FINECO
BANK

REPORT ON THE TRANSITION TO IFRS 9 FINANCIAL INSTRUMENTS

Reclassifications from first application of IFRS 9
From January 1st 2018, FinecoBank has adopted the accounting standard IFRS 9: Financial Instruments

The project – in coordination with a similar project carried out at UniCredit Group level and developed with the involvement of the Bank's reference functions and, most recently, the Board of Directors – was organised through specific work-streams, in particular:

- "Classification and Measurement" work-stream, aimed at reviewing the classification of financial instruments in line with the new criteria of IFRS9;
- "Impairment" work-stream, aimed at developing and implementing models and methodologies for the calculation of impairment losses.

The new accounting standard:

- introduces significant changes compared to IAS 39, regarding the rules on the classification and valuation of financial instruments.
  With reference to loans and debt instruments, the classification and subsequent valuation of these instruments is based on the business model and cash flow profile of the financial instruments (SPPI - Solely Payments of Principal and Interests).
  With reference to the equity exposures, they are classified at fair value with a recognition of differences in the income statement or under "Other income components". In this second case, contrary to the provisions of IAS 39 in relation to financial assets available for sale, IFRS 9 has eliminated the request to recognise long-term value impairments and provides that if the instrument is sold, the profits or losses from the sale must be reclassified in another net equity reserves and not on the income statement.
  With regard to financial liabilities, IFRS 9 changes the accounting of the so-called "own credit risk", i.e. changes in the value of liabilities measured at fair value linked to fluctuations of one's own credit rating. The new standard requires these changes to be recognised in a Shareholders' equity reserve rather than through profit and loss, as provided for by IAS 39, thus eliminating a source of volatility for economic statement results[1].
- introduced a new model for recognising impairments for credit exposures based on (i) an "expected losses" approach instead of the existing model, which is based on the recognition of "incurred losses" and (ii) on the concept of the expected lifetime loss;
- has intervened on the hedge accounting rules, by revising them in regard to the designation of a hedging account and the verification of efficiency, with the aim of improving the alignment between the accounting representation of the hedging operations and the underlying operational logic. The Bank, like the UniCredit Group, has taken advantage of the option to continue to apply the existing IAS 39 hedge accounting requirements for all hedging accounts until such time as the IASB has completed its macro-hedging accounting rules project.

The Bank, in accordance with UniCredit Group, has decided to take advantage of the option offered by the accounting standard, of not showing the comparative figures for past years. Therefore the first time adoption of the new standard is January 1st 2018.

Below is the balance sheet of FinecoBank as of 1.1.2018 and 31.3.2018, prepared in accordance with the obligatory models as provided for in the 5th update to the Bank of Italy Circular 262 of 22 December 2017.

[1] On the FTA and on 31 March 2018, FinecoBank did not hold any own financial liabilities valued at fair value.

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	Balance sheet assets	31-Mar-18	01-Jan-18
10.	Cash and cash balances	744,558	613,033
20.	Financial assets at fair value through profit or loss	16,696,296	568,019,894
	a) financial assets held for trading	10,368,380	8,827,354
	c) other financial assets required to be designated at fair value	6,327,916	559,192,540
30.	Financial asset designated at fair value with an impact on other comprehensive income	1,042,039,251	1,042,470,606
40.	Financial assets at Amortised cost	21,853,070,547	20,287,386,713
	a) loans and receivables with banks	13,789,222,627	13,332,937,989
	b) loans and receivables with customers	8,063,847,920	6,954,448,724
50.	Hedging derivatives	1,062,911	458,102
60.	Changes in fair value of portfolio hedged items (+/-)	(707,205)	(339,210)
90.	Property, plant and equipment	14,838,672	15,205,122
100.	Intangible assets	97,186,047	97,511,341
	of which		
	- goodwill	89,601,768	89,601,768
110.	Tax assets	6,427,549	8,638,879
	a) current tax assets	730,308	1,765,333
	b) deferred tax assets	5,697,241	6,873,546
130.	Other assets	203,695,989	315,413,615
	Total assets	**23,235,054,615**	**22,335,378,095**

(Amounts in €)

	Balance sheet liabilities and Shareholders' equity	31-Mar-18	01-Jan-18
10.	Financial liabilities at Amortised Cost	21,876,425,105	21,131,037,329
	a) deposits from banks	960,045,559	926,001,336
	b) deposits from customers	20,916,379,546	20,205,035,993
20.	Financial liabilities held for trading	4,891,995	11,936,439
40.	Hedging derivatives	4,461,667	3,373,965
50.	Changes in fair value of portfolio hedged items (+/-)	(4,922,004)	(3,772,231)
60.	Tax liabilities	36,307,337	7,717,874
	a) current tax liabilities	36,307,337	7,717,874
80.	Other liabilities	207,334,598	338,287,008
90.	Provisions for employee severance pay	4,876,132	4,998,596
100.	Provisions for risks and charges:	113,632,991	112,864,316
	a) commitments and guarantees given	485,437	450,395
	c) other provisions for risks and charges	113,147,554	112,413,921
120.	Revaluation reserves	(3,994,480)	(6,363,692)
140.	Equity instruments	200,000,000	-
150.	Reserves	534,992,321	319,063,782
160.	Share premium reserve	1,934,113	1,934,113
170.	Share capital	200,773,450	200,545,404
180.	Treasury shares (-)	(623,373)	(365,178)
200.	Net Profit (Loss) for the year	58,964,763	214,120,370
	Total liabilities and Shareholders' equity	**23,235,054,615**	**22,335,378,095**

(Amounts in €)

1. Classification and valuation

As a result of the entry into force of the new accounting standard, the Bank has reclassified the financial liabilities existing on 1.1.2018 into the categories provided for in the new accounting standard.
This classification is based on the business model and the contractual cash flow profile; for the classification of financial instruments in the new categories as provided for in the accounting standard, the business model was analysed by mapping the financial assets on the Bank's balance sheet and allocating a specific business model to each of them.
The financial assets in the Bank's portfolio were allocated "held-to-collect" or "held-to-collect and sell" business models according to the purpose for which they are held, and the expected turnover.
The financial assets in the trading portfolio were allocated the business model "Other", to reflect the trading intentions.

For the purposes of classifying financial instruments into the new IFRS 9 categories, the business model analysis must be accompanied by a cash flow analysis (the "SPPI Test").
In this regard, in line with the Parent Company UniCredit S.p.A., the Bank has developed systems and processes to analyse the existing debt securities and loans portfolio, to assess whether the contractual cash flow profiles allow a valuation at the amortised cost "held-to-collect" portfolio) or at fair value with an impact on overall profits ("held-to-collect and sell" portfolio).
This analysis was done on a contract by contract basis, both by defining clusters based on the operations' profiles, and by using an internally-developed SPPI Tool to analyse the profiles of the contracts with regard to IFRS 9.

In application of these rules, the Bank's financial assets and liabilities were classified as follows.

Item 20.a) Financial assets held for trading
A financial asset is classified as held for trading if it is:
- acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking;
- a derivative contract not designated within hedge accounting operations, with a positive fair value incorporated into financial liabilities other than those valued at fair value through profit and loss.

Like other financial instruments, on initial recognition, at settlement date, a held-for-trading financial asset is measured at its fair value, usually equal to the amount paid, excluding transaction costs and income, which are recognized in profit and loss even when directly attributable to the financial assets. Trading book derivatives are recognised at trade date.

After initial recognition these financial assets are measured at their fair value through profit or loss.
An exception is represented by derivatives settled by delivery of an unlisted equity instrument whose fair value cannot be reliably measured, and which are therefore measured at cost.

A derivative is a financial instrument or other contract with all three of the following characteristics:
- its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (usually called the 'underlying') provided that in case of non-financial variable, this is not specific of one of the parties;
- requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors;
- it is settled at a future date.

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

An incorporated derivative is separate from financial liabilities other than those valued at fair value with recognition of income effects on the income statement, and from non-financial instruments, is recognised as a derivative if:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and;
- the hybrid (combined) instrument is not measured entirely at fair value through profit or loss.

When an embedded derivative is separated, the host contract is recognised according to its accounting classification.

Item 20.b) Financial assets designated at fair value

A non-derivative financial asset may be designated at fair value if such designation avoids accounting mismatches deriving from the valuation of assets and associated liabilities according to different valuation criteria

The accounting treatment for these transactions is same as for “Financial assets held for trading.”

Item 20.c) Other financial assets required to be designated at fair value

A financial asset is necessarily classified under financial assets at fair value if it does not meet the conditions, in terms of business model or cash flow profile, for valuation at amortised cost or at fair value with an impact on total profits.

In particular, this portfolio includes:

- debt instruments, securities and loans whose business model is neither held to collect, nor held to collect and sell, but which do not belong to the trading portfolio;
- debt instruments, securities and loans whose cash flows are not merely the payment of capital and interest;
- units in investment funds;
- equity exposures for which the Bank does not exercise the option granted by the standard, of valuing these instruments at fair value with an impact on total profits.

The accounting treatment for these transactions is same as for “Financial assets held for trading.”

Item 30. Financial asset designated at fair value with an impact on overall profitability

A financial asset is classified among financial assets valued at fair value with an impact on total profits if:

- its business model is held to collect and sell;
- the related cash flows only represent the payment of capital and interest.

This item also includes equity exposures for which the Bank exercises the option granted by the standard, of valuing these instruments at fair value with an impact on total profits.

Financial assets measured at fair value with an impact on overall profitability are initially recognised on the date of settlement at fair value, which is usually equal to the consideration of the transaction, plus transaction costs and income directly attributable to the instrument.

For debt instruments, after initial recognition, the interest accruing on interest-bearing instruments is recognised on the income statement according to the amortised cost principle.
Gains or losses arising out of changes in fair value are recognized in the schedule of total profits and shown in item “120. Valuation reserves” in equity.
These instruments are the subject of a calculation of losses due to lasting value impairments in accordance with the illustration given in the relevant section. These lasting value impairments are recorded on the income statement as a contra-entry of the schedule of overall profits, and are also shown in item “120. Valuation reserves” in equity. In the case of sale, the cumulative profits and losses are recognised on the income statement.

For Equity exposures, the profits and losses from changes in fair value are recognised in the schedule of overall profits and shown in item “120 Valuation reserves” in equity.
Equity instruments are not the subject of income statement recognition of lasting value impairments in accordance with IFRS 9.
In the case of sale the cumulative profits and losses are recognised in item “150. Reserves".

Item 40 Financial assets at Amortised cost
A financial asset is classified among financial assets valued at amortised cost, if:
- its business model is held to collect;
- the related cash flows only represent the payment of capital and interest.

Financial assets at amortised cost are initially recognised on the date of settlement at fair value, which is usually equal to the consideration of the transaction, plus transaction costs and income directly attributable to the instrument.
After the initial recognition at fair value these assets are valued at the amortised cost which determines the recognition of interest based on the effective interest rate principle, on a pro rata basis throughout the duration of the receivable.

The balance sheet value of financial assets at amortised cost is adjusted to take into account any write-downs/write-backs resulting from the valuation process as described in the relevant section.

Item 10. Financial liabilities at Amortised Cost
Financial liabilities valued at an amortised cost include financial instruments (other than trading liabilities and those valued at fair value, representing various forms of third-party funding.

These financial liabilities are recognized on the settlement date principle initially at fair value, which is normally the consideration received less transaction costs directly attributable to the financial liability. After initial recognition, these instruments are measured at amortised cost using the effective interest method.

Hybrid debt instruments relating to equity instruments, foreign exchange, credit instruments or indexes, are treated as structured instruments. The embedded derivative is separated from the host contract and recognised as a derivative, provided that separation requirements are met, and recognised at fair value. The embedded derivative is entered at fair value, classified under financial assets or liabilities held for trading, and is then valued at fair value, with the relative profits or losses recognised on the income statement.

The difference between the total amount received and the initial fair value of the embedded derivative is attributed to the host contract.

Instruments convertible into treasury shares imply recognition, at the issuing date, of a financial liability and of the equity part, recognized in item “160. “Equity instruments”, whenever the contractual terms provide for physical delivery.

The equity component is initially measured at residual value, i.e., the overall value of the instrument less the separately determined value of a financial liability with no conversion clause and the same cash flow.
The financial liability is recognised at amortised cost using the effective interest method.

Securities in issue are recognised net of the repurchased amounts; the difference between the book value of the liability and the amount paid to buy it, is recorded on the account. Subsequent disposal by the issuer is considered as a new issue which doesn't produce gains or losses.

Item 20. Financial liabilities held for trading
Financial liabilities held for trading include:
- derivatives that are not designated as hedging instruments;
- obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it does not yet own);
- financial liabilities issued with an intention to repurchase them in the near term;
- financial liabilities that are part of a portfolio of financial instruments considered as a unit and for which there is evidence of a recent pattern of trading.

Financial liabilities in this category, including derivatives, are valued at fair value initially, and during the life of the operation.

Item 30. Financial liabilities designated at fair value
Financial liabilities, like financial assets may also be designated, according to IAS 9, on initial recognition as measured at fair value, provided that:
- this designation eliminates or considerably reduces the discrepancy that could arise from the application of different methods of measurement of assets and liabilities and related gains or losses;
  or
- a group of financial assets, financial liabilities or both are managed and measured at fair value under risk management or investment strategy which is internally documented with the entity's Board of Directors or equivalent body.

This category may also include financial liabilities represented by hybrid (combined) instruments containing embedded derivatives that otherwise should have been separated from the host contract.
Financial liabilities in this category, including derivatives, are valued at fair value initially, and during the life of the operation.
Changes in fair value are recognised on the income statement except for any changes in fair value that derive from changes in the credit rating, which are shown in item 120. Valuation reserves" in equity unless that recognition causes a discrepancy that would result from a different valuation of assets and liabilities and related gains and losses, in which case the changes in fair value deriving from changes in credit rating are also recognised on the income statement.

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2. Impairment

2.1 General matters

Loans and debt instruments classified in the items: Financial assets at amortised cost, financial assets at fair value with an impact on overall profitability and the relevant off-balance sheet exposures, are subjected to an impairment calculation in accordance with IFRS 9.

These instruments are classified in stage 1, stage 2 or stage 3 depending on their absolute or relative credit rating, compared to the initial disbursement. In particular:

- Stage 1: this includes newly originated or acquired credit exposures and exposures that have not suffered a significant deterioration in credit risk compared to the date of first recognition;
- Stage 2: this includes credit exposures that are performing but which have suffered a significant deterioration in credit risk compared to the date of first recognition;
- Stage 3: this includes impaired credit exposures.

For Stage 1 exposures, the impairment is equal to the expected loss calculated on a time frame of up to one year.
For Stage 2 and 3 exposures, the impairment is equal to the expected loss calculated on a timeframe equivalent to the residual duration of the related exposure.

In order to meet the standard, the Group has developed specific models to calculate the expected loss. These models draw on the PD, LGD and EAD criteria used for regulatory purposes, to which specific directions are made to ensure full cohesion with the accounting standard[2]. In this regard, forward-looking information has also been included[3] with the elaboration of specific scenarios.

Expected loss is calculated for the institutional counterparties common to the Group, using the methods and credit parameters developed at centralized level.
As the retail counterparties do not have internal rating systems at their disposal, they use proxies. Segmentation by product type is carried out and the PD is replaced by the average decay rate observed by the transition matrixes defining the change to classified. This approach is based on the assumption that when there are no changes in the criteria adopted to assess the creditworthiness of the individual counterparties, the quality of the future credit will be consistent with the quality of the credit found in the time series available. Nevertheless, unlike the approach followed when applying the IAS 39 standard to implement the requirements of the IFRS9 rule, the proxies of the parameters are corrected using forward looking information, entirely in line with the Group's approach as described below.

A key aspect of the new accounting model required to calculate the expected loss is the Stage Allocation model, the aim of which is to transfer exposures between Stage 1 and Stage 2 (as Stage 3 is equivalent to that of impaired exposures), where Stage 1 mainly includes (i) newly disbursed exposures, (ii) exposures that have no significant impairment of credit risk compared to initial recognition, and (iii) exposures with a low credit risk (low credit risk exemption) on the reporting date.
The Stage Allocation valuation model is based on a combination of relative and absolute elements: The main elements were:

- the comparison at transaction level between the PD value at the time of disbursement and the value on the reporting date, both qualified according to internal models at fixed thresholds to take into account all the key

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[2] See paragraph 3.2 for a more detailed explanation of the risk measures used within the Group to calculate the expected credit loss in accordance with IFRS 9.

[3] See paragraph 3.3 for a more detailed explanation of the forward-looking information and scenarios used to calculate the expected credit loss in accordance with IFRS 9.

variables of each transaction that may influence the Bank's expectations about ongoing changes in PD (e.g. age, maturity, level of PD at the time of disbursement);
- absolute elements such as the backstops provided for by the regulation (e.g. 30 day Expired);
- other internal findings (forborne classification).

With reference to debt instruments, the Bank has opted to apply the low credit risk exemption on investment grade securities, in full accordance with the provisions of the accounting standard.

The criteria for determining the write-downs of receivables are based on the discounting of expected cash flows of principal and interest. In line with the business model, these can also refer to market operations; for determining the present value of cash flows, the basic requirement is the identification of estimated collections, the timing of payments and the discounting rate used.

The amount of the loss on impaired exposures classified as non-performing and unlikely to pay according to the categories specified below, is the difference between the carrying value and the present value of estimated cash flows discounted at the original interest rate of the financial asset.

For all fixed-rate positions, the interest rate determined in this manner is also held constant in future years, while for floating rate positions the interest rate is updated according to contractual terms.

If the original interest rate is not directly available, or if finding it would be excessively onerous, the interest rate that best approximates the original one is applied, including through practical expedients that do not affect the substance and ensure consistency with international accounting standards.

Recovery times are estimated on the basis of business plans or forecasts based on historical recovery experience observed for similar classes of loans, taking into account the customer segment, type of loan, type of security and any other factors considered relevant.

2.2 Parameters and definitions of risk level used in the calculation of value adjustments

As mentioned above the Group has developed specific models to calculate the expected loss, which draw on the PD, LGD and EAD criteria, as well as the effective interest rate.

These models are used for calculating value adjustments of all the institutional counterparties common to the Group, for the most part made up of FIBS (Financial Institutions, Banks and Sovereigns) counterparties.
Specifically:
- PD (Probability of Default) expresses the percentage of estimated loss, and hence the expected recovery rate whenever a credit position default event occurs;
- LGD (Loss Given Default) expresses the percentage of estimated loss, and hence the expected recovery rate whenever a credit position default event occurs;
- EAD (Exposure at Default) expresses the measurement of the exposure at the time of the credit position default event;
- Effective Interest Rate is the discount rate expressing the time value of the money.

These parameters are calculated on the basis of identical parameters used for regulatory purposes, with specific adjustments made to ensure full cohesion, net of the various regulatory requirements, between the accounting treatment and the regulatory treatment.

The main adjustments are made in order to:
- remove the conservatism which is only required for regulatory purposes;
- introduce point-in-time adjustments to replace the through-the-cycle adjustments required for regulatory purposes;
- include forward-looking information;
- extend the credit risk parameters to a multi-year perspective.

With regard to the lifetime PD, the through-the-cycle PD curves obtained by adapting the cumulative non-compliance rates are adjusted to reflect point-in-time provisions and forward-looking provisions with regard to the portfolio non-compliance rates.

The rate of recovery incorporated in the through-the-cycle LGD was adapted in order to remove the conservatism margin and to reflect the latest trends in recovery rates, and expectations about future trends discounted to the actual interest rate or its best approximation.

With reference to the quantitative component of the Staging assignment model, the Group has adopted a statistical approach based on a regression of the quantiles, whose objective is to define a threshold in terms of maximum acceptable change between the measurement of the PD at the time of disbursement and that recorded on the reporting date. The target variable of the regressive model is therefore the change between PD on the reporting date compared to disbursement, while the explanatory variables are factors such as transaction age, the PD on the disbursement date, etc. A fundamental component of the model is the definition of the quantile that identifies the expected Stage 2 quota on the average over the long-term and that affects determination of the PD change threshold that, when passed, the transaction is moved to Stage 2. The average long-term quantile is determined based on the average expectation of decay of the portfolio, which is determined by the rate of slipping into default like in one of the other decay stages (e.g. past-due 30 days). The Stage 2 amount on each reporting date will fluctuate around the long-term quantile based on the current economic conditions and on the future expectations regarding evolution of the economic cycle.

For Stage 3, this includes the corresponding impaired exposures which, in accordance with the Bank of Italy rules defined in Circular 272 of 30 July 2008 as updated, correspond to the aggregate Non-Performing Exposures referred to in ITS EBA (EBA/ITS /2013/03/rev1 24/7/2014).

Specifically, the EBA has identified Non-Performing exposures as those that satisfy either or both of the following criteria:
- material exposures which are more than 90 days past due;
- exposures for which the Bank has assessed that the debtor is unlikely to pay its credit obligations, without the enforcement and realisation of collateral, regardless of the existence of any past due and/or overdrawn impaired exposures or of the number of days past due.

The aforementioned Circular 272 establishes that the impaired assets aggregate is divided into the following categories:
- Non-performing loans i.e., the on-balance-sheet and off-balance-sheet exposures to insolvent borrowers, even if the insolvency has not been recognised in a court of law. They are measured individually (including by verifying statistically defined coverage levels for some loan portfolios below a predefined threshold) or, for individually insignificant amounts, on a flat basis by type of homogeneous exposure.
- Unlikely to pay - on- and off-balance sheet exposures which do not meet the borrower's condition for classification as non-performing loans and for which, in the absence of actions such as the enforcement of collateral, the debtor's ability to fully meet its credit obligations (principal and/or interest) is assessed as unlikely. This assessment is made independently of any past due and unpaid amount (or instalment). The classification of an

exposure as unlikely to pay is not necessarily tied to evident issues (non-repayment), but is rather linked to indicators of a potential default of the borrower. The "unlikely to pay" exposures are measured in the accounts individually (including by verifying statistically defined coverage levels for some loan portfolios below a predefined threshold) or by applying a percentage on a flat basis by type of homogeneous exposures. Exposures classified as unlikely to pay and identified as forborne, may only be reclassified to unimpaired loans after at least one year has passed from the time of the forbearance and the conditions established in paragraph 157 of the EBA Implementing and Technical Standards have been met. With regard to their measurement, they are generally measured on an individual basis and the resulting allowance may include the discounted cost due to renegotiation of the interest rate at a rate lower than the original contractual rate.

- past due and/or overdrawn impaired exposures - on-balance sheet exposures, other than those classified as non-performing or unlikely to pay that are past due or overdrawn at the reporting date. The past due and/or overdrawn impaired exposures in FinecoBank are determined with respect to the individual debtor. Specifically, they represent the total exposure to any borrower not included in the unlikely to pay and non-performing loans categories, who at the reporting date has expired facilities or unauthorised overdrafts that are more than 90 days past due and meet the requirements set out by local supervisory regulations for their classification under the "past due exposures". Past-due and/or overdrawn impaired exposures are valued at a flat rate on a historical/stochastic basis by applying where available the risk rating referred to Loss Given Default (LGD) under Regulation (EU) No. 575/2013 (CRR) on prudential requirements for credit institutions and investment firms.

2.3 Forward-looking information used in calculating value adjustments

The credit loss expected from the parameters described in the forgoing paragraph considers macroeconomic forecasts by applying multiple scenarios to the forward looking components in order to offset the partial non-linearity that is naturally implied in the correlation between the macroeconomic changes and credit risk.

The process defined to include macroeconomic scenarios is also fully consistent with the macroeconomic forecasting processes used by the Group for further risk management purposes (such as the processes used to translate macroeconomic forecasts into expected credit losses based on the EBA Stress Test and the ICAAP Framework) and was also drawn from the independent work of UniCredit Research.

The forecasts in terms of change in Default rate and change in Recovery Rate provided by the Stress Test function are incorporated within the PD and LGD parameters during calibration. The credit parameters are usually calibrated over a through-the-cycle (TTC) horizon, so their point-in time (PIT) and forward-looking (FL calibration become necessary in so far as it reflects the current situation and the expectations on the future evolutoin of the economic cycle in these credit parameters.

To this regard, the PD parameter is calibrated using a normal calibration procedure - logistic or Bayesian - taking an arithmetic mean between the latest default rates seen on the portfolio and the expected default rates provided by the Stress Test function as the pegging point. The PD obtained this way will lose its TTC nature in favour of a PIT/FL philosophy.

The LGD parameter is made PIT with a graduated factor that offers the possibility to consider the ratio between average long-term recoveries and recoveries made in recent years. Forecasts are instead included in the LGD parameter by adjusting implicit annual recovery rates in this parameter in order to take into account expectations of future recovery rates provided by the Stress Test function changing.

2.4 Governance (Risk management organization, processes and key functions have been organized to run the ECL Methodology)

The adjustments arising from application of the standard also concerned the organizational and internal governance aspects.
In particular, the major changes concerned the process of calculating loan loss provisions for accounting purposes.
The process of determining loss provisions was altered in order to include the adjustments described for the credit parameters, calculation of the expected multi-period loss, inclusion of the macroeconomic and forward-looking components and inclusion of the sales scenarios, where applicable.
A specific process for production and sharing multi-scenario and forward looking adjustments pertaining to the Group Wide loans perimeter (i.e. loans pertaining to Customers common to the Group) between Fineco and the Group has also been defined.

3. Other aspects

3.1. Renegotiations

Renegotiations of financial instruments that lead to a change in the contractual terms are recognised on the basis of the materiality of those contractual changes.

For renegotiations considered not to be significant, the gross value is re-determined by calculating the present value of cash flows resulting from the renegotiation, at the original rate of the exposure. The difference between the gross value of the financial instrument prior to and after the renegotiation of the contractual terms, adjusted to consider the associated changes to the cumulative value adjustments, is recognised as a profit or loss from contractual amendments without cancellations, on the income statement.

Renegotiations formalised by means of changes to the existing contract or by the signing of a new contract, which lead to the exclusion of the right to receive cash flows according to the provisions of the original contract, are considered to be significant. The rights to receive cash flows are considered to be excluded in the case of renegotiations that lead to the introduction of clauses resulting in a change of classification of the instrument, which result in a change in the currency and which are made at market conditions, thus not constituting a credit exposure.

3.2 Write – offs

The Bank will enter a write-off by reducing the gross exposure of a financial asset if there are no reasonable expectations of recovering all or part of that asset.

A write-off, which may relate to the whole of a financial asset or of part of it is recognised before the legal debt recovery actions have been concluded, and does not imply the waiver of the legal right of recovery.

As a result, the Bank will recognise a write-off in the following cases:

- there is no longer any reasonable expectation of recovering all or part of the asset despite the presence of the legal rights to recover the accrued capital and interest;
- waiver of the legal right to recover the accrued capital and interest;
- cessation of the legal right to recover capital and interest due to completion of the attempts at recovery.

4. Impacts on net equity resulting from the adoption of IFRS 9

The adoption of IFRS 9 has, overall, had a negative impact on consolidated net equity, in the amount of -€2.9 million (-€4.8 million inclusive of fiscal effects), of which -€4.9 million was recorded in the balance sheet item IFRS 9 150.

“Reserves” as a liability, and +€2 million was recorded as a liability in balance sheet item IFRS 9 120. “Valuation reserves”, in particular:

- -€10.3 million (-€14.3 million inclusive of fiscal effects) relating to the application of a value reduction based on the expected loss recorded in the FTA Reserve under the liability item IFRS 9 150. "Reserves";
- +€5.4 million (+€6.1 million inclusive of fiscal effects) relating to the classification and valuation of financial assets recorded in the FTA reserve in the liability item IFRS 9 150. "Reserves";
- +€2 million (+€3.4 million inclusive of fiscal effects) relating to the classification and valuation of financial assets recorded in the valuation reserve, in the liability item IFRS 9 110. "Valuation reserves".

Below is the consolidated net equity on the closing date of 31 December 2017 and the consolidated net equity for the start date of 1 January 2018.

	31 December 2017	*Change IFRS 9*	*1 January 2018*
1. Share capital	200,545	-	200,545
2. Share premium reserve	1,934	-	1,934
3. Reserves	323,932	(4,868)	319,064
- di utili	291,841	(4,868)	286,973
a) legal reserve	40,109	-	40,109
b) statutory reserves	-	-	-
c) treasury shares reserve	365	-	365
d) other	251,367	(4,868)	246,499
- altre	32,091	-	32,091
4. Equity instruments	-	-	-
5. (Treasury shares)	(365)	-	(365)
6. Revaluation reserves	(8,340)	1,976	(6,364)
7. Net Profit (Loss) for the year	214,120	-	214,120
Total	**731,826**	**(2,892)**	**728,934**

(Amounts in € thousand)

With reference to the reclassification of financial instruments in order to implement the new accounting standard, the following tables show, separately, for the financial assets and liabilities:

a. the IAS 39 balance sheet item and the related closing balance as at 31 December 2017;
b. the reclassification of that balance in the various IFRS 9 balance sheet items;
c. the effects resulting from the application of the valuation criteria required by IFRS 9;
d. the IFRS 9 opening balance on 1 January 2018 (the sum of b. and c.).

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Reclassification of financial assets

Key

A: Reclassification of IAS 39 balance sheet value

B: Change in measurement

C: New balance sheet value ex IFRS 9

	Carryng value 12/31/2017 IAS 39	Financial assets at fair value through profit or loss								
		Financial assets held for trading			Financial assets designated at fair value			Other financial assets required to be designated at fair value		
		A	B	C	A	B	C	A	B	C
Financial assets held for trading	10,879	8,827	-	8,827	-	-	-	2,052	-	2,052
Available-for-sale financial assets	1,047,689	-	-	-	-	-	-	5,218	-	5,218
Held-to-maturity investments	4,826,390	-	-	-	-	-	-	-	-	-
Loans and receivables with banks	13,878,117	-	-	-	-	-	-	532,584	19,338	551,922
Loans and receivables with customers	2,129,219	-	-	-	-	-	-	-	-	-
Total IFRS 9				**8,827**			**-**			**559,192**

(Amounts in € thousand)

	Carryng value 12/31/2017 IAS 39	Financial asset designated at fair value with an impact on other comprehensive income			Financial assets at Amortised cost					
					Loans and receivables with banks			Loans and receivables with customers		
		A	B	C	A	B	C	A	B	C
Financial assets held for trading	10,879	-	-	-	-	-	-	-	-	-
Available-for-sale financial assets	1,047,689	1,042,471	-	1,042,471	-	-	-	-	-	-
Held-to-maturity investments	4,826,390	-	-	-	-	-	-	4,826,390	(469)	4,825,921
Loans and receivables with banks	13,878,117	-	-	-	13,345,533	(12,595)	13,332,938	-	-	-
Loans and receivables with customers	2,129,219	-	-	-	-	-	-	2,129,219	(691)	2,128,528
Total IFRS 9				**1,042,471**			**13,332,938**			**6,954,449**

(Amounts in € thousand)

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Below are the details of the classifications as made:

- the financial assets shown in the balance sheet item IAS 39 50. "Financial assets held to maturity" which consist exclusively of securities issued by sovereign states totalling €4.826 million, which were classified in the held to collect (HTC) business model and shown in the asset item IFRS 9 40. "Financial assets valued at amortised cost b) loans to customers";
- the financial assets shown in the balance sheet item IAS 39 60. "Bank receivables", totalling Euro 13.878 million euro, were classified in the "Held To Collect – HTC" business model and were shown in the balance sheet item IFRS 9 40. "Financial assets valued at amortised cost a) "bank receivables", with the exception of
    - a debt instrument issued by UniCredit with coupon in arrears, totalling Euro 382.5 million subscribed by the Bank in past years, with the rate risk covered by a derivative with the same Parent Company. Its contractual profile did not pass the SPPI Test and it was thus included in the asset item IFRS 9 20. "Financial assets at fair value through profit and loss c) other financial assets with compulsory designation at fair value";
    - a debt instrument issued by UniCredit with coupon in arrears, totalling Euro 150 million subscribed by the Bank in past years. Its contractual profile did not pass the SPPI Test and it was thus included in the asset item IFRS 9 20. "Financial assets at fair value through profit and loss c) other financial assets with compulsory designation at fair value"; this exposure expired on 31 December 2017 but was settled on 2 January 2018[4];
- the financial assets shown in the balance sheet item IAS 39 70. "Customer loans", totalling Euro 2.129 million, were classified in the "Held To Collect – HTC" business model and shown in the balance sheet item IFRS 9 40. "Financial assets valued at amortised cost b) customer loans"
- financial assets shown in balance sheet item IAS 39 40. "Financial assets held for sale", totalling Euro 1.048 million, were classified
    - in the business model "Held To Collect and Sell – HTCS" and shown in balance sheet item IFRS 9 30. "Financial asset designated at fair value with an impact on overall profitability", as to the part represented by sovereign state issues, as to Euro 1,042.5 million;
    - in the "Other business models" and balance sheet item IFRS 9 20. "Financial assets valued at fair value through profit and loss c) other financial assets with compulsory designation at fair value" as to Euro 5.2 million, consisting of the preferred shares of Visa INC class "C" as to Euro 4.5 million and the residual exposure in equity instruments relating to the Voluntary Scheme of the Interbank Deposit Protection Fund (FITD) totalling Euro 0.7 million;
    - finally the "FVTOCI"[5] option was exercised for equity instruments relating to shares in UniCredit Business Integrated Solutions S.C.p.A. and the Patti Chiari consortium (recognised, respectively at Euro 172 and Euro 5,000), shown in the asset item IFRS 9 30. "Financial assets designated at fair value with an impact on overall profitability";
- financial assets shown in balance sheet item IAS 39 20. "Financial assets held for Trading" are classified in the "Other business models" and shown:
    - in the asset item IFRS 9 20. "Financial assets at fair value through profit and loss a) financial assets held for trading" as to Euro 8.8 million, relating to securities held in connection with customer insourcing and trading activities;
    - in the asset item IFRS 9 20. "Financial assets at fair value through profit and loss c) other financial assets with compulsory designation at fair value"; as to Euro 2.05 million, relating to securities withdrawn by customers (splits and/or defaulted securities) to the value of Euro 30,000, and units in investment funds held in portfolio for initial seeding, to the value of Euro 2.02 million.

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[4] As this exposure expired on 31 December 2017 and was reimbursed at par value on 31 December 2018, no fair value adjustments were made on first-time adoption.

[5] With regard to non-trading equity instruments, IFRS 9 provides for the possibility of measuring them at the fair value recognised in the other overall income statement items ("FVTOCI" – Fair Value Through Other Comprehensive Income).

Below are the details of the adjustments made to the starting balances on 1 January 2018 as a result of the changes to classification and measurement following the introduction of IFRS 9:

- as a result of the application of a reduction in value based on Expected Credit Loss or "ECL".
    - reductions were made to the value of securities, receivables and loans in the HTC business model, entered in the asset item IFRS 9 40. "Financial assets valued at amortised cost a) loans and receivables with banks", totalling €12.6 million;
    - reductions were made to the value of securities, receivables and loans in the HTC business model, entered in the asset item IFRS 9 40. "Financial assets valued at amortised cost b) loans and receivables with customers", totalling €1.2 million, of which:
        a) Euro 0.7 million relating to customer loans and receivables;
        b) Euro 0.5 million relating to exposures to sovereign debt issues, belonging to the HTC business model and valued at the amortised cost;
- a positive fair value valuation was recorded at Euro 19.3 million, on the debt instrument issued by UniCredit with coupon in arrears, totalling Euro 19.3 million subscribed by the Bank in past years, with the rate risk covered by a derivative with the same Parent Company. Its contractual profile did not pass the SPPI Test and it was thus reclassified in the asset item IFRS 9 20. "Financial assets at fair value through profit and loss c) other financial assets with compulsory designation at fair value"[6].

With reference to the financial assets reclassified in the asset item IFRS 9 30. "Financial asset designated at fair value with an impact on overall profitability", this table does not include the effects of applying the impairment rules on these instruments, equal to Euro 0.1 million, as the securities remain entered at fair value on the balance sheet assets. However, these effects have no impact on the total net equity as according to the rules of the accounting standard, impairment leads to the recognition of a negative reserve at the time of first application, in the liability item IFRS 9 150. "Reserves" offset by an increase of the same amount in the liability item IFRS 9 120. "Valuation reserves".

An adjustment was also made to the opening balance of the asset item IFRS 9 60. "Adjustments to the value of financial assets with generic hedging (+/-)", to the value of Euro -9.9 million, as a result of the closure of the positive adjustment to the value of the UniCredit share mentioned above, which was reclassified in the asset item IFRS 9 20. "Financial assets at fair value through profit and loss c) other financial assets with compulsory designation at fair value".

[6] The UniCredit shares valued at fair value in the IFRS 9 transition were restructured on January 2, 2018, incorporating the contractual profile of the derivative used up to that date to hedge the interest rate risk. The Bank therefore derecognised the old financial instrument recognised at December 31, 2017 and recognised the new one, whose characteristics support compliance with the SPPI Test, with consequent classification of the instrument to assets measured at amortised cost.

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Reclassification of financial liabilities

Key

A: Reclassification of IAS 39 balance sheet value

B: Change in measurement

C: New balance sheet value ex IFRS 9

	Carryng value 12/31/2017 IAS 39	Financial liabilities at Amortised Cost								
		Deposits from banks			Deposits from customers			Debt securities in issue		
		A	B	C	A	B	C	A	B	C
Deposits from banks	926,001	926,001	-	926,001	-	-	-	-	-	-
Deposits from customers	20,205,036	-	-	-	20,205,036	-	20,205,036	-	-	-
Financial liabilities held for trading	2,617	-	-	-	-	-	-	-	-	-
Hedging derivatives	12,694	-	-	-	-	-	-	-	-	-
Total IFRS 9				**926,001**			**20,205,036**			**-**
(Amounts in € thousand)										

	Carryng value 12/31/2017 IAS 39	Financial liabilities held for trading			Financial liabilities desginated at fair value			Hedging derivatives		
		A	B	C	A	B	C	A	B	C
Deposits from banks	926,001	-	-	-	-	-	-	-	-	-
Deposits from customers	20,205,036	-	-	-	-	-	-	-	-	-
Financial liabilities held for trading	2,617	2,617	-	2,617	-	-	-	-	-	-
Hedging derivatives	12,694	9,320	-	9,320	-	-	-	3,374	-	3,374
Total IFRS 9				**11,937**			**-**			**3,374**
(Amounts in € thousand)										

The reclassification of Financial liabilities shows that the classifications applied on the basis of IFRS 9 are essentially the same as those applied on the basis of IAS 39, despite taking into account the differences in the denomination of the various categories resulting from the application of the 5th Update to Circular 262. However, there was a reclassification, in liability item 20. “Financial liabilities held for trading” of the fair value of the derivative used to hedge the rate risk of the UniCredit share, with coupon in arrears mentioned above, to the value of Euro 9.3 million.

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With reference to the impairment, the table below illustrates the gross exposure and value adjustments as at 1 January 2018, divided by item and classification stage. The gross exposure of the financial asset designated at fair value with an impact on overall profitability corresponds to the balance sheet amount, as these financial assets are valued at fair value and the related value adjustments are recognised as an increase to the liability item IFRS 9 120. "Valuation reserves".
The off-balance sheet exposures refer to the commitments and guarantees issued, which are subject to the IFRS 9 write-down rules.

	Gross amount			Impairment provision		
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
30. Financial asset designated at fair value with an impact on other comprehensive income	**1,042,470**	**-**	**-**	**(93)**	**-**	**-**
- Debt securities	1,042,465	-	-	(93)	-	-
- Equity instruments	5	-	-	-	-	-
40. Financial assets at Amortised cost	**20,297,912**	**11,454**	**23,723**	**(18,695)**	**(5,964)**	**(21,043)**
- Debt securities	15,132,717	-	-	(10,193)	-	-
- Loans and receivables with banks	3,039,207	-	-	(2,872)	-	-
- Loans and receivables with customers	2,125,988	11,454	23,723	(5,630)	(5,964)	(21,043)
Off-balance sheet exposures	**2,581,092**	**404**	**-**	**(450)**	**-**	**-**
(Amounts in € thousand)						

4.1 Impacts on regulatory capital resulting from the adoption of IFRS 9

The application of IFRS 9 has led to a reduction in CET1, corresponding to the reduction in the Bank's net equity.
Regulation (EU) 2017/2395 published on 27 December 2017 provides, as an option, for the possibility of financial institutions adopting transitional rules in order to reintegrate within CET1 the adjustments resulting from the adopting of the impairment model according to the new accounting standard, using a phase-in period of 5 years starting in 2018; in line with the choice made by the UniCredit Group, the Bank will not adopt the transition regime.

5. Further reclassifications made as at 1.1.2018 in accordance with the 5th Update to Circular 262

The 5th Update to Circular 262 clarified that tangible assets recognised in accordance with IAS 2 need to be recognised in asset item 90. "Tangible assets", but this has not impacted the Bank's financial position.

The same update also required that provisions made in respect of off-balance sheet exposures are shown in the liability item 100. "Provisions for risks and charges" in place of the previous liability item, IAS 39 100. "Other Liabilities".

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6. Reconciliation of condensed accounts to mandatory reporting schedule

ASSETS	Amounts as at 31-Mar-18	Amounts as at 01-Jan-18
Cash and cash balances = item 10	745	613
Financial assets held for trading	10,368	8,827
20. Financial assets at fair value through profit or loss a) financial assets held for trading	*10,368*	*8,827*
Loans and receivables with banks	3,487,848	3,036,333
40. Financial assets at Amortised cost a) crediti verso banche	*13,789,223*	*13,332,936*
less: Attività finanziarie valutate al costo ammortizzato a) loans and receivables with banks - Debt securities	*(10,301,375)*	*(10,296,603)*
Loans and receivables with customers	2,318,096	2,128,528
40. Financial assets at Amortised cost b) loans and receivables with customers	*8,063,848*	*6,954,449*
less: Financial assets at Amortised cost b) loans and receivables with customers - Debt securities	*(5,745,752)*	*(4,825,921)*
Financial investments	17,095,494	16,724,188
20. Financial assets at fair value through profit or loss c) other financial assets required to be designated at fair value	*6,328*	*559,193*
30. Financial asset designated at fair value with an impact on other comprehensive income	*1,042,039*	*1,042,471*
Attività finanziarie valutate al costo ammortizzato a) loans and receivables with banks - Debt securities	*10,301,375*	*10,296,603*
Financial assets at Amortised cost b) loans and receivables with customers - Debt securities	*5,745,752*	*4,825,921*
Hedging instruments	356	119
50. Hedging derivatives	*1,063*	*458*
60. Changes in fair value of portfolio hedged items (+/-)	*(707)*	*(339)*
Property, plant and equipment = *item 90*	14,839	15,205
Goodwill = *item 100. Intangible assets of which: goodwill*	89,602	89,602
Other intangible assets = *item 100 net of goodwill*	7,584	7,909
Tax assets = *item 110*	6,428	8,639
Other assets = *item 130*	203,695	315,415
Total assets	**23,235,055**	**22,335,378**

(Amounts in € thousand)

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LIABILITIES AND SHAREHOLDERS' EQUITY	Amounts as at	
	31-Mar-18	01-Jan-18
Deposits from banks	960,046	926,001
10. Financial liabilities at Amortised Cost a) deposits from banks	*960,046*	*926,001*
Deposits from customers	20,916,380	20,205,036
10. Financial liabilities at Amortised Cost b) deposits from customers	*20,916,380*	*20,205,036*
Financial liabilities held for trading = *item 20*	4,892	11,936
Hedging instruments	(460)	(397)
40. Hedging derivatives	*4,462*	*3,375*
50. Changes in fair value of portfolio hedged financial assets	*(4,922)*	*(3,772)*
Tax liabilities = *item 60*	36,307	7,718
Other liabilities	325,843	456,150
80. Other liabilities	*207,334*	*338,287*
90. Provisions for employee severance pay	*4,876*	*4,999*
100. Provisions for risks and charges	*113,633*	*112,864*
Shareholders' Equity	992,047	728,934
- capital and reserves	937,076	521,178
140. Equity instruments	*200,000*	-
150. Reserves	*534,992*	*319,064*
160. Share premium reserve	*1,934*	*1,934*
170. Share capital	*200,773*	*200,545*
180. Treasury shares (-)	*(623)*	*(365)*
- revaluation reserves	(3,994)	(6,364)
120. Revaluation reserves of which: Available-for-sale financial assets	*5,260*	*3,449*
120. Revaluation reserves for actuarial net gains (losses) for defined benefit plans	*(9,254)*	*(9,813)*
- net profit = item 200	58,965	214,120
Total liabilities and shareholders' equity	**23,235,055**	**22,335,378**

(Amounts in € thousand)

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INCOME STATEMENT	1° Quarter 2018	2017
Net interest	68,904	62,963
30. Net interest margin	*68,904*	*62,963*
Dividends and other income from equity investments	7	6
70. Dividend income and similar revenue	*14*	*9*
less: dividends from held-for-trading equity instruments included in item 70	*(7)*	*(3)*
Net fee and commission income	71,462	64,681
60. Net fee and commission income	*71,462*	*64,681*
Net trading, hedging and fair value income	14,538	13,710
80. Gains (losses) on financial assets and liabilities held for trading	*13,988*	*13,695*
90. Fair value adjustments in hedge accounting	*12*	*12*
100. Gains (losses) on disposal or repurchase of: b) financial asset designated at fair value with an impact on other comprehensive income	*531*	*-*
+ dividends from held-for-trading equity instruments (from item 70)	*7*	*3*
Net other expenses/income	487	531
200. Other operating expenses/income	*24,627*	*22,865*
less: other operating income - of which: recovery of expenses	*(24,701)*	*(23,277)*
less: adjustments of leasehold improvements	*561*	*943*
OPERATING INCOME	**155,398**	**141,891**
Payroll costs	(20,533)	(19,216)
160. Administrative expenses - a) staff expenses	*(20,535)*	*(19,230)*
less: integration costs	*2*	*14*
Other administrative expenses	(65,467)	(62,442)
160. Administrative expenses- b) other administrative expenses	*(64,906)*	*(61,499)*
+ adjustments of leasehold improvements	*(561)*	*(943)*
Recovery of expenses	24,701	23,277
200. Other operating expenses/income - of which: recovery of expenses	*24,701*	*23,277*
Impairment/write-backs on intangible and tangible assets	(2,339)	(2,330)
180. Impairment/write-backs on property, plant and equipment	*(1,116)*	*(1,145)*
190. Impairment/write-backs on intangible assets	*(1,223)*	*(1,185)*
Operating costs	**(63,638)**	**(60,711)**
OPERATING PROFIT (LOSS)	**91,760**	**81,180**
Net impairment losses on loans and provisions for guaranteed and commitments	(1,311)	(597)
130. Impairment losses/writebacks on: a) financial assets at Amortised cost	*(1,259)*	*(597)*
less: impairment losses/writebacks on: a) financial assets at Amortised cost - Debt securities	*(17)*	*-*
130. Impairment losses/writebacks on: b) financial asset designated at fair value with an impact on other comprehensive income	*(16)*	*-*
less: impairment losses/writebacks on: b) financial asset designated at fair value with an impact on other comprehensive income - Debt securities	*16*	*-*
170. Net provisions for risks and charges a) for credit risk relating to commitments and guarantees given	*(35)*	*-*
NET OPERATING PROFIT (LOSS)	**90,449**	**80,583**
Provisions for risks and charges	(1,774)	(2,377)
170. Net provisions for risks and charges b) other net provisions	*(1,774)*	*(2,377)*
Integration costs	(2)	(14)
Net income from investments	1	8
+ Impairment losses/writebacks on: a) financial assets at Amortised cost - Debt securities	*17*	*-*
+ Impairment losses/writebacks on: b) financial asset designated at fair value with an impact on other comprehensive income - Debt securities	*(16)*	*-*
250. Gains (losses) on disposal of investments	*-*	*8*
PROFIT (LOSS) BEFORE TAX FROM CONTINUING OPERATIONS	**88,674**	**78,200**
Income tax for the period = *voce 270*	(29,709)	(26,506)
NET PROFIT (LOSS) BEFORE TAX FROM CONTINUING OPERATIONS	**58,965**	**51,694**
PROFIT (LOSS) FOR THE PERIOD	**58,965**	**51,694**

(Amounts in € thousand)