> <p>In designing and implementing stress testing on liquidity risks the regulation clearly states that banks must refer to the hypothesis provided by the “Principle for sound liquidity risk management and supervision” issued by the Basel Committee in 2008. Among other requirements, it’s clearly stated that different scenarios must reflect the interconnections and dependences between liquidity risk and other risk categories and possible events of contagion.</p> <p>For banks that implement model-based risk measurement systems to calculate capital requirements, regulations require banks to have in place a rigorous and comprehensive stress-testing program. The results of the tests must be communicated to the board and the management body and reflected in the policies and exposure limits set by the competent governing bodies. In addition, if stress testing reveals vulnerability to a given set of circumstances, the bank shall adopt appropriate measures to adequately manage those risks. Banks provide a description of the methods used to establish test stress scenarios and the outcomes obtained to the BI.</p> <p>Specific guidance on internal model validation, and the activity performed by the BI to check compliance with stress test requirements, can be found also in the Guide to Supervisory Activities. In the Guide are given some examples of action that banks should activate (apart from increasing the level of capital) on the basis of the stress test results (modify the limits to certain categories of risks; change or reduce the involvement in certain business). BI assesses the adequacy of risk-specific stress testing within the overall review of the ICAAP process as well as through other in-depth analysis (periodic monitoring of liquidity and interest rate risk exposures).</p> <p>The BI requires corrective action if material deficiencies are identified in a bank’s stress testing program or if the results of stress tests are not adequately taken into consideration in the bank’s decision-making process.</p>
<p>EC14</p>	<p>The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.</p>
<p>Description and findings re EC14</p>	<p>BI requires banks to establish a system of internal transfer pricing of funds, integrated into their internal governance; taking into account the level of liquidity risk tolerance set by the strategic supervisory board, as well as other liquidity risk management and mitigation tools.</p> <p>For new product approval, the market risk management function is responsible for both the validation of the new product pricing models and of the periodic estimation of the parameters underlying the model (correlations, volatilities). In addition, the new product</p>

	procedures should define the interaction mechanisms among the bank's functions involved in the introduction of new products, markets or activities, ensuring a correct management of risks, an accurate accounting representation and price adequacy.
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	As mentioned under EC5, in the ICAAP banks must consider all relevant risks they incur in their activity, including risks not subject to specific capital requirements or risks not easily measurable through quantitative tools (Circ. 263–Tit. III, Ch. 1, Section 1, §1). The supervisory instructions explicitly include reputational and strategic risks among the risks to be assessed—at least in qualitative terms—in the ICAAP process. The Guide to supervisory activities includes both strategic and reputational risks among risks to be evaluated and assessed by the supervisor; scores attributed to those risks contributes to the overall score of the bank.
Assessment of Principle 15	Largely Compliant
Comments	<p>The BI has set in place an extensive risk management regulatory and supervisory compendium of requirements. The guidance is principles-based and lacks detail in certain areas required for CP compliance. There are deficiencies in risk management guidelines for operational, credit, country/transfer and concentrations risk. These deficiencies are fully discussed in those CPs.</p> <p>The guidance issued on new products and involvement in new complex services is comprehensive but does not establish a risk/significance threshold or guidance that when met requires direct Board approval for implementation.</p>
Principle 16	Capital adequacy. ⁴⁸ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and	Articles 53 and 67 of the 1993 BL make it clear that banks need to meet minimum capital

⁴⁸ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

findings re EC1	<p>requirements. BI is responsible for issuing regulations on capital adequacy and limitation or risks (see CP 1 and 2). The main regulatory source for the definition of capital and capital requirements, besides the BL, is Circular 263. It is applicable to all banks and banking groups, defines the components of capital and the calculation of requirements. Breaches of the regulatory minimum (and target and trigger Pillar 2 ratios) trigger supervisory actions as explained in CP 11.</p> <p>Definition of capital and capital requirements used in the regulation is consistent with EU Directives, which transposed Basel II and II.5 frameworks in the European Union (see details in EC 2). More specifically, the supervisory instructions require at least 50 percent of Tier 1 to be represented by ordinary shares (Core Tier 1). Since December 31, 2010, preferred shares have been disqualified from Core Tier 1. Until December 31, 2010, the threshold for participation of hybrid instruments in Tier 1 used to be 20 percent (with a sublimit of 15 percent for innovative instruments) instead of 50 percent as allowed by the European framework (until the end of 2006 the threshold was set at 15 percent, including both innovative and non innovative instruments. CRD II set the limit for innovative tier 1 at 15 percent at 35 percent for non innovative and at 50 percent only for instruments that convert into common shares in case the 8 percent ratio is breached and restricted the use of stricter limits by member countries).</p> <p>The loss absorption of capital seems to be higher than the current European framework (CRD II and CEBS/EBA Guidelines), but still allowing that the largest part of capital to be composed of instruments other than common shares. In practice the use of tier 2 and tier 3 and of non-common equity elements in Tier 1 is relatively small in most banks. The definition of capital will be enhanced with the planned implementation of Basel III, where a minimum level of common equity capital will start to be required.</p> <p>According to Circular 263 and Circular 155 Banks calculate quarterly the level of own funds and transmit to the BI detailed reports providing an analytical indication of the different on- and off-balance-sheet components determining the risk profile of banks and banking groups. Parent companies of banking groups transmit consolidated reports on the same profiles on a quarterly basis (Circular 263, Title I, Chapter 2 and Circular 155).</p>
EC2	At least for internationally active banks, ⁴⁹ the definition of capital, the risk coverage, the method of calculation, and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings re EC2	<p>The regulatory framework applies the same definition of capital, risk coverage, calculation and thresholds for internationally and non-internationally active banks. These are derived from the transposition of Basel II and II.5 into the European framework, as transposed into Italian legislation (see EC 1).</p> <p>Capital is composed by the sum of Tier 1 Capital and Tier 2 Capital. Tier 2 Capital is limited to 100 percent of the Tier 1 Capital. Tier 3 Capital can be used to cover up to 71, 4 percent of market risk capital requirements (net of capital requirements on counterparty risk and settlement risk related to the supervisory trading book).</p>

⁴⁹ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

	<p>Tier 1 Capital is composed by: (1) paid-up share capital; (2) reserves; (3) innovative and non innovative capital instruments (up to 50 percent of Tier 1 Capital, with 2 sub limits: 15 percent for innovative instruments; 35 percent for non innovative ones, which do not convert automatically into capital in case of breach of the total capital ratio); (4) net income for the period; (5) positive Tier 1 capital prudential filters. The following negative components are deducted: (1) own shares; (2) goodwill; (3) intangible assets; (4) credits' value adjustments; (5) losses carried forward and losses for the current financial year; (6) supervisory adjustments on fair valued activities; (7) negative Tier 1 capital prudential filters.</p> <p>Tier 2 Capital is composed by: (1) valuation reserves;⁵⁰ (2) innovative and non innovative capital instruments not eligible for inclusion in Tier 1 capital (because exceed limits); (3) hybrid capital instruments and subordinated liabilities (the latter up to 50 percent of Tier 1 capital); (4) net gains on participating interests; (5) any total net value adjustments in excess of expected losses; (6) positive Tier 2 capital prudential filters.</p> <p>Deductions in Tier 2 are: (1) net losses on participating interests; (2) negative Tier 2 capital prudential filters. Tier 3 capital is composed by subordinated debt exceeding the limits for inclusion in Tier 2 and 3rd level subordinated debt meeting the conditions provided for article 14, par. 2 of directive 2006/49/EC (see EC 1). Prudential filters applicable under the Italian regulatory framework are available-for-sale financial assets; property; forward purchase commitments in respect of banks' own capital instruments; sale of property used mainly for functional purposes; fair value option for changes in banks' own creditworthiness.</p> <p>The following items are deducted 50 percent from Tier 1 and 50 percent from Tier 2:</p> <p>(a) Participating interests in banks, financial companies, electronic money institutions and payment institutions exceeding 10 percent of the share capital of the investee entity and innovative and non innovative capital instruments, hybrid capital instruments and subordinated assets (both of second and third level) issued by those entities regardless of the allocation portfolio; (b) participating interests in insurance companies, as well as the subordinated assets issued by such companies, if considered by the issuer for capital purposes; (c) participating interests of registered securities in excess of 20,000 shares in SICAVs; (d) participating interests in banks, financial companies, electronic money institutions and payment institutions that do not exceed 10 percent of the capital of the investee entity, innovative and non innovative capital instruments, hybrid capital instruments and subordinated assets (both of second and third level), other than those referred to in point (a) above, towards banks, financial companies, electronic money institutions and payment institutions even where the bank has no participating interest in the entity and regardless of the allocation portfolio. The portion of the sum of such interests exceeding 10 percent of the value of Tier 1 and Tier 2 capital shall be deducted; (e) securitization positions; (f) the holding in the capital of the BI; (g) exposures linked to the settlement risk on non DVP (delivery versus payment) transactions.</p> <p>Other deductions for banks authorized to use IRB approaches to calculate the capital requirement for credit and counterparty risk: (i) expected losses in excess of total net value adjustments; (ii) expected losses deriving from capital instruments and from collective investment schemes having as underlying capital instruments or other instruments with the same treatment;</p> <p>Circular 263 establishes that banks and banking groups must hold supervisory capital that is</p>
--	---

⁵⁰ Revaluation gains are included up to 50 percent of their value in the Tier 2. Revaluation reserves deriving from specific revaluation laws (Leggi speciali di rivalutazione) are fully included in the Tier 2.

	<p>at all times more than or equal to the total capital requirement. Total requirement is the sum of the capital requirements for credit, counterparty, market and operational risk, as well as those for holdings and real estate acquired in debt collection. Ratio between the supervisory capital and the risk weighted assets is set at 8 percent. However, The CRD allows Member States not to apply minimum own funds requirements on a solo basis to banks belonging to banking groups that fulfill own funds requirements on a consolidated basis. Italy imposes solo requirements, but for banks in a banking group these can be reduced by 25 percent, if the consolidated group is not below 8 percent on a consolidated basis.</p> <p>On capital charges, see EC 3.</p>
EC3	<p>The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions)⁵¹ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.</p>
Description and findings re EC3	<p>According to Circular 263, Title III, Chapter 1, Section III, par. 5, the BI has the power, inter alia, to require banks (on both a solo and a consolidated basis) to hold own funds in excess of the capital requirements needed to cover credit, counterparty, market and operational risks. In order to reduce the risk exposures; the BI has also the power to impose measures to limit the risk incurred by banks and to restrict the business or the network of branches and subsidiaries (BL article 53).</p> <p>The excess capital (pillar 2 add-on) to be held has to be determined having regard to the risk categories listed in annex A of Circular 263, Title III, Chapter 1. These include, among others, the residual risk (the risk that recognised credit risk mitigation (CRM) techniques used by banks prove less effective than expected) and the securitisation risk (the risk that the economic substance of the transaction is not fully reflected in the risk assessment and management decisions), concentration, interest risk in the banking book, strategic risk, etc. BI can include other categories in annex A also on a case by case base.</p> <p>In particular, the BI has the power to impose to banks specific capital requirements or target ratios if the SREP shows weaknesses in capital adequacy or risk management. In the last few years, banks have been required to achieve (target ratio) or maintain (trigger ratio) a minimum level of capital defined according to various parameters such as the overall capital adequacy as well as the systemic relevance and the possible capital shortfall identified as a result of EBA stress tests. Banks which have a target ratio have to submit to BI a capital plan with the actions to satisfy the supervisory requirement in a given time horizon. Banks required to achieve a trigger ratio are required to continuously monitor their capital position, promptly putting in place remedial actions in case of the ratio is close to diverging from the identified floor.</p> <p>The current regulatory framework has both standardized and advanced approaches for credit, market, and operational risk, counterparty risk, securitization, and credit risk mitigation. The various approaches are available to different types of institutions, considering their size, sophistication, and systemic importance (see EC 4). The framework covers both on and off balance sheet exposures.</p>

⁵¹ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks ⁵² in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	<p>Circular 263, Title III, Chapter 1, establishes that the frequency and the intensity of the supervisory review and evaluation process to assess the capital adequacy of banks take into account the systemic relevance and complexity of banks. In that sense, BI has divided banks and banking groups in three classes, based on their dimension and complexity.</p> <p>Class 1 is composed of banking groups and banks authorized to use IRB systems to calculate capital requirements for credit risk or Advanced Measurement Approaches (AMAs) to calculate capital requirements for operational risk, or internal models for quantifying capital requirements for market risks. Class 2 is composed of banking groups and banks that use standardized methodologies with, respectively, consolidated or individual assets greater than EUR 3.5 billion. Class 3 is composed of banking groups and banks that use standardized methodologies with, respectively, consolidated or individual assets equal to or less than EUR 3.5 billion.</p> <p>For each class, the BI has set specific criteria for calculating internal capital:</p> <p>Class 3 banks are required to use the Standardized Approach for credit and market risks and the Basic Indicator Approach or Standardized Approach for operational risk. For risks not covered under Pillar 1, banks may measure concentration risk and interest rate risk in the banking book using a simplified algorithm set out in Supervisory regulation and may refer to the supervisory guidelines with regard to liquidity risk.</p> <p>Class 2 banks, as Class 3 banks, may use the less advanced methodologies for calculating supervisory capital requirements for Pillar 1 risks. Depending on their operational complexity and strategic focus, these banks should assess the possibility of adopting more advanced internal Pillar 1 risk measurement methodologies, with a view to possible future recognition of such advanced methods for calculating supervisory capital requirements. Similarly, with regard to concentration, interest rate and liquidity risks, Class 2 banks are expected to assess the possibility of refining the simplified methodologies set out in supervisory instructions.</p> <p>Class 1 banks are required to establish the most appropriate measurement methodologies for calculating the internal capital for each material risk to which they are exposed. BI expects that banks in this class develop statistical models for calculating VaR or other measurements of maximum potential loss. With regard to other difficult-to-measure risks, banks in this class must establish adequate control and mitigation systems and assess the possibility of developing methodologies, including experimental approaches to be refined over time, for assessing their exposure to such risks.</p> <p>The regulatory level of capital is not higher than the minimum Basel requirement, but banks' capital adequacy is verified with reference to both regulatory capital and internal capital, taking into account the composition and the level of own funds. As mentioned in EC 3, the BI</p>

⁵² In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	<p>has the power to require banks (on both a solo and a consolidated basis) to hold own funds in excess of the capital requirements in order to meet the capital needs. Trigger ratios are also set above the Basel minimum capital.</p> <p>So far there is no specific higher capital requirements linked to the systemically relevance of the bank. In practice the 5 largest Italian banks participated in the 2011 EBA capital exercise, which required a 9 percent Core Tier 1 ratio by end 2012 (one bank did not meet the target ratio). In addition, the assessment of capital adequacy under SREP considers the systemic importance of the banks. The Basel G-SIB framework is scheduled to be in force starting in 2016. Italy only has one G-SIB according to the latest FSB public report, which has currently met with EBA capital exercise and would be above the additional loss absorbency foreseen for G-SIBs in the lower bucket.</p> <p>The analysis on the capital adequacy is completed providing information on the common equity tier 1 and the total exposure in order to calculate the leverage ratio. Italy participates in the BCBS observation exercise of the leverage ratio under Basel III.</p>
EC5	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <ul style="list-style-type: none"> (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	<p>According to Circular 263, Title I, Chapter 1, Part V, the use of banks' internal assessments of risk as inputs to the calculation of regulatory capital has to be approved by the BI. Qualitative and quantitative requirements (specified for each risk categories) must be met (Circular 263, Title II, Chapters 1, Part II (IRB); 3 (Counterparty Credit Risk); 4, part III (Market risk); 5 (Op Risk). Circular 269, Part II, Section III indicates criteria and procedure, differentiated for each risk category, for the validation and the assessment of internal risk measurement models. It also indicates expected firm practices related to such models. These expected practices are published on the BI's web site.</p> <p>The BI may impose additional conditions with reference to some aspects of the process or model not perfectly coherent with the complexity and the risk profile of the bank. The BI verifies on a continuous basis the compliance of the internal processes and models with the requirements provided for by the supervisory instructions. Circular 269 indicate the procedures for the monitoring procedure. Material modifications of the bank's processes and models for producing internal assessments are subject to the approval of the BI. In addition, banks have to provide the BI with any relevant information on the impact on the internal processes and models of external factors such as mergers, restructurings, regulatory changes. If banks no longer comply with the requirements, BI may revoke the approval.</p>

	<p>There are currently 5 banks authorized to use internal models for market risk, 7 banks authorized to use IRB, 6 authorized to use AMA. The authorization to use advanced approaches may take a long time in Italy. Banks which experienced validation by Italian and foreign supervisors indicate the process is detailed, throughout, and technically deep. The validation involves a "pre-authorization" phase and continuous contact with offsite and on-site supervisors. The usual steps involve (i) preliminary contacts; to assess the banks preparedness; (ii) Submission of the application and verification of the documentation completeness; the submission of the application triggers the formal stage of the recognition process, in which the internal system's compliance with the prudential requirements ("regulatory requirements") is evaluated (including information on databases and systems supporting them, on the logics followed to build and calibrate the models for the estimation of risk parameters, on the methods used to integrate the system into the corporate processes as well as on the control mechanisms of (and on) the internal system); (iii) verification of compliance with the requirements: off- and on-site assessments, the on-site verification following the formal application consists in the assessment of the progress of initiatives and actions required to fix the deficiencies identified in the preliminary stage; (iv) completing the examination and drawing the final proposal to the competent operational unit; at the conclusion of the activities, the Group responsible for the validation prepares a final report where: (a) it summarizes the results of the tests carried out; (b) it issues its opinion on the internal system's adequacy in relation to regulatory requirements; (c) it gives its final opinion on the application.⁵³ Based on that, BI will define specific capital and/or organizational measures; as conditions for authorization, as long as the overall validity and reliability of the internal system are not affected. These measures are generally a "floor" with respect to a reference base, and/or a capital "add-on."</p> <p>All domestic banks using internal models are subject to an overall specific floor on RWAs, established on a case by case base. These are beyond the current general transitional floor under Basel II, which is still in effect (the sum of capital requirements to cover credit, market, counterparty and operational risk, for banks authorized to adopt internal ratings based approaches for credit risk or advanced measurement approaches for operational risk, must be at least equal to the 80 percent of the capital requirements calculated under the Basel I framework).</p> <p>BI has the capacity to carry out such evaluations. The process involves coordination by senior officers with more than 10 years experience in risk analysis and bank supervision, quantitative analysts with experience and statistics-financial background, business analysts with an economics-financial background, and supervisors having cross-sectoral competence on risk analysis, financial statements, organizational processes and authorization procedures. The estimated amount of man-hours needed in 2013 for the validation of internal models is</p>
--	---

⁵³ The scale of the assessments is the following: Rating 1 corresponds to full compliance with regulatory requirements. It normally does not call for any organizational action. Rating 2 indicates situations of non-significant deviations: (a) which are deemed likely to be solved in a reasonable timeframe without requiring drastic actions or significant changes in the working plan; (b) whose extent the bank shows to have grasped and with regard to which the various functions involved clearly demonstrate to be aware of the actions needed to address them. Rating 3 indicates situations of non-compliance which (i) while not serious, nevertheless require significant actions or (ii) are joined to a limited awareness of deficiencies. Rating 4 corresponds to partial or full non-compliance with regulatory requirements, serious enough not to allow the recognition of the internal system, even if just a single area of examination is concerned (there are three examination areas: quantitative standard, qualitative standard, EDP systems). In such a case, the bank should face and solve the specific problems that hinder recognition before a new application is submitted.

	roughly 3,400, corresponding to about 17 full-time equivalent staff members. Overall, these activities involve about 50 officers of the Banking Groups Supervision Department, 11 of whom belong to the Risk Analysis Support Division (seven staff members are busy for at least 75 percent of their working time with validation activities and other related support activities).
EC6	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).⁵⁴ The supervisor has the power to require banks:</p> <p>(a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and</p> <p>(b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.</p>
Description and findings re EC6	<p>Banks have to carry out stress tests in order to assess their vulnerability to exceptional events. Depending on the size and the complexity of banks, they have to carry out sensitivity analysis to assess the effects of specific events or scenario analysis. Circular 263 states in the ICAAP process that stress tests carried out by banks must comply with the principle of proportionality, i.e. they shall be proportionate to the nature, scale and complexity of the business conducted by the bank (in practice banks are divided in the three classes described above). The BI has the power to assess whether the internal capital requirements in stress conditions set by banks are reliable and, if the case, set different capital levels according to supervisory stress tests carried out by the supervisor itself.</p> <p>Furthermore, the BI has the power to assess the modalities through which the bank has taken into account the stress tests' results and the reasons provided to justify the undertaken or programmed actions (e.g., changes in internal risk assessment processes and models, reinforcement of risks' mitigation and control systems, restriction or limitation of the business, risks' exposure reduction, increase of the own funds' level).</p> <p>In practice, the use of stress tests to assess internal capital adequacy is expected (and supervised) in banks using advanced approaches for capital adequacy.</p>
AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	See EC 2. Regulations do not distinguish between internationally and non-internationally active banks
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁵⁵
Description and findings re AC2	According to Circular 263, Title I, Chapter 1, Part II, each bank belonging to a banking group has to comply with prudential regulation regarding own funds and capital requirements. The CRD allows Member States not to apply minimum own funds requirements on a solo basis to banks belonging to banking groups that fulfil own funds requirements on a consolidated

⁵⁴ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

⁵⁵ Please refer to Principle 12, Essential Criterion 7.

	basis. Italy imposes solo requirements, but for banks in a banking group these can be reduced in 25 percent, if the consolidated group is not below 8 percent on a consolidated basis. This allocation of capital within a group is not necessarily dependent on the risk allocation assessment of the entity, although the parent company is responsible to ensure an appropriate capital allocation among the group entities.
Assessment of Principle 16	Compliant
Comments	<p>Financial leverage, measured as the ratio of total balance sheet assets to tier 1 capital, is lower for Italian intermediaries in comparison to foreign financial systems: 18 as against a European average of 24 at the end of 2011 (Financial Stability Report, nr. 4 Nov. 2012, page 39). The loss absorption of capital seems to be higher than in the general European framework, but still allowing that a large part of capital to be composed of instruments other than common shares. In practice the use of tier 2 and tier 3 and of non-common equity elements in Tier 1 is relatively small in most banks. The definition of capital will be enhanced with the planned implementation of Basel III, where a minimum level of common equity capital will start to be required. The timeline of the implementation of Basel III depends on the EU legislative proceedings. At the time of this assessment, draft CRD IV was scheduled to be discussed by EU legislators in April 2013. Transposition into national legislation and application of new regulations usually involve several months.</p> <p>The BI has the capacity to impose additional capital requirements, on an individual basis, and assessors were presented ample evidence both in supervisory reports and from the industry that BI is actively using this power. All banks using advanced approaches have individual capital floors, several banks have add-ons imposed due to managerial or model deficiencies. There are also cases where the BI imposed Pillar 1 adjustments requiring higher weighting to be applied to some types of loans, reverting capital relief related to credit risk mitigation techniques due to weaknesses in the data management, IT systems and controls, imposed Pillar 2 capital add-on residual risk (poor effectiveness of CRM techniques). The add-on and floors are considered to define trigger and target ratios.</p>
Principle 17	Credit risk. ⁵⁶ The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁵⁷ (including counterparty credit risk) ⁵⁸ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and

⁵⁶ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵⁷ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁵⁸ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	<p>Circular 229 requires banks to implement appropriate governance arrangements and mechanisms for the management and control of their risk profiles.</p> <p>On credit risk:</p> <p>(1) The Board is required to define the bank's risk appetite and risk profile, and establish credit risk management and controls policies. (2) Senior management has to establish methods and procedures for measuring and monitoring credit risk in accordance with lending policies, subject to the prior approval of the Board of directors. (3) Risk management functions are required to monitor compliance with the risk policies set out by the Board, the operating limits set out for each type of risk, including the bank and group-wide credit risk. (4) Internal Audit is required to assess the consistency of business lines with the risk appetite set out by the Board.</p> <p>The BI assesses the effectiveness of internal control systems and processes for credit risk control within the SREP. The BI assesses, mainly for the largest and systemically important banks, the consistency of their credit policies and risk management processes with the characteristics, size and complexity, and in light of the market and macroeconomic perspective.</p> <p>Furthermore, the BI assesses the effectiveness of credit procedures in assuring sound practices concerning the full credit cycle. The assessment of the risk management encompasses the credit granting processes and the procedures used by banks to classify the risk level of customers, including the credit scoring and rating systems, as well as their consistency with the risk appetite set out by the Board.</p> <p>For IRB banks, the BI verifies that such measures are used in their own lending activity, including origination, monitoring and risk quantification and that they result in prudent credit risk quantification.</p> <p>The BI verifies that risk management monitors lending taking into account external economic factors and that impaired credits are properly identified.</p>
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, ⁵⁹ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC2	<p>Circular 229 requires the Board to approve lending guidelines and policies. BI guidelines require that origination, credit-granting, monitoring of positions, revision of credit lines, and actions on non-performing loans be governed by internal rules that are periodically reviewed.</p> <p>The BI determines that the Board approves and regularly reviews strategic guidelines and policies of risk management, with a view to ensuring that roles and responsibilities are properly allocated and taking the internal distribution of the decision powers into proper</p>

⁵⁹ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<p>consideration. Senior management must implement the credit guidelines and policies set out by the Board and define the credit risk measurement methodologies and monitoring tools. Where the Board approves new business lines and/or new products or markets, the senior management is required to update the credit risk procedures, consistent with the credit risk profile of any such new products and markets.</p> <p>At least annually, within the SREP, the BI assesses whether these regulatory requirements are complied with. The supervisory review also focuses on organizational issues and is aimed at assessing whether the Board ensures the consistency of the internal control system with the credit risk strategy and profile, as well as regularly overseeing the functionality, efficiency and effectiveness of the risk management process and control system.</p> <p>Furthermore, the BI assesses whether and how the senior management has implemented the credit risk strategy set out by the Board, with specific reference to the overall framework of the bank's internal control system, and the effectiveness of the reporting flow of information to properly inform the top management and governing bodies' comprehensive assessment of the bank's credit risk profile (Circular 269).</p> <p>During on-site examinations, the BI's staff assesses the actual effectiveness of the organization and risk governance, with respect to all the phases of the lending process and evaluates its effective integration within the bank's corporate decision-making process (Circular 269).</p>
EC3	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> (a) a well documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and (g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.

Description and findings re EC3	<p>BI requires banks to develop internal procedures to assess and monitor their credit risk profiles to comply with lending policies approved by the Board of Directors.</p> <p>Circular 229 requires banks to adopt and implement adequate documented policies and procedures for credit risk. In more general terms, the whole process of credit and counterparty risk management must be documented within banks' internal regulations:</p> <ul style="list-style-type: none"> • Credit risk policies are set out by the Board and are consistent with the economic framework, as well as the size and operational characteristics of the bank; • Any credit application is properly documented and includes data and information that the bank has received from borrowers; to this end, banks must analyse and assess a complete set of information related to the borrowers, i.e., both quantitative information (financial statements, assets and income capacity, guarantees) and qualitative (project reliability, business plan, reviews of market and economic sectors reviews) information; • Banks' internal procedures must provide for information on borrower's creditworthiness (e.g., credit scoring, rating); • Bank's decision-making process for credit risk must be objective and documented. To this end, proper organizational segregation must be ensured between those units that are responsible for credit proposals and those responsible for the relevant granting decision. <p>The BI assesses: (i) whether the decision-making complies with both regulatory requirements and internal rules; (ii) whether the entire process is well documented; (iii) the overall soundness of the process for credit granting (e.g., by verifying both the above mentioned organizational separation and the ability of the bank to track internally the relevant decision).</p> <p>As regards the use of external ratings, the new regulation on internal control systems states that external ratings represent only one of the tools used by banks to assess the creditworthiness of borrowers. Therefore, banks must implement their own internal methodologies to assess the credit risk arising from exposures to borrowers, financial transactions, and securitizations. These tools must not rely automatically on the assessments provided by External Credit Assessment Institutions (ECAIs), given that the internal credit assessment faced by the banks might differ from external ratings.</p> <p>The BI analyses the internal rules and procedures concerning decision powers (usually based on the size or risk level of exposures), and assesses the consistency of credit granting policies with the economic area where the bank operates, and both its size and operational characteristics. During on-site examinations, inspectors review whether credit granting procedures are adequately documented and credit procedures include all the information available to the intermediary on borrowers. In particular, the inspector assesses the information supporting the credit decision: i) to assess compliance with the internal policies and suggest any necessary corrective measures; ii) where applications might either raise any potential conflicts of interest, or lead to risky and more complex credit operations (e.g., leveraged finance, project finances), complies with the existing safeguards.</p> <p>As regard the existing tools supporting the evaluation of borrower's creditworthiness, the inspector assesses the comprehensiveness of available data and information (e.g., reclassification of individual and consolidated data, estimation of future cash flows), having regard to the size and complexity of credit exposures.</p> <p>The BI requires banks to perform internal controls for credit risk on an on-going basis (e.g., by verifying whether banks periodically reviews the credit positions, and the relevant underlying documentation) and implement effective procedures to allow for early detection of any difficulties by the borrowers to repay its debt. The BI assesses the effectiveness of such on-going credit risk controls, by assessing available procedures and tools used by banks to</p>
---------------------------------	---

	<p>classify the risk level of all borrowers (credit scoring, rating systems).</p> <p>The BI also assesses whether banks' IT management systems allow banks to monitor on an on-going basis available collateral or any other type of credit risk mitigation techniques. For specific types of transactions (such as, for example, syndicated loans and specialized lending) the BI establishes the soundness of the credit procedures by controlling and monitoring covenants, and assessing contractual waivers (Circular 269).</p> <p>Banks must set up dedicated units that are responsible for risk monitoring that must be separate from those that are responsible for the granting decision; the internal rules on monitoring must also identify the necessary corrective measures depending on the level of creditworthiness.</p> <p>During on-site examinations, inspectors assess the banks' capacity to ascertain at an early stage the borrowers' difficulties; to this end, it verifies both the effectiveness and reliability of available controlling tools. With regard to syndicated loans, project financing and other structured credit operations, inspectors review banks' internal process for monitoring existing covenants.</p> <p>The BI verifies the ability of the information system to provide adequate reporting flow of information to the top management and governing bodies. In addition, the BI assesses whether adequate statistics on bad and non-performing loans—that are defined according to specific provisions for loan classification set out by the BI.</p> <p>The BI verifies whether the decision powers and the relevant set of operational limits are implemented and formalized accordingly to the credit risk strategy, and that those delegated powers are consistent with the bank's size and operational characteristics. Moreover, the BI assesses whether banks have adequate internal reporting systems for the top management and governing bodies.</p> <p>During on-site examinations, the BI staff analyses the behavioural tools used to monitor and report the firm-wide risk profile and reviews the effectiveness of any such procedures to promptly detect any deterioration of the borrowers' creditworthiness and report to the appropriate senior level within banks.</p> <p>Compliance with all the above requirements is assessed by the BI within the SRP and especially through on-site examinations. Its assessment of banks' internal process for credit-granting, loan management, and control of credit risk represents a key part of the broader organizational analysis, which is performed by using all the information gathered during meetings with corporate officers. In addition, on-site examinations allow effective verification of the adequacy of both the structures and procedures supporting this internal process.</p>
EC4	<p>The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.</p>
Description and findings re EC4	<p>BI assesses whether banks have information systems (made up of one or more registers provided that they can be easily integrated) that provide a unique identification of all the borrowers of the parent company and the different group entities in order to properly detect, at a consolidated level, banks' overall credit risk exposures, irrespective of the main risk underpinning such exposure.</p> <p>Banks make use of the BI credit registry to monitor the borrower's debt in the financial system. There are also privately run credit bureaus that provide this information.</p> <p>Where relevant, the BI verifies whether the bank is aware of any material impact arising from</p>

	adverse exchange rate movements on borrowers' debt servicing capacity for loans or credits denominated in foreign currencies (Circular 269).
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	<p>The regulations do not specifically require that loans be made at arms' length and on market terms, the regulations do require that loan pricing reflect the credit quality of the borrower.</p> <p>The civil code requires that directors inform the other members on interest held in each banking operation, detailing nature, terms, origin and extent.</p> <p>Banks are also required to define internal procedures to prevent persons benefiting from any transaction from being part of the process of granting and managing that transaction (Banking Law—art. 136).</p> <p>According to the rules on corporate governance issued by the BI, banks are required to develop internal rules for managing potential sources of conflicts of interest (transaction with related parties, obligations of corporate officers). In addition, large and complex banks must set up dedicated committees to avoid any such conflicts.</p>
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	<p>There is no specific regulation requiring that large exposures be decided by the bank's Board or by senior management.</p> <p>The BI evaluates the consistency between delegated powers and the bank's size and operational characteristics, and verifies whether the decision powers and the operational limits are implemented and formalized according to the credit risk strategy and policies (Circular 269).</p>
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	According to the BL (article 51, 66), banks are required to provide the BI with periodic data and reports, both at the solo and consolidated levels, and any other necessary information for supervisory purposes. Pursuant to articles 54, and 68 BI may conduct on-site examinations, at the individual and group level, and ask for the necessary documentation for carrying out its supervision tasks.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	Stress testing minimum requirements for banks that use internal models within the Pillar I framework, and for all banks according to the Pillar II regulatory framework are in place. The results of stress tests are also examined within the supervisory review process (Pillar II), according to the principle of proportionality, and they include the banks' credit risk exposure. The BI performs periodically its supervisory stress testing program, which consists in both the top-down and bottom-up exercises (with the latter being the EU-wide stress test coordinated by the EBA) that takes all relevant risks, mainly credit risk, into proper consideration.
Assessment of Principle 17	Largely Compliant

Comment	There is no requirement that large or high risk exposures be approved by the Board nor is there a requirement that lending transactions be on market terms (arm's length).
Principle 18	Problem assets, provisions and reserves. ⁶⁰ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁶¹
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>Circular 229 requires banks to formulate policies and establish processes on the overall credit process—including loan extensions, monitoring and valuation—and to perform regular reviews of credit positions. In particular, the criteria to follow for non-performing loan identification, valuation and management—as well as the units responsible for these tasks—must be established by Board resolution, which must also indicate the manner of reconciling such rules with those established by supervisory reports. Monitoring of the single exposures must be performed in a structured manner and effective and reliable procedures must be in place to identify deterioration that may arise and testing the adequacy of provisioning.</p> <p>Asset valuation rules are established by European regulation 1606/2002 on the application of international accounting standards and by the Legislative Decree 38/2005 regarding IAS/IFRS. For supervisory reporting purposes, additional rules on the classification of impaired financial assets, and more specifically of nonperforming loans, are set out in BI Circular n. 272.</p> <p>In particular, IAS 39, paragraph 58 requires an assessment of financial assets or group of financial assets at the end of each reporting period in order to identify impairments. In such cases, banks have to calculate the impairment loss. Balance sheet amounts are reported net of any impairment loss. BI requires this assessment to be performed at least on a semi-annual basis (Circular 272).</p> <p>The loss is considered as being “incurred” if there is objective evidence of impairment due to one or more events occurred after the initial recognition of the assets (IAS 39, paragraph 59). Expected losses linked to future events are not recognized.</p> <p>Indicators of impairment are: significant financial difficulty of the issuer or obligor, a breach of contract, any concession made by the lender to the obligor in financial difficulties that the lender would not otherwise consider bankruptcy or other financial reorganization of the borrower becomes probable, the disappearance of an active market for the financial asset because of financial difficulties.</p>
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the

⁶⁰ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁶¹ Reserves for the purposes of this Principle are “below the line” non-distributable appropriations of profit required by a supervisor in addition to provisions (“above the line” charges to profit).

	supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes.
Description and findings re EC2	<p>Through off-site analysis and on-site inspections, the BI reviews the bank's loan classification and provisioning practices. Circular 272 and Circular 139 require information on the classification and provisioning of assets. The BI continually assesses the reliability of banks' classifications, using supervisory statistics and CCR information.</p> <p>During onsite visits, inspectors examine files on a large sample of individual loans, including the riskiest ones. In particular, the loans are selected on the basis of judgmental criteria and/or by means of statistical sampling. The sample size is related to the risk exposure, the reliability of bank's data and quality of internal controls. The analysis aims to verify whether the bank's classification and valuation decisions comply with the legislative framework in force as well as internal regulation.</p> <p>As part of SREP, supervisors assess trends in measures and ratios related to problem assets and provisions, also through comparisons among banks with similar organizational and risk profiles. This analysis heavily leverages on detailed information provided by the CCR which are assembled by statistical tools.</p> <p>Reviews of bank classifications and valuations are also carried out by the independent auditors that audit the annual accounts.</p>
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁶²
Description and findings re EC3	Circular 272, requires banks to consider both on- and off-balance sheet exposures (cf. EC. 4) when defining the criteria that banks must follow for non-performing loans classification and valuation.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>The provisioning and write-offs of problem loans are required to be compliant with IFRS, which are implemented for all banks. Practices are influenced by fiscal and judicial considerations that result in a longer timeframe for loan workouts. With specific regard to write off practices, the BI provided a general principle according to which write-offs take place when there is an event which extinguishes partially or fully the loan. Such an event takes place also when the competent management formally acknowledges the impossibility to collect the loan or part of it, or ceases any action to continue the collection of amounts due.</p> <p>Through on-site examinations BI inspectors verify that policies and procedures on provisioning and write-offs are designed in such a way so as to encompass and to take into account all relevant factors. In analyzing the selected sample of individual loans, inspectors assess whether banks have appropriate policies and procedures to ensure that loan-loss provisions and write-offs reflect realistic repayment expectations. For each individual loan subject to analytic assessment, the bank must appraise: the reimbursement capacity of the debtors; the updated value of guarantees; the time horizon for reimbursement. Inspectors also focus on write-offs in order to evaluate the reasonableness of the management's</p>

⁶² It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	<p>valuation for these positions.</p> <p>The primary focus of BI supervision is to ensure that IAS 39 is correctly applied and that “incurred losses” as defined by accounting rules are recognized. Additionally, BI relies on the credit registry to highlight outliers in classification.</p>
EC5	<p>The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks’ treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).</p>
Description and findings re EC5	<p>According to Circular n. 263 an exposure is considered past due (default) after 90 days past due: this is consistent with Directive 2006/48. Payments in arrears for a minimum number of days (over 30) are considered a signal of delinquency, often requiring the classification in a watch-list. Consumer loans delinquent in excess of 150 days are classified as substandard and reported as nonperforming.</p> <p>Circular 269, establishes requirements for BI to test banks’ asset classification and provisioning standards during on-site inspections. Inspectors also estimate “modified bad debts”, i.e., loans the bank report as performing, which are classified as non-performing by a significant number of other intermediaries; inspectors may request banks to change the classification of one or more positions in order to better reflect the risk.</p> <p>In the off-site analysis supervisors use a set of statistical tools to identify any material circumvention of the classification and provisioning standards (e.g., adjusted bad loans or adjusted deteriorated loans, ratio of adjusted provisions to total deteriorated loans).</p> <p>Inspectors perform an analysis of the performing positions that are more vulnerable (e.g., negative economic results, cash flow reduction, financial leverage increase, etc) included in the bank’s watch-list and/or in the supporting procedure on credit risk analysis (i.e., “MARC,” which is a procedure able to support the BI inspectors in defining the sample of credit exposures to be examined; this procedure is based on the collection and the selection of information contained in internal and public databases, resulting in an overall evaluation of the credit exposure riskiness) in order to obtain information about the credit portfolio.</p>
EC6	<p>The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.</p>
Description and findings re EC6	<p>According to articles 51 and 66 of the BL, banks are required to provide BI any information required to perform its functions. The information may go beyond that submitted by banks on a regular basis.</p> <p>Moreover, according to Circular 155, (Instructions for preparing reports on regulatory capital and prudential ratios), specific information on nonperforming loans is requested in the “Note to Financial Statements” and for prudential purposes.</p> <p>During inspections, in analyzing the selected sample of individual loans, inspectors have full access to documentation to support classification and provisioning levels adopted by the bank and evaluate the adequacy of the said documentation.</p>

EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	<p>Inspectors assess the bank's internal asset classification and provisioning guidelines onsite. In case of credit deterioration the inspector assesses that the credit policy clearly defines the objectives to be pursued, the actions to be taken, the time necessary for their implementation. If the inspector finds that classifications are inaccurate or provisions are inadequate, adjustments are required. Assessors reviewed instances where the BI either through Pillar 2 add-ons or reclassification of the loan, required the bank to correct/offset inadequate provisions/classifications.</p> <p>More generally, in case of deficiencies in the credit process, BI may request a strengthening of the organizational structure and the procedures connected with every phase of this process. Where the problem is particularly serious, the supervisory action consists in requesting the bank to carry out a plan for organizational restructuring of the credit process.</p> <p>When the credit risk management process is judged inadequate, the BI, on a case by case basis, has set higher minimum capital requirements for individual banks and banking groups or applies higher risk weights to specific categories of assets.</p> <p>BI has adopted IFRS and does not interject prudential requirements such as; provisioning for expected losses.</p>
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	<p>Circular 229 requires banks to maintain a continually updated database supporting the value of collateral.</p> <p>Inspectors check compliance and assess that banks have in place appropriate mechanisms for regularly appraising the value of risk mitigants and guarantees; taking into account possible change in market conditions. To use Credit Risk Mitigation techniques for prudential purposes, banks have to comply with specific rules to assure an updated and reliable valuation of collateral and guarantees. In particular, the general requirements, which seek to ensure the legal certainty and effectiveness of guarantees, concern the binding nature of the legal commitment between the parties and its enforceability, documentation, the enforceability of the instrument in all relevant jurisdictions against third parties with regard to establishment and liquidation and the timeliness of liquidation in the event of breach. Banks must have adequate mechanisms to assess the fair value of collateral at least on a semi-annual basis.</p> <p>According to IAS 39, collateral is valued taking into account costs for obtaining and selling the collateral and therefore, the BI does not require banks to estimate a discounted or liquidation value for collateral when determining provisions. Given the declining value of real estate and the low volume of transactions on which to base current market value it is important for prudential factors that the BI consider the possible impact of underestimated loan losses due to real estate value estimates.</p>

EC9	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <p>(a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and</p> <p>(b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).</p>
Description and findings re EC9	<p>Circular 272 establishes the following</p> <p>(a) Bad (sofferenze) loans—On and off-balance sheet exposures to an insolvent counterparty (even if the insolvency is not legally ascertained) or in equivalent situations, regardless of any loss estimate made by the bank;</p> <p>(b) Substandard (incagli) loans—On and off-balance sheet exposures to a counterparty in a situation of difficulty, that is expected to be eliminated within a reasonable period of time. This category includes, but is not limited to, exposures on the basis of objective factors, such as consumer credit over 150 days delinquent;</p> <p>(c) Restructured loans—On and off-balance sheet exposures in which a pool of banks or an individual bank, upon granting a moratorium on loan repayment, renegotiates the loan at lower-than-market interest rates recording a loss;</p> <p>(d) Past due—On and off-balance sheet exposures that are not classified as bad debts, substandard loans or restructured loans that are past due for more than 90 days. To this aim, past due exposures can be determined according to the single counterparty or to the single transaction. In case the “single counterparty” approach is used, a materiality threshold is provided in order to ensure a classification coherent with the risk embedded in the exposure. BI requires banks to report all the above classification categories as nonperforming. Restructured loans can be reclassified after two years of performance.</p> <p>Although the categories of substandard and restructured may not seem appropriate to be included in NPL, in the case of Italy the approach by the BI is warranted. The loan classification, provisioning and write-off processes are highly influenced by judicial and fiscal considerations. Debtors’ rights are protected by the courts and collection may take years thus banks prefer to work with the borrower and avoid the courts where rulings normally favour the debtor. Tax benefits are granted only when the debtor has been declared insolvent, if the loan is written-off or provisioned before bankruptcy, the deferred tax credit is amortized over 18 years (some recent changes may improve this in the future). Loans classified as NPL continue to accrue interest given that the banks consider them recoverable based on historical collections and/or collateral. The age of NPLs in Italy can be high and although recovery rates are also high, it may take years to achieve recovery.</p> <p>Circular 139 establishes the criteria for doubtful assets to be reclassified (e.g., when the situation of insolvency or the equivalent situation ceases, when the loan has been reimbursed by the debtor or by a third party, etc.) During on-site inspections, the inspector verifies the correctness of the criteria adopted by the bank for identifying problem assets and for the reclassifications of nonperforming loans as performing loans and the compliance with the above mentioned regulatory framework.</p>
EC10	<p>The supervisor determines that the bank’s Board obtains timely and appropriate information on the condition of the bank’s asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum,</p>

	summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	Circular 229 requires that Directors be regularly informed of the situation of non-performing loans and procedures for recovery. During on-site examinations inspectors verify whether the bank's Board obtains timely and appropriate information on the condition of the loan portfolio, including classification of assets, the level of provisions and reserves and major problem assets. Furthermore, inspectors determine that the accuracy of reports verified by independent units (audit or others).
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	IAS 39 has to be applied. For significant financial assets, the assessment aimed to evaluate the impairment must be conducted on an individual level. In particular, banks shall first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If they determine that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, they include the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. The responsibility to identify significant exposures is up to the board and senior management and to the external auditing.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment
Description and findings re EC12	<p>During SREP the BI integrates micro and macro prudential issues, especially for systemically important banks. A Financial Risk Outlook (FRO, an internal document prepared by a task force of the Banking and Financial Supervision Area) identifies the main vulnerability factors for the Italian financial system. The document represents an input for the definition of the annual plan of inspections of the intermediaries, as well as possible horizontal reviews (aimed at common risk factors highlighted in the document). The findings of inspections on single intermediaries and horizontal reviews, in turn, feed back into the next FRO process, effectively integrating micro and macro perspective in the supervision action.</p> <p>Systemic dimensions of risks faced by banks are also assessed including risks related to problem assets. To this end, from a macroprudential perspective, BI periodically assesses the overall stability of the Italian financial sector with specific regard to risk build-up across the banking sector in relation to banks' problem assets, concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing losses. In particular, obligor-by-obligor information (drawn from both the Central Credit Register and the prudential reports) allows BI to compare the amount of provisions calculated by a bank on each single position with those calculated by all other banks on their exposures to the same obligor; in case of shortfalls in a bank's provisions with respect to those of its peers on the same names, the bank can then be invited to increase its provision accordingly or, alternatively, can be required to hold a commensurate capital add-on.</p>

	Moreover, a number of analyses on credit risk, including stress tests, are regularly performed off site, with a view to assess both the adequacy and soundness of banks' provision policies and their resilience with respect to a severe deterioration of the macroeconomic environment.
Assessment of Principle 18	Largely Compliant
Comments	<p>The loan classification, provisioning and write-off processes are required to be compliant with IAS 39 (Financial Instruments: Recognition and Measurement). Practices are also influenced by judicial and fiscal considerations. Debtors' rights are protected by the courts and collection may take years thus banks prefer to work with the borrower and avoid the courts where rulings normally favour the debtor. Tax deduction of losses is allowed when the debtor has been declared insolvent or, as a consequence of a recent amendment of the tax law, when loans are derecognised according to IAS 39, for IAS-adopter companies (write-off). If the loan is provisioned before bankruptcy, a deferred tax credit arises which is amortized over 18 years (some recent changes may improve this in the future). According to IAS 39 loans classified as NPL continue to include interest in the estimated future cash flow provided that the banks consider them recoverable based on historical collections (this is not the case for bad loans, the so-called "sofferenze"), the assessment of the exposure) and/or collateral. In addition, collateral is valued taking into account costs for obtaining and selling collateral. The age of NPLs in Italy can be high and although recovery rates are also high, it may take years to achieve recovery.</p> <p>According to IAS 39, collateral is valued taking into account costs for obtaining and selling the collateral and therefore, the BI does not require banks to estimate a discounted or liquidation value for collateral when determining provisions. Given the declining value of real estate and the low volume of transactions on which to base current market value estimates it is important for prudential reasons that the BI consider the possible impact of underestimated losses due to real estate value estimates.</p>
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. ⁶³
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁶⁴ Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and	The general regulation on risk management applies (Circ. 263—Tit. I, Ch. IV, Part 4. See CP 15). The requirements regarding concentration risk are contained in Circular 263, Title V,

⁶³ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

⁶⁴ This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

findings re EC1	<p>Chapter 1, which regulates the large exposures regime. It is focused on name concentration, which is considered a component of credit risk. Besides large exposures, concentration is also treated as part of the ICAAP review process (Circ. 263—Tit. III, Ch. 1) and in the Risk Assessment System (Circ. 269—Part I, Sec. III), specifically as part of the credit risk assessment (Circ. 269—Part I, Sec. III, Ch. IV) and market risk assessment (Circ. 269—Part I, Sec. III, Ch. V).</p> <p>For name concentration, the definition of exposure includes both on and off balance sheet exposures. Concentration is monitored both against limits for large exposures, and a measure of portfolio concentration based on a Herfindahl index. Management and monitoring of other sources of risk is not standardized, and is supervised on a case by case basis, following general guidelines, through on and off site supervision. Assessment of concentration is part of the annual SREP. The ICAAP review employs quantitative measures for name concentration and a qualitative assessment.</p>
EC2	<p>The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure⁶⁵ to single counterparties or groups of connected counterparties.</p>
Description and findings re EC2	<p>See EC1 for regulatory framework. There is no specific requirement for identification and aggregation of exposures creating risk concentration (such as on a same industry, economic sector or geographic region or in market and other risks when the bank is exposed to particular asset classes, products, collateral, or currencies). In practice, the analysis of concentration other than name risk is conducted by on and off site supervision on a case by case basis.</p> <p>There is sufficient information available to banks (and the BI) through the CCR, which identifies borrowers also by geographical location and industry. Analyses using this and other databases are frequently used by supervision to verify risk management of concentration.</p> <p>The regulation defines large risk any exposure above 10 percent of regulatory capital. In addition, banks are required to particularly monitor exposures representing 2 percent or more of their regulatory capital. IRB banks have to inform the largest 20 exposures regardless of their relative size to the capital.</p> <p>The exposure to be considered includes a borrower and its connected parties. The definition of connected parties for this regulation is wide: it includes not only parties among which a legal definition of control applies but also when persons or entities are so economically interconnected that financial difficulties of one of them, including funding, are likely to involve repayment difficulties for the other (the so called "economic" connection").</p> <p>Banks report their large exposures to the BI on a quarterly basis. Individual reports made by banks, including those belonging to banking groups, must make reference exclusively to their own exposures, while the parent entity of the banking group must report the overall exposures of the group on a consolidated basis.</p>
EC3	<p>The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile</p>

⁶⁵ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).

	and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	There is no specific requirement that risk concentrations must be regularly reviewed and reported to the Board, or specific risk management requirements for concentration risk. The general risk management and internal control regulation applies (see CP 14 and 15). The BI requires banks to establish formal risk management policies concerning all material risks and periodically review them. On credit risk, there are requirements (Circ. 269, Part 1, Section III, Chapter IV, Par. 5.2.) that banks define and implement formal policies approved by the competent internal body on lending standards, including operating limits, while those units responsible for risk control should set the methodologies and metrics for risk evaluation, "by assuring compliance with operating limits and consistently with the bank's credit policies and strategies." The supervision in practice included the verification of compliance with large exposures limits (see EC 6) under this chapter.
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	See EC 2. Banks are required to report quarterly the amount of their large exposures both at the solo and consolidated bases. Other prudential data submitted by banks cover portfolio allocation including the breakdown by economic sector, geographical area and currency. BI regularly uses the information to assess concentration in the SREP review of the banks ICAAP. Such tools also contribute to the Risk Assessment System (RAS) within the scoring algorithm for the credit profile, together with the assessment of compliance with the Large Exposure regulation. (Circ. 269, Part 1, Section III, Chapter IV, Par. 4.1(B)). Segmentation of bank's portfolio, including sectoral, geographical and currency exposures is analyzed during on site examinations. BI uses the information available to conduct analysis of the material risks in the banking sector, including by industry, economic sector or geographic region or in market and other risks when the bank is exposed to particular asset classes, products, collateral, or currencies. They are included in a non-public report on the risks of the banking sector which is submitted to the BI Directorate.
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	See EC 2. The Circ 263 defines "client" as a single person or "group of connected clients" vis-à-vis which the bank takes on risks, including banks, international organizations and states. A "group of connected clients" means two or more natural or legal persons that constitute a single risk because: a) one of them has got, directly or indirectly, the control over the other(s) ("legal connection"); b) or, independently of the control referred to in point a), the persons in question are so interconnected that the financial difficulties of one of them—in particular, funding or repayment difficulties—are likely to involve repayment difficulties for the other(s) ("economic connection"). Special rules are set with reference to the definition of the connected clients and the calculation of exposures in case of exposures towards "investment schemes"—such as SPV, investment funds and the like—that are interposed between the bank and the underlying assets. As a general rule, banks that assume exposures to investment schemes must know in

	<p>advance and monitor over time the identity of the underlying activities so that they may apply a look-through approach. Where banks are not able to apply the “full look-through” approach, stricter prudential approaches are applied.</p> <p>The BI may challenge banks’ definition of connected counterparties on a case-by-case basis, based on the qualitative assessment of legal and economic connection.</p> <p>During on site examinations, the inspector carries out a specific review of “groups of connected counterparties” so as to assess whether they include all entities linked by legal or economic relation. As a consequence of the qualitative analysis on such relationships, the BI’s staff may modify the perimeter of the group of connected counterparties, where appropriate. Assessors saw a practical case, when after some mergers between major industrial companies; the BI coordinated with CONSOB and requested banks to consider these industrial aggregations as groups of connected entities.</p>
EC6	<p>Laws, regulations or the supervisor set prudent and appropriate⁶⁶ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. “Exposures” for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.</p>
Description and findings re EC6	<p>Circular 263, Title V, Chapter 1, Section I and V. describe the requirements and limits. For monitoring, see EC 2.</p> <p>The regulation imposes limits on exposures on a single client or group of connected clients. It is important to note that although for monitoring purposes the exposure is as described in EC 2, for the calculation of limits a different definition is used. Limits are imposed on “risk position,” where some exposures are in fact risk weighted according to the risk weights similar to weights used for the calculation of capital requirements (annex A of Circular 263).</p> <p>Limits are as follows:</p> <p>Banking groups and banks that do not belong to banking groups are required to limit each risk position to a single client or group of connected clients within 25 percent of their regulatory capital. The limit applicable on a solo basis for banks which are part of a banking group is 40 percent, provided the group is compliant with the consolidated limit.</p> <p>Other exceptions apply:</p> <p>(a) If the client is a supervised institution (i.e., banks or investment firms), the 25 percent limit may be exceeded, provided that the following conditions are met:</p> <p>(1) the risk position is not greater than EUR 150 million;</p> <p>(2) the risk position to the clients connected to the institution, that are not institutions themselves, comply with the 25 percent limit; and</p> <p>(3) the bank has prudently assessed that the risk position is consistent with its capital base and, in any case, does not exceed 100 percent of its regulatory capital.</p> <p>(b) Trading book positions are not included in the calculation of the limit. Circular 263, Title II, Chapter 4, section IV, describes the treatment of such exposures: the limits above can be</p>

⁶⁶ Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

	<p>exceeded because of the positions in the trading book, under certain conditions, and the excess over the limit is covered by an additional capital requirement for concentration risk, applicable under Pillar 1.</p> <p>For responsibilities with compliance, see CP 14 and 15. Where, as a result of circumstances beyond the banks' control (such as a capital reduction or a merger between borrowers), such limits are exceeded, banks and banking groups must take prompt action to reduce their risk positions below the limits, and must notify the BI.</p>
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	There is not specific requirement to include significant risk concentrations in stress testing programs. Within the overall framework of the Pillar II banks are to conduct stress testing during the ICAAP, including all "material" risk factors. Therefore concentration risk is only included in stress tests when considered material in the ICAAP process. To define the main risks, banks must perform a sensitivity analysis to the main risks included in the Annex A of Title III, Chapter 1, Section II, which include concentration risk.
Additional criteria	
AC1	<p>In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following:</p> <p>(a) 10 percent or more of a bank's capital is defined as a large exposure; and</p> <p>(b) 25 percent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties.</p> <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	For definition of large exposures, see EC 2, for limits, see EC 6.
Assessment of Principle 19	Largely compliant
Comments	<p>Italy has not yet established guidance covering the whole spectrum of concentration risk management and monitoring required by the revised CP (which has been considerably expanded from the previous methodology, and the focus has shifted from "large exposures" to "risk concentration," which includes not only name risk but by industry, economic sector, geographic region, and by market). In particular, there is no requirement that risk concentrations, in this broader sense, should be regularly reviewed and reported to the Board, and that specific concentration risk management policies and processes are established. At the time of this Assessment, the revised guidance by the BCBS on concentration risk has not yet been published.</p> <p>BI has a wealth of information to monitor and analyze concentration risk in banks portfolios, in particular in the loan portfolios, and has conducted such analysis on a bank by bank basis within the SREP process and system-wide. Although monitoring of concentration risk in the broader sense of the revised CP is conducted occasionally, based on general guidelines for credit risk and market risk evaluation there is not systematic guidance or review beyond name risk/large exposures.</p> <p>However, even the case of large exposures, there are exceptions to the limits that reduce its</p>

	<p>prudential effect. Contrary to the definition of footnote 71 of the Methodology, limits are imposed on a risk-weighted basis for several exposures (this means exposures to 0 percent RW counterparties, such as all G-10 sovereign, are limitless), and exposures in the trading book are not included in the limit but are covered by a separate capital charge. Also, the same limits do not apply on both solo and consolidated basis—banks in a group are subject to larger solo limits than other banks calculating the limit on a solo basis, provided that the consolidated limit is complied with. The authorities have explained that the framework is given by EU level legislation and a different treatment would be an infringement of EU Law.</p> <p>The deficiencies in this CP are somewhat mitigated by evidence of strong supervisory action in many instances. In the case of large exposures, assessors were presented several examples of supervisory action. Assessors were also shown examples where, even in absence of specific regulation on concentration on sector or market products, strong supervisory action was taken to curb such types of concentration.</p>
Principle 20	<p>Transactions with related parties. In order to prevent abuses arising in transactions with related parties⁶⁷ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties⁶⁸ on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.</p>
Essential criteria	
EC1	<p>Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties". This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.</p>
Description and findings re EC1	<p>The Italian framework for related parties has been recently upgraded. The BL was amended in 2006 (Art. 53, paragraphs 4 ff), granting specifically to the ICCS the capacity to regulate connected parties and conflict of interest. A resolution by the ICCS was adopted in July 2008 (on a proposal by BI), defining related parties and general criteria for setting prudential limits and procedures. The resolution left to the BI the task to adopt more detailed technical regulation. A first consultation was performed in 2010, and a second in 2011. The final regulation has been issued in December 2011, as a new Chapter of the Circular 263 (Title V, Chapter 5). The implementation of the new rules was phased in: banks had to define their procedures for transactions with related parties, compliant with the new prudential regulation, by June 30, 2012. The rest of the regulation, including both limits to lending and procedures, entered into force starting from December 31, 2012, with transitional provisions for grandfathering exposures originated before December 2011.</p> <p>Title V, Chapter 5 defines "related parties" as those persons who are in a direct relationship with the bank because of their ability to directly influence the decision-making process, or of</p>

⁶⁷ Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁶⁸ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	<p>their involvement in transactions from which significant conflicts of interest may arise. These are more specifically:</p> <ul style="list-style-type: none"> • officers, meaning those who perform administrative, management and monitoring functions at banks, financial holding companies or supervised intermediaries within the banking group; • participants, meaning those who hold at least 10 percent of capital and/or exercise the inherent voting rights, as well as those who can exercise control, joint control, or significant influence, on a bank, financial holding company or supervised intermediaries within any banking group; • those persons, other than participants, who are empowered to appoint one or more members of the management or supervisory bodies, also on the basis of agreements concluded in any form or statutory provisions whose object or effect is the exercise of such rights or powers; • a company or firm, also established as a non-corporate structure, over which a bank or a subsidiary of the banking group may exercise control or significant influence. <p>The Circular 263 also defines “connected persons,” which are persons connected to a related party, due to business or familiar relationships. Connected persons are:</p> <ul style="list-style-type: none"> • companies and other firms, also established as non-corporate entities, controlled by any related party; • entities that control any related party among those listed under points 2 and 3 of the definition provided above, as well as entities subject, directly or indirectly, to joint control with the same related party; • close relatives of any related party—meaning first and second degree relatives (first degree only, in case of foreign subsidiaries facing difficulties in collecting information), spouse or partner of any related party and the sons thereof—and companies and firms controlled by them. <p>For the purposes of the regulation (i.e., prudential limits and procedures described below) any related party and its connected persons must be considered a single entity.</p> <p>As far as banking groups are concerned, those parties that are qualified as related to any bank entity belonging to the group (including the parent company) are considered as a related party to all the entities belonging to the said group (so-called “consolidated approach”).</p> <p>BI is empowered to identify additional related parties to those that are already included in the general definition on a case by case basis, due to their ability to influence the management of the bank.</p> <p>It is important to note that the definition of connected parties for this legislation is different from that used to define large exposures. In the case of related parties, the economic dependence is not considered <i>per se</i> as a criterion to identify related or connected parties (see CP 19, EC 2, definition of “economic” connection).</p>
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees,

	amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁶⁹
Description and findings re EC2	<p>The regulation does not require that transactions with related parties are not to be undertaken on more favourable terms than market terms. There are requirements that related party transactions undergo a special procedure (see EC 2 below), where the explanation of the (more favourable) terms needs to be provided and analysed, and Board deliberations must be supported by adequate motivations on the convenience and the economic advantages of the transaction for the bank.</p> <p>The procedure applies to all transactions, including not only exposures, but also any transfer of resources, provision of services or assumptions of obligations, even without any compensation. It does not apply to (i) intra-group transactions, where any party is wholly-owned by the other; (ii) employees remuneration (since they are covered by specific and detailed provisions); (iii) intra-group transactions performed in compliance with liquidity risk management systems; (iv) transactions required by the BI to preserve stability.</p> <p>The regulation seems to assume transactions may occur on more favourable terms, as it differentiates between “ordinary transactions” with related parties, which are defined as less relevant transactions entered into at market terms, and the other “relevant” and “less relevant” related party transactions which may take place on different (than market) conditions (Title V, Chapter 5, part 3, page 7).</p> <p>For listed banks, transactions at conditions other than at market terms are subject to Consob’s regulation on disclosure of the independent directors’ opinion.</p>
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank’s Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	<p>The approval process for related party exposures is complex. There is a specific requirement for approval by the Board only in the case of related-parties transaction whose value is equal to or exceeds 5 percent of the regulatory capital of the bank (transactions of “major importance”). These transactions need to be entered into only by the Board of directors (or by the general shareholders meeting, when required by law or bylaws) upon prior opinion by independent directors. Independent director’s opinion is not binding. In case of negative opinion by the independent directors, the board must (i) request the advice of the control body before entering into the envisaged transaction and (ii) inform the shareholders meeting at least once per year.</p> <p>Listed banks have narrower options: in order to comply with Consob Regulation, in case of negative advice of independent directors they, either (a) choose not to enter into the transaction; (b) or submit the decision to the shareholders that must decide without the vote of the interested shareholder (whitewash mechanism).</p> <p>Article 136 of the BL provides for stricter requirements than those referred above for transactions with officers performing managerial, strategic direction or controlling functions in the bank (or in any entity belonging to the banking group); such transactions can be</p>

⁶⁹ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

	<p>entered into only upon prior, unanimous approval by both the Board and the control body. Non-compliance with this provision constitutes a criminal offence.</p> <p>For all transactions with related parties, the procedures requires independent directors to be involved in each transaction at both (i) the preliminary stage, during which the board should provide the independents with adequate information, and the independents may express their opinions on the envisaged transaction; and (ii) the deliberative process, where the independents are required to issue their non-binding advice on the transaction. In case of negative advice from the independent directors, the Board (or the person in charge of the decision according to the bank's by-laws) must (i) provide explanations on the reasons for its approval with specific reference to the opinions of the independents, and (ii) immediately inform the supervisory or the control body.</p> <p>As mentioned, some waivers are provided in relation to cases which are otherwise regulated and/or are potentially less risky, including: (i) transactions which are already under the scope of application of Article 136 of the BL concerning exposures towards the officers of the bank ; (ii) non material transactions, whose value is below the maximum thresholds (EUR 250.000 for banks whose regulatory capital is below EUR 500.000.000; for other banks, the least between 0,05 percent of the regulatory capital and EUR 1.000.000); (iii) "ordinary transactions" (other than "major transactions," as defined below) entered into at market/standard conditions; (iv) urgent transactions (this waiver can be applied only if provided for by the bank's by-laws; independent directors must receive adequate information on such transactions; for most relevant transactions, the board must be informed in advance about the reasons for applying the waiver and if it believes that the operation does not fall within that category it shall inform the shareholders meeting).</p> <p>The procedure for approval of related party transactions does not apply to (i) intra-group transactions, where any party is wholly-owned by the other; (ii) employees remuneration (since they are covered by specific and detailed provisions); (iii) intra-group transactions performed in compliance with liquidity risk management systems; (iv) transactions required by the BI to preserve stability.).</p> <p>There is no general requirement that the member of the board with conflicts of interest should be excluded from the decision. There is a general requirement under Article 2391 of the Civil Code, by which conflicted directors must fully disclose to the Board their personal interests in the envisaged transaction before its approval. According to general corporate law, the board member with a conflicted interest cannot take the decision alone. If the Board approves the transaction, it must provide adequate motivations on the convenience and the economic advantages for the corporation. The transaction can be voided within 90 days from its approval, if it could not have been approved without the vote of the conflicted director and if the transaction harms the company.</p> <p>Civil and criminal liability rules are in place to discourage such participation in the decision making progress (art. 2391 and 2634 of the Civil Code).</p>
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	See EC 3 for procedures for the approval of related party transactions. In addition, Circular 263, Title V, Chapter 5, Section III, paragraph 2, banks must adopt internal policies that require staff members identified as "material risk takers"—see CP 14) to declare the existence of any personal interest in any envisaged transaction and, in case of any conflict, provide for the transfer of the responsibility for entering into the transaction to any higher hierarchical

	level. There is no general requirement that persons other than “material risk takers” who are to benefit from the transaction (or persons related to such a person) should not be part of granting and managing the transaction.																														
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.																														
Description and findings re EC5	<p>Circular 263, Title V, Chapter 5, Section II sets forth prudential limits (on both an individual and a consolidated basis) for exposures to related parties. These came into force since 31 December 2012, and transactions agreed before December 2011 have been grandfathered (see EC1). The Italian authorities have chosen a multi-layered approach to limits. Regulatory limits are differentiated depending on: (i) the financial or non-financial nature of the related party (non-financial related parties are subject to stricter limits due to the risks of conflicts of interest arising from close relations between banks and industrial companies); and (ii) the position of the related-party with respect to the supervised bank. Lower thresholds are provided for exposures with “upstream” related parties (such as participants who control the bank or who can exercise significant influence on it) as these are in the position to unduly influence the management; less restrictive limits are established for exposures to other participants in the capital and to “downstream” related parties.</p> <p>Limits for related-parties exposures are defined in terms of: (i) supervisory capital at both the consolidated and solo basis, if the bank belongs to a banking group; (ii) supervisory capital at solo level, for other banks.</p> <p>Exposures are measured (i) according to risk weighting factors corresponding to the inherent riskiness of different categories of counterparties; and (ii) taking into account credit risk mitigation techniques. Risk weighting factors and permissible credit risk mitigation techniques are determined in accordance with the provisions governing the large exposures regime (see EC 19).</p> <p>Any related party and its connected persons must be considered as a single entity for the purposes of the application of prudential limits to the overall exposure.</p> <p>Exposures related to operations between (i) entities belonging to the same banking group; or (ii) an Italian bank and its EU parent (both under consolidated supervision by the parent’s home authority) or other banks under common control, are not subject to the limits</p> <p>The limits for related-parties exposures are summarized in the following table:</p> <table border="1" data-bbox="402 1461 1357 1749"> <thead> <tr> <th rowspan="2">Consolidated Limits</th> <th>Officers (in percent)</th> <th>Participants (in percent)</th> <th>Other shareholders and appointing persons (in percent)</th> <th>Other persons (in percent)</th> </tr> </thead> <tbody> <tr> <td></td> <td></td> <td></td> <td colspan="2">Non-Financial related parties</td> </tr> <tr> <td></td> <td></td> <td>5</td> <td>7.5</td> <td>15</td> </tr> <tr> <td></td> <td>5</td> <td></td> <td colspan="2">Other related parties</td> </tr> <tr> <td></td> <td></td> <td>7.5</td> <td>10</td> <td>20</td> </tr> <tr> <td>Solo basis limit</td> <td></td> <td></td> <td colspan="2">20</td> </tr> </tbody> </table> <p>These limits must be met on an on-going basis. In case of breach of prudential limits for involuntary reasons (e.g., new familiar or economic relationships involving parties whom the bank is already exposed to), the bank must notify to the BI a plan providing for adequate</p>	Consolidated Limits	Officers (in percent)	Participants (in percent)	Other shareholders and appointing persons (in percent)	Other persons (in percent)				Non-Financial related parties				5	7.5	15		5		Other related parties				7.5	10	20	Solo basis limit			20	
Consolidated Limits	Officers (in percent)		Participants (in percent)	Other shareholders and appointing persons (in percent)	Other persons (in percent)																										
				Non-Financial related parties																											
		5	7.5	15																											
	5		Other related parties																												
		7.5	10	20																											
Solo basis limit			20																												

	<p>measures to reduce the exposure.</p> <p>There is no requirement that when limits are breached a deduction in capital should occur. Nevertheless, BI can impose capital add-ons based on the breaches during the ICAAP/SREP process. If the related party concerned is a participant to the bank's capital, its voting rights are suspended.</p> <p>BI may impose stricter limits for exposure by an ad hoc discretionary decision.</p>
EC6	<p>The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.</p>
Description and findings re EC6	<p>Circular 263 Title V, Chapter 5, Section II, requires banks to implement internal processes and policies to:</p> <ul style="list-style-type: none"> (i) identify and list all related parties; (ii) identify and quantify related-parties transactions both at the aggregate and the individual levels; (iii) identify transactions of "major importance;" (iv) define the decision-making process (including the phase of negotiation of the envisaged transaction) and the role of independent directors; (v) set forth exceptions to the application of the processes, when authorized by the regulation; (vi) monitor the correct measurement and management of risks towards related parties; and (vii) ensure adequate information flows towards all levels of company functions and structures (in particular, internal policies should require internal audit to periodically report to the governing bodies on the overall risk exposure arising from these transactions and ensure timely disclosure of transactions falling within one of the cases of waivers provided for by the regulation to the management body, to the body in charge of the control function and to the shareholders). <p>Internal policies on exposures and conflict of interests must be approved by the body in charge of the strategic supervision of the bank. Independent directors and the body in charge of the control function should issue an opinion on the policies prior to their approval.</p>
EC7	<p>The supervisor obtains and reviews information on aggregate exposures to related parties.</p>
Description and findings re EC7	<p>Circular 263, Title V, Chapter 5, Section V, obliges banks to report to the BI their exposure and other transactions to related parties, both on individual and consolidated bases. As the section only came into force on December 31, 2012, at the time of the assessment no evaluation of related party risk was available. Prior to the issuance of the regulation, in 2009, BI had conducted a specific survey which showed some banks had exposures out of the limits. These would be covered by the grandfathering mechanism described above.</p> <p>The BI published in December its draft implementing regulation on reporting duties for public consultation. The draft regulation requires banks to submit to the BI information on</p>

	<p>exposures to each related party and connected persons, on a nominative basis. Information may be aggregated to determine the overall exposure to a single entity (related party and its connected persons) in order to monitor the compliance with prudential limits. In addition, the draft regulation requires bank to submit information about transactions with related parties:</p> <p>(i) each transactions of “major importance” must be reported on a nominative basis, including their main characteristics (urgency; market conditions; independent directors’ advice etc.);</p> <p>(ii) all transactions must be reported on an aggregated basis. Information on exposures and major transactions will be reported quarterly; other information will be provided on an annual basis.</p>
Assessment of Principle 20	Materially Non-Compliant
Comments	<p>Related party lending is a major cause of bank failures across the globe. Italy’s framework for related party lending was majorly deficient before the amendments to the BL in 2006 and to Circular 263 in 2011. Regulating related party lending is known to be a difficult process, and regulatory improvements achieved so far are most welcome. At the time of this assessment, however, the new framework had just entered into force, and naturally there was no sufficient evidence available to assess implementation, as required by the BCP methodology. For that reason, compliance could not be verified and will need to be reviewed in future assessment updates.</p> <p>In addition, the regulatory framework has some deficiencies when compared to the requirements of this CP. In particular, the various exceptions to the limits may affect their effectiveness (exposures are risk weighted, as in the large exposures regime, intra-group exposures, including cross border, if between the parent and wholly owned subsidiary, are not only exempt from the limits but also of the approval and monitoring procedures—see footnote 73 of the methodology). It is important to note that the definition of connected parties for this legislation is different from that used to define connected parties in the large exposures regime. In the case of related parties, the economic dependence is not considered (see CP 19, EC 2, definition of “economic” connection). In a practical case, if the main shareholder is an entity, the entity would be considered related party, but a loan to the CEO of that entity would not be a related party transaction.</p> <p>Although the new procedures represent a large improvement compared to the previous situation, there is no specific requirement that the board member or persons involved are automatically excluded for decision making process, nor that all related party lending should occur in no more favourable terms than those to non-related party, as required by the CP (BI believes that requiring market conditions might turn out a purely formal requirement, difficult to challenge by the supervisor).</p> <p>The regulation allows the BI to impose case-by-case stricter definition; therefore the capacity of BI to impose definitions of connected parties by judgment (other than control, shareholding and familiar relationship) remains to be determined in practice, as well as its capacity to intervene in situations when economic influence is the real element connecting the related parties.</p> <p>These deficiencies might be mitigated by the specific procedures for related party transactions approval and disclosure, active enforcement of risk management procedures by BI and by the use of its powers to require consolidation, and other corrective measures under its power (see CP 11). As mentioned above, however, the regulatory framework only came into full force in December 31, 2012; there is not yet evidence of implementation that could be presented to assessors.</p>

	<p>Authorities are ready to re-assess the appropriateness of some of these elements based on factual evidence of the significance of the exempted transactions. To this aim they are asking banks to report, at least at the aggregated level, any transaction with related parties, including those that are partially exempted.</p> <p>The review of effectiveness of this CP will need to be carefully conducted in next update of BCP assessment.</p>
Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁷⁰ and transfer risk ⁷¹ in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>There are no specific requirements for management of country risk and transfer risk. The general risk management and internal control regulations apply. (see CP 15) According to the Circular 269, Part I, Section III, Chapter 4, country risk is considered as components of credit risk. Regulations do not do not define transfer risk; transfer risk is mentioned only within the IRB methodology with specific reference to specialised lending activity (Circ. 263, Title II, chapter I, part II, Annex C "regulatory criteria for specialised lending classification").</p> <p>BI assesses the appropriateness of banks' practices regarding country risk on a case by case basis, through off-site and on-site analysis, as part of the annual SREP. In practice, it only happens when country risk is considered material.</p>
EC2	The supervisor determines that bank' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	There are no specific requirements for management of country risk and transfer risk. The general risk management and internal control regulations apply (see CP 15). According to the Circular 269, Part I, Section III, Chapter 4, country risk is considered as components of credit

⁷⁰ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

⁷¹ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country (Reference document: *IMF paper on External Debt Statistics—Guide for compilers and users*, 2003).

	risk. Regulations do not define transfer risk.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	<p>There are no specific requirements for management of country risk and transfer risk. The general risk management and internal control regulations apply (see CP 15), including in respect to information systems for risk management (circ. 229 title IV, chapter 11).</p> <p>The proposed amendments to the internal control regulation will include more specific requirements regarding information systems. Currently, BI assesses the appropriateness of banks' practices regarding country risk on a case by case basis, through off-site and on-site analysis, as part of the annual SREP. In practice, it only happens when country risk is considered material.</p>
EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <p>(a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate.</p> <p>(b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate.</p> <p>(c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.</p>
Description and findings re EC4	<p>The Circular N. 263 changed treatment of country risk. The previous regulatory framework for country risk envisaged a top down framework based on specific provisions on country risk exposures and related deductions from the regulatory capital. The new framework does not make reference to specific requirements for country or transfer risk.</p> <p>The only regulatory guidance on country risk is in Circular 269, Part I, Section III, Chapter IV, D, which is not publicly available. The whole text is <i>"One of the innovations introduced by the new legislation for banks is focused on the discipline of "country risk". In particular, there no longer is an obligation to make - if the specific provisions are insufficient or absent - minimum adjustments to capital. As part of supervisory reports, however, the Bank of Italy continues to require banks and banking groups a series of information at statements relating to exposures to counterparties resident abroad, broken down by country of residence. Such information can be used for an evaluation of policies of financial statements of banks and banking groups, in particular, the actual accruals for exposures to counterparties in countries considered "at risk." For the definition of the countries considered at risk, you can refer to the benchmark defined by the ABI, based on specific methodologies for assessing country risk assessments and attributed to rating agencies recognized by the supervisory authorities or export credit agencies (SACE in Italy). These insights are necessary especially when the analyst finds a concentration of credit risk with one or more countries outside the European Union and the Group of Ten. In these cases, it is necessary to connect this analysis with that conducted part of the review of the</i></p>

	<p><i>ICAAP to see which policies pursued by the intermediary</i></p> <p>Based on this, the BI understands the current framework provides banks with autonomy in defining proper rules for provisioning. While large banks are expected to use their own internal models, smaller banks are encouraged to use a statistical model developed by ABI named "country risk compass" (which does economic financial risk analysis in emerging countries). As far as capital requirements are concerned, large banks are expected apply a specific correction factor to the risk parameters (PD, LGD).</p> <p>Country risk is to be considered within the "other relevant risks" in Pillar II. Within the ICAAP document, banks may need to estimate an economic capital buffer to cover country risk in normal and stressed conditions.</p> <p>The assessors were show examples of country risk and supervisory action in large internationally active banks. In the assessment of the country risk management and adequacy, supervisors are supported by the results of the regular country risk assessment analysis for the Italian banking system as a whole developed by the Macroprudential Analysis Division and by the Financial Stability Unit, presented in the financial risk outlook and in the financial stability report (both released every six months).</p> <p>There are no specific guidance or specifications for transfer risks. BI expects that large banks adopting IRB systems model transfer risk in Pillar 1, whereas banks that use the standardised method would need to consider this type of risk (if material) within Pillar 2. Under the current market conditions, specific rules on economic capital buffer against sovereign risk have been defined within the SREP process.</p>
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	There is no specific requirement regarding country risk. In general, banks are expected to conduct sensitivity analyses on the main risks taken. Banks adopting internal methodologies for calculating capital requirements have to perform stress test exercises (circ. 263, Title I, Chapter 1). Further stress testing may be required occasionally by the supervisor with reference to specific countries experiencing turbulence.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	<p>Banks send to BI a breakdown of their foreign exposures by country for statistical purposes to the ECB and to the BI. Such report is transmitted separately for the banking units operating in Italy (monthly) and for branches and subsidiaries abroad (quarterly). All balance-sheet assets are classified according to the country of the counterparty and details are given on technical form, currency, location of disbursing unit, original maturity and residual maturity, counterparty's sector, guarantor's state and sector. For off-balance-sheet items, banks must report details of guarantee commitments, commitments and derivative (nominal values and credit equivalents) positions. For BIS statistical purposes, banking groups also report on a quarterly basis and at a consolidated level, foreign exposures, also including a break-down by economic sector. Consolidated data are supplemented by individual data on "translation risk." Such data are produced by banks with the aim of identifying exposures towards non-Italian counterparties backed by a guarantee provided by a third country counterparty. Banks also have to report information on provisioning by individual country.</p> <p>Supervisory reporting data on foreign exposures are used to feed a specific supplementary table called "Country risk" within the credit risk analysis scheme (available for the analysis at</p>

	<p>consolidated level) and with a breakdown according to on-/off-balance sheet nature of the exposures, economic sector, type of risk mitigant (i.e., collateral/guarantee).</p> <p>Moreover, BI, in case it is necessary, can collect data on a more frequent and granular basis. Recently, BI adopted this approach for specific sovereigns.</p> <p>Finally, the units in charge of the supervision of large Italian banks perform on an ongoing basis ad hoc analyses, based on managerial data, to assess banks exposures towards countries at risk. Further input for country risk supervision on emerging markets comes from the economic research department, where a specific sector is tasked with the analysis on developing countries that have been identified as those where Italian banking groups have a relevant presence. Such analyses can result in specific interventions (e.g. strengthening monitoring processes and controls, disposal of the shares held in banks located in countries at risk).</p>
Assessment of Principle 21	Materially Non-Compliant
Comments	<p>There are no specific requirements for management of country risk and transfer risk. The general risk management and internal control regulations apply. (see CP 15) According to the Circular 269, Part I, Section III, Chapter 4, country risk is considered as components of credit risk. Regulations do not define transfer risk.</p> <p>BI assesses the appropriateness of banks' practices regarding country risk on a case by case basis, through off-site and on-site analysis, as part of the annual SREP. In practice, it only happens when country risk is considered material. Assessors were shown evidence that BI does review country risk in depth in the large internationally active banks.</p> <p>However, the regulatory framework is too general to be conducive to good country and transfer risk management in the banks not using IRB. Also, the guidance seems to overlook country risk derived to exposures within the EU, as if the only sources of country and transfer risk were availability of Euro and sovereign risks.</p> <p>Italian banks are active in exposures abroad, and not only the largest. BI is strongly recommended to issue guidance on country and transfer risk that can be understood and applied to all banks; in particular, banks need to be made aware that an overall deterioration of credit risk in a country can lead to many private contracts not being observed, even when not linked to any specific restrictions imposed by governments. In another words, country risk may be linked to the possibility that political and/or economic events occur and influence the quality of the banks portfolio. That can also happen indirectly through exposures to sectors and large clients whose payment capacity depends on events in a foreign country.</p>
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring,

	monitoring and control of market risk.
Description and findings re EC1	See EC1-CP15.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	<p>The BI assesses the appropriateness of banks' practices by the means of off-site and on-site analysis, as an integral part of the supervisory review and evaluation process. Such an assessment is performed at least annually within the SREP with reference to banks' risk profile, appetite and capital strength. In this context, the materiality of banks' market risk exposures is gauged by drawing on prudential reports that, for larger institutions, include also the outcomes of banks' internal models. Mainly through the on-site examination the BI assesses the adequacy of risk management process. On site visits allow assessing the materiality of risks with a thorough evaluation of banks business models going beyond the regulatory trading book and taking into account the threats arising from unexpected deteriorations of market conditions. In this context are specifically addressed: the adequacy of the articulation of roles and responsibilities for identifying, measuring, monitoring, controlling, mitigating and reporting market risk; the effectiveness of internal control systems in the market risk area; the adequacy of prudential value adjustments on the trading book portfolio. The examination may leverage on the analysis of actual decisions of the concerned managers.</p> <p>Additionally, BI assesses that boards:</p> <ul style="list-style-type: none"> • are aware of all material bank's risk exposures; • approve relevant procedures for identifying and assessing risk sources; • verify the consistency of risk control functions with strategic policies; • ensure the establishment of reporting systems able to provide accurate, complete and timely data on risk exposures; • review the functionality, efficiency and effectiveness of risk management systems, taking corrective actions when needed. <p>Further requirements are defined for banks that rely on internal models for computing market risk capital requirements; in this regard, Circular 263 requires the Supervisory board:</p> <ul style="list-style-type: none"> • to approve the risk model design as well as the significant modifications to the model's design; • to identify the responsibilities related to model development, validation, and roll-out; • to assess the annual reports issued by the audit and validation functions and adopt corrective actions as required. <p>Effective compliance with all these requirements is reviewed by off-site analyses and on-site inspections (Circular 269).</p>
EC3	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <p>(a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management;</p>

	<p>(b) appropriate market risk limits consistent with the bank’s risk appetite, risk profile and capital strength, and with the management’s ability to manage market risk and which are understood by, and regularly communicated to, relevant staff;</p> <p>(c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank’s senior management or Board, where necessary;</p> <p>(d) effective controls around the use of models to identify and measure market risk, and set limits; and</p> <p>(e) sound policies and processes for allocation of exposures to the trading book.</p>
<p>Description and findings re EC3</p>	<p>All banks must set out strategies, policies and processes to manage market risks exposures on a portfolio basis and satisfying all requirements provided for by the regulation: (a) A market risk information system must be in place to ensure prompt identification, measurement, monitoring, control, mitigation, and reporting of all relevant positions compute the exposures to different risk sources. (b) Appropriate market risk limits in order to contain risk exposure are required. (c) The internal control system must ensure that any breach be communicated in a timely manner to any appropriate level of the organization and to the supervisory and management board if significant; specific procedures must be incorporated in the system to cope with any breach of established limits with reference to all categories of risk including market risk. (d) All banks’ supervisory board must approve the development and validation process of internal models for the measurement of all risks (including market risk) and periodically verifies their correct functioning.</p> <p>Effective compliance with these requirements is reviewed by BI by means of specific set of analyses that include meetings with the concerned risk managers and on-site examinations which frequency vary according to the size of risk and complexity of strategy and business in the market risk segment.</p>
<p>EC4</p>	<p>The supervisor determines that there are systems and controls to ensure that banks’ marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
<p>Description and findings re EC4</p>	<p>Banks must:</p> <ul style="list-style-type: none"> • identify roles and responsibilities of the organizational units in charge of the evaluation processes; • supplement the evaluations performed on an on-going basis by front-office units with an independent assessment, at least monthly; • provide units in charge of the evaluation processes with all necessary data flows. <p>Banks are required to have procedures for calculating prudential value adjustments of scarcely liquid positions. Such adjustments must reflect the degree of liquidity of the position and are made, if necessary, also in excess of valuation adjustments for accounting purposes. In order to decide if a prudential value adjustment is necessary, banks must consider different factors, among which: time necessary to offset the position, the average bid/ask spread and its volatility, market prices availability, the average size of transactions and its volatility,</p>

	<p>including under stressed conditions, market concentration, limits of the model used for the evaluation, the estimated impact of any other model risks.</p> <p>The BI reviews the reliability of valuation procedures, as an integral part of the overall assessment of the robustness of the organizational arrangements adopted in the market risk management area. Inspectors check the processes responsibilities, the reliability of the market information used and the independency of the revaluation process from risk-taking units.</p>
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	<p>Annually banks perform an independent assessment of their capital adequacy, taking into account all risk sources. Regulations explicitly require banks to compute internal capital so to cover unexpected losses.</p> <p>Banks' internal assessments are reviewed by the BI; leveraging on the information gathered during the SREP to ensure that capital computations factor all material risks, including those related to trading activities (banks deemed significantly active in market risk are checked via more granular and frequent reporting data). When assessing bank capital, specific attention is paid to the robustness of the asset and liability valuation processes. For market risk, specific attention is devoted to banks using internal models for calculating capital requirements. At the end of the validating process or in the course of monitoring the BI may impose specific add-on when deficiencies are spotted in the model and in its use, which generate doubts on the adequacy of calculation performed by the bank. For those banks that do not use internal models, such valuation is performed in the course of the ordinary SREP.</p>
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	Circular 263 requires banks to perform a thorough assessment of their capital adequacy explicitly include stress tests as a mandatory tool to investigate firms' vulnerability to exceptional events. Such a general requirement applies to market risk as well as to all other material risk area. Stress test programs have to be designed so to be appropriate to a bank's scale and operational complexity.
Assessment of Principle 22	Compliant
Comments	
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁷² in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The

⁷² Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	See EC1-CP15
EC2	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.
Description and findings re EC2	<p>The BI assesses the appropriateness of banks' practices by through off-site and on-site analysis, within the broader supervisory review and evaluation process. Such an assessment is performed at least annually within the SREP with reference to banks' risk profile, appetite and capital strength. In this context, the materiality of IRR exposures is gauged by drawing on prudential reports. The BI assesses the adequacy of the risk management process mainly through on-site examinations; in particular, on-site visits allow the BI's staff to assess the materiality of risks with a thorough evaluation of banks' business models by considering any threats arising from unexpected deteriorations of market conditions. In this context the following issues are specifically addressed: the adequacy of the allocation of roles and responsibilities for identifying, measuring, monitoring, controlling, mitigating and reporting IRR; the effectiveness of internal control systems in the ALM area. The examination may leverage on the analysis of actual decisions taken by the concerned managers.</p> <p>Regulations require the Supervisory Board to play a key role in developing effective and efficient risk management and control systems for IRR.</p> <p>The BI requires boards to play roles and responsibility attributed by the regulation, and through on site examinations assesses that boards:</p> <ul style="list-style-type: none"> • are aware of all material risk exposures; • approve the necessary procedures for identifying and assessing any sources of risk; • verify the consistency of risk control functions with the bank's strategic policies; • ensure the establishment of reporting systems able to provide accurate, complete and timely data on risk exposures; • review the efficiency and effectiveness of risk management systems, and take corrective actions, when needed.
EC3	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <p>(a) comprehensive and appropriate interest rate risk measurement systems;</p> <p>(b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions);</p> <p>(c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff;</p> <p>(d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and</p>

	(e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
Description and findings re EC3	<p>Circular 263 requires banks to set up organizational arrangements adequate to the materiality of IRR exposures and to the complexity of the related activities. All banks must set out strategies, policies and processes to manage IRR on a portfolio basis and comply with all requirements provided for by the regulation.</p> <p>(a) The BI, through off-site and on-site reviews, verifies that: measurement systems include all the risk-sensitive interest rate positions in the banking book; all the assumptions embedded in the models are well documented and consistent with the banks' operational characteristics; all possible sources of interest rate risk (e.g. maturity mismatch, yield curve risk, option risk) are taken into account; the assumed scenarios reflect period of severe stress in relation to banks' specificities.</p> <p>(b) All banks' supervisory board must approve the development and validation process of internal models for the measurement of IRR and periodically verifies their correct functioning. The risk management function is responsible for the development, validation and maintenance of the IRR measurement and control systems and makes sure that: (i) these systems are subject to periodic form of testing; (ii) an appropriate number of scenarios are analyzed; (iii) conservative assumptions are made on IR dependencies and correlations; (iv) model risk and uncertainties embedded in financial instruments are adequately taken into account.</p> <p>(c) Appropriate IRR limits are required to contain risk exposure and consider both the results of stress tests and the economic context;</p> <p>(d) The BI verifies that internal control systems are adequate to ensure that any breach would be communicated in a timely manner to any appropriate level within the organization and to the supervisory and management board, where material; specific procedures must be incorporated in the internal control system to cope with any breach of established limits.</p> <p>(e) A market risk information system must be in place to ensure prompt identification, measurement, monitoring, control, mitigation, reporting of all relevant positions, so as to precisely estimate the overall exposures to different risk sources. A specific and detailed regulation on the requirements that banks must comply with as to the information system in currently under consultation.</p>
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	<p>Circular 263 requires a hypothetical 200 bp parallel shift of the interest rate curve on the interest rate exposure of the banking book. Should this test prove that the shock results in a reduction in the economic value of a bank of more than 20 percent of its supervisory capital, the BI shall examine the results with the bank and require the bank to adopt appropriate corrective action.</p> <p>Smaller banks can limit the program to assess the economic effects associated to the 200 bp parallel shift, larger banks (i.e., all those that compute internally part of the RWAs) are required to consider additional and more realistic interest rate scenarios (included non-parallel shocks), so as to better explore their vulnerabilities to this source of risk.</p>
Additional criteria	

AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	Together with the stress-test results, for a wide sample of large banks, the raw data used by risk management departments to assess the exposure to IRR are collected on a quarterly basis as part of the on-going evaluation of these banks' exposure to IRR.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	BI supervisors are required to assess the adequacy of banks' measurement systems; when those systems are deemed inadequate to provide prudent estimates of the bank's exposure to IRR, the related capital estimates are overridden by those provided by the BI simplified tool for the purpose of determining the overall internal capital assessment.
Assessment of Principle 23	Compliant
Comments	
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	<p>Circular 263 requires banks (as part of their bank-wide risk management system), to formalize their policies for the governance of liquidity risk and implement an effective process for its management, in accordance with the characteristics, scale and complexity of the activities performed and taking into due consideration the relevance of the bank in the market of each EU country in which it operates. Banks are required to identify and measure liquidity risk on a forward looking basis according to a methodology similar to the Basel 3 liquidity coverage ratio (LCR), even though the use of internal models to measure inflows and outflows is permitted to a limited extent. Banks must keep a liquidity buffer consistent with the chosen appetite risk level.</p> <p>Circular 263 provides banks with a wide set of general principles and more detailed rules which pertain to all the relevant aspects of liquidity risk management (roles and responsibilities of the relevant corporate bodies, characteristics of processes to identifying, measuring, evaluating, monitoring, controlling, mitigating and reporting liquidity risk; role and responsibility of the internal control system). Banks are required to comply on an individual and on a consolidated level (a few rules apply only at the consolidated level where</p>

	<p>an effective centralized liquidity risk management system is in place).</p> <p>Compliance with the regulatory framework is reviewed through both off-site and on-site examination within the supervisory assessment process (SREP), which also includes an overall evaluation of the liquidity risk profile of the bank. The final score attributed to the liquidity risk profile results from the combination of a quantitative analysis and of a qualitative one: (a) firstly the analyst proceeds to analyze the risk exposure by using the indicators suggested by the methodological scheme (inflows and outflows within the maturity ladder, the detailed composition of the buffer, data on concentration of funding by maturity and banking counterparties, for more details, loans to fund-raising; (b) then, he assesses and evaluates the bank's ability to identify, measure or evaluate, monitor, control, mitigate and report that risk. By combining the quantitative and the qualitative analysis a final score for the liquidity risk profile is attributed. On the basis of results of the analysis, the BI defines the necessary supervisory actions.</p> <p>According to Articles 51 and 66 of the BL, the BI is entitled to request banks and banking groups to provide all information deemed to be necessary for the purpose of monitoring liquidity risk. The exercise of such powers is described above, with reference with the information provided by bank to BI.</p>
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	In measuring liquidity risk and determining the required liquidity buffer, banks take into account all the probable financial flows connected with their intermediation activities, on and off-balance sheet (e.g., off-balance-sheet exposures and sight deposits, early repayment clauses, liquidity lines granted to special purpose vehicles set up for securitizations). Within SREP, both in the off-site and in the on-site inspections, an assessment of both the bank's liquidity risk exposure (funding liquidity risk and market liquidity risk) and liquidity risk governance/management/control on a consolidated and stand-alone basis is performed. Such assessment takes into account the context of the markets and macroeconomic conditions in which the bank operates. If the inspected bank belongs to a group, special attention is also paid to coordination of the bank with its holding company.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance.
Description and findings re EC3	<p>According to Circular 263 the supervisory and management boards are responsible for approving risk management policies and processes (which include also liquidity risk). To this end, the supervisory board shall, among others, approve:</p> <ul style="list-style-type: none"> • the methodologies used by the bank to determine its exposure to liquidity risk; • the main assumptions underlying the stress scenarios; • the warning indicators used to activate the emergency plans; • the emergency plan to be activated in the event of a market crisis or bank-specific situations (Contingency Funding Plan); • the principles underlying the internal funds transfer pricing system. <p>The management board is responsible for implementing the strategies and governance</p>

	<p>policies approved by the supervisory board.</p> <p>Compliance is assessed through on-site inspections, although a constant off-site control is performed. During the on-site inspections, the inspector in charge evaluates if financial institutions are able to manage their expected liquidity needs in a prudential manner under ongoing concern basis' and to absorb unexpected liquidity exogenous and endogenous shocks through stress testing of their liquidity position. After a preliminary classification of the supervised institution (depending on its size, complexity and other characteristics), the inspector verifies the bank's reliance on wholesale funding, assess the structure of tasks and responsibilities assigned to treasury department, risk management function and other committees involved in bank's liquidity risk management process, assesses the main liquidity risk monitoring tools, the reporting framework and the contingency funding plan in place, evaluates the liquidity degree of financial instruments included in bank's portfolio. In case of liquidity strain or liquidity stress, the inspector monitors the end-of-day treasury liquidity position and the bank's exposure towards the financial system as a whole.</p>
EC4	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ul style="list-style-type: none"> (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	<p>The Board is responsible for determining the liquidity risk tolerance of the bank; this can be expressed as a threshold on a going concern basis, supplemented by stress scenarios, taking into account prudential rules in force and bank strategies, business model, complexity of operations and ability to raise funds. The liquidity risk tolerance shall be communicated to the operational units. Banks shall identify and measure the level of liquidity risk to which they are exposed, currently and prospectively.</p> <p>The BI assesses the following requirements banks must comply with in the intra-day liquidity risk management process: (a) monitoring on a continuous basis of cash flows by also making available sufficient forecast of them within the same working day; (b) maintenance of liquidity reserves specifically for intra-day transactions which can be used when stress conditions occur; (c) definition of specific actions to undertake when in case of sudden shortage of liquidity in the market; (d) definition of stress scenario so as to provide the failure of at least one important participant to the payment and settlement system for financial instrument which the bank is exposed to.</p> <p>IT systems must permit timely access to financial instruments available as collateral, wherever they are held. The IT platforms for internal market of eligible assets, within the banking</p>

	<p>groups (for instance, bond lending, repos), is carefully taken into account as a pre-condition for a full and timely availability of collateral to be used on the re-financing channels.</p> <p>BI focuses on IT solutions and processes banks have developed for daily management of compulsory liquidity reserves, especially where a dynamic approach is followed. Similarly, banks have to maintain adequate monitoring systems for the intraday positions they keep as long as they're active in the daily payment system.</p> <p>For purposes of managing short-term liquidity risk and structural liquidity risk, banks collect information on the behavior of the financial flows coming from all the corporate/group units and on the behavior and composition of the assets that can be used to meet the funding needs. Banks shall also monitor the medium and long-term fund-raising capacity and lending operations and regularly monitor the balance-sheet aggregates included as part of the bank's asset-liability management. Within banking groups, the parent company is responsible for the generation of the data and applications used by its subsidiaries.</p> <p>Inspectors ascertain that the management body is responsible for establishing the guidelines for the liquidity risk management process, in compliance with the risk tolerance approved by the supervisory body, and that defines the internal reporting flows necessary to provide the governing bodies and control functions all the relevant information necessary to fully understand and govern liquidity risk factors. Inspectors also assesses that banks adopt a process that allows their governing bodies to have prompt knowledge of the stress tests outcomes, in order to promptly highlight vulnerabilities or the inadequacy of the liquidity reserves held by the bank and permit the timely adoption of the necessary corrective measures. The supervisor assesses the comprehensiveness of the contingency funding plan including whether it addresses vulnerabilities identified in stress tests, and management's program for promoting understanding of the plan through periodic testing and internal communication. The whole liquidity risk management process must also be revised periodically to ensure it remains effective over time.</p> <p>The internal audit function shall evaluate the functionality and reliability of the overall system of controls for liquidity risk management and verify that the governing bodies and all functions concerned make full use of the available information. The internal audit function must report the outcome of the controls to the governing bodies of the banks. In the on-site examination, the supervisor verifies that the internal auditing perform all its duties in a reliable and effective manner.</p>
ECS	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and	According to the regulation, policies and processes must include consideration of how other

findings re EC5	<p>risks may impact the bank's overall liquidity strategy: stress tests must reflect the interconnections between liquidity risk and other relevant risk which the bank is exposed to. Banks must consider alternative scenario in the analysis of funding scenario and test if the resort to alternative source of liquidity to offset liquidity outflows is plausible.</p> <p>Banks must keep a liquidity buffer consistent with the chosen appetite risk level. The regulation states the requirements of assets to consider in the liquidity buffer: high liquidity, unencumbered, not giving origin to "wrong way" risk. In determining the liquidity buffer, banks must exclude some items which are likely to be illiquid.</p> <p>Banks must adopt strategies, policies and procedures to limit excessive funding concentration and ensure an appropriate diversification of the residual maturities of their liabilities. To identify the concentration of the funding sources, banks must have an adequate knowledge of their financial structure and be aware of the risk factors that can influence it over time. In assessing the degree of funding concentration, banks must consider at least the following elements:</p> <ul style="list-style-type: none"> • the degree of dependence on a single market or an excessively small number of markets/counterparties (e.g., the interbank market, bond issues, deposits of institutional investors or large firms); • the concentration of particular technical forms (such as securitizations); • the importance of activities in currencies other than the euro; • the amount of liabilities maturing in the coming month as a ratio to the total stock of outstanding liabilities. <p>The procedures for concentration risk management must be documented and periodically revised, to ensure their consistency with the evolution of the bank's operations.</p> <p>Banks are required to frequently assess the adequacy of liquid assets especially when significant changes occur in market conditions.</p>
EC6	<p>The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.</p>
Description and findings re EC6	<p>Banks are required to prepare and constantly update a Contingency Funding Plan (henceforth CFP), to identify at least possible sources of liquidity strains and the consequent remedial actions. The CFP must lay down the intervention strategies to be followed in the event of liquidity strains and establish the procedures for raising funds in an emergency situation. In particular, the plan must contain at least the following information:</p> <ul style="list-style-type: none"> • a catalogue of the different types of liquidity strains, so as to identify their nature (systemic or idiosyncratic); • identification of the powers and responsibilities of governing bodies and functions in emergencies; these guidelines must be revised periodically and transmitted to all the structures that could be involved; • estimates of back-up liquidity that, in the event of adverse scenarios, can determine, with

	<p>a sufficient degree of reliability, the maximum amount obtainable from the various sources of funding.</p> <p>In case of banking groups, the CFP must indicate the mechanisms for the interaction between the various entities and the steps that can be taken; in particular, it must specify the steps to be taken in the event of restrictions on the circulation of funds.</p> <p>In the event of stress test results indicating an exposure to liquidity risk close to or above the limit set within the liquidity risk tolerance, the CFP must envisage procedures that ensure an immediate notification to the bodies in charge with deciding and/or adopting the necessary corrective actions. Banks must ensure that the procedures indicated in the CFP are reviewed regularly and updated on the basis of the stress tests results. The function in charge for updating the CFP must inform the competent bodies of the results of their activity, in order to permit the timely adjustment of the existing strategies and procedures. The strategy is one of the main elements of the CFP; it clearly sets out management responsibilities and roles and therefore must be promptly communicated to all the structures and functions that may be involved in the liquidity risk management process.</p> <p>According to the Supervisory Guide, CFP is a central source of information to evaluate the liquidity risk profile of a bank. Moreover banks should be ready to discuss their CFPs with the Supervisory Authority. Such talks are held on a regular basis (at least on a yearly basis) for large institutions, while for smaller institutions such discussion is held on the basis of evidence from data monitoring.</p>
EC7	<p>The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.</p>
Description and findings re EC7	<p>Banks are required to perform stress tests regularly.</p> <p>In particular, it is necessary to ensure that:</p> <ul style="list-style-type: none"> • the stress test process is sufficiently defined and formalized (the frequency with which the tests are to be conducted, the techniques to be used, the risk factors to be considered, the relevant scenarios and the time horizons shall be clearly defined); • the assumptions underlying the scenarios are realistic but, at the same time, sufficiently conservative in the severity and duration of the simulated shock; the assumptions are updated sufficiently frequently, especially in times of market volatility; • the scenarios reflect any interconnections and interdependencies between liquidity risk and other risks to which the bank is exposed, as well as possible contagion effects; • the simulation techniques are periodically reviewed to permit the detection of potential weaknesses and vulnerabilities; • the robustness of the assumptions underlying the stress scenarios is verified, with special reference to the plausibility of the existence of alternative liquidity sources to offset any potential cash outflows; • the stress tests results are used to increase the effectiveness of liquidity management in the event of a crisis, to plan funding operations so as to meet any potential net funding requirement, and to revise the operating limits on liquidity risk. <p>Banks are also required to adopt a process that allows their governing bodies to have prompt knowledge of the stress tests results, to highlight vulnerabilities or the inadequacy of the liquidity reserves held by the bank and permit the timely adoption of the necessary corrective</p>

	<p>measures.</p> <p>Banks must ensure that the procedures indicated in the CFP are reviewed regularly and updated on the basis of their stress tests results. The function in charge with the updates must inform the competent bodies of the results of their activity, to permit the timely adjustment of the existing strategies and procedures.</p>
EC8	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities</p>
Description and findings re EC8	<p>Circular 263 requires banks to:</p> <ul style="list-style-type: none"> • pay special attention to financial instruments denominated in illiquid currencies that are included in the liquidity buffer; • be able to assess at every moment and especially in times of stress the amount and quality of liquidity reserves for all the different group members and for each jurisdiction and currency in which they operate; • set operating limits for each of the main exposures to currencies other than the Euro; • diversify their funding structure considering also the importance of activities in currencies other than the euro. <p>Moreover, BI collects data on composition of assets and liabilities by currency. This allows the BI to identify those banks carrying out significant foreign currency liquidity transformation and carried out supervisory intervention when requested.</p>
Additional criteria	
AC1	<p>The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.</p>
Description and findings re AC1	<p>Banks are required to be able to readily assess and especially in times of stress the amount and quality of the liquid assets available, having regard, among other things, to possible legal, regulatory and operating restrictions on their use.</p> <p>During on-site visits the inspector in charge verifies whether the bank is able to gather complete and timely information on the available unencumbered assets (that can be liquidated or pledged to obtain liquidity) and if such assets are properly classified, eligible for central banks refinancing operations, subject to appropriate haircuts. The integration between front and back office procedures and the effectiveness of daily data reconciliation procedures is also assessed.</p>
Assessment of Principle 24	Compliant

Comments	
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁷³ on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	<p>Circular 263, Title II, Chapter V, is the main regulatory source for operational risks. It is mostly focused on the calculation of capital requirements for operational risk, but it includes a definition of operational risk, and the requirement that the principles of governance and management of operational risks should be observed by all banks, regardless of the modality of calculation of capital requirements. The governance and management rules are contained in Section II of that chapter. They are not detailed, only require that banks must pay particular attention to events of high gravity and low frequency, and should identify the various forms operational risk can manifest. It establishes that banks should assess operational risks related with the introduction of new products, activities and processes, and that should have in place emergency and business continuity plans to operate on an ongoing basis and limit operating losses in the event of severe business disruption.</p> <p>The proportionality may be imbedded in the general rules for risk management (see CP 15), which establishes that the bank needs to be aware of "all" the risks incurred by the bank. These procedures under Title I, Chapter 1, Part 4, would include operational risk, but it is not explicitly mentioned. Circular 229 (title 4, Chapter 11) does mention specifically that operation risk is one of the categories of risk that must be covered by the bank's internal controls framework.</p> <p>For AMA banks, Circular 263 contains more detailed requirements on collecting and processing operational risk data, requirements of an operational risk management function, and requirements that internal processes verify the overall quality of these systems and their continued compliance with regulatory requirements, business needs and developments in the relevant market.</p> <p>In particular, banks that use the AMA must have an operational risk management function responsible for designing, developing and maintaining the operational risk management and measurement systems and for calculating the capital requirement. For these banks, an internal validation process is required to verify the overall quality of these systems and their continued compliance with regulatory requirements, business needs and developments in the relevant market. In AMA banks, the measurement system must be closely integrated into</p>

⁷³ The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	decision-making and risk management processes.
EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	<p>There is no specific provision regarding operational risk. See EC1. The general risk management regulation (see CP 15), contained in Circular 263 (Title I, Chapter 1, Part 4) , and in Circular 229 (Title 4, Chapter 11) requires that the supervisory body:</p> <ul style="list-style-type: none"> • establishes strategic risk management guidelines and policies, periodically reviewing them in order to ensure their continuing effectiveness. The board needs be aware of the risks to which the bank is exposed, understand and approve the procedures for identifying and assessing risks; • ensures on a continuing basis that tasks and responsibilities are assigned in a clear and appropriate manner, with special regard to mechanisms for delegating powers; • verifies that risk control functions have been established in a manner consistent with strategic policies, that such functions have appropriate independence of judgment and have been provided with qualitatively and quantitatively adequate resources; • ensures the establishment of a system providing accurate, complete and timely information concerning risk management and control; • ensure that the functionality, efficiency and effectiveness of the risk management and control system are periodically reviewed and that the findings of such review are reported to the strategic oversight body where shortcomings or irregularities are found, the oversight body shall adopt appropriate remedial measures.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	<p>Circular 269, Part I, chapter VIII, details the supervisory expectations on operational risk. The analysis of a bank's operational risk is done, at least on annual basis, within the Risk Assessment System, according to an approach which takes into account of both quantitative elements and qualitative inputs.</p> <p>For AMA banks, expectations are higher, as detailed in Part II, Section III, chapter VI. Regular data analysis and annual on-site visits are performed on candidate and accredited AMA banks, to assess and monitor the compliance of the AMA framework with the pertinent regulation. Off-site meetings and specific investigations are conducted on TSA banks, reviewing the data and the documentation (i.e., self-assessment and internal audit reports) regularly transmitted to the BI. More in general, on site examinations on a bank's operational risk (both exposure and management framework) are performed during general and sectoral inspections or in response to emerged relevant loss events and/or weaknesses.</p>
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	According to Circular 263 (Title II, Chapter 5, Part 1, Section II) banks must adopt contingency and business continuity plans that ensure their ability to operate on an ongoing basis and limit losses in the event of severe business disruptions. Further rules, specific to business continuity and disaster recovery plans, have been issued in 2004 (Bollettino de Vigilanza, July

	<p>2004, applicable to all banks) and 2007 (March 21, 2007—special requirements for processes of systemic importance). These cover in more detail the scenarios to be considered, the necessary infra-structure and the contingency mechanisms expected for different types of systems in cases of severe disruption. These requirements are being consolidated into one single draft regulation, which is open for public consultation.</p> <p>Verification is mostly done by dedicated on-site examinations in larger banks and ongoing supervisory activity for all the other banks/financial institutions. In particular for the larger banks, BI verifies that banks have defined risk-based organizational and emergency solutions for each critical process. The processes of systemic importance (identified in the 2007 regulation, which include, for instance, payment and settlement systems) are always considered as critical. For the major banking groups, the BI verifies that a business continuity plan is put in place, establishing: (i) the time necessary to recover critical processes; (ii) the management of back-up archives and procedures; (iii) the expected resources and communication line for the management of emergency situations.</p>
EC5	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.</p>
Description and findings re EC5	<p>There are no specific requirements for information technology processes. There are general information integrity requirements contained in the regulations regarding the CCR and supervisory reporting (see CP 10 and 17). The non-public part of the supervisory guide (Circular 269) contains detailed instructions for supervisors to determine the adequacy of the IT policies and infrastructure, including integrity, security, and integration to risk management. Assessors were given access to the standard inspection reports regarding the topic.</p> <p>The BI included some of that detailed guidance on the appropriate governance and organizational arrangements for information and communications technology systems and procedures into the draft regulation on internal controls, which was open for consultation (see CP 26).</p>
EC6	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	<p>Banks are required to have sufficiently detailed information on operational risk to allow the calculation of a supervisory score on their estimation of operational risk losses, expectations regarding TSA and AMA banks are higher (see above). Quality and effectiveness of the information systems, loss data collection processes and reporting systems for operational risks in BIA banks are conducted on site and less frequently.</p> <p>All TSA (10 banks) and AMA banks (6 banks) and many BIA banks participate in the Italian Database of Operational Risk Losses (DIPO). DIPO, which originated from the ABI in 2003, is a separate private entity since 2007. Since 2003 it gathers data on each single event generating an operational risk loss exceeding EUR 5.000, which are input by member banks. In addition, it also includes other useful information to contextualize the situation in which the losses</p>

	<p>were generated (for example exposure indicators such as earning margin for each business line, operating costs, legal category of the entity reporting the data). The detailed manual and definition were discussed with BI and CEBS, as to be compliant with supervisory expectations. DIPO processes the information and gives back to banks statistical data and also feedback on issues such as suggestions on recovery, to macro territorial areas, second level event type. All the information conveyed to members is on an anonymous basis, but includes the legal category of each reporting entity, and all the peer groups, composed of other entities presenting similar values of operating costs and earning margins both complete and open for business line. The BI has access to the DIPO reports.</p>
EC7	<p>The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.</p>
Description and findings re EC7	<p>See EC 6 on DIPO. Circular 263 requests TSA and AMA banks to provide on quarterly/half year basis information on the number and amount of operational risk losses, split by type of event and line of business. More detailed reporting requirements are required of AMA banks.</p> <p>The draft regulation on internal controls, in consultation, will require that, in case of severe operational risk events that may undermine a normal bank operations, the bank timely informs the BI and provides for an assessment of its expected impact on the operating functions, both centrally and locally, as well on the relationships with clients and counterparts.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <ul style="list-style-type: none"> (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>There are no regulatory requirements specifically focused on outsourcing in general. There are requirements on outsourcing of the internal audit function (see CP 14). Controls on the banks processes related to outsourced activities have so far been performed during on-site examinations. The non-public part of the supervisory guide (Circular 269) contains specific instructions regarding the supervisory procedures for assessing the adequacy of controls in this regard. Assessors were given access to the standard inspection reports regarding the topic. It seems the focus of outsourcing supervision has mainly been on IT services.</p> <p>The draft regulation for internal controls, in consultation, proposes a specific framework on outsourcing. The consultative document states that banks need to maintain internal technical and managerial skills of the outsourced activities, to be able to control the outsourced activities and access to data. It sets criteria and conditions that banks have to meet in terms of the due diligence and decision process for outsourcing activities, service level agreements, controls over the outsourced activities, information flows from the outsourced activities to permit the banks to be aware of and manage the underlying risks, the contingency plans for the outsourced activities.</p>

Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	<p>BI conducts on a quarterly basis, as part of its financial stability review, an analysis of the operational risk exposure of the TSA and AMA by examining the operational risk losses and related info transmitted by those banks on regular basis. Half yearly, the BI analyses the systemic exposure to operational risk, using supervisory data and the Italian banking association dataset (DIPO). See EC 6. Common points of exposure identified are included in the Financial Risk Outlook that is provided to BI's Directorate. Such common points of exposure may also identify the need for targeted on and off site supervisory reviews and actions (for instance, Libor/Euribor scandal).</p> <p>The BL (article 146) also gives the BI the power to exercise oversight of any provider of payment and clearing services as well as technological or network infrastructures. In this respect the BI issued regulation setting requirements and exercise of controls (Provisions on Retail Payment System Oversight and Operational Guide for controls of September 2012) applicable to 'systemic' providers. BI is encouraged to expand regulatory guidance for BIA banks.</p>
Assessment of Principle 25	Largely compliant
Comments	<p>AMA and TSA banks comprise some 90 percent of the Italian banking system, as measured by the banks total assets. For all banks, the BI calculates, under RAS, a score for operational risk, which uses both quantitative assessment and qualitative. It is clear that requirements for operational risk management are much more detailed and stringent for TSA and AMA banks. Guidance for BIA banks on operational risk monitoring and control is at very high level, in fact, the regulatory basis for action is derived from the general internal controls framework. There is no specific requirement that an operational risk management policy is approved by the board, or that all banks have adequate channels of information of operational risk data and events to boards or the supervisor. The regulation does not properly guide BIA banks on how to identify, assess, evaluate, monitor, report and control or mitigate operational risk. Furthermore, the regulatory framework, even for the more sophisticated banks lacks guidance on IT and outsourcing.</p> <p>However, in spite of the deficiencies in the regulatory framework, assessors were presented evidence, both from the supervisor and from market participants, that actual supervision of operational risk, in particular for TSA and AMA banks, is intensive and intrusive, and supervisors have actively required corrective actions related to operational risks. Capital add-ons are often imposed based on weaknesses of management (even for BIA banks) or relevant findings in AMA frameworks. Market participants confirm the technical quality of the BI team involved in the supervision of operational risk is high and that analysis conducted by BI both onsite and offsite constantly challenges and questions the bank's adequacy of operational risk management and quantification.</p> <p>The supervisory guide contains more details on BI's approach to management of operational risk, including IT and outsourcing, but these are contained in the non-public part of Circular 269. BI has already identified the need to provide more specific requirements on operational risks for all banks, including BIA banks, and has included these elements in the draft regulation on internal controls, still under consultation process at the time of this assessment.</p>

	The BI is encouraged to provide further guidance and requirements based on the BCBS's documents "Principles for effective risk data aggregation and risk reporting", of Jan 2013, "Principles for the Sound Management of Operational Risk", of June 2011, "High-level principles for business continuity, of August 2006, and "Outsourcing in Financial Services" of February 2005, which are applicable to banks and banking groups of all sizes and profiles.
Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁷⁴ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <ul style="list-style-type: none"> (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access.
Description and findings re EC1	<p>Bank internal control and audit requirements are addressed in Circular 229 and Circular 263 and for banks providing investment services the joint regulation of BI and Consob as of October 29, 2007 also applies.</p> <p>Circular 229 defines internal controls as the set of rules, procedures and organizational structures designed to ensure that corporate strategies are complied with and the following objectives achieved:</p> <ul style="list-style-type: none"> • effectiveness and efficiency of corporate processes (administration, production, distribution, etc.); • limitation of risks taken within the limit of approved risk tolerance/appetite set by the

⁷⁴ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>strategic supervisory body;</p> <ul style="list-style-type: none"> • preservation of the value of assets and protection from losses; • reliability and integrity of accounting and management systems; • prevention of the risk that banks are involved in criminal activities such as money laundering and terrorism financing; • conformity of transactions with laws, supervisory regulations and internal policies, plans, rules and procedures. <p>Supervisory instructions require banks to adopt organizational structures that:</p> <ul style="list-style-type: none"> • ensure separation between operating and control functions and prevent conflicts of interest in the assignment of tasks; • are able to adequately identify, measure, prevent or mitigate and monitor all the risks that have been incurred or may be incurred in the different business segments; • establish controls at every operating level and permit unequivocal, formal attribution of tasks and responsibilities; • ensure reliable information systems and appropriate reporting procedures at the different levels of management entrusted with control functions; • guarantee that anomalies found by operating units, the internal audit function or other staff assigned to controls are promptly reported to the competent corporate structures; • allow the recording of every operational event and, in particular, all individual transactions in adequate detail and ensure their correct recognition. <p>The supervisory instructions also include guidance on the control procedures to be implemented at group level so that the holding company can effectively provide direction and coordination as provided for by law.</p>
EC2	<p>The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.</p>
Description and findings re EC2	<p>Circular 269 requires BI to assess the bank organizational structure, during the annual SREP. In particular; verify that there is an appropriate balance in skills and resources of back-office, control and operational functions.</p> <p>According to the circular, control functions have to be provided with an adequate number of qualified staff (both at parent and subsidiary level in groups). Staff has to be qualified on an on-going basis and receive proper training. They need to have appropriate data systems and support at their disposal, with access to the internal and external information necessary to meet their responsibilities.</p> <p>The heads of internal control functions have to be highly skilled professionals with direct access to the supervisory and management bodies and their committees. They cannot have any management or financial responsibility in any operational business lines and are not allowed to be subordinated to business units' heads.</p> <p>In order to assess the expertise and authority of control functions and back office staff within the organization, BI carries out on-site inspections aimed at verifying whether:</p> <ul style="list-style-type: none"> • the staff assigned to control functions have skills and competences adequate to their responsibilities and to the degree of specializations of the tasks that they

	<p>carry out; there are proper and dedicate recruitment procedures;</p> <ul style="list-style-type: none"> • the tasks and the resources assigned to the control functions are coherent with the dimensions and features of the business; • the information available with reference to the professional expertise of the heads of the internal control functions and of the staff testify that specific attention is paid to the professional profiles of internal control functions' staff; • there are training programs for the staff and investments to strengthen the internal control framework; • there is adequate job rotation within each control function and proper tutorial program for new staff.
EC3	<p>The supervisor determines that banks have an adequately staffed, permanent and independent compliance function⁷⁵ that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function</p>
Description and findings re EC3	<p>Circular 229 requires banks to establish a Compliance function to assist senior management in prevent the breach of laws, regulations, Code of Conduct and Ethics and to meet and assess the possible impact of any changes in the legal or regulatory environment on banks' activities.</p> <p>BI requires that the Compliance function and the staff be independent and skilled.</p> <p>The Compliance function has to be established at an adequate hierarchical level and report directly to the supervisory and management bodies. In particular, banks are required:</p> <ul style="list-style-type: none"> • to give it a mandate specifying tasks, responsibilities, resources and information flows directly addressed to the governing bodies; • to appoint an independent responsible; • to ensure adequate safeguards to prevent conflict of interests through separated and dedicated information flows. <p>The main tasks of the Compliance function are the following:</p> <ul style="list-style-type: none"> • identify on a continuous basis laws and regulations applicable to the bank and assess their impact on processes and procedures; • propose changes to the organizational structure and company procedures aimed at ensuring an adequate protection from non-compliance risk; • set information flows with the board and the other control functions; • verify the effectiveness of organizational measures undertaken to prevent compliance risk. <p>BI requires the staff to be competent, updated through training activities and numerically adequate. The banks—where it is necessary, i.e., for specific and complex regulatory changes—have to permit the Compliance function to require external advice. In smaller and</p>

⁷⁵ The term “compliance function” does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	<p>less complex institutions this function may be combined with or assisted by the risk management function.</p> <p>The Compliance function has to ensure that the compliance policy is observed and report to the supervisory and management body on the bank's management of compliance risk. The findings of the Compliance function should be taken into account by the supervisory and management body within the decision-making process.</p> <p>According to supervisory instructions, the bank's Board—with the opinion of the Board of Auditors—endorses the risk compliance policy and at least once year it has to assess the Compliance function adequacy.</p>
EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function⁷⁶ charged with:</p> <p>(a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and</p> <p>(b) ensuring that policies and processes are complied with.</p>
Description and findings re EC4	<p>BI guidance requires banks to establish a permanent Internal Audit function, entrusted to assess whether the quality of an institution's internal control framework is both effective and efficient.</p> <p>For small banks—where establishing this function can be burdensome—the Internal control could be outsourced to third parties provided that the requirements set by the supervisory instructions (i.e., responsibility of senior management, competence and independence of the personnel in charged) are fulfilled.</p> <p>The Internal Audit has unfettered access to relevant documents and information in all operational and control units even if outsourced.</p> <p>Internal audit has to submit to the board and the management the improvements to the risks management policies, measurement tools and procedures. In particular, the Internal Audit is required to evaluate the functionality of the internal control system as a whole and the compliance of all activities and units of a bank (including the Risk Management and Compliance function) with its policies and procedures.</p> <p>Therefore, the Internal Audit cannot be combined with any other function. The Internal Audit shall also assess whether existing policies and procedures remain adequate and comply with legal and regulatory requirements.</p> <p>The Internal Audit verifies, in particular, the integrity of the risk management process, ensuring the reliability of the banks' methods and techniques, assumptions and sources of information used in its internal models (for instance, model risk and accounting measurement). It also evaluates the quality and use of qualitative risk identification and assessment tools.</p>
EC5	<p>The supervisor determines that the internal audit function:</p> <p>(a) has sufficient resources, and staff that are suitably trained and have relevant experience</p>

⁷⁶ The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

	<p>to understand and evaluate the business they are auditing;</p> <p>(b) has appropriate independence with reporting lines to the bank’s Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations;</p> <p>(c) is kept informed in a timely manner of any material changes made to the bank’s risk management strategy, policies or processes;</p> <p>(d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties;</p> <p>(e) employs a methodology that identifies the material risks run by the bank;</p> <p>(f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and</p> <p>(g) has the authority to assess any outsourced functions.</p>
<p>Description and findings re EC5</p>	<p>According to supervisory instructions, the Internal Audit function has to be independent, established at an adequate hierarchical level and must regularly inform the board of directors, board of auditors and management about its activity and results.</p> <p>In more detail, the main tasks of the Internal Audit function are the following:</p> <ul style="list-style-type: none"> • verify, in each business area, the compliance with the limits foreseen by the delegation mechanism as well as the full and right use of the information available to each business unit; • verify the reliability of the information systems, including the automatic data elaboration system and the accounting data recognition system; • carry out periodic tests on the functioning of the operative procedures and of the internal control system; • verify whether there have been irregularities in the business activities; • verify that the deficiencies found in the course of the business or in functioning of the controls have been removed; • assess the functioning and the reliability of the overall risk management process; in addition, for each risk, the internal audit function has to carry out specific tasks; • assess and review the risk management process at least yearly. <p>Based on Circular 269, inspectors during on-site controls verify that the Internal Audit function:</p> <ul style="list-style-type: none"> • has skills and competences adequate to their responsibilities and to the degree of specializations of the tasks that they carry out; • is independent and established at an adequate hierarchical level and regularly informs the board of directors with adequate reports; the head of the Internal Audit has to report directly to the management body in its supervisory function and to relevant control committees within the board and has to be provided with appropriate authority; has access to all bank’s activities regardless of where they are carried out, including outsourced activities and has adequate tools to identify in a timely manner weaknesses in risks’ identification, measurement and management; • defines a plan, approved by the Board or the audit committee, in which the main intervention to perform in the next year are pointed out according to accurate criteria. <p>During the annual SREP, the supervisor assesses the Internal Audit performance drawing</p>

	information from internal audit reports as well as BI inspectors' reports. In doing this assessment, supervisors take into consideration: "governance" of internal auditing processes, e.g., the internal regulation; structure of the function, e.g., the hierarchical level and the number of resources involved into internal auditing and their skills; the professional profile; the quality of its actions; the ability to communicate the evidence from the internal inspections.
Assessment of Principle 26	Compliant
Comments	
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor ⁷⁷ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	Board and management are responsible for preparing financial statements in accordance with the IAS/IFRS endorsed by the European Commission. Circular 262 states that banks—without prejudice to the independent responsibility of the government bodies for their internal control system—shall implement structures that permit the adequate recording of the banks' transactions and ensure their correct recognition over time. Circular 262 defines requirements for financial statements and requires that the accounting system provide a link between the book-keeping records and the financial statements. Similar rules apply to banking groups in accordance with Article 67, par 1, d) of the Banking Law.
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	In compliance with the Italian Law and the BI's regulation, the banks' financial statements are subject to an opinion issued by an independent external auditor; the financial statements are annually transmitted to the BI. In accordance with Articles 14 and 16 of the Legislative Decree n. 39/2010 (which adopted the 8th Directive on auditing), an independent external auditor must: (a) issue an opinion on

⁷⁷ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

	banks' financial statements as a result of an audit conducted in accordance with the auditing standards established by CONSOB that are aligned to the internationally accepted auditing practices and standards; (b) verify that the accounts are kept properly and the transactions are correctly reported in the accounting records.
EC3	The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes
Description and findings re EC3	<p>Regulation EU no. 1606/2002 sets out the provisions to adopt the IASs to consolidated annual reports for listed banking groups. Legislative Decree no. 38/05, according to the Regulation EU no. 1606/2002, extended the application of IASs to non-listed banking groups and all individual banks (solo annual reports) and delegated the BI in regulating the presentation of the banks' financial statements.</p> <p>In performing the audit of the financial statement, the external auditor reviews the reliability of estimated fair value for financial reporting purposes.</p> <p>BI doesn't have any powers on accounting valuations, however through the assessment of valuation used for regulatory purposes indirectly affects those used for financial reporting purposes.</p> <p>The valuation used for financial reporting purposes and for regulatory purposes are generally consistent. Some differences can be provided for credit and market risk for banks that adopt internal valuation models.</p> <p>Regulation lays down that for credit risk valuation banks are required to keep all the related information with an adequate detail level. Moreover the Regulation lays down that, in the scope of market risk valuation, banks must apply adjustment to accounting data in some cases (e.g., in case of illiquid market position). Banks' internal auditing is required to review the framework, structure and processes for fair value estimation.</p>
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit
Description and findings re EC4	External auditors apply the auditing standards issued by the National Professional Accountant Association which are substantially consistent with the International Auditing Standards (ISA). These standards require the use of a risk and materiality based approach in planning and performing the external audit.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	The auditing standards recommended by CONSOB cover all the main areas of the financial statements, including the ones indicated in this essential criterion. With regard to the audit of banks' financial statements, the Italian Auditing Standard 1006, which is compliant with IAPS 1006, provides additional guidance for banks' external auditors that lists specific risk factors in bank auditing activities and how to respond (e.g., specific consideration in the assessment of General IT Environment and Service Organizations and substantive procedures to perform on

	significant accounting balances such as loans, securities and off-balance items).
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	<p>Pursuant to the Italian Law, the external auditors are supervised by CONSOB which supervises the organization and the activity of the external auditors of public interest entities (which include all banks) to verify their independence and technical adequacy. CONSOB periodically performs quality controls on external auditors and it has access to external auditors' working papers. Where CONSOB finds irregularities in the performance of auditing activity, it has the power to revoke the audit engagement.</p> <p>The external auditor is appointed by the banks' shareholders on the basis of a proposal made by the supervisory body, for a period of maximum nine years. The appointment of the external auditor shall be communicated to the BI. The latter has no power to reject the audit engagement since the appointment of the external auditor comes from a decision taken by banks in their own management autonomy. However, bank's supervisory body must, inter alia, monitor the external audit process and BI oversees, inter alia, the adequacy and experience of the members of the bank's supervisory body.</p> <p>The BI doesn't have any supervisory powers on external auditors because, as mentioned above, such powers are entrusted to CONSOB. For this reason, BI does not have any power to reject or rescind the audit appointment.</p>
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	Article 17 of L.D. n. 39/2010 provides for both audit firm rotation and audit partner rotation. With regard to the former, it provides that: the audit engagement shall last for nine financial years for audit firms and seven financial years for individual statutory auditors. It may not be renewed if at least three financial years have not elapsed from the termination of the previous engagement (so called cooling-off period of three years). As far as audit partner rotation is concerned, the Article provides that: the same person may not be responsible for the audit of the accounts of a company for a period exceeding seven financial years nor may such person be appointed to the position again, in relation to the audit of the accounts of that company, including on behalf of a different audit firm, until at least two years have elapsed from the termination of the previous appointment (so called cooling-off period of two years).
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	BI meets periodically, at least twice a year with representatives of the external auditors' association (Assirevi) to discuss about the current accounting issues and to ensure the consistent application of the accounting and disclosure standards to banks' financial statement. Moreover bilateral or trilateral meetings with the bank and its external auditor are held, when it's deemed necessary, in order to discuss specific accounting issues.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.

Description and findings re EC9	In accordance with Article 52 of the Banking Law and the BI regulation, the external auditor has to notify the BI, without delay, of acts or facts found in the performance of the audit engagement that may constitute a serious breach of the banking law, affect the bank's ability to continue as a going concern or result in an adverse or a qualified opinion on the financial statement or a disclaimer. BI has the power to require the external auditor to send any other information or documents. The above provisions also apply to the bodies that perform the same tasks with respect to companies that control banks or are controlled by banks pursuant to Article 23 of the Banking Law.
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	In performing its oversight function, CONSOB has the power to access external auditors' working papers. Since BI has no supervisory responsibility on external auditors of banks, it has no access to external auditors' working papers except when, according Article 52 of the Banking Law, the external auditor of banks has to notify the BI of acts or facts found in the performance of the audit engagement that may constitute a serious breach of the banking law, affect the bank's ability to continue as a going concern or result in an adverse or a qualified opinion on the financial statement or a disclaimer.
Assessment of Principle 27	Largely Compliant
Comments	BI lacks authority to require banks to replace an external auditor and also lacks the authority to review the work papers of external auditors.
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁷⁸ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	Disclosures concerning risk exposures and risk management strategies are addressed in Circular 263, issued by BI according to Pillar 3 framework. The Circular requires the banks to use standardized tables and formats (consistent with the schemes included into the Basel 2 Regulation) to provide the required information. Further details about the bank's financial condition and performance are included in the notes to the annual report, according to BI's Circular 262 which requires the banks to use standardized tables and formats to provide the required information. The Circular requires

⁷⁸ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	<p>that annual reports, on solo and consolidated basis, are prepared transparently and represent in the true and fairly way the financial condition and performance of the intermediaries. For this purpose banks must include any other information that they retain useful for a true and fairly representation.</p> <p>The BI Circular 263 requires banks to adopt suitable arrangements to ensure the compliance of disclosure with the regulations as part of the internal controls system. The quality of information is independently assessed and verified by the governing bodies.</p> <p>The banks are required to formalize strategies and procedures in order to assure the respect of the information requirements. The banks have to ensure completeness, fairness and truthfulness of the information disclosed.</p> <p>Disclosures according to the regulations shall be published by the deadline provided for the publication of the annual report.</p>
EC2	<p>The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.</p>
Description and findings re EC2	<p>According to the BI's Circular 263 banks are required to disclose quantitative and qualitative information on capital structure and adequacy (own funds, capital requirements), risk exposures (standardized and IRB credit risk approach, market risk, operational risk), risk management and remuneration systems.</p> <p>In compliance with the BI's Circular no. 262, banks shall also provide in the notes to the financial statements qualitative and quantitative information on: financial performance and financial position; risk exposures and risk management strategies and practices; accounting policies; transactions and aggregate exposures with related parties; remuneration.</p> <p>Listed banks are required to disclose information on corporate governance in the report on operations, according to accounting provisions. In some cases, banks issue a specific and detailed report on corporate governance (available on their web-site), referenced in the report on operations.</p> <p>On the basis of the principle of proportionality, the level of detail of the disclosures is commensurate with the organizational complexity of the banks and the type of business they engage in. Furthermore, banks must disclose information related only to the activities in which they are engaged, the risks assumed and methodologies used to measure and monitor them.</p>
EC3	<p>Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.</p>
Description and findings re EC3	<p>Banks are required to describe the entities within the group distinguishing if these entities are: (1) fully consolidated, (2) proportionally consolidate, (3) deducted from the supervisory capital, (4) neither consolidated nor deducted. Furthermore, banks are asked to report the differences in the consolidation approach respectively for accounting and prudential purposes.</p> <p>Information on the interest held in all entities, included those in the group, is disclosed in the "Management Commentary" enclosed to the annual report, on solo and consolidated basis.</p>

EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	<p>The BI assesses compliance with requirements on public disclosure through the following types of activities:</p> <ul style="list-style-type: none"> • assessment of the reliability of the processes of production, processing and dissemination of information. Such activity is carried out mainly as part of the on-site controls. These controls include the assessment of the independence and qualification of function in charge of controlling the quality of the disclosure; • analysis of the disclosure required by Pillar 3 requirements, with particular reference to those required for the use of internal systems for the calculation of capital requirements and risk mitigation; • analysis of the disclosure included in the financial statements. • according to art. 144 of BL in case of non-compliance with the supervisory regulations, included those concerning Pillar 3 disclosure, managers and employees are liable of a penalty ranging from EUR 2.580 to EUR 129.110. Imposition of such penalty is published on the BI Supervisory Bulletin.
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	<p>BI regularly publishes aggregated information and statistics on the banking system.</p> <p>The BI Statistical Bulletin (published quarterly) and the series of related supplements (most of which are published monthly) contain, among other things, detailed data and parameters on the operations and risks of banks, the distribution of credit, balance sheet items and interest rates. Among the others, it is worth citing the supplement "Money and Banking." A summary of the main indicators concerning the balance sheet is published monthly in the paper "Main items of bank's balance sheets."</p> <p>An analysis of the banking system is presented in specific sections both in the Annual Report and the Economic Bulletin (the latter published on a quarterly basis).</p> <p>The Financial Stability Report provides aggregate information on risk factors within banking sector.</p>
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	<p>Information included in the notes of the annual reports contains, among other things: average data (e.g., notional value of financial derivatives) that provide with information on the average size of the transactions during the reporting period; a reconciliation of changes in the allowance for financial assets impairment; residual contractual maturity data and repricing date/residual maturity data.</p> <p>Further information included in the notes of annual reports and in the pillar 3 disclosure refers to interim changes of impaired assets and provisions. These data describe the evolution</p>

	<p>of bank's credit risk exposure during the reporting period.</p> <p>Specific interim information is required to banks with internal systems for the calculation of capital requirements and to listed banks.</p> <p>Banks with internal systems for the calculation of capital requirements for credit and operational risk publish supervisory capital and capital adequacy information at least on a quarterly basis, whereas the other quantitative information has to be provided at least on a semi-annual basis.</p> <p>Listed banks publish interim reports in March and September and a half yearly report in June.</p>
Assessment of Principle 28	Compliant
Comments	
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁷⁹
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>For legal responsibilities and powers of the BI, see CP 1. With the entry into force of Legislative Decree n. 231 of November 21, 2007 (hereinafter AML Law)⁸⁰, which transposed the directive 2005/60/EC of the European Union on anti-money laundering and combating terrorist financing, all financial institutions supervised by the BI (banks, investment firms, asset management companies, non bank financial institutions, electronic money institutions, payment institutions) have also been subject to specific anti-money laundering and counter financing of terrorism (AML/CFT) obligations. In particular, the AML Law introduced CDD obligations that financial institutions must calibrate against the material level of customer's risk (risk-based approach).</p> <p>The Legislative Decree also draws a new AML/CFT institutional lay out, defining roles and competences of relevant actors (among others Supervisory Authorities and UIF). The AML Law established, from January 1, 2008, the Unità di Informazione Finanziaria (UIF) within the Banca d'Italia as the new Financial Intelligence Unit, following the suppression of the Ufficio Italiano dei Cambi. The UIF is responsible for the collection and the analysis of suspicious transaction</p>

⁷⁹ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8, and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

⁸⁰ The Decree was updated by Legislative Decree n. 151 of September 25, 2009 and Decree-Law n. 78 of May 31, 2010 converted into Law n.122 of July 30, 2010, Decree-Law n. 16 of March 2, 2012 converted into Law n. 44 of April 26, 2012, Legislative Decree n. 45 of April 16, 2012, Legislative Decree n. 130 of July 30, 2012 and Legislative Decree n. 169 of September 19, 2012.

	<p>reports. In line with international standards, The UIF performs its functions autonomously and independently using human, technical and financial resources and instrumental goods provided by the BI. The organization and activity of the UIF are governed by a BI regulation. The BI is a member of the Financial Security Committee, the intergovernmental body in charge with the coordination of AML/CFT policies. The BI has the task of issuing implementing provisions for supervised entities on customer due diligence, registration and internal organization requirements; the BI is also responsible for conducting controls in the area and applying sanctions for violations detected.</p> <p>More specifically, according to art. 7 of the AML Law, the BI issues provisions with regard to: customer due diligence, recording and preserving data in a single computerized and standardized database (so-called Archivio Unico Informativo—AUI) ; organizational, procedural and internal control matters aimed at ensuring the performance of anti money-laundering duties, including the obligation to report suspicious transactions. On 11 March 2011 the BI issued a Regulation on internal organization, procedures and controls specifically addressed to AML/CTF issues.</p> <p>To verify compliance with anti-money-laundering obligations, the BI can carry out inspections and require the presentation or transmission of documents, acts and any other useful information (art. 53 AML law). On-site and off-site controls are integrated into the broader supervisory evaluations: ML/FT risks facing each bank are part of the general supervisory examination conducted off-site to verify the sound and prudent management of the bank and specific AML/CFT requirements or controls may be tailored according to the degree of money-laundering risk to which the banks are exposed, in line with the provisions of AML law (and Circular 269, Part I, Section I, Chapter 3 and Part III, Chapter 1). Ad-hoc on-site visits to banks' HQ or branches may be conducted. In cases of failure to comply with the provisions of the AML Law, the BI can impose pecuniary administrative sanctions (art. 56 AML law). In addition, according to the seriousness of the breach detected, the BI may exercise all the supervisory powers assigned by the BL (See CP 11).</p>
EC2	<p>The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>See CP 14 and CP 15. Internal controls are expected to promote proper conduct and to prevent banks from being involved in fraud or used for criminal purposes. Specifically regarding AML, BI issued, in March 2011, provisions on internal organization, procedures and controls intended to prevent the use of intermediaries for ML and TF purposes. The regulation—which came into force on September 1, 2011—requires intermediaries to have appropriate organizational arrangements and procedures to deal with the risk of being involved, wittingly or unwittingly, in money laundering and in terrorism financing. Intermediaries must introduce procedures designed to ensure the full knowledge of the customer, the traceability of financial transactions and the detection and reporting of suspicious transactions. Banks are required to institute a dedicated anti-money-laundering function.</p> <p>The AML/CTF law requires banks to report to the UIF suspicious transactions (articles 11, paragraph 1, lett. a) and article 41 of the AML/CTF law). The BI provisions on internal organization, procedures and controls of March 2011 detail the requirements that banks have to comply with in handling and reporting suspicious transactions.</p> <p>Great emphasis was placed on the contribution of corporate bodies responsible for the overall supervision of the company. They are required to define business policies consistent</p>

	<p>with the principles and rules against money laundering; adopt appropriate policies to preserve the integrity of the company; implement organizational and operational measures aimed at avoiding the risk of involvement in cases of money laundering and financing of terrorism; carry out checks on compliance with the regulations and the appropriate risk management procedures; ensure a system of information flows to the corporate bodies and within them that is adequate, complete and timely.</p> <p>The BI is also going to issue further instructions on Customer Due Diligence (CDD) measures to help banks define their internal CDD policies; a draft text was submitted to public consultation in March 2012 and the new provisions will be issued later in the year.</p>
EC3	In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank. ⁸¹
Description and findings re EC3	<p>According to art 52 of AML Law, the banks' control bodies (Board of Auditors, Supervisory Board, Management Control Committee, supervisory body referred to in Article 6(1)(b) of the AML law and all the persons charged with management control) must communicate, without delay, to the BI all the acts or deeds coming to their notice in the course of their duties which could constitute a violation of the provisions issued under Article 7 (regarding customer due diligence, internal organization, recording, procedures and controls). Failure to comply with this obligation is punished under criminal law (art. 55(5) of the AML Law).</p> <p>More generally, Art. 52 of the BL requires that the bank bodies in charge with control functions must inform the BI without delay of every act or fact it comes to know of that may constitute an irregularity in the management of banks or a violation of the provisions governing banking.</p>
EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.
Description and findings re EC4	<p>The AML Law requires the BI to cooperate with the other financial supervisors and with the Italian FIU for anti-money laundering purposes; thus, in derogation to the obligation of professional secrecy, the BI may exchange information with other financial supervisors and the FIU, in order to facilitate the performance of their respective functions (art. 9 AML law).</p> <p>Coordination between the BI and the Financial Intelligence Unit is governed by a memorandum of understanding, which guarantees consistent and effective performance of their respective duties. In accordance with this agreement, the BI reports to the FIU suspicious transactions and any facts that may be relevant to the functions of the Unit, found in the performance of its supervisory activities.</p> <p>In addition, pursuant to article 331 of the Italian Code of Criminal Procedure, the BI reports to the judicial and police investigative bodies (i.e., the Finance Police) any irregularities which appear to be criminal offences. In addition, according to the BL, the BI supplies judicial authorities with information requested in the framework of investigations or proceedings involving violations subject to criminal sanctions.</p>

⁸¹ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	<p>In accordance with Legislative Decree 109/2007, the BI collaborates with the Financial Security Committee in the field of terrorism financing, also exchanging information deriving from its supervisory activities.</p> <p>Finally, pursuant to the 2007 Protocol with CONSOB, the BI must timely communicate to the CONSOB any fact of possible interests detected in the performance of its supervisory activities.</p> <p>Assessors were shown examples where such communications occurred in practice.</p>
<p>EC5</p>	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.
<p>Description and findings re EC5</p>	<p>The Regulation issued by the BI in March 2011 on internal organization, procedures and controls requires banks to define business policies consistent with the principles and rules of AML Law. Banks must also establish procedures to ensure compliance with the obligations of customer due diligence, record keeping, reporting of suspicious transactions.</p> <p>CDD policies and processes should be well documented and communicated to all relevant staff and fully integrated into the bank's overall risk management; a dedicated anti-money laundering function should be created and integrated within the corporate control. Parent companies should ensure that these CDD procedures are consistently applied at group-wide level.</p> <p>The BI is going to issue instructions on CDD measures to help banks define their internal CDD policies; a draft text was submitted to public consultation in March 2012 and the new provisions will be issued later in the year. The new instructions will provide intermediaries with provisions on the implementation of the risk-based approach in the area of CDD as well</p>

<p>as specific requirements for the cases where enhanced CDD measures should apply.</p> <p>As concerns the specific AML obligations applicable under the Italian law and regulations:</p> <p>CDD banks' procedures must be applied by calibrating them to the risk of money laundering and terrorism financing associated with the individual case (business relationship and/or transaction). To assess the level of this risk, which gives rise to the application of differentiated measures of CDD—simplified or enhanced in relation respectively to cases of lower or greater risk—banks can apply the general criteria indicated in art. 20 of AML Law.</p> <p>These criteria make reference, for the customer, to legal form; principal activity, behavior, geographical area of reference and—for transaction or continuous relationship—to the type, the manner of performing, the amount; the frequency, the reasonableness, the geographical area of destination.</p> <p>Banks should not enter business relationships whose risk is not acceptable.</p> <p>The AML Law requires financial intermediaries to perform customer due diligence when establishing a business relationship or when carrying out occasional transactions involving the transmission or transfer of means of payment amounting to EUR 15,000 or more, regardless of whether the transaction is carried out in a single operation or in several operations that appear to be related, so as to carry out a split operation. Regardless of any applicable derogation, exemption or threshold, CDD should also be performed when there is a suspicion of money laundering or terrorist financing or when there are doubts about the veracity or adequacy of previously obtained customer identification data.</p> <p>CDD implies the identification and verification of the customer and, where applicable, of the beneficial owner; it is also required to obtain information on the purpose and intended nature of the business relationship. Financial intermediaries must ensure ongoing monitoring of the relationship. The CDD procedures must be applied by calibrating them to the risk associated with the type of customer, relationship, professional service, operation, product or transaction in question. Enhanced CDD should apply whenever banks assess that a relationship or a transaction is high-risk.</p> <p>When financial institutions are unable to comply with CDD requirements laid down by AML Law, they may not establish the relationship or carry out transactions or professional services or must terminate the continuous relationship or professional service and must assess whether to make a report to the FIU.</p> <p>CDD procedures should allow an ongoing monitoring of customers in order to periodically review their risk profile.</p> <p>Banks should have in place policies and procedure to detect unusual or potentially suspicious transactions. To this end, they may make use of electronic screening software dedicated to the monitoring of transactions.</p> <p>Banks must apply enhanced CDD measures when there is a greater risk of money laundering or terrorist financing, as well as in the cases expressly indicated by the AML Law (art. 28), which are the following: (1) when the customer is not physically present (non face-to-face transactions); (2) in the case of correspondent accounts with non-EU respondent institutions (see sub EC6); (3) in respect of transactions or relationships with politically exposed persons (PEPs).</p> <p>Enhanced measures may comprise the request of additional information from the customer, closer and more frequent monitoring of transactions, the need for prior approval by banks' senior management.</p>

	<p>For PEPs, in particular, the law requires that banks should: establish adequate risk-based procedures to determine whether the customer is a PEP; obtain the authorization of the general manager or a person performing an equivalent function before establishing a continuous relationship with such customers; take all necessary measures to establish the source of wealth and source of funds that are involved in the continuous relationship or the transaction; conduct enhanced ongoing monitoring of the continuous relationship or professional service.</p> <p>Pursuant to art. 7 of AML Law, the BI issued in December 2009 instructions on the recording in the single electronic database (Archivio Unico Informativo—AUI) of the customer data that banks acquire in the course of customer due diligence. The text contains technical provisions that implement the requirements set by the AML Law. Financial institutions must retain the documents and record the information acquired in satisfying the customer due diligence requirements for a period of ten years and store them in the single electronic database.</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	<p>The BI requires credit institutions to apply enhanced CDD measures with respect to correspondent accounts with non-EU respondent institutions. Italian banks must gather sufficient information about the respondent institution to fully understand the nature of the respondent's business and to determine, on the basis of public registers, lists, acts or publicly available documents, the reputation of the institution and the quality of the supervision to which it is subject. Banks are also called to assess the quality of the anti-money-laundering and anti-terrorist-financing controls to which the respondent institution is subject and to obtain the authorization of the general manager, his delegate or a person performing an equivalent function before opening new correspondent accounts (AML law, art. 28.4).</p> <p>If banks are unable to comply with these obligations, they must refrain from establishing the relationship or carry out transactions or must terminate the relationship or professional service and make a report to the FIU when appropriate.</p> <p>AML law (art. 28.6) expressly prohibits to open or to maintain correspondent accounts with a shell bank (or with a bank known to allow a shell bank to use its accounts).</p>
EC7	<p>The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.</p>
Description and findings re EC7	<p>The BI requires banks to set up a structured and coordinated system of internal controls, functional to the timely detection and management of risk of money laundering: deficiencies and anomalies detected following those checks at various levels must be brought promptly to the attention of the corporate bodies (BI Regulation of March 2011 on internal organization, procedures and controls to prevent financial intermediaries and other subjects from being used for the purposes of money laundering and terrorist financing).</p> <p>The BI also requires the establishment of procedures to ensure compliance with the requirements of suspicious transactions reporting. These procedures must be able to ensure certainty of reference, consistency in behavior, general application to the whole structure, as</p>

	<p>well as the confidentiality of the identity of persons who participated in the process of suspicious transaction reporting. Banks must also adopt tools for the detection of anomaly operations.</p> <p>In its supervisory activity, the BI assesses reliability and effectiveness of controls and systems which banks must have in place according to the abovementioned regulation.</p>
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	See CP 11. The BI can choose from a wide range of measures against a bank which is not compliant with the obligations arising from law or regulation regarding criminal activities.
EC9	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> (a) requirements for internal audit and/or external experts⁸² to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.
Description and findings re EC9	<p>According to the Circ. 229, the BI requires banks to establish an internal audit function with the task of assessing the adequacy, reliability and functionality of the risk management processes and the internal control systems and verifying the correctness of operations and the sustainability of risks taken. The internal audit functions must have the power to request information and to conduct on-site verification. The internal audit should be autonomous and independent from other control functions (i.e., compliance and AML) in order to ensure the impartiality of periodic assessments conducted by internal audit itself on the adequacy and effectiveness of corporate control system. The BI may at any time access reports prepared by internal audit (see CP 26).</p> <p>In addition the BI requires the appointment of a person responsible for compliance and for anti-money laundering functions. Specific procedures are provided for the nomination of the dedicated staff, which must possess an appropriate level of independence, authority and experience; Given the importance of the tasks attributed, the internal regulations of the bank should define the measures for the protection of the stability and independence of the responsible. The anti-money laundering officer may also be entrusted with the task of assessing and transmit the suspicious transaction reports to the FIU (BI Regulation of March 2011 on internal organization, procedures and controls to prevent financial intermediaries and other subjects from being used for the purposes of money laundering and terrorist financing).</p> <p>Staff that performs compliance or AML functions must be sufficient in number, possess the</p>

⁸² These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>necessary technical and professional expertise and have up-to-date skills, which should be maintained through ongoing training programs. The compliance function must also verify whether the company compensation system (specifically, employee remuneration and incentive systems) is consistent with the objective of complying with regulations. (BI Regulation of March 2011 on internal organization, procedures and controls to prevent financial intermediaries and other subjects from being used for the purposes of money laundering and terrorist financing).</p> <p>In the case of outsourcing, the principal should ensure that the outsourcer commits to the respect of the applicable AML rules. The principal remains responsible for any violation of those rules. (BI Regulation of March 2011 on internal organization, procedures and controls to prevent financial intermediaries and other subjects from being used for the purposes of money laundering and terrorist financing).</p> <p>The AML Law (art. 54) places great emphasis on staff training, which must include training programs to ensure prompt detection of activities potentially linked to money laundering or terrorist financing. The 2011 regulation of the BI expressly states that staff qualifications must be state-of-the-art and maintained through on-going training. To this end banks should plan specific training programs.</p>
EC10	<p>The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.</p>
Description and findings re EC10	<p>The BI requires banks to instruct staff on their duties and responsibilities in the architecture of internal controls. Banks should also define proper channels of communication in order to provide banks' boards, management and the dedicated officers with timely and appropriate information on relevant facts of abuse for immediate action (Supervisory Instructions, Circ. 229 of April 10, 2007).</p> <p>The compliance officer must have direct access to all relevant information for its duties, including through direct communication with relevant staff. (BI Regulation on compliance of July 9, 2007).</p> <p>Internal audit and compliance must prepare periodic reports to banks' boards and management on their activities. Timely and appropriate information must be provided when problems related to abuse have been detected. Banks' boards may request internal audit or compliance to conduct ad-hoc investigations on facts that may constitute a risk of non-compliance with relevant laws or regulations.</p> <p>The BI is reviewing its regulation on internal controls of banks to establish also a whistle-blowing procedure. This procedure allows banks' staff to directly report to both management and control functions any irregularities affecting the activities of the intermediary. A dedicated channel of communication should be created and reporting staff would enjoy specific guarantees of confidentiality to avoid retaliations or discrimination. The draft regulation is currently under public consultation (Supervisory Instructions, Consultative Document of September 4, 2012).</p>
EC11	<p>Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.</p>
Description and	<p>Pursuant to art. 41(6) of the AML Law, reports of suspicious transactions must not constitute a</p>

findings re EC11	<p>violation of secrecy requirements, professional secrecy or any limits to the communication of information imposed by contract or by laws, regulations or administrative provisions and, if the reports are made for the envisaged purposes and in good faith, they must not incur liability of any kind.</p> <p>Furthermore, art. 45 of the AML Law protects the privacy of the individuals who make reports. Indeed, intermediaries must adopt adequate measures to ensure the maximum protection of the identity of such persons. Acts and documents that give the identifying particulars of such individuals must be kept under the direct responsibility of the owner or legal representative of the business or his/her delegate. The identity of individuals can only be revealed when the judicial authority, by reasoned decree, deems it indispensable for the purposes of ascertaining the crimes that are the subject of proceedings.</p>
EC12	<p>The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.</p>
Description and findings re EC12	<p>See CP 3. Cooperation with domestic and foreign financial supervisors is regulated by art. 7 of the BL. At the national level, the BI, Consob, COVIP, ISVAP (now IVASS) and the UIF must cooperate to facilitate the performance of their respective functions. These authorities may not invoke professional secrecy against each other. The duties of collaboration between supervisory authorities have been reinforced with the entry into force of law 262/2005.</p> <p>The BI cooperates, including by exchanging information, with the competent supervisory authorities of the other EU member. Information received by the BI may be transmitted to competent Italian authorities unless permission is denied by the authority of the member state providing the information. Within the framework of cooperation agreements and equivalent obligations of confidentiality, the BI may exchange information related to the performance of supervisory functions with non-EU competent supervisory authorities.</p> <p>The cooperation with foreign counterparts includes the possibility of conducting joint inspections on Italian intermediaries established overseas and on foreign intermediaries established in Italy. EU supervisory authorities may delegate the BI to conduct on-site visits on their behalf.</p> <p>The AML Law requires financial sector supervisory authorities to cooperate with each other and with the FIU in order to facilitate the performance of their respective functions; by way of derogation from the obligation of professional secrecy, cooperation includes the exchange of information, including by reporting to the FIU suspicious cases detected in the course of supervision.</p> <p>The BI cooperates with the judicial and law enforcement authorities, in accordance with article 7 of 1993 BL and article 9 of AML Law. The BI reports to the judicial authorities any irregularities detected in the course of supervisory activity which may have criminal relevance.</p>
EC13	<p>Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.</p>
Description and findings re EC13	<p>Within the Banking Supervisory Area of the BI there is a specialized unit (Divisione Rapporti con le Autorità within the Servizio Rapporti Esterni e Affari Generali) dedicated to the relationships with the Judiciary and the police investigative bodies for matters related to abuse of credit institutions for criminal purposes. This unit oversees the supervisory policies of the BI to combat economic crime; in this framework, it is also in charge with the regulatory and control activities in the AML sector.</p>

	<p>The Divisione Rapporti con le Autorità contributes to the definition and implementation of the annual program of (general and targeted) on-site visits drafted by the Supervision Inspectorate Service.</p> <p>Following requests from the Judiciary, the BI also provides assistance in criminal investigations supplying advisors in financial matters, normally drawn from staff of the Supervision Inspectorate Service. Furthermore, specialized staff of the BI is permanently seconded to the Milan Prosecutor Office to collaborate in economic crime investigations.</p> <p>As a part of its activities, the Divisione Rapporti con le Autorità issues general warnings to supervised entities on risks of money laundering and the financing of terrorism. These warnings usually identify specific ML/FT risks encountered in the exercise of supervisory tasks or draw the attention of banks on AML/CFT measures recommended or requested at international level (i.e., FATF black list, UN sanctions); these warnings provide also instructions on the proper procedures for fulfilling anti-money laundering obligations and compliance with the rules.</p> <p>Furthermore, the BI, in collaboration with the UIF, provides banks with red-flag indicators for the purpose of facilitating the identification of suspicious transactions. In this respect, an articulated document has been published in August 2010.</p> <p>As a part of its institutional tasks, the UIF regularly publishes analyses and studies on models and patterns of money laundering or terrorist financing. The UIF is also responsible for providing feed-back to reporting entities on the results of the analysis conducted on reported suspicious transactions.</p>
Assessment of Principle 29	Compliant ⁸³
Comments	

⁸³ Assessors benefited from the FATF reports on AML legal framework in Italy, in particular the Mutual Evaluation Report update of 2009.

RECOMMENDED ACTIONS AND AUTHORITIES

COMMENTS

A. Recommended Actions

Recommended Actions to Improve Compliance with the Basel Core Principles and the effectiveness of regulatory and supervisory frameworks	
Reference Principle	Recommended Action
1. Responsibilities, objectives and powers	<ul style="list-style-type: none"> Introduce legal changes to allow BI to withdraw banking licenses independently from the MEF
5. Licensing criteria	<ul style="list-style-type: none"> Expand the definition of fit and proper so that adverse regulatory judgments can be taken into consideration Amend regulatory framework so that BI routinely receives the underlying documentation relative to the banks' assessment of fitness and propriety, so that it can conduct its own assessment as part of a normal licensing process. Amend supervisory guidance for licensing providing more explicit guidance for the assessment of financial suitability of major shareholders, including a sustainability analysis of leverage levels and the capacity to provide additional capital in the first years of the new institution or under a scenario of stress.
7. Major acquisitions	<ul style="list-style-type: none"> It is recommended that prior notifications are extended to all cases where acquisition will imply control, even within prescribed limits, to allow timely preventive measures by the BI.
11. Corrective and sanctioning powers of supervisors	<ul style="list-style-type: none"> Introduce legal changes to provide BI with the power to remove and suspend bank's managers from exercising functions in financial institutions. Introduce legal changes to provide BI with the capacity to impose pecuniary sanctions not only on individuals, but also on the entity.
13. Home-host relationships	Resolution is pending adoption of EU legislation on resolution.
14. Corporate governance	Implement internal control regulation that just completed the consultation period.
15. Risk management process	See risk management recommendations in CPs 17, 19, 21 and 25.

17. Credit risk	Issue guidance requiring that credit transactions be made on market terms and that large and/or high risk operations over a certain threshold be approved by the Board.
18. Problem assets, provisions, and reserves	Develop prudential guidelines to expedite the turnover of NPLs.
19. Concentration risk and large exposure limits	<ul style="list-style-type: none"> • issue guidance/regulation covering the whole spectrum of concentration risk management and monitoring required by the revised CP. • review current exceptions to large exposures regime that may undermine prudential considerations. • review limits as to apply consistently on both solo and consolidated.
20. Transactions with related parties	<ul style="list-style-type: none"> • Amend regulations to require explicitly that the board member or persons with conflict of interest are excluded from the decision making process. • Amend regulation to require that related party transactions do not occur in more favorable terms than those to non-related party clients.
21. Country and transfer risks	<ul style="list-style-type: none"> • Issue guidance on country and transfer risk that can be understood and applied by all banks. In particular, banks need to be made aware that an overall deterioration of credit risk in a country can lead to many private contracts not being observed, even when not linked to any specific restrictions imposed by governments. In another words, country risk may be linked to the possibility that political and/or economic events occur and influence the quality of the banks portfolio.
25. Operational risk	<ul style="list-style-type: none"> • Amend regulations to provide more guidance, in particular to BIA banks, on how to identify, assess, evaluate, monitor, report and control or mitigate operational risk. • Amend regulations to clarify that the operational risk management policy needs approved by the board, that all banks must have adequate channels of information of operational risk data and events to boards or the supervisor. • Enhance regulations on IT and outsourcing, as planned.
27. Financial reporting and external audit	Propose amendments to CFL granting BL authority to review external auditor work papers and to remove auditors for bank-specific prudential reasons.

B. Authorities' Response to the Assessment

49. The Italian authorities appreciate the positive assessment of Italy's banking supervisory rules and practices. The authorities emphasize that Italy is the first country to be evaluated and rated according to the full set of the new Basel Core Principles—Essential and Additional Criteria—which are both stricter and broader in scope than the previous BCP release and now attach greater importance to the effectiveness of actual supervision.

50. We wish to submit a few general remarks and a number of more specific comments on the Report's evaluations and recommendations.

General Remarks

51. Regulatory choices of the Italian authorities have to be consistent with EU legislation: it is impossible for Italy to implement any recommendation inconsistent with EU law. Within this framework, the degree of freedom available to national authorities is limited and will decrease further over the next few years. In the case of the rules governing major acquisitions (CP 7), for example, EU directives do not envisage prior approval by supervisors: the Italian requirement of prior notification of major acquisitions to the Bank of Italy (and the Bank's power to block the acquisition for prudential reasons) thus appears to strike an appropriate balance. Similar considerations apply to certain exemptions from the large exposure regime (CP 19), which are provided for in the EU legislation and not subject to derogation by Member States.

52. A second general comment refers to the application of one specific critical remark to the grading of more than one CP, thereby inflating the count of not fully positive evaluations and generating a negative bias in the overall assessment. For example, the lack of powers of supervision in respect of banks' board members and managers affects four CPs: CP1 on "Responsibilities, objectives and powers," CP5 on "Licensing," CP 11 on "Corrective powers" and CP 14 on "Corporate governance." Similarly, the final grade of CP 15 (risk management) is affected by weaknesses pertaining to the CPs dedicated to specific risk profiles.

53. A third observation is that some of the recommendations concern measures that have already been adopted by recent or forthcoming regulations (e.g. legal protection for bank supervisors and licensing), as is more extensively described in the specific remarks on CP2, CP5, and CP21.

54. Notwithstanding these general considerations, the Italian authorities broadly share the IMF's recommendations and, within their regulatory powers, intend to take—indeed in many cases have already taken—the necessary steps to implement them. In particular, the transposition of the forthcoming CRD IV will provide the opportunity for a review of the requirements of integrity and experience for banks' directors and of the sanction regime.

Specific remarks

Protection for Bank Supervision (CP2)

55. The Bank of Italy has now issued an internal regulation (circular 283 of 15 April 2013) implementing the decision of the BI's Board of Directors of 18 December 2012) that the BI will pay the legal costs of employees (as well as former employees) in advance for lawsuits concerning actions and/or omissions in the performance of their duties. The BI will also reimburse such legal costs where they have not been requested in advance or where they come to more than the amount advanced, not only after the final judgement (as in the previous regulation), but also after each intermediate judgment (lower court, appeal, etc.), at which the court finds the employee or former employee not liable.

Licensing (CP5)

56. The IMF recommends amending the regulatory framework to ensure that the BI routinely receives the underlying documentation relative to the banks' assessment of experience and integrity of bank directors and managers, as part of its own assessment and normal licensing procedures. We would like to point out that already under current regulations, the BI gets the minutes of the meetings at which banks' boards of directors assess their directors' qualifications, and if necessary the BI also requires banks to transmit the relevant background documentation. In our view, therefore, this recommendation is already in effect.

57. In addition, the recommendations call for an enhancement of the fit-and-proper-person criteria for banks' shareholders, including the capacity to provide additional capital and the sustainability of the leverage level. In this respect, we note that the BI already verifies shareholders' requirements, including financial soundness, pursuant to EU legislation (Directive 2007/44/EC) and the criteria laid down in the CEBS, CESR, EIOPA Guidelines, according to which financial soundness is to be understood as the "capacity of the acquirer to finance the proposed acquisition and to maintain a sound financial structure for the foreseeable future." In any case, to make it clearer that evaluation of major shareholders' financial soundness is an integral part of the BI's review process, our new Supervisory Instructions on bank licences, adopted in April 2013, now contain an explicit provision envisaging the assessment of major shareholders' capacity to provide additional capital and sustain the leverage level.

Loan loss provision (CP 18)

58. The IMF recommends developing prudential guidelines to expedite the turnover of non-performing loans; more generally, it suggests prudential guidance to ensure a minimum level of harmonization in loan loss provisions and write-off practices.

59. The Bank of Italy notes that the adequacy of banks' loan loss provisioning and of banks' policies and practices in this regard and the homogeneous interpretation and application of existing rules across the banking sector is regularly monitored as part of the on- and off site supervisory

activity. Moreover, in November 2012 a series of inspections focused on provisioning policies was undertaken at twenty banking groups. Findings were incorporated in banks' financial statements for 2012.

Concentration risk and large exposure limits (CP 19)

60. With reference to the recommendation on large exposure limits at solo level, the Italian authorities note that limits higher than that allowed at consolidated level, provided that the latter is complied with, are consistent with the integrated nature of banking groups as envisaged in the Italian Banking Law; such higher limits constitute merely formal deviation from the general rule envisaged by the CP. In the cases where EU legislation allows national discretion, such exemptions and limits will be carefully reviewed, considering among other things the impact on intra-group liquidity management and the need to ensure a level playing field.

Related party transactions (CP 20)

61. **The current Italian regulatory framework on transactions with related parties** represents significant progress since the previous IMF assessment. Following amendments to the primary legislation, the Bank of Italy has adopted completely new, comprehensive supervisory provisions for all banks, entailing quantitative limits to exposures, governance arrangements and specific requirements on internal control systems. Listed banks are also subject to a regulation issued by the securities market regulator CONSOB that imposes additional requirements concerning the decision-making process and disclosure to the market.

62. **In our view, the overall assessment of CP 20 is unduly severe.** In particular, the Italian authorities note that the overall assessment of lack of material compliance with CP 20 is due largely to the fact that as the new BI regulation only went into effect in January 2013, no evidence of its effectiveness is available yet. In particular, the Bank of Italy is confident that its off- and on-site controls, once fully operating, will effectively complement the regulation assessed by the IMF and will ensure robust and effective supervisory action even where the particular situation calls for a specific supervisory intervention (to be assessed on a case-by-case basis). Moreover, for listed banks (which accounted for more than 60 percent of total banking system assets at the end of 2011), the rapid implementation of the new BI rules on RPT was less urgent, since in any case these banks have to comply with the CONSOB Regulation on RPT (applicable to all listed companies since January 2012).

63. **As to the judgment of potential weaknesses in the BI Regulation,** the Italian authorities note that it is incorrect to say that there is no requirement for board approval. Actually, board approval is always required when the transaction value exceeds 5 percent of regulatory capital. Moreover, CP 20 does not explicitly prohibit risk-weighting; the weights applied are those for concentration risk, which are limited to specific asset classes and are more stringent than those for credit risk. Similarly, economic connection in the definition of related parties is not required under CP 20. In any event, the supervisory regulation authorizes the BI to impose a broader definition of

related parties on a case-by-case basis (including based on influence in decisions or economic dependence).

64. As to the exclusion of the conflicted board member from the decision-making process, the Italian authorities note that while the Civil Code does not specify exclusion as a general rule, the regulation already envisages cases in which the interested member cannot take part in the approval process, as required by CP20. With respect to the arm's length principle, the regulation does not impose market conditions, as transactions may not all have comparable market prices, but relies instead on the assessment of independent directors, who are called on to consider also the economic terms of related party transactions (duly motivating any deviation from market conditions) and weigh their advantageousness for the bank.

65. However, the Bank of Italy is open to re-assessing the effectiveness of the Regulation when an impact assessment of its implementation in practice becomes possible. The BI has instituted a periodic reporting system covering both banks' risk exposures towards related parties and the decision-making processes required for RPTs. A first set of data suitable for thorough analysis will be available by March 2014 to permit the possible fine-tuning of the Regulation. The authorities will also consider whether the legislation on conflicts of interest needs modification to systematically exclude the interested party from the approval process.

Country and transfer risks (CP 21)

66. The subject of country and transfer risks (CP 21 and CP 15) is addressed in the new draft Supervisory Instructions on internal controls systems, information systems and business continuity, which will go into force shortly.

External auditors (CP 27)

67. As to the recommendation that the Bank of Italy be given the power to remove auditors and to review external auditors' papers, in the opinion of the Italian authorities this is not a regulatory priority. The current framework is consistent with the overall supervisory approach to external audits. It does not assign any supervisory task to external auditors, whose function is limited strictly to the auditing of financial accounts. Moreover, pursuant to Legislative Decree 39/2010 the external auditors of listed financial intermediaries—most importantly banks—are supervised by the securities market regulator, CONSOB. CONSOB assesses auditors' organization and activity, to verify their independence and technical capability. In carrying out this task, CONSOB periodically runs quality checks on external auditors and has access to their working papers. Where irregularities are detected, the regulator has the power to revoke the audit assignment.