

**BANCA VALSABBINA - DIRECTORS' REPORT ON OPERATIONS**

**FINANCIAL STATEMENTS AS AT 31 DECEMBER 2016**

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## **The greeting of the Chairman Renato Barbieri**

Dear Shareholders, I am about to present the report to the 2016 financial statements of our Bank not without a bit of emotion, being certain that the role of Chairman is prestigious and laden with responsibilities. This is my first time and I do it with a state of mind that is grateful for the trust that the Board of Directors placed in me and that is fully aware of the delicate responsibilities that the banking supervision assigns to the Chairman as guarantor of good corporate governance.

Last August, I replaced Ezio Soardi, who was appointed Chairman in 2010 after a lifetime spent in the Bank in gradually higher positions of responsibility, until the position of General Manager: under his guidance, Valsabbina grew, exceeded the historical boundaries of the valleys and of the province and became known in many important areas of the region in Trentino, in the nearby Veneto and, recently, in Emilia Romagna. We thank him, at the start of our meeting works, because this is the best opportunity and place to share ideally, together with all the corporate bodies, the many positive feelings that bind us to Ezio Soardi, currently our Honorary Chairman.

In the most spontaneous continuity of examples and thoughts - which still reminds us today of another great Chairman, Pietro Caggioli - the Bank faces its 120th financial year with confidence and a positive outlook for the future, leaving behind - like all banks - a 2016 tormented by problems accumulated in almost ten years of crisis. Problems not only of impaired assets, interest rates, spreads and currencies, but of a political and social nature, which in turn have had a major impact on banking, regulation, customer relations, investment and payment services, supporting technologies: just think of the ruthless wars in Africa and the Middle East, the terrorist attacks in Europe, the migratory flows of biblical proportions on our shores, natural disasters in Central Italy and hunger and poverty in all parts of the world including our Country. An upsurge of uncommon situations that affected our boundaries by transforming the balance among communities and weakened the safety to the point of changing - and we are not exaggerating - rules and habits of our own way of life.

In a context that places us in a territory unexplored by manuals on economy - where traditional lending activities are likely to lose their face and the profitability from ordinary operations has been at its lowest for the past decade - the financial statements of banks paid a very high price to the crisis from which we are coming out only now. The financial statements of local and cooperative banks suffered the most, first of all cooperative banks - but not ours - that served and supported the economy of their territories, allowing many companies to overcome serious financial problems and restart virtuous income circuits, often overlooking competition on international markets. We are proud of this.

The role of cooperative banks, the one that actually qualifies "local banks" or "home banks", was crucial in stemming the effects of the crisis.

In a legal and institutional framework in which we have been a cooperative bank for 120 years, we continue our journey with energy and enthusiasm, combining tradition and innovation. In 2016, these two words were harmoniously formulated and certainly took part in the positive results of management: the net profit for the year was less brilliant than last year, but still appreciable if considered in the light of the discussed difficulties, of the closeness - difficult indeed in terms of income statement - shown in supporting households and businesses in our territory and of the dimensional and organisational growth that places Valsabbina, after the transformation of most of them into joint stock companies, at the top of the list of cooperative banks that retain the status of cooperative banks.

We will talk about it widely later when providing an analytical account of the operating results for the 119th financial year, the development of which was affected, as said, by the great events and by the profound transformations that have taken place in the domestic and international scenarios: none of these changes was neutral to the strategies of the Bank, on its income results and on the stock trend.

## **1. INTERNATIONAL ECONOMIC AND FINANCIAL SITUATION**

The analysis of the trend of the international economic cycle is of particular importance for our Bank in the presence - among its customers or in any case in the economic fabric in which it operates - of several national export-oriented companies, whose contribution is a significant component of the performance of the Italian economy.

The results of the 2016 final figures relating to the international cycle are different by geographic area in a context of moderate recovery of the economic growth, by 3.1%, and international trade. Overall inflation at a global level increased when the negative contributions of energy prices ceased to exist.

The United States recorded a robust economic trend in 2016: GDP grew at an annualised rate of 3.4% whereas the overall twelve-month inflation, measured on the consumer price index, rose to 2%, mainly due to the rise in oil prices. The US economy retains its basic force despite political uncertainty, in a context where only a few details have emerged about the economic policies to be introduced by the new Administration.

GDP continued to grow (2.4% on an annual basis) in the United Kingdom as well, despite expectations of a sharp slowdown in the period immediately after the Brexit referendum. The impact of the weakening of the pound is also becoming increasingly visible, as shown by the strong increases in import and production prices in recent months, with a gradual increase in inflation.

Conversely, in Japan, the pace of growth remained modest (1.3% on an annual basis). Towards the end of 2016, there was a recovery in exports in real terms and of industrial production in the presence, however, of a weak trend in private consumption.

In China, there is a stabilisation of the GDP growth rate by 6.5%, with a significant expansion of activity in public companies. The twelve-month inflation, measured on the consumer price index, fell to approximately 2%.

The other main economies of emerging countries show different trends. In India, GDP continued to expand at a high rate (7.2%) whereas in Brazil the severe recession continued (-2.9%) and the economic situation remained uncertain. In Russia, the recovery in oil prices mitigated the decline in GDP (-0.4%) by consolidating the prospect of a return to growth.

In the Eurozone, the expansion of economic activity is gradually consolidating. The measures taken by the Governing Council of the European Central Bank have considerably reduced the risks of deflation and laid the groundwork for a gradual return to monetary stability.

In this context, the ECB reports a gradual strengthening in the area, mainly supported by domestic demand (GDP + 1.7%). However, GDP growth rates between different countries have different trends, higher in Spain (3.2%) and Germany (1.8%), lower in France (1.3%), and in Italy (0.9%). Inflation is also rising gradually (1.1%) with an underlying trend that still does not show a steady upward trend.

## **2. PERFORMANCE OF THE MONETARY AND FINANCIAL MARKETS**

The trend in the stock markets at international level recorded in 2016 an increase in the price value, both in the United States, with an increase in the Standard & Poor 500 index by 9.5%, and in Europe, with a lower trend of the DJ Stoxx 50 Europe index equal to 2.9%.

Dwelling upon the difference between the stock-market trends in USA and Europe, it should be noted that this is mainly due to the performance of bank securities.

In Italy, in particular, where the securities of the sector represent more than 15% of total capitalisation, the FTSE-MIB index lost 9.7% during 2016. It should be noted that these stock-market trends do not often reflect the economic fundamentals of listed brokers.

The trend of the Banca Valsabbina share must refer - albeit with its peculiarities - to this context of reference; it will be discussed more extensively in the chapter called "Shareholding structure and share trends". In this case as well, it is necessary to distinguish between the actual value of the Bank (represented by its shareholders' equity, the soundness of capital ratios and a recognised earnings capacity over time) and the share price, which is affected by economic factors.

With regard to the bond markets, the 2016 figure recorded, in terms of new issues, a net balance that is still negative, with lower values for Italy and higher values for the Eurozone. These negative values were recorded mainly in the banking sector (both in Italy and in the Eurozone), compared to positive values recorded with reference to issues of other financial and non-financial companies.

The figures above show the persistence of serious uncertainties - for banks - related to the trend in financial markets of instruments issued by the bank, especially in Italy, despite the difficulties involving specific banks. In this context, important initiatives of significant public support of liquidity and capital of the banks were adopted, with an allocation of funds up to Euro 20 billion.

The measures for supporting liquidity consist in the granting of a government guarantee on liabilities issued by banks and on emergency liquidity assistance by the Bank of Italy. The aim of the guarantee is to support the raising capacity of the intermediaries, by facilitating the issue of new securities and expanding the availability of instruments accepted by the market or by the Bank of Italy as collateral in financing transactions.

However, the public recapitalisation interventions consist in the possibility for the government to subscribe share capital increases of banks, with precautionary purposes: measures compatible with the European regulations on government aid and on the management of banking crisis.

These urgent measures run alongside those of the structural reform of the sector already taken both with reference to Cooperative Banks in 2015 and with reference to cooperative credit banks (Banche di Credito Cooperativo, BCC) in 2016: reforms still awaiting the full implementation of their effects or, in some cases, not fully implemented.

Lastly, with reference to the money market trends, around the turn of the year, the ECB decided to keep the interest rate of the main refinancing transactions null whereas the Federal Reserve raised its reference rate to 0.75%. In this context, the 3-month Euribor recorded a -0.32% in December 2016, whereas the long-term interest rates in the Eurozone (government securities) rose to 1.04%.

### **3. ITALIAN ECONOMIC SITUATION**

In last year's report to the financial statements, at the beginning of this chapter, we recorded a growth in GDP of 0.8% for 2015 and the prospect for future growth of 1.3% for 2016. However, the final Eurostat figures for 2016 show a more moderate growth, by 0.9%, slightly higher than the previous year.

The trend, albeit positive, is certainly disappointing when compared with a growth of 1.7% for the Eurozone, gap that could further expand prospectively in the presence of an uncertain political framework, like the one that was determined after the outcome of the referendum on the constitutional reform and the increasing pressure at European level to balance in a short time the public accounts with an additional manoeuvre of Euro 3.4 billion.

In this scenario of light and shade, some consolidation points of the Italian real economy slowly gain ground, as pointed out by the Bank of Italy.

Industrial activity continues to expand and business confidence indicators are at higher levels. The accumulation of capital increased in the last part of the year.

Household consumption continued to grow moderately, a phenomenon associated with a gradual increase in the propensity to save and improved confidence in connection with a higher disposable income.

Italian exports of goods and services remained almost stable, affected by the weak growth in world trade, but with prospects for improvement with regard to foreign orders and a gradually increasing surplus of the balance of payments.

Labour market conditions improved and in 2016, the remuneration trend of the private sector decreased considerably, affected both by the delays in signing many contract renewals and by the non-payment of salary increases for 2016. However, the unemployment rate remained largely unchanged at 11.6%.

The underlying inflation, albeit slightly recovering (0.7% in December), is still at low levels with the persistence of large margins of unused production capacity and weak salary trend.

The Bank of Italy analyses indicate in short that in Italy the economic pick-up continues gradually, confirming the re-composition of the elements that push this growth, already highlighted in last year's report, from exports to internal demand.

In this macroeconomic scenario, the expansion of loans to the private non-financial sector continued in recent months. The cost of loans to households and businesses stood at historically very low levels, thanks to the expansionary measures taken by the ECB.

The Cooperative Banks continued to support their customer base, on the one hand small and medium-sized businesses, by disbursing - during the year - Euro 30 billion of new loans, on the other hand households, for which new mortgages amounted to approximately Euro 12 billion (+ 10% compared to 2015).

The credit quality of Italian banks continues to benefit albeit marginally from the improvement of the economic situation. The flow of new impaired loans fell to the lowest levels since 2008; their amount started to decrease, albeit gradually, as from the end of 2015.

Economic growth remains the main antidote for the reduction of impaired loans and receivables, as recently mentioned by Governor Visco. Euro 191 billion of this aggregate included net non-performing loans, i.e. exposures to insolvent debtors, amounted to Euro 88 billion, 4.8% of total loans. The remaining Euro 103 billion concerns situations where prospects for returning to regular payments are more favourable in a context of economic recovery.

Therefore, light and shade characterise also the trend of Italian banks, in the presence, on the one hand, of an average strengthening of the degree of capitalisation, and on the other hand, of an annualised return on capital and reserves (ROE) decreased to 1.4% (from 3.8%).

#### **4. THE ECONOMY IN OUR MARKET**

After outlining schematically the trend of monetary and financial markets and the salient features of the economy of our country - daily issues heard and commented on by the press and television - we now come to the local context, to which it is right that we reserve a much wider space, bearing in mind, among other things, that the dull use of figures, estimates and indicators alone cannot give us the depth of such complex phenomena and, above all, the feel of its protagonists.

For this reason, we need a collective “selfie”, in which the work of each individual - from the entrepreneur to the craftsman, from the merchant to the professional, to the one who holds the fate of the domestic economy in our households - forms the tissue of the economic and social fabric of places. Because the story of a year of banking activity, which is actually the financial statements we are now called to deepen and approve, summarises so many small stories of production and use of wealth, together with those of customers who use the services of this Bank.

The shareholders' meeting serves also for this: becoming protagonists, as shareholders, of a story that feeds on expectations and needs of entire communities and of the level of response that the bank is able to give them. Stories that often symbolise a bright tradition of entrepreneurship.

#### **A look at the Lombardy Region**

So let's start our discussion with a preliminary look at this region as it becomes day by day the reference and development area of our commercial and financial activity.

Bridge to Europe, Lombardy is undoubtedly one of the four driving forces of the continental economy, together with Baden-Wurttemberg (Germany), Rhone-Alpes (France) and Catalunya (Spain). A strong reference to the regional context, of which the opening of our Milan office is an expressive signal, is therefore very appropriate because staying hooked on the Lombard engine means not to lose contact with the trends of the mainland economy. As pointed out in the analysis of the Lombard Unioncamere, it is better to *“control the distance separating Lombardy from the most dynamic economies and not to consider only the average figure that can hide very different situations”*, also because the results of our region stand comparison with similar foreign situations.

So, without forgetting that thanks to the significant expansion of our sales network we are now active, albeit marginally, in the other three regions - Veneto, Trentino and Emilia Romagna - we consolidate our strong reference to the Lombard economy, whose dynamics summarise the underlying trends of other territories where the Bank is present.

#### **Industry and crafts in Lombardy**

According to the survey data of Unioncamere Lombardia concerning the fourth quarter of 2016 on a sample of 2,700 manufacturing companies, divided into industrial enterprises (1,557) and crafts businesses (1,166), the annual average growth in industrial production was 1.3%, slightly lower than last year (1.5%), whereas crafts businesses showed an increase of 1.2%, compared with 1.3% in 2015.

The positive results of 2016 still do not allow the industrial production index to exceed 100 (2005 annual basis =100) by setting itself at 99.6, down 9 points compared to 108.3, the highest level reached in pre-crisis.

The index of crafts businesses also stands at 71.4, 5 points below the highest level recorded in 2011.

The overall positive trend of industrial turnover is the result of a recovery in domestic demand (+1.5% relating to the economic trend), despite being affected by the reduction in foreign orders (-1.1%), resulting in a slowdown in international trade. Domestic demand for the crafts business sector is still weak: albeit recording a +0.1% compared to the previous quarter, it shows a negative average annual change (-0.1%). A similar decrease is recorded also by foreign demand. In terms of employment, apart from the seasonal trends and a slightly negative balance in the fourth quarter, there is an increase in the number of employees in line with that of production (+ 0.3%), to which a decrease both in the portion of companies claiming to have used hours of redundancy fund - which drops to 11.1% - and in the portion out of the total hours - which stands at 1.6% - correspond.

Slightly negative (-0.3%) is the employment balance of crafts business, which is also accompanied by a decrease in the use of the redundancy fund.

Albeit considering the necessary precautions suggested by the instability of the international context, short-term economic forecasts are positive. The expectations of entrepreneurs on production remain stable, improving in terms of foreign demand and recovering in terms of domestic demand, which is positive again.

On the contrary, the forecasts on production and employment in the crafts business are still negative, albeit with a possible turning point.

#### Commerce and services in Lombardy

The Lombard service companies achieved a 1.5% growth in turnover on an annual basis, following the slowdown in the previous period. The figure related to retail trade is slightly negative (-0.4%), reflecting the probable worsening of household confidence. As expected, the tourism industry was affected (-1.3% in the fourth quarter) by the driving effect of the Expo that came to an end. The trend in wholesale trade (+2.8%) and in services to persons (+2.7%) was positive, as well as the trend in business services, sector significant in size, which reversed the weak trend of the first nine months, achieving a positive result in the fourth quarter (+ 1.7%).

#### Agriculture in Lombardy

The positive trend of the agricultural sector in the last quarter, combined result of a positive trend in demand and a fair trend in prices, was not enough to change the opinion on a 2016 characterised all in all by some critical issues. However, the fourth quarter reveals, despite a still weak domestic demand, a possible breakthrough in the driving sectors of the agri-foodstuff sector, such as that of pork and dairy products, mainly thanks to a recovery in international demand and an uptrend in prices.

The overall positive trend of the entire regional economy is summarised by the employment figures that in the first nine months of 2016, as reported by Prometeia, “accelerated, showing one of the best performances in central and northern Italy and, at the sectorial level, a more intense growth in services. Work units should have ended 2016 with a 1.7% increase, more than half a percentage point higher than the national average”.

#### **The province of Brescia**

To give a picture of the development trends of the provincial economy, it seems advisable to precede the traditional analysis of the trend in various sectors by a demographic balance of businesses, in terms of closing downs and new setting-ups. Because, albeit in the last twelve months the result was substantially stable, with a balance of only 11 units of registered and closed down businesses in the last quarter of the year, behind this apparent inactivity, there are internal developments hiding deeper phenomena.

In fact, the companies registered at the end of 2016 amounted to 119,242, only 730 less than 2015 and the service sector showed positive trends, especially for companies operating in professional activities (+118 businesses), in business services (+ 106 units) and in accommodation and catering (+88 businesses).

However, if we extend the analysis to the last five years, we see that over the years, perhaps without noticing, the entrepreneurial system of Brescia essentially changed its traditional feature: we see a decline in agriculture,

more due to the historical context than to the effects of the long economic crisis, and in industry, due to the long economic downturn, counterbalanced by the growth in the service sector.

Starting from 2012, the manufacturing sector, because of the recession that affected it, especially the crafts business, recorded a sharp decline: crafts businesses, today 9,561 units, are 999 less. In the construction sector, traditionally lively and thriving, more than 2,000 own businesses closed down from 2011 to 2016, one per day in these six years.

The sharp decline in domestic consumption affected the trading sector, whose entrepreneurial base decreased by 707 businesses compared to 2011. The trend in the service sector is different: its percentage impact on registered businesses increased from 37.7% of 2011 to 40.2% at the end of 2016, with a significant trend in tourist services.

The development of the situation was always closely monitored by the Bank that was able to consequently adapt its commercial line of action to the changed market conditions. This is confirmed later when illustrating the credit policies, in the changes occurred in the last five years in the distribution of loans within the different economic sectors. The reduction in the percentage of loans in the construction and mechanical engineering sectors and the strong commitment in the service sector is consistent and perfectly symmetrical to what was just observed.

At the end of the schematic review on the trends in terms of quantity, we develop now some quick comments on the performance profiles of the different sectors as they are reported to us by the economic surveys of the Chamber of Commerce.

### Industry

The industry of Brescia closed 2016 with an annual average growth of production of 2.2%, higher than the average figure of 2015 (+1.2%) and of the regional figure of 1.3% compared to the same quarter of the previous year. Historically, the activity is at the level of 2010, year in which the local industry was able to benefit from a “rebound effect”, after the downfall of 2009, but lower (-24%) than the pre-crisis period. Growth was characterised by different intensities. In terms of size, the best result was achieved by large companies that closed 2016 with a +3.9% compared to the same quarter of the previous year, followed with lower percentages by small and medium-sized companies. In terms of product categories, positive results characterised the wood-furniture sector (+7.9%), engineering sector (+5.9%), food industries (+4.8%) and iron and steel industry (+2.8%), whereas sundry industries (-23.1%), clothing (-55.8%) and non-metallic minerals (-3.1%) showed negative trends.

In line with the positive trend in production, industrial turnover increased on average by 4.5% compared to 2015. Orders increased in the fourth quarter as well, up compared to the same quarter last year by 4.5%: domestic orders increased on an annual basis by 1.9% and foreign orders by 8.0%.

The positive trend of industrial production was also reflected in terms of employment, despite the absence of government benefits, with the fourth quarter of 2016 that closed with +0.7% relating to the economic trend. On the other hand, there was an unusual increase in the portion of companies using the redundancy fund: from 4.2% of the third quarter to 6.7% in the fourth quarter.

### Crafts sector

The craft manufacturing output showed a positive trend as well, better than the regional, with a result increasing year on year by 1.7%: combined effect of the favourable trend both of turnover (+4.3%) and of orders (+3.1%). In particular, textiles (+13.2%), food (+7.8%), engineering (+6%), non-metallic minerals (+5.3%), wood-furniture (+3.8%) and iron and steel industry (+1.4%) contributed to the results of this sector. On the other hand, the results of the leather/footwear sector (-8.8%), paper-publishing sector (-6.5%) and clothing sector (-3.7%) were negative. The main contributions to productive growth came from the good performances of companies with more than 10 employees, which recorded an annual increase of 5.8%. The crafts sector closed the year with a turnover up by 2.8% compared to 2015.

As a whole, orders in this sector increased by 3.1% compared to 2015, driven by the internal component that registered a good 3.3% growth, since the foreign one was stable but irrelevant in terms of sector. Employment also recorded a 0.8% increase.

Whereas, as mentioned, industry expectations tend to remain positive, for what concerns both production and employment, the sentiment of crafts-and-trades entrepreneurs remains negative both in terms of production and employment, with conflicting expectations on demand, which remain negative for the domestic demand and optimistic for the foreign demand.

### Trade

For the retail businesses in the province of Brescia, 2016 closed with a modest 0.6% growth in turnover on an annual basis, slowing down compared to the positive trend that characterised the end of 2015. The last quarter is characterised by good performances in the food (+3.4%) and non-food (+2.2%) sectors, whereas non-specialised shops showed a further decline (-1.8%).

As a whole, the 2016 result was at 80, 20 points below the index, which is based on 100 in 2005. Although the year ended with an increase in employees compared to the previous quarter, prospects for retailers remain cautious.

### Services

The economic survey carried out among the companies in this sector showed at the end of the year a further decline in business turnover (-2.2% compared to the same period last year) that confirms the negative trend started in the first quarter of 2016.

Only large companies, those with more than 200 employees, went against the tide by further increasing (+1.3%), albeit less than the previous quarter (+3.4%). The result of medium-sized enterprises was definitely penalising: their turnover decreased by 5% on an annual basis. Less significant than that of small enterprises and micro-enterprises. With regard to the commodity sectors, the negative result of constructions (-6.1%) and transports (-5.6%) must be pointed out, offset by the gratifying trend of IT and telecommunications businesses (+4.0%), wholesale trade (+3.9%), tourism (+ 3.1%), and advanced services (+3.1%). In the first quarter of 2017, forecasts are characterised by stability but with some optimism.

We conclude our discussion with the effective words of the president of Associazione industriale bresciana, Marco Bonometti, which, albeit referring to the manufacturing sector, seem to be able to set the overall economic performance of our province: *"Maybe we are about to turn the corner: there is certainly a trend reversal that has been confirmed for several quarters"*.

We accompany this authoritative omen with the renewed commitment - in the wake of the traditional closeness that the Bank has always shown to local communities - to implement all the possible measures and initiatives that can help intensify the tangible signs of recovery. In this sense, all men and women of the Bank are devoutly involved in the daily commitment to help, advice and support all the protagonists, small or big, of our story, starting from those working in the 70 branches located in the following provinces: 51 in Brescia, 8 in Verona, 3 in Trento, 2 in Monza, 2 in Vicenza, 1 in Mantua, 1 in Bergamo, 1 in Modena and 1 in Milan.

## **5. ECONOMIC AND FINANCIAL OUTLOOK**

The international economy may benefit, according to the latest forecasts of the International Monetary Fund, from a 3.4% growth scenario for 2017, with a 1.9% increase in advanced economies and a 4.5% increase in emerging and developing economies.

According to the projections prepared by the central banks of the Eurosystem and disseminated in December 2016, in the current year, GDP of the Eurozone is expected to increase by 1.7% and inflation by 1.3%.

However, GDP forecasts in Italy show a moderate growth of around 0.9%, with a further increase of 1.1% in 2018 and 2019. This scenario is affected by the adjustment of 0.2 percentage points of the deficit/GDP ratio, which is expected to fall - in 2017 - to 2.1%, as a result of the additional manoeuvre requested by the European Union to prevent the start of an infringement procedure.

The downward trend of the world economy is strongly affected by political uncertainties and by the persistence of strong financial imbalances between different areas of the planet. This scenario includes trade negotiations between the European Union and the United Kingdom following Brexit, the emergence of protectionist pressures in the United States, possible turmoils in emerging economies associated with the normalisation of



the monetary policy announced by the US Central Bank. A contribution to international growth could actually come from the implementation of a tax expansion programme by the new US administration.

In the Eurozone, the monetary and financial conditions are expected to remain easygoing in 2017, albeit affected by the increase in long-term yields on international markets. The ECB continues to expect the reference interest rates to be maintained at a level equal or lower than the current one for a long period of time. The Governing Council recently confirmed that it will continue to make purchases, as part of its quantitative easing programme, at a monthly rate of Euro 80 billion, with a reduction to Euro 60 billion as from April and until the end of December of this year. This policy could continue even beyond the 2017 horizon, if necessary, until it will not report an enduring adjustment of the price trend, consistent with the inflation rate target indicated by the ECB.

In this scenario, certainly less complicated than the one with which it started last year, the main ratios of the major European stock exchanges showed, starting from the end of 2016, an improving trend both due to the recovery of oil prices, resulting in a rise in inflationary expectations both in terms of easing and in terms of gradual quantitative easing.

With reference to the Italian banking system, the funding is expected to grow in 2017 by 1.2% especially due to the aggregate referring to deposits (+2.3%), with a decrease in the bond component of 6.3%. Loans, especially medium to long term, are expected to increase by 1.7%. The forecasts relating to the system of cooperative banks are consistent with the general reference framework, with the estimated funding increasing by 1.5%, deposits by 3.9% and loans by 1.7%.

A scenario such as that outlined should positively affect the Italian bank's income statement, estimated to improve.

## **6. SHAREHOLDING STRUCTURE AND SHARE TRENDS**

The orders collection activity relating to the ordinary share of Banca Valsabbina - temporarily suspended following the impossibility of continuing by using the previous organised trading system managed by Istituto Centrale delle Banche Popolari (ICBPI) - was resumed last 18 July. The transition – in view of the introduction of the new regulations and of the closing communication of the ICBPI market - to the trading of the security on the HI-Mtf market, an external platform set up in compliance with the MiFid Directive and recognised by Consob, represents an important step forward to encourage trade, with the intent to improve the liquidity of the security.

The opportunity of dealing with a more efficient market was already widely discussed by the Board of Directors and presented during the Shareholders' Meeting of 2016; it was carried out with the aim to improve the liquidity of the corporate shares. The contingent market phase has at times led Shareholders to dispose shareholdings both to cover commitments and deadlines of various kinds and due to a crisis of confidence in the banking system, also due to situations of instability involving some banks; the combination of these events spoiled the values of the bank stock listings, including those of the banks not listed on organised markets.

The choice of Banca Valsabbina to list its shares on an MTF is, however, consistent with the recommendations that CONSOB had sent to all market operators last 19 October, as well as with the provisions of the so-called MIFID 2 directive soon to be implemented.

The first weeks of trading, characterised by a downward adjustment of the price due to a greater propensity to sell by the shareholders - propensity related to the need to adapt to the new trading methods and to a limited knowledge of the ways in which the share market works, as well as to the more general economic context of the specific banking system - was followed by an increase in trade with a higher propensity to purchase that resulted in a gradual rise in the listing.

From the initial value of Euro 14, the price of the share fell to a minimum of Euro 4.60 and then increased in the next sessions and reached Euro 7.

However, it is necessary to distinguish between the actual value of the Bank (represented by a shareholders' equity of more than Euro 11 per share, the soundness of capital ratios and a recognised earnings capacity over time) and the share price, which is affected by economic factors. In other words, whatever the level reached by the price of the security, the Bank's assets are not affected, consisting of payments of the shareholders and allocated profits in more than one hundred years of history.

From July 2016 to December 2016, a total of 1,002,635 shares were traded on the HI-MTF, against approximately 524,000 traded in the previous year, for a total value of Euro 5,729,009.

Therefore, the choice of listing the shares on Hi-MTF was certainly positive for the liquidity of the security. After the difficulties of the first sessions, the market became particularly dynamic: no small/medium size bank not listed on the stock market can have such trading volumes.

During the same period, the Bank intervened in the negotiations with the relevant Fund, in support of the liquidity of the security, by virtue of the authorisation of the Shareholders' meeting and that of the Bank of Italy, pursuant to the CRR regulations and to the internal regulations that envisage interventions to the price recorded in the last auction.

In the 14 weekly auctions held in the second half of 2016, the Bank intervened by purchasing 291 thousand shares at an average price of Euro 5.62 for a total of Euro 1.636 million and by selling 135 thousand shares at an average price of 5.73 for a total of Euro 774 thousand.

During the financial year, as authorised by the last shareholders' meetings, the fund was also used for purchasing the shares of the Bank offered for sale as part of insolvency procedures or garnishments notified to the banks, as well as for purchases envisaged by the Articles of Association in cases of Shareholder exclusion.

All in all, including the transactions carried out in the first half of the year in the organised trading system, during 2016 the Bank purchased 377,188 shares for Euro 3.048 million, cancelled 280 thousand shares for Euro 5.040 million as announced at the shareholders' meeting of last year, sold 135,200 shares for Euro 775 thousand. From the enhancement of sales based on the average prices charged, there were capital losses of Euro 907 thousand, charged to the share premium reserve, as required by the regulations.

Therefore, own shares in the portfolio decreased from 491,787 for an equivalent value of Euro 8.855 million as at 31 December 2015 to 453,775 for an equivalent value of Euro 5.182 million as at 31 December 2016.

The complex economic situation of banks as well as divestment requests received in the first weeks of trading also led to a slight decrease in the number of shareholders who as at 31 December 2016 totalled 39,234 compared to 40,129 as at 31 December 2015, confirming the Bank as one of the most popular among co-operative banks and at the same time one of the largest, in size of assets, among those that will retain the status of co-operative bank.

## **7. EQUITY AND CAPITAL RATIOS**

The reference regulations consist of the EU Regulation no. 575/2013 (Capital Requirements Regulation, known as CRR) and of the 2013/36/EU Directive (Capital Requirements Directive, known as CRD IV) that transpose in the European Union the standards defined by the Basel Committee on Banking Supervision (known as Basel III framework).

The new regulatory digest envisages that "own funds" (former Regulatory Capital) are made up of:

- Tier 1 Capital, in turn made up of Common Equity Tier 1 - CET1 and Additional Tier 1 - AT1;
- Tier 2 capital (T2).

Tier 1 capital mainly consists of Common Equity: ordinary shares net of the authorised purchase of own shares, capital reserves, income-related reserves, valuation reserves, deducted elements such as goodwill, other intangible assets, deferred tax assets (DTA) related to future profitability.

The capital instruments issued, so as to be reckoned in Common Equity, must ensure the absorption of the so-called "ongoing concern" losses by means of the observance of the following conditions: maximum level of subordination; possibility of suspension of the acknowledgement of the dividends/coupons at the total discretion of the issuer and in a non-cumulative manner; irredeemability; absence of incentives for redemption.

Tier 2 is in turn made up of other financial assets, such as subordinated loans.

The application of the rules of Basel III is subject to a transitional regime during which they will be applied - in most cases - in an increasing proportion until 2019, when they will be fully applied. At the same time, non-

conforming capital instruments will be gradually excluded from the financial aggregate, useful for supervisory purposes, by 2021.

The minimum regulatory requirements for 2016 envisage that:

- Common Equity Tier 1 must be at least 4.5% of total RWA;
- Tier 1 must be at least 6% of total RWA;
- own funds (sum of Tier 1 and Tier 2) must be at least 8% of total RWA.

Moreover, banks are required to hold a capital conservation buffer which, according to recent Bank of Italy regulations, is 1.25% for 2017 compared to 2.5 % envisaged for 2016.

With the implementation in Italy of Directive 2013/36/EU (CRD IV), the Bank of Italy carried out an initial process during 2015 for the prudent review of the Bank (SREP) on the basis of which additional capital requirements were determined for 2016:

CET 1 Ratio equal to 7%, inclusive of the 2.5% required by way of capital conservation reserve (there are no additional requirements than the minimum requirements);

Tier 1 Ratio equal to 9%, inclusive of the 2.5% by way of capital conservation reserve and 0.5% from the outcome of the SREP process;

Total Capital Ratio equal to 12%, inclusive of the 2.5% by way of capital conservation reserve and 1.5% further to the SREP process;

The own funds amount as at 31 December 2016, without the allocation of the profit for the year, to Euro 416.879 million made up of Euro 374.074 million of Common Equity Tier 1 (CET 1) and Euro 42,805 of Tier 2 Capital, mainly consisting of two accountable subordinated loans.

With risk weighted assets amounting to Euro 2.476 billion, the Tier 1 capital ratio, determined by the ratio between the Tier 1 capital and the risk weighted assets, comes to 15.11% as against 14.94% in December 2015, while the Total capital ratio, which expresses the ratio between total own funds and risk weighted assets stands at 16.83% compared with 16.33%.

Both ratios are higher than the minimum requirements for 2016, respectively 9% and 12%.

In the calculation of own funds, as already occurred in recent years, both capital gains and capital losses related to Government securities of the countries of the European Union included in the portfolio of available-for-sale financial assets ("AFS") were neutralised, as allowed by the Bank of Italy on a transitional basis, even if this facilitation is soon to come to an end following the introduction of IFRS 9.

The main capitalisation ratios present the following trend:

	31/12/2016	31/12/2015	31/12/2014	31/12/2013
shareholders' equity / customer deposits	12.34%	12.55%	12.13%	11.98%
shareholders' equity/loans and receivables	14.09%	14.11%	13.34%	12.80%
shareholders' equity/total assets	8.83%	9.30%	8.98%	9.00%
net impaired loans/own funds	90.84%	94.83%	103.80%	* 108.29%
net non-performing loans/own funds	46.92%	46.24%	43.89%	* 45.02%
total capital ratio	16.83%	16.33%	14.75%	14.58%
Tier 1 capital ratio	15.11%	14.94%	14.72%	13.63%

*\*Net of subordinated loans calculated in 2013.*

The amount of equity and the large surplus of the capital ratios with respect to the minimum regulatory requirements make it possible to plan a harmonious growth in the size of the business operations, without programming extraordinary capital strengthening measures.

Also in terms of liquidity, the Bank's position was already well above the minimum ratios. The expected regulatory instrument is the LCR (Liquidity Coverage Ratio) coefficient given by the ratio between the reserve of liquid assets and the net outflow of liquidity envisaged over a 30-day stress period.

This indicator is designed to ensure that banks have sufficient high quality (uncommitted) liquid reserves available in a 30-day stress situation. At the end of December, the Bank's LCR ratio was 1.87 against the minimum regulatory requirement of 0.7, equal to the ratio between the liquidity buffer of Euro 505.1 million and the expected net outflow (30 days) of Euro 270.4 million (net liquidity outflow).

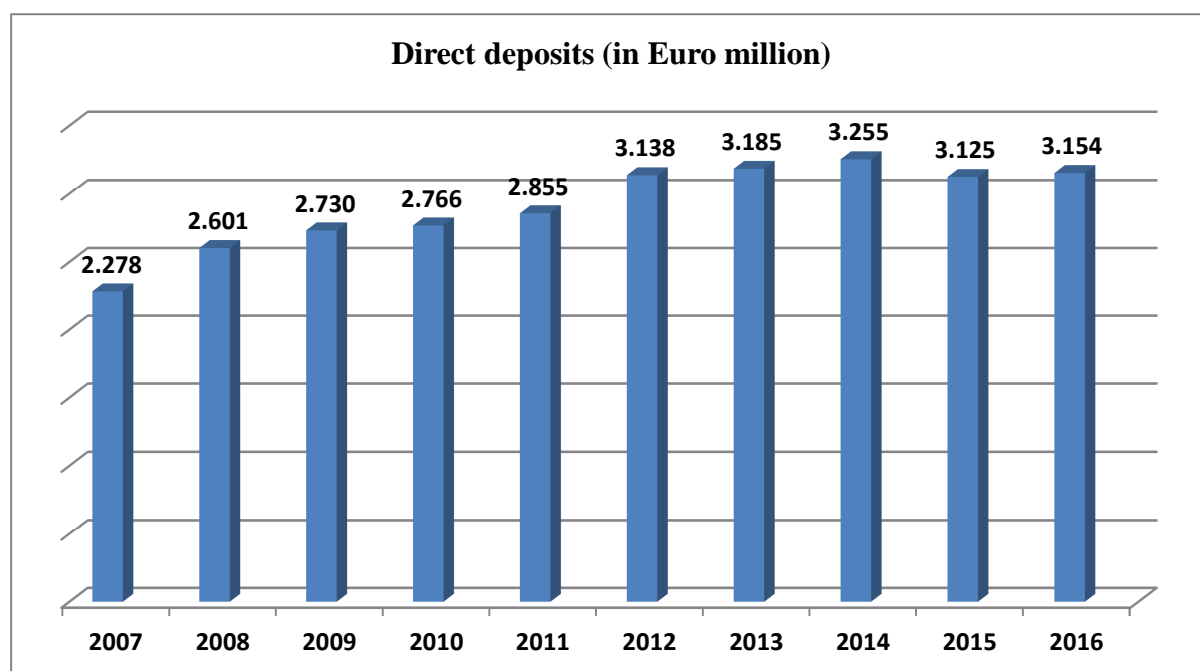
## 8. CUSTOMER DEPOSITS

During 2016, the Bank adopted an accommodating policy with regard to the guidelines of customer deposits, with the aim of maintaining the pricing adequate to the market and the volumes related to the financing of loans. At the end of 2015, the sudden entry into force of the regulations on bail-in and the use at the same time of the resolution funds for the rescue of the four banks administered through an external commissioner - in addition to the intervention shortly thereafter of Fondo Atlante against two important Venetian banks - caused a strong disorientation in investors, partially dropped only towards the end of the year. In the second part of 2016, bonds were no longer placed, while other forms of compulsory deposits, including time deposits and deposit certificates covered by the Deposit Guarantee Fund, were offered to customers.

On the other hand, the general economic situation, characterised by stable prices and slow paces in recovery, certainly did not favour any increase in disposable income of households; circumstance that led - in line with a generalised conduct by banks - to direct the technical forms of the offer towards indirect deposits, with a special reference to the managed component.

The total volume of direct deposits, including cash pooling with institutional counterparties, reached Euro 3.154 billion, up 0.9% on the previous year.

The development of the aggregate is represented by the following chart:



The comparison of individual components of the item with respect to 2015 is shown in the following table.

<b>Customer deposits</b>	<b>31/12/2016</b>	<b>31/12/2015</b>	<b>Change</b>	
<b>(in Euro 000)</b>			<b>Absolute</b>	<b>%</b>
Savings deposits	35,813	38,058	(2,245)	(5.90%)
Current accounts	1,872,031	1,905,617	(33,586)	(1.76%)
Time deposits	188,431	214,775	(26,344)	(12.27%)
Other deposits	539	895	(356)	(39.78%)
Deposits from institutional investors	309,979	-	309,979	NS
<b>Due to customers</b>	<b>2,406,793</b>	<b>2,159,345</b>	<b>247,448</b>	<b>11.46%</b>
Bonds	636,208	869,125	(232,917)	(26.80%)
Subordinated bonds	69,587	84,711	(15,124)	(17.85%)
Certificates of deposit	41,154	11,725	29,429	250.99%
<b>Securities issued</b>	<b>746,949</b>	<b>965,561</b>	<b>(218,612)</b>	<b>(22.64%)</b>
<b>Total direct funding</b>	<b>3,153,742</b>	<b>3,124,906</b>	<b>28,836</b>	<b>0.92%</b>

Within direct deposits, the current preferences of customers for on-demand technical forms and for short-term time technical forms, presented with numerous possibilities of choice between agreements and targeted products. Deliberately, as mentioned, the incidence of bond issues, more onerous for the Bank's income statement and not covered by the deposit guarantee fund, were reduced.

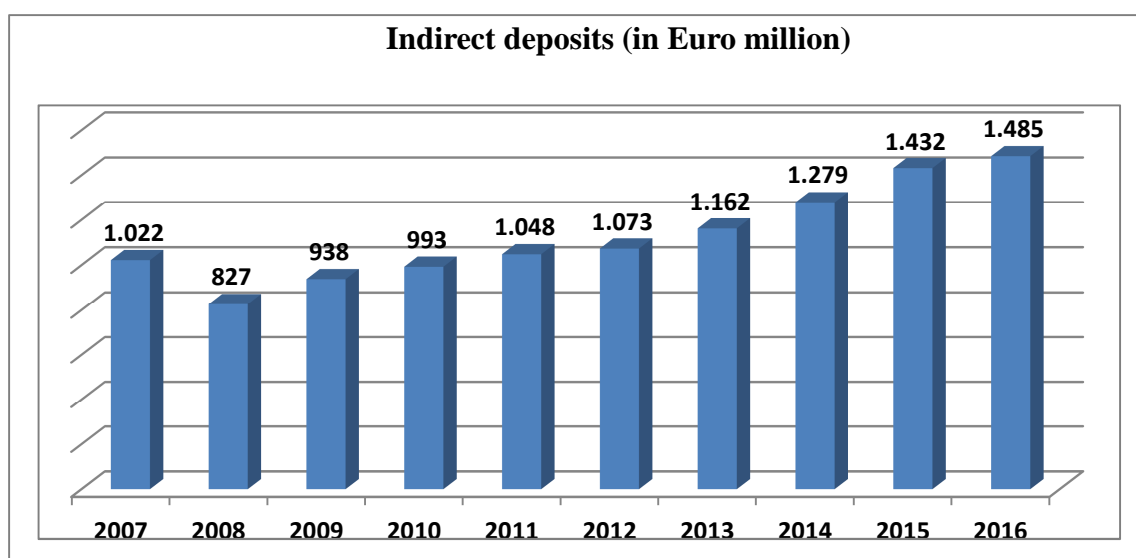
With the treasury component – raised on the NewMic of Euro 309 million with negative rates - “due to customers” amounted to Euro 2.4 billion, with an increase of 11.5% compared to 2015.

On the other hand, the amount of “securities issued” decreased, for the said reasons, from 966 million at the end of 2015 to 747 at the end of 2016.

During the year, the Bank also placed Euro 15 million of subordinated bonds accountable to own funds, repurchased subordinated bonds issued not accountable for Euro 25 million, whereas other Euro 5 million of these securities accrued.

At the end of the year, the issued subordinated bonds, with the above-mentioned characteristics of accountability, amounted to a nominal value of Euro 49.8 million.

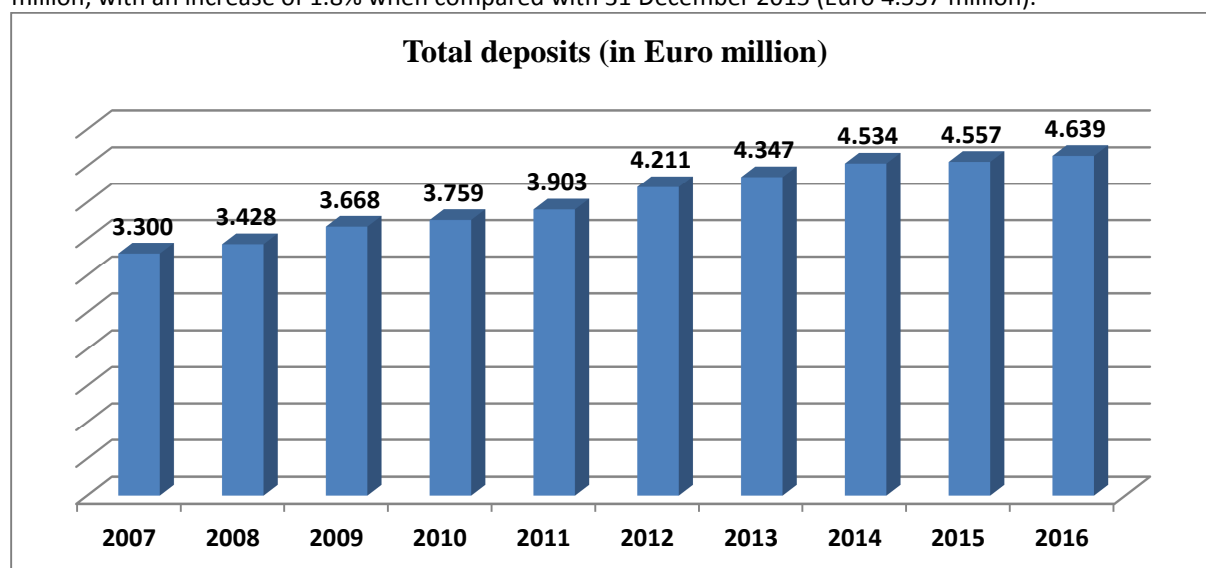
The emphasis on the development of managed deposits by the territorial network, adequately supported at the central level by the constant refinement of the product range, by the planning of effective commercial initiatives and by the systematic training programmes for the personnel, led to an increase in indirect deposits by 3.7%, within which the amount of the share component decreased due to the generalised drop in prices compared to the end of 2015.



The increase in mutual funds and management (to Euro 469 million, +20%) was considerable like the one recorded in life insurance policies, which at the end of the financial year reached the consistency of Euro 337 million (+24.4%). The managed component as a percentage of total indirect funding therefore reported significant progress, increasing year on year from 46.2% to 54.2%, by shifting the Bank considerably closer to the system indicators entirely to the benefit of the expansion in net revenues from services, the priority objective of business strategies.

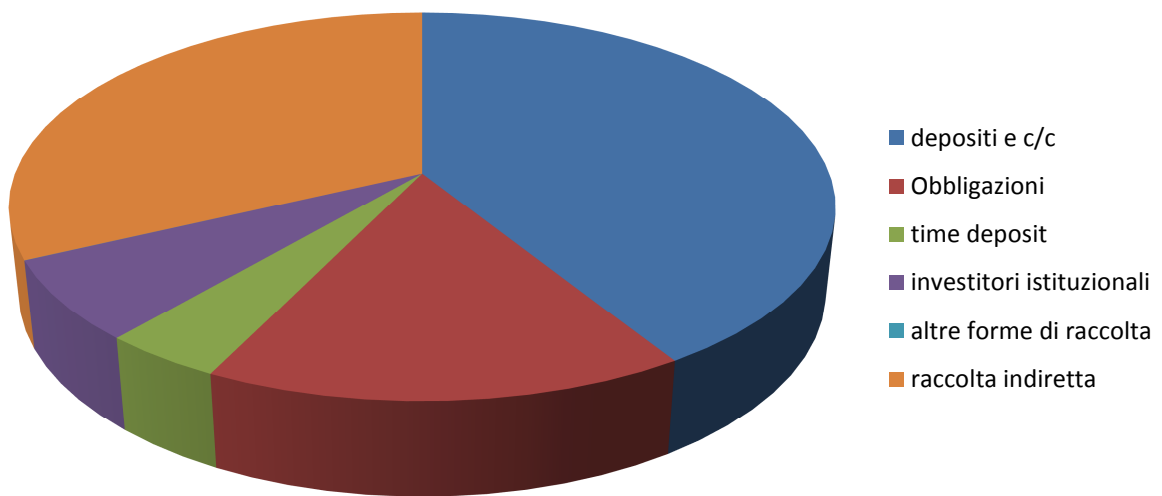
Indirect deposits from customers	31/12/2016	31/12/2015	Change	
(in Euro 000)			Absolute	%
Bot (T-bills) Government securities	307,607	336,353	(28,746)	(8.55%)
Italian and foreign shares	223,726	268,472	(44,746)	(16.67%)
Corporate and foreign bonds	147,934	165,785	(17,851)	(10.77%)
Mutual funds and management schemes	468,680	390,775	77,905	19.94%
Zurigo / Arca vita	337,179	271,003	66,176	24.42%
<b>Total indirect funding</b>	<b>1,485,126</b>	<b>1,432,388</b>	<b>52,738</b>	<b>3.68%</b>

As a result of the significant growth in indirect funding, the balance of total deposits came to Euro 4.639 million, with an increase of 1.8% when compared with 31 December 2015 (Euro 4.557 million).



The breakdown of total deposits as at 31 December 2016 is structured as follows

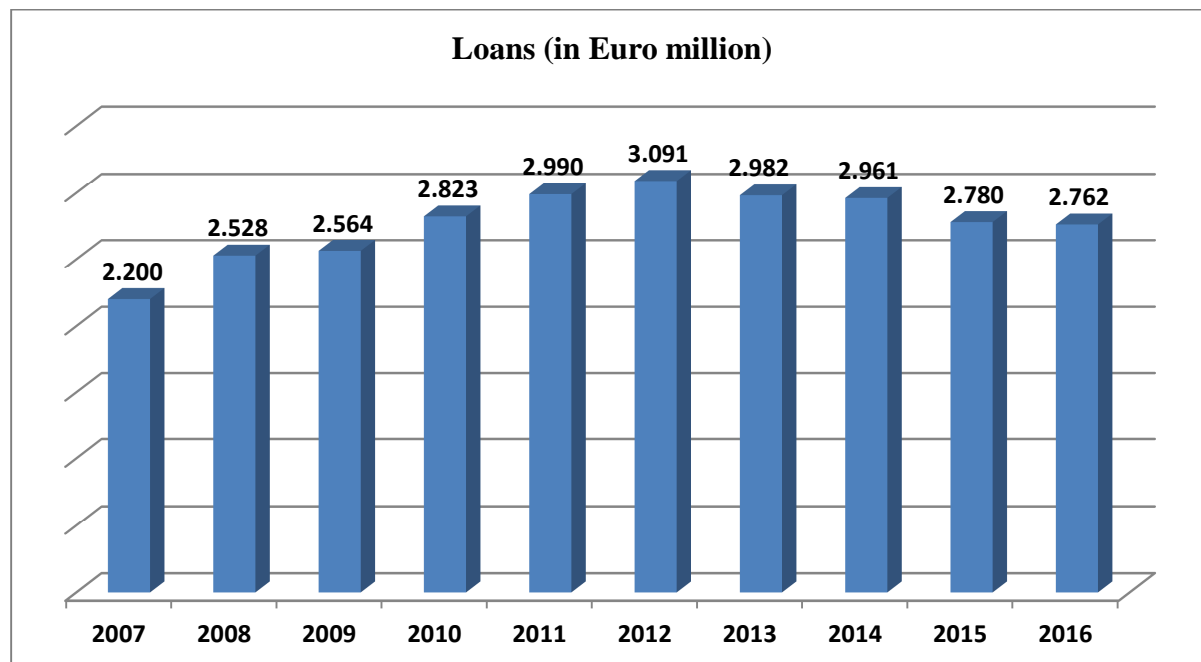
## Components of deposits



Legend: deposits and c/a – Bonds – time deposits – institutional investors – other forms of funding – indirect deposits

## 9. LOANS

Loans and receivables with customers amounted to Euro 2.762 billion at the end of the year, with a slight decrease of 0.6%. The result must be deemed positive, considering the negative developments that have characterised for years the changes in the aggregate at the level of the entire banking system.



In full compliance with the credit policy guidelines approved by the Board of Directors, the Bank continued to support the demand for credit from households and small and medium size companies, without neglecting - compatible with the need to strictly contain risk concentrations - those counterparties requiring financial support, advice and assistance for those development projects that are considered valid and deserving attention also due to their effects on employment.

This business policy, primarily - but not exclusively - aimed at supporting smaller sized economic players, also through the acceptance of requests for a moratorium of the debts of small and medium-sized companies furthered by ABI, the Ministry of the Economy and Finance and the trade and consumer associations, is certainly consistent with the institutional profiles of a cooperative bank and rewarding to deal with the decline in quality of assets.

This explains the development of initiatives in favour of microcredit, as a result of which - albeit necessarily affected by a slower development of the total volume of the aggregate - household loans increased by 1.6%.

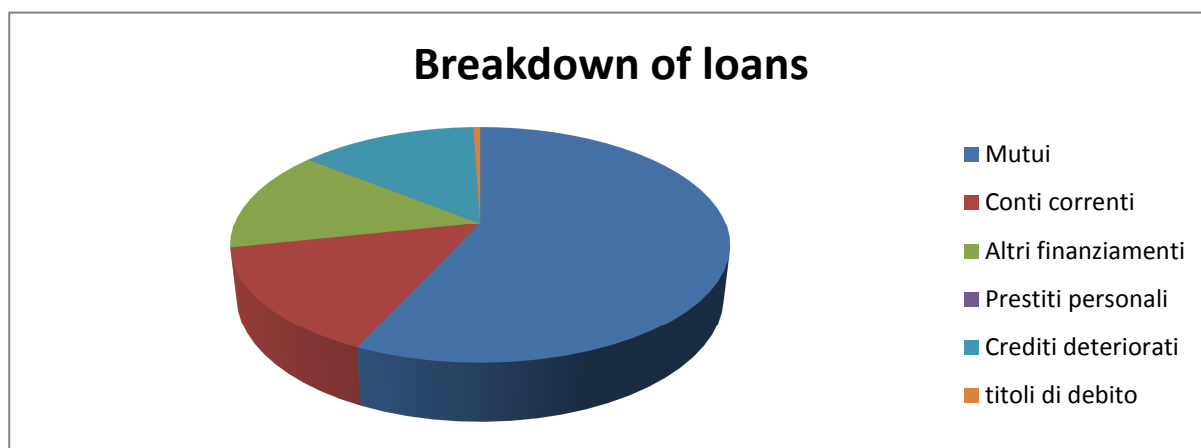
At the same time, as part of the largest amount of loans granted to businesses in a temporary state of difficulty, the Bank did not put up resistance - for the part falling within its remit - to the access to regulated procedures that allow them to overcome the state of crisis: albeit within a legislation still demanding and slow with regard to insolvency proceedings, the Bank intervened in the crisis management by means of the most appropriate instruments as and when: unconditional arrangement with creditors (Article 161 of Italian Bankruptcy Law), debt restructuring agreements as per Article 182 bis of Italian Bankruptcy Law and arrangement with creditors on a going concern basis (Article 186 bis of Italian Bankruptcy Law) as well as the recovery plans (Article 67 of Italian Bankruptcy Law.).



The change in the breakdown of loans by technical form in 2016 compared to 2015 is presented as follows:

Loans to customers (in Euro 000)	31/12/2016	31/12/2015	Change	
			Absolute	%
Current accounts	409,795	459,295	(49,500)	(10.78%)
Mortgages	1,570,100	1,604,258	(34,158)	(2.13%)
Personal loans	874	3,529	(2,655)	(75.23%)
Other loans	388,574	324,722	63,852	19.66%
Impaired loans	378,683	388,627	(9,944)	(2.56%)
Debt securities	14,424	-	14,424	NS
<b>Total loans to customers</b>	<b>2,762,450</b>	<b>2,780,431</b>	<b>(17,981)</b>	<b>(0.65%)</b>

The analysis of the trends of the technical forms shows a decrease mainly in the item current accounts (which includes "overdrafts" and "advances subject to collection"), unfortunately, a typical sign of decline in turnover that can be paid in advance by the Bank to the production sector. The amount of mortgages also decreased by Euro 34.2 million, against an increase of Euro 63.9 million in the item "other loans".



**Legend: Mortgages – Current accounts – Other loans – Personal loans – Impaired loans – debt securities**

The efficient initiative of loans backed by government guarantees up to 80% of the amount via Mediocredito Centrale continued in 2016. The credit facilities granted through this technical form, including those in the microcredit sector for companies with a turnover not exceeding Euro 2 million and a maximum of nine employees, totalled 613 for an equivalent value of Euro 126.6 million.

Moreover, the chapter of mortgages for the purchase of the first home developed considerably: in 2016, approximately 1,000 contracts were finalised amounting to more than Euro 115 million, more than twice as much compared to 2015.

Ordinary land, building and mortgage loans totalled 1,284 amounting to Euro 226 million, compared to 667 for Euro 124 million in 2015.

Finance leasing operations intermediated by means of the partner company SG Leasing recorded very positive results: 287 contracts were finalised for Euro 35 million, compared to 238 for Euro 24.4 million in 2015.

MEDIUM/LONG-TERM DISBURSEMENTS (in Euro 000)	2016		2015	
	Trans. No.	Amount	Trans. No.	Amount
<b>A) Directly using funds of the Bank</b>				
Loans with Mediocredito Centrale backing made available by Italian Law No. 662/1996	613	126,587	714	135,205
Artisan loans backed by surety of the Credit Guarantee Consortiums making reference to the various Trade Associations	150	6,606	96	4,269
Ordinary mortgage, building and land loans	1,284	226,020	667	124,463
Loans and mortgages to Shareholders of the Bank	845	18,694	671	9,155
Mortgage-secured current accounts	6	1,505	7	1,620
<b>B) Indirectly as intermediary of specialised Institutes</b>				
Lease transactions	287	35,058	238	24,362

The breakdown of customers granted credit by category of credit facility confirms what was commented above on the objectives of the credit policy pursued in recent years: i.e. the expansion of the customer base - in parallel with the mitigation of risks through a suitable fractioning of the loan portfolio - and a continuous and proven attention to the requirements of households and small-to-medium-sized companies that represent the reference customers in the area of choice.

Number of customers granted credit facilities broken down by credit facility category						
	2016	% of total credit facilities	2015	% of total credit facilities	2014	% of total credit facilities
Up to Euro 40,000	14,434	4.7	14,312	4.5	14,025	4.1
From Euro 40,001 to Euro	6,222	14.3	6,107	13.7	6,070	12.9
From Euro 125,001 to Euro	2,699	13.8	2,707	13.4	2,887	13.6
From Euro 250,001 to Euro	1,176	12.3	1,184	12.0	1,237	11.8
From Euro 500,001 to Euro	633	13.1	647	13.1	714	13.6
From Euro 1,000,001 to Euro	486	27.7	492	27.4	528	27.5
Over Euro 5,000,001	47	14.1	57	15.9	64	16.5
<b>Total</b>	<b>25,697</b>	<b>100.0</b>	<b>25,506</b>	<b>100.0</b>	<b>25,525</b>	<b>100.0</b>

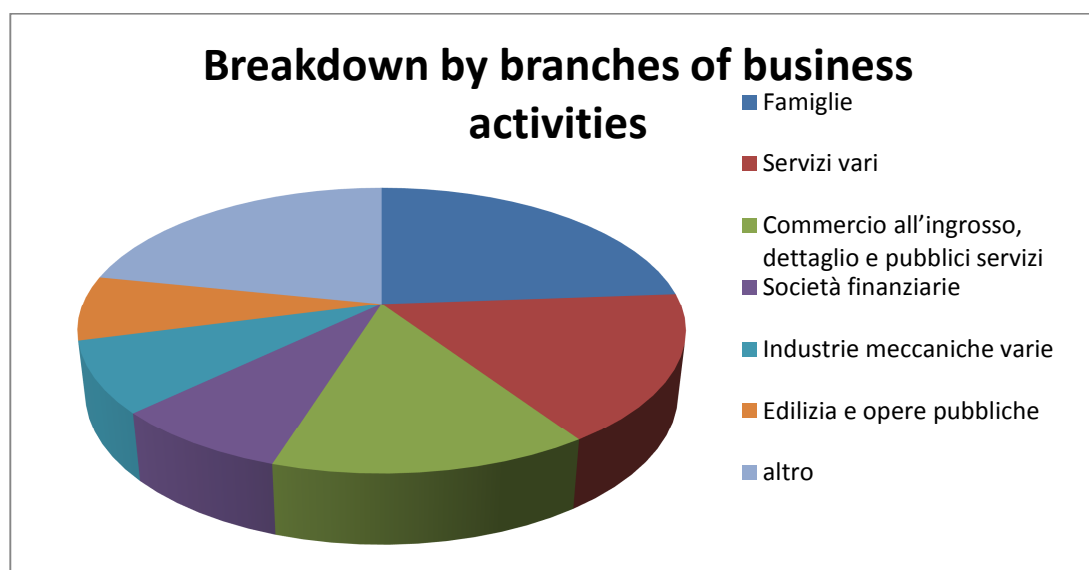
The credit facilities of more than Euro 1 million decreased compared to previous years both in number and in percentage. Compared to 2015, they decreased from 549 to 533 and from 43.3% to 41.8%.

Credit facilities of less than Euro 500 thousand had an opposite trend. As at 31 December 2016, they accounted for 45.1% of the total compared to 43.6% last year.

The breakdown of the aggregate by business sector is balanced, taking into account the average system figures referring to the areas in which the Bank is present and the trend of the various sectors of the economy of the served territories upon which we dwell in the specific section of this report.

The figures shown in the following table confirm the constant attention reserved for households which, within the various sectors, rank first in all the years under observation, with percentages tending to increase. At the end of the year, the loan granted to households accounts for 23.8% of the aggregate.

	Sectors of business activities	2016	2015	2014	2013	2012
1	Households	23.81	23.05	22.45	23.3	22.64
2	Other services	16.76	17.10	16.76	18.07	17.91
3	Wholesale trade	9.70	9.18	9.37	9.11	8.90
4	Financial companies	8.04	6.24	6.58	2.56	2.23
5	Other mechanical engineering businesses	8.00	8.58	8.63	10.25	10.73
6	Construction and public works	7.34	7.86	8.05	8.72	9.16
7	Retail trade and public services	4.60	4.73	4.78	4.99	4.92
8	Agriculture, forestry and fishing	2.23	2.48	2.53	2.57	2.57
9	Foodstuffs and beverages	2.21	2.22	2.26	2.42	2.62
10	Agricultural and industrial machinery	2.10	2.34	2.49	2.17	2.05
11	Wood, furniture and other industrial products	1.86	1.84	1.8	1.83	1.91
12	Iron and steel industries	1.85	2.13	2.36	1.44	1.3
13	Construction materials	1.72	1.65	1.49	1.73	1.57
14	Textile products and clothing	1.69	1.68	1.75	1.88	2.08
15	Transport services	1.36	1.38	1.34	1.51	1.52
16	Electricity, energy and chemical products	1.24	1.66	1.59	1.40	1.60
17	Electrical supplies and materials	1.20	1.19	1.16	1.13	1.18
18	Rubber and plastic products	0.99	1.01	1.13	1.39	1.45
19	Vehicle repairs and sundry articles	0.68	0.75	0.7	0.72	0.68
20	Public administration authorities	0.65	0.69	0.7	0.75	0.75
21	Paper and publishing	0.60	0.78	0.68	0.55	0.63
22	Glass and ceramic industries	0.48	0.61	0.62	0.60	0.60
23	Means of transport	0.43	0.40	0.36	0.44	0.49
24	Non-ferrous metal industries	0.29	0.29	0.26	0.32	0.34
25	Fine and precision engineering	0.17	0.16	0.16	0.15	0.17
	Total	100.00	100.00	100.00	100.00	100.00



Legend: Households – sundry services – Wholesale trade, retail trade and public services – Financial companies – Other mechanical engineering businesses – Construction and public works - other

On a consistent basis with the operating logics of the last few years, the policies for selecting and handling the credit facilities were appropriately reviewed and streamlined so as to limit the generalised quality decline in the portfolio, caused by the considerable deterioration of the economic operating context, especially in those sectors to which the local economy is more inclined and the bank consequently committed.

In this sense, additional procedural and organisational stratagems have been adopted suitable for intensifying the efficacy of the monitoring and the accuracy of the control units on the facilities granted. Nevertheless, the persistence of the economic crisis has led to the further weakening of the traditional solidity of the fabric of our small and medium businesses - in particular in the construction sector and related supply-side industries, the engineering and transformer machinery sectors - with inevitable repercussions on the risk profiles of the bank assets.

However, in as much as the flow of new impaired loans has registered a slowdown with respect to the three-year period from 2011 to 2013, the mitigation of the deterioration of the quality of the credit is finding difficulty in consolidating itself, especially in relation to the still modest intensity of the economic pick-up and the value depreciation of real estate collateral in the enforcement proceedings initiated in the past. Gross impaired loans, for an overall amount of Euro 620 million (Euro 598.5 million in 2015), as a result of provisions amounting to Euro 241.3 million - result of a rigorous and careful check - are recorded in the financial statements for Euro 378.7 million compared with Euro 388.6 million last year (-2.6%).

The incidence of net non-performing loans on total loans was 13.71%, compared to 13.98% of 2015.

The decrease was due not only to the collection managed by legal and dispute service of the Bank but also to coverages fed with the recognition of impairment losses to the income statement.

Specific impairment losses (analytical coverages) increased from Euro 209.9 million to Euro 241.3 million. The amount booked to the income statement under items “profits/losses on sales of loans” and “impairment losses/reversals of impairment losses on loans” totalled Euro 36.3 million compared to Euro 47.2 million last year.

Within the impaired loan sector, net past due loans remained almost stable at Euro 29.6 million, non-performing loans amounted to Euro 195.6 million compared to Euro 190 million of the previous financial year. Net probable defaults (former substandard loans) decreased from Euro 169.5 to Euro 153.5 million both for the desired return to performing and for the worsening of their quality that requested a different classification as non-performing loans.

The following tables show the amount of impaired loans, classified according to the regulations in force, and their adjustments in absolute terms.

<b>31/12/2016</b> <b>Type of exposure/values</b> (in Euro 000)	<b>Gross exposure</b>	<b>Individual impairment</b>	<b>Collective impairment</b>	<b>Net exposure</b>	<b>% of total net exposure</b>
a) Non-performing loans	402,457	206,851	-	195,606	7.08%
b) Probable defaults	185,405	31,882	-	153,523	5.56%
c) Past due loans	32,160	2,606	-	29,554	1.07%
Total impaired loans	620,022	241,339	-	378,683	13.71%
d) Performing loans	2,396,650	-	12,883	2,383,767	86.29%
Total	3,016,672	241,339	12,883	2,762,450	100.00%

<b>31/12/2015</b> <b>Type of exposure/values</b> (in Euro 000)	<b>Gross exposure</b>	<b>Individual impairment</b>	<b>Collective impairment</b>	<b>Net exposure</b>	<b>% of total net exposure</b>
a) Non-performing loans	358,175	168,675	-	189,500	6.81%
b) Probable defaults	208,368	38,877	-	169,491	6.10%

c) Past due loans	31,995	2,359	-	29,636	1.07%
Total impaired loans	598,538	209,911	-	388,627	13.98%
d) Performing loans	2,408,405	-	16,601	2,391,804	86.02%
Total	3,006,943	209,911	16,601	2,780,431	100.00%

The amount of impairment was determined on the basis of the stringent internal regulations approved by the Board of Directors in 2014 and revised also during 2016, which specifies the prudent criteria to be used when examining the irregularly performing loans evaluating the guarantees, in determining the recoverable amount and timing of periodic revision of the defaulting counterparties.

The ratio between the total amount of impairment losses and the amount of gross loans and receivables represent the so-called "coverage ratio of the impaired loan": the measure of this ratio is the competition ground of operators specialised in the acquisition of NPLs, speculatively interested in portfolios with a higher coverage ratio regardless of what is reasonable to expect from the trend in real estate values as collateral.

As shown in the following tables, our Bank's coverage ratio on impaired loans rose from 35% to 38.9%; percentage that reached 42.45% including the extinguished loans and receivables still held by the Bank as at 31 December 2016 and default interests.

The coverage on non-performing loans reached 51.4% from 47.09% in 2015 and up to 55.59%, including both extinguished loans and receivables and default interests on non-performing loans.

The coverage on probable defaults was 17.2% and that on past due loans 8.1%.

The coverage reflects the presence, for the majority of these loans, of suitable collaterals valued in relation to the consistency and quality of the underlying assets and the related estimated recoverable amount. Net non-performing loans, backed by collateral or by government guarantee via Mediocredito Centrale, represent 68.8% of the aggregate.

The cost of credit, represented by the percentage-based incidence of the losses and impairments on loans and receivables with respect to the amount of the net loans and receivables recorded in the financial statements, amounted to 1.31%, compared with 1.70% last year.

The percentage of coverage of the performing loans - calculated using the new evolved model made available by the IT outsourcer Cedacri - came to 0.54% of the loans.

The change in the last five years with regard to the amounts of the different categories of doubtful loans, the related indicators and the respective degrees of coverage, is presented below:

<b>Net exposure</b> (in Euro 000)	<b>31/12/2016</b>	<b>31/12/2015</b>	<b>31/12/2014</b>	<b>31/12/2013</b>	<b>31/12/2012</b>
Non-performing loans	195,606	189,500	162,122	167,765	146,198
Probable defaults	153,523	169,491	193,370	179,135	177,481
Past due loans	29,554	29,636	27,944	56,627	40,132
<b>Total impaired loans</b>	<b>378,683</b>	<b>388,627</b>	<b>383,436</b>	<b>403,527</b>	<b>363,811</b>
Performing loans	2,383,767	2,391,804	2,577,142	2,578,643	2,727,010
<b>Total net loans and receivables</b>	<b>2,762,450</b>	<b>2,780,431</b>	<b>2,960,578</b>	<b>2,982,170</b>	<b>3,090,821</b>

<b>CREDIT QUALITY RATIOS</b>	<b>31/12/2016</b>	<b>31/12/2015</b>	<b>31/12/2014</b>	<b>31/12/2013</b>	<b>31/12/2012</b>
<b>on gross loans and receivables</b>					
% of non-performing loans out of total gross loans and receivables	13.34%	11.91%	9.30%	8.28%	7.18%
% of probable defaults out of total gross loans and receivables	6.15%	6.93%	7.32%	6.39%	6.07%
% of past due loans out of total gross loans and receivables	1.07%	1.06%	0.95%	1.89%	1.33%
% of impaired loans out of total gross loans and receivables	20.55%	19.90%	17.57%	16.56%	14.58%

<b>coverage percentages</b>					
Non-performing loans	*55.59% 51.40%	*52.32% 47.09%	*52.30% 44.64%	** 34.87%	40
Probable defaults	17.20%	18.66%	16.12%	9.80%	9
Past due loans	8.10%	7.37%	6.14%	3.70%	1
Total impaired loans	*42.45% 38.92%	*39.06% 35.07%	*36.10% 30.68%	** 21.64%	24
Performing loans	0.54%	0.69%	0.69%	0.61%	0
*also including extinguished loans still held by the Bank and default interests					
** reduction to be ascribed to the sale of more than Euro 65 million in gross non-performing loans with almost complete coverage					
<b>percentages out of net loans and receivables</b>					
% of non-performing loans out of total net loans and receivables	7.08%	6.82%	5.48%	5.62%	4
% of probable defaults out of total net loans and receivables	5.56%	6.10%	6.53%	6.01%	5
% of past due loans out of total net loans and receivables	1.07%	1.06%	0.94%	1.90%	1
<b>% of impaired loans out of total net loans and receivables</b>	<b>13.71%</b>	<b>13.98%</b>	<b>12.95%</b>	<b>13.53%</b>	<b>11</b>

## 10. FINANCIAL ASSETS AND EQUITY INVESTMENTS

Financial assets and liabilities comprise:

<b>Financial assets and liabilities (in Euro 000)</b>	<b>31/12/2016</b>	<b>31/12/2015</b>
20. Financial assets held for trading	394	109
30. Financial assets measured at fair value	9,175	-
40. Available-for-sale financial assets	1,257,014	1,141,089
60. Loans and receivables with banks	212,026	135,021
100. Equity investments	1,121	1,375
<b>Total</b>	<b>1,479,730</b>	<b>1,277,594</b>
<b>Financial liabilities</b>		
10. Due to banks	795,650	621,160

For ease of exposition, for their contribution to the financing of the activities, it should be noted first that due to banks amounted to Euro 796 million. They include: loans received from the ECB of Euro 510 million, the advance payment received from Hypo Alpe Adria Bank of Euro 53 million for the purchase of the collection and of the other assets of the 7 branches, net of the restructuring contribution, repurchase agreements of Euro 190 million with banks and balances of payable current accounts, other deposits and loans received of Euro 43 million.

The Bank participated in the programme of new Targeted Longer-Term Refinancing Operations (TLTRO2) offered to the intermediaries by the European Central Bank. This programme was divided into four quarterly auctions beginning June 2016, with which the banks can obtain loans, with a duration up to four years and without early repayment clauses in the event of failure to reach the benchmark, up to an amount equivalent to 30% of the amounts of appropriate loans outstanding as at 31 January 2016. The interest rate will initially be the same as that on the main refinancing operations in force at the time of allocation, but may be reduced, depending on the loan disbursed by each counterparty, until reaching the rate, currently negative, on deposits with the central bank. A loan amounting to maximum Euro 694.4 million was granted to Valsabbina, used at the end of the year for Euro 400 million, of which 170 used to repay the previous TLTRO1 loan. The residual amount will be used in the last auction available in March 2017.

Loans and receivables with banks amounted to Euro 212 million. They comprise the advance payment of Euro 105 million relating to the purchase in bulk from Hypo Alpe Adria Bank, effective as from 1 January 2017, of performing mortgages of the nominal amount of approximately Euro 120 million.

Two capitalisation insurance policies issued by two important operators are recorded in financial assets measured at fair value: since they are not listed securities, they were allocated to this portfolio not valued in previous years.

"Available-for-sale financial assets" (AFS) - which form the main component of the financial assets of the Bank - amounted to Euro 1.257 billion, increasing by Euro 116 million compared to the previous year and are broken down as follows:

Available-for-sale financial assets (in Euro 000)	31/12/2016	% of portfolio	31/12/2015	% of portfolio
Italian government securities (BTP, CCT)	1,019,880	81.14%	807,704	70.78%
Government securities of other EU countries	-	-	98,145	8.60%
Other bonds	6,491	0.52%	-	-
<b>Total Bonds and government bonds</b>	<b>1,026,371</b>	<b>81.65%</b>	<b>905,849</b>	<b>79.38%</b>
Units in stock & share	169,234	13.46%	191,665	16.80%
Real estate UCITS units	35,324	2.81%	26,938	2.36%
Fondo Atlante units	3,098	0.25%	-	-
Equity securities	22,987	1.83%	16,637	1.46%
<b>Total UCITS and equity securities</b>	<b>230,643</b>	<b>18.35%</b>	<b>235,240</b>	<b>20.62%</b>
<b>Total</b>	<b>1,257,014</b>	<b>100.00%</b>	<b>1,141,089</b>	<b>100.00%</b>

Even in the past year, the Bank paid special attention to the selection of financial investments, in the presence of a sharp decrease in the possibility of forming capital gains as a result of a trend towards increased rates, in the wake of the Federal Reserve's decisions and of the widening of spreads of Italian government securities compared to other Eurozone countries for the listing of a higher political risk.

At the end of the financial year, the bond portfolio consisted in Government securities of Euro 1.020 billion, of which long-term treasury bonds (BTP) of Euro 487 million and treasury certificates of credit (CCT) of Euro 533 million, and in corporate bonds of Euro 6 million.

On the basis of their maturity, the Government securities are broken down as follows (amounts in Euro 000):

Duration	31/12/2016	% of aggregate	31/12/2015	% of aggregate
up to one year	136,733	13.41%	30,104	3.32%
between 1 and 2 years	71,987	7.06%	324,379	35.81%
between 2 and 3 years	61,894	6.07%	145,636	16.08%
between 3 and 5 years	183,916	18.03%	86,975	9.60%
between 6 and 10 years	565,350	55.43%	211,892	23.39%
beyond 10 years	-	-	106,863	11.80%
<b>Total</b>	<b>1,019,880</b>	<b>100.00%</b>	<b>905,849</b>	<b>100.00%</b>

The average duration of the bond portfolio, considering the expected cash flows, was 3 years (2.7 years at the end of 2015).

The gain generated by operations in the finance segment during the financial year amounted to Euro 8.8 million, compared with Euro 38.6 million in the previous financial year for the above-mentioned reasons.

Mutual equity funds came to Euro 169 million, compared to Euro 192 million last year.

The units of closed-end real estate alternative investment funds were recorded for Euro 35.3 million and comprise funds set up by the investee company Polis Fondi sgr of Euro 20.7 million, by the Finint Fenice fund of Fenice Investments sgr of Euro 14.1 million and by Fondo Leopardi of Euro 0.5 million, originating from the restructuring of Aedes.

The units in real estate funds increased from Euro 26.9 to Euro 35.3 million following new subscriptions and recalls carried out also via the contribution of real estate property assets recognised by the subsidiary Valsabbina Real Estate to support the debt collection activities. Impairment on real estate funds resulted in the recognition in the income statement of Euro 545 thousand under item 130 b) impairment on securities available for sale.

In April 2016, the Bank undertook to subscribe units of Fondo Atlante, closed-end equity alternative investment fund, for a total amount of Euro 5 million, subscribed at the end of the year for Euro 4.1 million and measured Euro 3.1 million. The difference of gross Euro 959 thousand was charged to shareholders' equity valuation reserves, net of the tax effect.

The fund, set up to support banks in difficulty and to purchase impaired bank loans with a view to safeguarding prices, intervened until now to rescue Banca Popolare di Vicenza and Veneto Banca.

The amount of equity securities held by the Bank and recorded as available-for-sale financial assets for the purpose of long-term investment amounted to Euro 23 million.

They include for the first time 300 capital shares of the Bank of Italy, purchased in March with an outlay of Euro 7.5 million. Only banks, insurance companies, social security institutions with registered office and central administration in Italy may participate in the capital of Bank of Italy for a maximum amount of 3% of the capital itself. As a result of merger operations in the credit system, some subjects are in the condition of having to reduce their participation. The importance of the investment is fully confirmed not only because it allows institutional visibility to the Bank but also for the expectations of its return. The dividends received in May reached the significant amount of Euro 340 thousand.

The aggregate includes the payment of the Voluntary Scheme held by the Interbank Guarantee Fund of Euro 415 thousand that subscribed the share capital increase of Cassa di Risparmio di Cesena of Euro 280 million, net of the impairment of Euro 135 thousand recorded under valuation reserves on the basis of the fair value policy. It is recorded as equity securities in that it has the same characteristics of risk, in accordance with the instruction provided by the Bank of Italy.

According to the measurement of Arca sgr, carried out by comparing the holding with similar securities on the stock exchange, a capital gain of Euro 609 thousand was recorded in the valuation reserves net of the tax effect. As a whole, against the amount recorded at the end of 2016 of Euro 7.861 million, gross valuation reserves of Euro 5.985 million and net valuation reserves of Euro 5.227 million are recognised.

The impairment of equity securities resulted in capital losses of Euro 2,188 thousand recognised in Item 130 b) of the income statement.

The breakdown of equity securities is described in the following table.

Description (in Euro 000)	Balance as at 31/12/20 15	Purchase s	Sales	Impairmen t to income statement	Change in Shareholde rs' equity	Balance as at 31/12/20 16	No. of shares	% % of holding
Arca Sgr Spa	7,252	-	-	-	609	7,861	755,442	1.51%
Bank of Italy	-	7,500	-	-	-	7,500	300	0.10%
Cedacri Spa	3,601	-	-	-	-	3,601	390	3.09%
UBI Leasing SpA	1,974	-	-	(190)	-	1,784	405,550	0.38%
B.ca Pop. Vicenza	1,950	-	-	(1,946)	-	4	40,634	NS
B.ca Pop. Cividale	1,656	-	-	-	-	1,656	84,500	0.50%
Aedes <sup>(1)</sup>	146	-	-	(38)	-	108	279,950	NS
Voluntary Scheme - Cassa Risp. Cesena	-	550	-	-	(135)	415	NS	0.19%
Unione Fiduciaria SpA	28	-	-	-	-	28	4,320	0.40%
Consulting SpA	24	-	-	-	-	24	22,500	15.00%
Pieffe assicurazioni srl	3	-	-	-	-	3	1	15.00%
Gr. Azione Locale Scrl	1	-	-	-	-	1	1	1.53%
Swift SC	1	-	-	-	-	1	2	NS



SSB SpA	1	-	-	-	-	1	8,147	NS
<b>TOTAL SHARES</b>	<b>16,637</b>	<b>8,050</b>	-	<b>(2,174)</b>	<b>474</b>	<b>22,987</b>	-	-

<sup>1)</sup> The negative valuation reserve of Euro 14 thousand was also entered in the income statement.

Equity investments of Euro 1.121 million are recorded and consist of 9.8% of the share capital of Polis Fondi Immobiliare di Banche Popolari Sgr S.p.A. (Euro 1.014 million) and of 100% of the subsidiary Valsabbina Real Estate srl (Euro 107 thousand).

As a result of the impairment, Euro 384 thousand were recognised in item 210 of the income statement "Net gains (losses) on equity investments", of which Euro 191 thousand for Polis Fondi and 193 thousand for Valsabbina Real Estate.

### Valsabbina Real Estate

During 2016, Valsabbina Real Estate continued its institutional activities by participating in several tenders.

For five tenders, for an equivalent value of Euro 877 thousand, the property was assigned to third-party bidders. The intervention of the subsidiary allowed not to cut back the awarding price by 25% and/or sell the property at prices above the starting price.

This confirms the usefulness of having a practical tool aimed at protecting efficiently the loans related to mortgage transactions through the direct participation in tenders to avoid passively undergoing the speculative effects that often characterise them, in the current moment of crisis of the real estate sector, in particular.

As at 31 December, the company owns 25 residential properties, including 3 garages, a shop and a portion of garden recognised for a value of Euro 3.346 million. During the year, a property was sold at a price of Euro 190 thousand with a loss of 6 thousand.

The company is waiting to receive the assignment decree or to exchange deeds for other 13 properties, including one for commercial purposes, for the tenders it participated in during 2016 with the payment of advances totalling Euro 1.110 million.

It should also be noted that in the first two months of 2017, three properties were sold to private individuals, including one with lien agreement, amounting to Euro 355 thousand, whereas agreements were reached for the sale of three other assets the deeds of which must be exchanged in the coming months.

Moreover, loans and receivables with customers are recognised in balance sheet assets for sales with lien agreement of Euro 228 thousand, amounts due from tax authorities of 48 thousand and prepaid expenses of Euro 2 thousand.

The amount due to the Bank is recognised in liabilities for the overdraft of Euro 4.567 million in addition to due to suppliers of Euro 44 thousand and tax or social security payables of Euro 12 thousand.

The value of production amounted to Euro 195 thousand, of which Euro 190 thousand for sales and Euro 5 for other revenues.

The 2016 financial year closed with a loss of Euro 127 thousand as indicated in the reclassified income statement below, compared with the previous financial year:

(in Euro 000)	31/12/2016	31/12/2015
Value of production	195	7,906
Costs for services	(90)	(118)
Operating expense	(23)	(35)
Difference between costs for purchases of properties and the change in	(196)	(7,797)
<b>Total net of interest and taxes</b>	<b>(114)</b>	<b>(44)</b>
Interest expense	(41)	(85)
Taxation	28	12
<b>Loss</b>	<b>(127)</b>	<b>(117)</b>

In December, the Parent Company Banca Valsabbina - on the basis of a forward-looking accounting statement - took steps to make a payment to cover losses for Euro 130, for the purpose of re-establishing the entire equity.

The paid-in and subscribed share capital amounted to Euro 100,000 and, as said, is entirely held by Banca Valsabbina S.C.p.A.

The shareholders' equity, inclusive of the loss for the year of Euro 127 thousand, amounted to Euro 110 thousand, of which Euro 100 thousand for share capital, 3 thousand for legal reserve and Euro 134 thousand for payments to cover losses (including the residual amount for the year 2015 of Euro 4 thousand).

The financial statements as at 31 December 2016 – if the conditions necessary exist - are prepared in condensed form pursuant to Article 2435 bis of the Italian Civil Code.

Consolidated financial statements are not drawn up due to the scant significance and relevance of the amounts of the subsidiary with respect to those of the parent company Banca Valsabbina, as emerges from the "Framework for the Preparation and Presentation of financial statements", which represents the conceptual model underlying the IAS standards. The financial statement total of the company (Euro 4.7 million) is lower than the limits envisaged by the Supervisory instructions for the consolidated reports (balance sheet assets less than Euro 10 million).

## **11. BUSINESS STRATEGIES**

Our Bank strongly believes in the value of relations with customers and in the proximity to the territory, central themes of a relation that feeds on mutual trust and is handed down from generation to generation.

These principles inspired the initiatives adopted by the Bank during the financial year just ended and will surely inspire the 2017-19 Strategic Plan to be adopted next.

First of all, we dedicate a reflection on the development of relations with customers, both in favour of businesses and in favour of households and private individuals.

The focus on the segment of businesses is evidenced by the three-year programme - approved last summer - for the purchase of trade receivables claimed by them from the Public Administration, programme with the remarkable ceiling of Euro 500 million allocated by the Bank. The purpose of the initiative is to enable a faster divesting of such loans and an improvement in the financial profiles of the participating companies, at favourable rates and with simplified methods compared to the traditional practices of administrative management of receivables to be collected. The initiative was planned with great care. It provides for an innovative use of the regulations concerning loan securitisation, conceived with the support of industry experts, and uses a special purpose vehicle financed entirely by the Bank in charge of purchasing the loans, certified on the specific platform of the Ministry of the Economy and Finance.

The attention to the segment of households and private individuals is evidenced by the initiatives taken in the year just ended, both in terms of loans and in terms of deposits. Investment opportunities concerned both assets under management products and financial insurance products, as well as time deposits and certificates of deposit, currently more appreciated by customers compared to bonds. The Bank joined the customers in analysing their needs and in assessing their risk appetite in order to favour more informed financing or investment choices and a wider diversification.

The proximity to customers on the territory was a major challenge for us in 2016, both in areas of origin and in those of recent branch openings. The interventions pursued a dual purpose: on the one hand, increase commercial penetration; on the other hand, diversify the concentration risk - geographical and sectorial - on the area of origin.

The first stage of this process was the opening of the branches of Monza and Seregno, implemented with the specific plan to export our experienced business model to new but substantially related and similar territories.

The development continued with the acquisition on 29 December 2016 of a business unit - consisting of 7 operating branches and a portfolio of performing mortgage loans of approximately Euro 120 million - from Hypo Alpe Adria Bank SpA. No incremental economic commitments are envisaged, considering that the operating margins generated by the mortgage portfolio, purchased with a "discount" on the nominal value, counterbalance the costs and administrative expenses associated with the operations of the branches themselves.

In perspective, the new markets are particularly profitable due to the following considerations:

- the market of Bergamo, natural conjunction of Brianza and Franciacorta, represents a rich social and economical fabric;

- the markets of Vicenza and Schio open up important prospects for strengthening the presence in Veneto, considering the difficulties of the historical banks of the territory;
- the market of Modena, although geographically not near the current network coverage, represents one of the most dynamic entrepreneurial fabrics in Northern Italy;
- the two bank branches of Brescia (Via Triumplina and Piazza Vittoria) are complementary to the current network of the Bank;
- the licence of the branch of Verona Porta Nuova is reused for opening a branch in Milan. Milan is an attractive opportunity for developing in an even more profitable way the relations already present in the economic capital of Italy.

Therefore, the new territorial expansion initiatives will produce not only a growth in aggregates but also and above all an increase in revenues, compared to correspondingly lower start-up and management costs. The bank is equipped with production, technological and distribution equipment designed to support - without additional investments - dimensional increases in volumes and provision of services.

Another major issue that distinguished business strategies in 2016 is credit management. The Bank concluded a new securitisation transaction involving mortgages and unsecured loans to Small and Medium Enterprises, for a total amount of Euro 648 million, a transaction aimed at maintaining the balance in structural liquidity. This transaction allows the Bank to increase its own financial instruments available for refinancing operations with the European Central Bank, with the ultimate aim of further strengthening the loans to SMEs, historically privileged partners of our Bank

The intensification of relations with customers and with the territory, as well as of the initiatives to strengthen the Bank's profit and equity profiles was necessarily complemented by the re-examination of the organisational structure. The changes made to the corporate structure are also a necessary condition for adapting - and as much as possible anticipating - the daily operations to the fast changing regulatory provisions: an even more compelling condition when you consider that the Italian banking company is a high-cost producer, historically committed to pursuing those standards of greater operational efficiency and cost effectiveness that are the prerogative of the most advanced banking systems. It is in this regard, and with a competitive approach, that the Board of Directors stimulated a complete rethinking of the operating machine to refine production, distribution and control processes, limiting its costs and controlling more reliably all the risk factors.

Therefore, the Bank developed over the last few months its organisational structure, by creating three Divisions: Area network, Business and Resources, to ensure a prompt guideline, quick control of operations and deviations, ability to strengthen co-ordination of initiatives. The Territorial Network Division is dedicated to the business supervision and development of the territory through branch offices; the Business Division is responsible for coordinating the "Business"-related sectors and services by dealing with the development of new products / markets and the coordination of areas of support for commercial development; the Resources Division is responsible for the enhancement of the Bank personnel.

In this renewed organisational context, the position of General Manager was entrusted to Tonino Fornari, former Deputy General Manager, supported, with the position of Deputy General Manager, by Marco Bonetti, former Market Area Manager. The Board of Directors entrusted Renato Barbieri - by co-opting him as Director and then appointing him as Chairman of the Bank, moving from the previous position of General Manager - with the delicate task of ensuring the balancing of powers, in the interest of the Shareholders and in compliance with the supervisory rules.

The organisational structure favoured generational turnover of the top management of the Bank, ensuring, on the one side continuity with the guidelines of the Strategic Plan, and on the other, a gradual adaptation of daily action to the renewed context of the economic and territorial fabric of reference. The reorganisation was positively welcomed by all levels of the structure, in the common understanding that the company mission and the competitive positioning evolve and are renewed day by day, nourished by the passion of all those who dedicate their best energies to the Bank.

Finally, we would like to introduce some reflections on future prospects, as the Bank is about to approve the 2017-2019 Strategic Plan in the coming months.

In the albeit complex and tiring scenario, some factors of consolidation of the real economy slowly advance and, with the improvement of the economic situation, the prospects of returning to regular payments by customers and of reduction of impaired loans are also confirmed, a crucial issue for all Italian banks.

The main objective of the Bank is to pursue a gradual and linear growth, with the firm determination to continue to be characterised as a very local retail commercial bank, focused on the requirements of the

territory and social framework, and not only on the market. In perspective, it is necessary to play on the Bank's fundamentals, continuing confidently and with constant attention the growth of loan brokerage and the development of managed assets, in support of businesses and households. At the same time, it is necessary to protect the income statement from the strong incidence of extraordinary components, which resulted in 2016 in significant changes compared to the previous financial year, affecting more markedly revenues rather than costs. We hope that the relevant contribution relating to the funds for the resolution of the bank crisis, which affected in the last two years the profitability of our bank, can be considered extraordinary.

The main guidelines of the actions that will be defined in the new Strategic Plan can be summarised as follows:

- constant care to the development of revenues from ordinary operations, especially from fees and commissions, through personnel enhancement as a critical success factor in relations with customers, the re-examination of the range of products and of the service model, a constant updating of the traditional distribution model and a further development of integrated multichannelling;
- maximum focus on the cost trend, through increasingly effective organisational solutions that enable the customer to carry out directly, more easily and economically, the transactions it requires without time constraints or risks of queues at the bank branch, as well as through a more effective management of impaired loans to limit the impact on impairment losses, also by using extraordinary sale/partnership transactions with external servicers;
- absolute priority for risk management, by improving the credit granting processes (both when assessing the creditworthiness and when managing the position), mitigating possible reputational and sanctionary consequences in managing customer relations, focusing the development on forms of low-capital or capital-free loans.

## **12. THE INTERNAL CONTROLS SYSTEM**

The mitigation of strategic, credit, financial, reputational and operational risks to which the Bank is exposed when carrying on its loan brokerage activities and the offer of financial and investment services to customers requires an effective internal management and control system.

Once again in 2016, the Board of Directors dedicated particular attention to these issues, convinced that the solidity and stability over the short- and mid/long-term cannot do without - in observance of the principles of sound and prudent management - an integrated and efficient control system that involves - according to skills that are the prerogative of the various roles - the Management body, the Board of Statutory Auditors, General Management, the departments specifically assigned to such activities as well as all the personnel.

The scope of reference of this control system is represented - more specifically - by the parent company Banca Valsabbina S.C.p.A. and the subsidiary Valsabbina Real Estate S.r.l., an operating company active in the real estate sector, whose share capital is wholly-owned by the parent company.

The Bank's internal control architecture is built according to a model that implements the indications of the Bank of Italy Circular no. 285/2013 and uses methods and procedures aimed at ensuring the efficacy and efficiency of the risk controlling processes, guaranteeing the adequacy of the organisational and control structures as well as the reliability and integrity of the company information. The above-mentioned architecture is broken down in the three levels indicated below.

The first level is represented by the controls delegated to the operating structures of branches or central headquarters aimed at ensuring the correct performance of the banking transactions. Typically, the first level is characterised by the line controls that allow to intercept the anomalies at the same time they occur. The Bank is increasingly sensitising its operational lines to cross-identify the related risks in customer relations, for example by paying particular attention to the interaction between credit risk and recycling risk, in order to make the performance of controlling activities more efficient. In this context, the capacity to outline in an integrated manner the economic, income and financial profile of the customer in the light of which to analyse its requirements, weigh out the solutions proposed by the Bank and measure exposure to risk becomes important. The questionnaires through which the Bank acquires information from the customer (from the due diligence questionnaire at the time and during the relationship, to the questionnaire for the profiling of financial risk tolerance, to the information flow envisaged for the purpose of assessing creditworthiness)

represent - ideally - an integrated system that the Bank must use to better define its proposals and controls, according to a risk-based approach.

The second level controls with the Bank have the aim of ensuring the correct implementation of the risk management process, the observance of the operating limits assigned to the various departments and the compliance of the business operations with standards, including those concerning self-regulation.

These second-level controls, specialised on the major types of risk, are divided among the following dedicated corporate functions:

- the standards compliance department (called Compliance Service) has the task of assessing ex-ante the compliance of new projects and new products, preventing any risks arising from violations of internal and external regulations. The Compliance Service also carries out an important role in assisting in the prior definition of the adjustments of internal regulations to new regulations;
- the risk control department (called Risk management Service), which is involved in defining and monitoring the Risk Appetite Framework (RAF), the risk governance policies and the various phases that make up the related management process as well as in determining the limits to the assumption of the various types of risk. The department is also involved in the ICAAP process, aimed determining the overall internal capital against the risks involved and the assessment of the Bank's capital adequacy;
- the department tasked with preventing reputational and sanction risks related to the involvement, even unknowingly, in money laundering and financing of international terrorism (called Anti Money Laundering Service), whose task is to prepare appropriate controls for mitigating the above-mentioned risks and monitor their proper use at the operational lines. The Head of the Anti-money Laundering Service is also assigned the task of "Appointee as per Article 42 of Italian Legislative Decree No. 231/2007" in relation to the reporting of suspect transactions, as well as reference individual for aggregate anti-money laundering reports (S.ar.a.).

Finally, the third level controls are entrusted to the internal audit department (called Audit Service), which is delegated the task of checking the regular performance of the operations and the evolution of the risks and assessing the completeness, adequacy, functioning and reliability of the components of the internal controls system. The Audit Service also carries out the task of Complaint Department.

Speaking of the results of the activities carried out by the above-mentioned second and third level controls during 2016, on the basis of the work plan previously assigned by the Board of Directors, significant critical issues or important malfunctions were not reported as far as each function is concerned.

The results of the checks of the control units - which directly report to the corporate bodies - were analysed in-depth using the internal apparatus concerned and subsequently submitted to the General Management and the Board of Statutory Auditors and formed the subject matter of systematic reporting to the Board of Directors within the sphere of the information flows, as envisaged by current legislation.

The Compliance activity concerned, more specifically, the control of the risk of non-compliance concerning investment services and also analysed in-depth the issues of customer relations in banking services, with a specific reference to the new regulations on real estate loan to consumers and on compound interest.

The activity carried out by the Risk Management will find an accurate representation in the next chapter dedicated to risk management, to which reference is made.

During 2016, the anti-money Laundering department, called to prevent the risk of the Bank's involvement in money laundering and/or financing of international terrorism, focused its attention on the implementation of the supervisory provisions regarding customer due diligence. A significant effort was also made with reference to the awareness of the network in connection with the development of money laundering and financing of international terrorism techniques, collaborating also in the preparation of the training plans established by the Bank for the employees. As a result of self-assessment of its level of exposure to the risk of money laundering and terrorist financing, requested by the Bank of Italy at the end of 2015 and carried out in 2016 making use of the operational and methodological support of the specialised firm of consultants KPMG Advisory S.p.A, there was an organisational and control system considered effective as a whole, with non-significant vulnerabilities and with a good capacity of identifying and contrasting the risks. The Anti-money Laundering Function, in view of the continuous refinement of its action, introduced during 2016 additional regulatory and procedural

adjustments to supplement the existing system, aimed at covering the areas of improvement identified in the mentioned financial year.

The Internal Audit Service focused - in observance of the agenda established in the annual plan and in the multi-year planning - on a wide programme of checks, both remote and at the various operating units; checks that concerned the main activities carried out in central services and the operations of the sales network. In continuation of the activities carried out in previous years, the controls carried out on the central departments were mainly concentrated on the loan sector, on the administration sector, on the commercial sector, allowing to carry out verifications concerning specific operating processes. With the checks carried out, besides the operating regularity, the adequacy and efficacy of the line and procedure controls were ascertained, which are the typical first-level controls.

The Board of Directors approved, at the beginning of March 2017, the control plan proposed by the company's control functions for the new financial year.

### **13. THE RISK MANAGEMENT SYSTEM**

The risk management system adopted by the Bank reflects the structure required by the supervisory instructions for banks, contained in the Bank of Italy Circular No. 285/2013.

The Bank is engaged in a constant process for strengthening its business risk management abilities, which is coordinated with the development strategies of the business model, and takes due account of the trend of the reference market, as well as of updates in the regulatory framework. Risk measurement methods are periodically reviewed and updated on the basis of the best practices in this area.

The risk management system consists of a set of rules, procedures, resources and processes aimed at identifying, assessing, monitoring, and controlling the risks taken or that can be taken by the Bank.

In particular, the supervisory provisions confirm how the system of internal controls must check the implementation of the corporate strategies and policies, ensuring the containment of the risk within the limits indicated in the reference framework for the determination of the Bank's propensity to risk (Risk Appetite Framework, abbreviated to RAF).

The Risk Appetite Framework, or risk target system, is the reference framework that defines - consistent with the maximum risk that can be taken, the business model and the strategic lines - the risk appetite, the tolerance thresholds, the risk limits, the risk governance policies, the reference processes needed to define and implement them.

The document that formalises the Risk Appetite Framework of the Bank was initially adopted in June 2014, with the definition of the metrics for the quantification of the Bank's risk position, the objectives in terms of desired risk profile (risk appetite), the tolerance to risk (understood as the absolute deviance from the established objectives) and the operating limits to be monitoring on an on-going basis for the each type of risk. The RAF has been updated and further implemented by the Board of Directors in July 2016, in particular, the document is reviewed annually in order to take into account the expected development of the risks taken, in line with the guidelines of the Strategic Plan, outlined and updated in the budgeting process.

The risk management system, as envisaged by the Supervisory regulations, is broken down in the "three pillars" introduced by the Basel Committee.

The "First Pillar" requires banks to have specific capital requirements to deal with the typical risks of banking and financial activity (credit, counterparty, market and operational); alternative methods of calculation are envisaged to measure these risk with different levels of measurement and control complexity, adopted according to the "principle of proportionality".

The "Second Pillar" requires banks to adopt a strategy and a process for controlling current and future capital adequacy (ICAAP - Internal Capital Adequacy Assessment Process), to be formalised in a special document, the "ICAAP Report", in which to carry out autonomously a precise risk identification to which the banks themselves are exposed in relation to their operations and to the markets of reference. This document considers, in addition to the First Pillar risks, other risks that are relevant in terms of size and operations of the Bank.

The Supervisory Authorities then have the task of verifying the reliability and consistency of the results of the processes adopted by the Bank in the so-called "SREP Process" (Supervisory Review and Evaluation Process) and, if circumstances so require, the appropriate corrective measures.

The "Third Pillar" introduces the disclosure to the general public and the regulation for the dissemination of transparent and standardised information to the market regarding capital adequacy, exposure to risks and the general characteristics of systems for identifying, measuring and managing such risks.

The structure of the risk management and control process envisages prompt and constant reporting of the risk measurements made and of the activities carried out by the corporate bodies, ensuring the on-going monitoring of the risks assumed and the assessment of the consistency with respect to the objectives defined.

By contrast, below reference is made - albeit in summary form - to the measurement, management and mitigation methods of the various types of the risk identified as significant in light of the business model adopted and the current operations of the Bank. Section E of the Explanatory Notes "Information on the risks and the related hedging policies" provides additional qualitative and quantitative information on risks, while section F "Information on Equity" includes detailed information relating to the own funds.

## **Credit risk**

The analysis of the risk associated with the disbursement of credit is particularly important in light of the business model adopted by the Bank, focused principally on traditional loan brokerage.

The analysis of the credit risk has the aim of assessing the ability of the Bank to suitably select its customers and the economic initiatives that are creditworthy, as well as the efficacy of the management, monitoring and trend control process of the counterparties to which loans were already granted.

The Board of Directors defines the lending policies overseeing the quality of the loans both during the first resolution and opening of the relation and in the subsequent management of the relation, taking into due consideration the Bank's economic/equity amounts and the related economic scenario.

In particular, the credit policies break down the strategic lines of the Bank in compliance with the established risk appetite level and the related risk target and limit system formalised in the RAF.

The Bank's business model is primarily geared towards supporting local economies, households, entrepreneurs, professionals and Small-Medium Businesses.

The particular focus placed on maintaining relations with customers and their development is the Bank's strength as it allows continuity of relationship and customer support in a long-term perspective.

The prevailing strategic inputs of the policies in recent years was obtaining an adequate remuneration of the risk taken by means of an adequate creditworthiness assessment, the splitting up and diversification of the counterparties as well as the assumption of suitable guarantees.

The origination and disbursement of credit, both during the first loan proposal resolution and in the subsequent renewal of the credit facilities, has a central role in credit risk taking and is carried out using an IT procedure that allows to collect systematically a series of external and internal information to the Bank, in order to carry out a thorough and in-depth analysis of the customer. Therefore, the assessment considers both quantitative information and qualitative analyses aimed at understanding the quality of the projects to be financed also prospectively, in order to allow the delegated subjects to decide the granting of adequate credit facilities, both in terms of the amount and in items of economic conditions, in full compliance with the relevant internal regulations.

The subsequent phase of trend control, monitoring and classification of exposures aims at enabling timely interventions in case of anomalies or impairment. These activities are organised in a detailed credit management process, which envisages the assignment of specific tasks based on the types of anomalies reported and on the classifications assigned to each credit, ensuring an adequate and systematic process of credit monitoring, with particular reference to impaired exposures.

For the accurate and constant analysis and monitoring of the credit risk, the Bank also uses a management system, known as "Credit Rating System - CRS", which classifies the customers on the basis of creditworthiness, via an internal scoring system. The system comprises a statistical-type insolvency risk measurement model which, by means of an appropriate customer segmentation, an analysis of the economic and financial indicators of the counterparty, the trend in the relationship with the Bank as well as with other Banks (Central Credit Register) makes it possible to estimate the Probability of Default (PD) of the Customer with the consequent assignment of the rating class.

The Rating System assigned by the CRS model, together with the estimate of potential loss in the event of default (LGD -Loss Given Default), also represents the reference basis for the calculation of the estimated loss used for the quantification of the adjustments (collective impairment) of performing loans.

The loan monitoring activity is also supported by the “Quality Credit Management” application that allows to quickly identify the counterparties with anomalies, divide customers up into monitoring sub-portfolios according to the Bank’s operational guidelines, and customise the process chosen in terms of players involved and actions to be undertaken, and historicising the recovery activities carried out.

With the aim of mitigating the assumption of the credit risk, the Bank considers and selects the collaterals and personal guarantees to be requested from customers granted credit, by monitoring constantly their values.

In particular, the Bank uses the “Collateral” procedure in order to have a management and monitoring system of the mortgage guarantees and to check their conditions of general and specific admissibility so as to benefit from a minor capital absorption in connection with the credit risk. This procedure also allows to carry out a statistical update process of real estate values, representing a monitoring of the residual risk, which consists in the risk that a minor amount than that envisaged is obtained from the enforcement of a guarantee.

The monitoring process of non-performing loans is entrusted to the “Performance Monitoring Service”, which manages non-performing loans and “past due” loans, and to the Pre-dispute Service, which manages positions classified as probable default.

The management activities for the loans classified as non-performing are by contrast carried out by the Legal and Disputes Service with the support of outside professionals.

In terms of capital absorption and for the purposes of calculating capital requirements, the credit risk represents the most significant risk for the bank, in the light of the high incidence of loans with respect to total balance sheet assets.

The Bank measures the capital requirement relating to the credit risk using the standardised method envisaged by the supervisory provisions, which envisages the application of different weighting ratios for the portfolio loans according to the segment the counterparty granted credit belongs to, the creditworthiness and the type of guarantees possibly acquired.

Moreover, the concentration risk per individual borrower and the concentration risk vis-à-vis counterparties belonging to the same business sector or the same geographic area (geo-sectorial concentration) represent specific interpretations of the credit risk.

The concentration risk per individual borrower is monitored examining - with specific methods - the exposures involving a significant amount vis-à-vis individual counterparties and between those associated legally and/or economically, while the risk measurement, for the purpose of capital adequacy assessment, takes place using a model on the entire loan portfolio based on the Herfindahl index, in line with the matters envisaged by the supervisory instructions.

The assessment of the geo-sectorial concentration risk is carried out by segmenting the loan portfolio by sectors of economic activity and by geographic areas of origin of the customers granted credit. For the purpose of assessing capital adequacy, the Bank uses the method proposed and defined by ABI.

Measurement and monitoring activities are carried out periodically, in order to maintain the degree of concentration within thresholds consistent with RAF and with credit policies and are designed to maintain an adequate diversification of risk.

In assessing capital adequacy, the Bank uses the procedure called C.C.M. (Credit Capital Management) both for credit risk and for concentration risk, with the aim of supplementing the figures relating to the calculation of prudential requirements (First Pillar), measured using the special SDB Matrix application. The CCM application is also used as part of the activities functional to the prudential control process (Second Pillar) and for the preparation of reports for public disclosure (Third Pillar).

## **Market risk**

The Bank has developed methods for the measurement of market risks that include price, interest rate and exchange risk on a consistent basis with the strategies adopted and with the characteristics of the financial assets held.

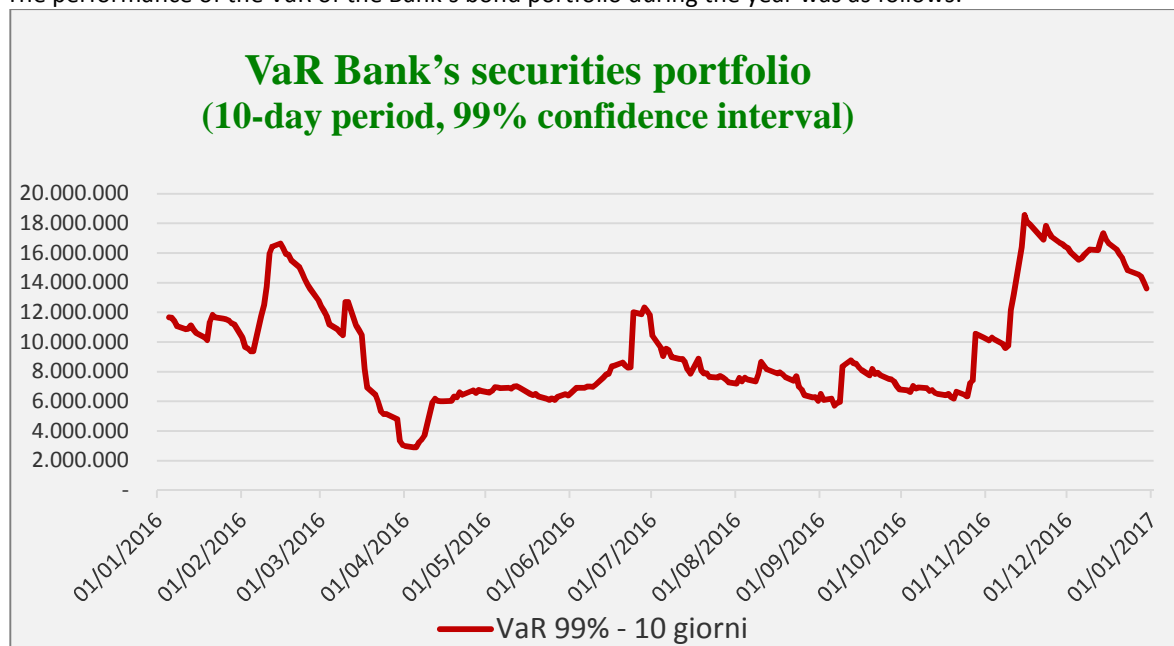
In 2016, the Bank continued the strategy of prudential management of the financial portfolio, mainly aimed at optimising the management of company liquidity, directing the investment choices mainly towards the bond market of government securities (BTP and CCT). As with the previous two years, with the aim of diversifying the risk and increasing the investment opportunities in particularly specialised areas, specific agreements were maintained with two important asset management operators to invest in stock & share units. The portfolio entrusted under management amounted as at 31 December 2016 to Euro 169 million. The management mandate envisages specific limitations of risk and pre-established compositions of the investment lines.



With regard to the assessment of the price risk on the securities portfolio, a management model is used based on the Value at Risk (VaR), able to express briefly the maximum possible loss of a static portfolio in monetary terms, with reference to a specific timescale and a specific confidence level.

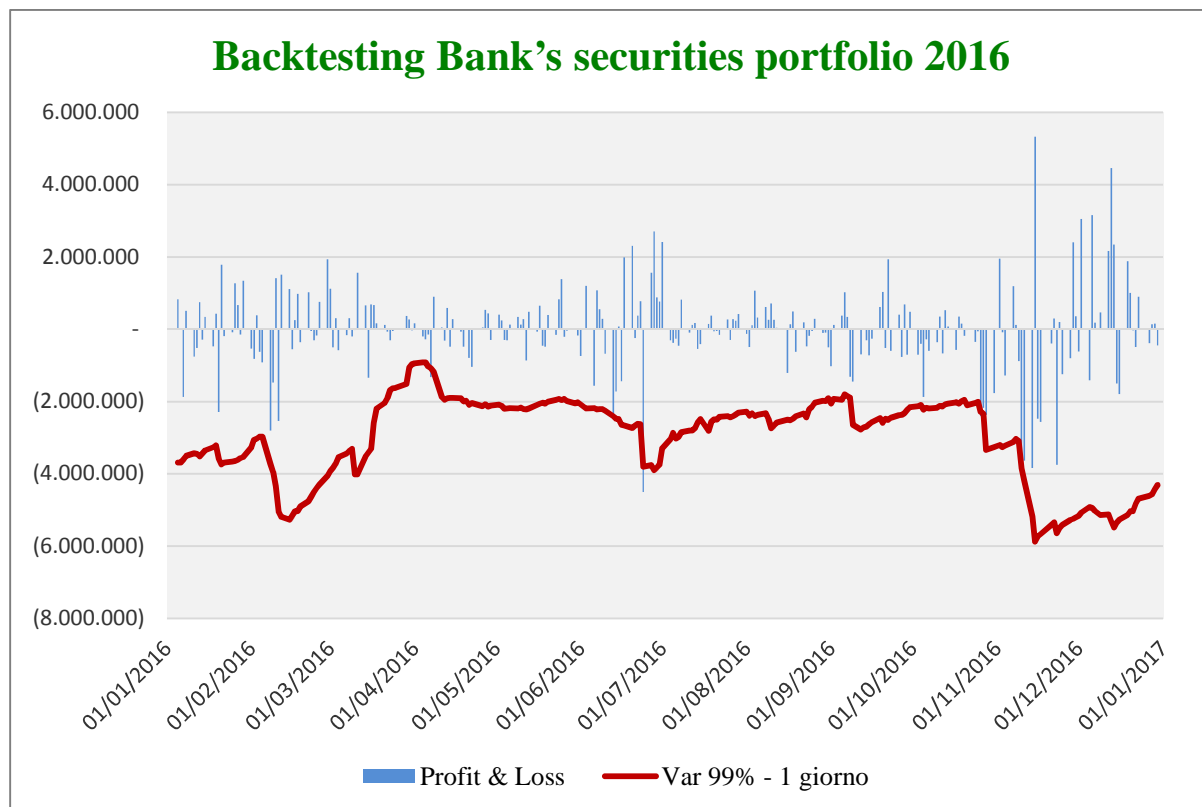
For the calculation of the VaR, the Risk Management, Planning and Control Service uses the ERMAS application. The financial information necessary for the determination of VaR (volatility, correlations, forward structure of the interest rates, exchange rates, stock and benchmark indices) is provided by the Risk Size product. The VaR model adopted is parametric and uses a confidence interval of 99% and a timescale of 10 days. The VaR is calculated on a daily basis both on the securities portfolio directly managed by the Bank and on the portfolio entrusted to external managers.

The performance of the VaR of the Bank's bond portfolio during the year was as follows:

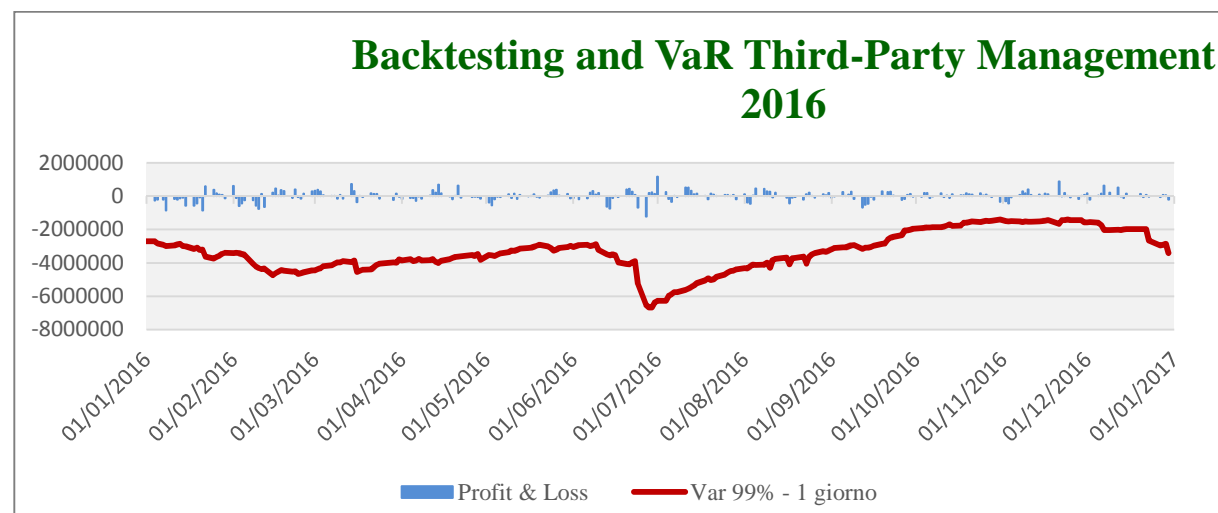


The VaR trend, from the moment that the securities portfolio is entirely made up of Italian government securities, aligned itself with the fluctuations and volatility registered on the related markets as well as with the choices of investment made during the period. The chart shows a downward trend in February and March, period in which the Bank reduced the size and duration of the portfolio; in the following months, there was an increase in risks with highest levels observed during the political tensions in the Eurozone at the end of June. In the last months of 2016, V.a.R. increased further as a result of the increase in the perceived risk on financial markets. The duration of the portfolio was consistent with the measurement of VaR, standing at the end of the year at a value of 3.04 years.

According to the "backtesting" analysis carried out in 2016, as shown in the graph, VaR was exceeded in 5 cases, recorded when negative news circulated on the market mainly due to national and international political tensions.



In order to monitor also the risk of the portfolio entrusted to outside operators, the VaR was also calculated on a daily basis on this portfolio as well, subjecting it to backtesting. The figure shows the 1-day VaR trend and the backtesting analysis; the latter, in particular, did not reveal any cases of exceeding of the VaR thereby confirming the reliability of the measurement made.



#### Operational risk

The operational risk is the risk of incurring losses due to the inadequacy or inefficiency of procedures, human resources and internal systems or external events.

The Bank determines the capital requirement in the presence of operational risk, using the B.I.A. method (Basic Indicator Approach), according to which the capital covering this type of risk equates to 15% of the average of the "basic indicator" of the last three financial years, calculated pursuant to Articles 315 and 316 of the CRR.

The supervision of the operational risk is subject to constant attention both in the various phases of the operational processes and procedures and periodic adequacy checks on the system of controls.

The first supervision for operational risk comprises the internal legislative framework adopted by the Bank, functional for guiding the conduct and the execution of the processes.

The Bank has defined a series of organisational processes for the supervision and management of operational risks, within which it uses - together with the competent Risk Management department - the Internal Audit, Compliance and the Supervisory Body established in accordance with Italian Leg. Decree No. 231/2001. In order to limit the negative consequences, in economic and reputational terms, deriving from the occurrence of operational risks, the Bank also adopted the Business Continuity Plan, aimed at safeguarding the Bank in the presence of critical events that may invalidate full operations and also carried out the mapping of the main operating processes.

For the purpose of improving the operational risk management process, the Bank adopted an integrated measurement, assessment, monitoring, mitigation and control system for these risks. In this regard, a system has been created for the collection and storage of data relating to operational events and losses, which permits the creation of a historical database. The LDC (Loss Data Collection) procedure was adopted to support this system, making it possible to collect the data relating to specific cases and classify it according to the regulations. The collection of the events that have led to operational losses allows the Bank to identify the reiteration of negative events or behaviour, thus encouraging appropriate corrective measures.

During 2015, for the purpose of supplementing the operations that are already carried out afterwards with the collation of the operating losses, the implementation of a self-assessment process was concluded functional for estimating - on a forecast basis - the Bank's exposure to the operating risk ("Risk Self Assessment"). Specifically, this involves an estimation self-diagnostic process that sets out to assess the degree of the exposure to the risk by means of a combination of opinions expressed in terms of impact, probability of occurrence, efficacy of the controls.

As part of the operational risk, the supervisory regulations placed particular emphasis on the IT risk, assigning the control system the task of assessing the reliability and security of company information and IT procedures. The Bank formalised the "Method for analysing and processing IT risks" on the basis of which the "Summary report on the situation of IT risk" is prepared on a regular basis. In particular, the "critical" processes were reported, the IT risks and related business continuity were identified, and the "Plan for managing emergencies and business continuity" was updated accordingly. The up-date of the analysis carried out in 2016 was performed with particular reference also to the valuations of the IT outsourcers, and confirmed a low risk exposure, consistent with the Bank's risk propensity.

## **Interest-rate risk**

The interest rate risk is generated by the imbalance between the maturities (repricing) and the asset and liability items belonging to the bank book, which is made up of all the financial assets and liabilities not included in the trading portfolio as per supervisory regulations. The mitigation of the interest rate risk takes place by means of the integrated management of the bank assets and liabilities, aimed at stabilising the net interest income and protecting the economic value of the bank book.

The measurement of the interest rate risk is carried out by the Risk Management, Planning and Control Service. The measurement of the interest rate risk according to the second pillar is first of all carried out on the basis of the standard algorithm envisaged by Circular No. 285 of 2013, by means of the creation of a summary index that expresses the ratio between the change in the net value of the banking book against an interest rate shock (+/- 200 base points) and "own funds". The Bank has always maintained the risk index at a level lower than the warning threshold established by the regulations (20%). The change in the economic value of the bank book is also calculated in the presence of negative and positive interest rate shocks that represent the 1st percentile and the 99th percentile of the changes in the market rates recorded over the last 6 years.

The regulatory measurement is also supplemented by monthly operational analysis, where for each sensitive item identified in the time period chosen for the analysis, account is taken of the specific repricing methods.

The ERMAS procedure makes it possible to monitor all the Bank's activities associated with the transformation of the maturities of the assets and liabilities and to quantify the balance sheet and income statement effects, induced by hypothetical shocks of the market rates.

For the purpose of measuring the variability of the net interest income, determined by positive and negative changes in the rates over a time period of 365 days, the differences between asset and liability items of the

financial statements are monitored, grouped according to the maturity or rate redefinition date; the method used is "gap analysis", via several approaches that make it possible to achieve increasingly accurate estimates. The valuation techniques of the interest rate risk also include the estimate of the effect related to the "core" component of the on demand items.

The measurement of the variability of the economic value of the Bank's assets and liabilities to monitor the current value of the equity is carried out via Duration Gap analysis and Sensitivity Analysis, which make it possible to check the sensitivity of the Bank's economic value with regard to the change in the interest rates.

### **Liquidity risk**

The liquidity risk is represented by the risk that the bank is unable to efficiently cover the expected and unexpected cash outflows without compromising its ordinary operations and its financial equilibrium.

The overall model adopted by the bank for managing and monitoring the liquidity risk is divided up into three distinct areas according to the reference scope, time horizon and the analysis frequency:

- the management of the intraday liquidity, or rather the management of the daily settlements of the debit and credit positions in the various settlement, payment and clearing systems the Bank takes part in;
- the management of the operating liquidity, or rather the management of the most volatile events that impact the Bank's liquidity position over a period between 1 day and up to 6 months, with the primary objective of maintaining the Bank's ability to meet its ordinary and extraordinary payment commitments, minimising the costs. In this context, the recognition of imbalances between incoming and outgoing sources and the related system of supervisory limits and thresholds, focus in particular on the maturities up to six months;
- the management of structural liquidity, or rather the management of all the events of the bank book that impact the Bank's overall liquidity position in the period beyond 6 months, with the primary objective of maintaining a balanced dynamic ratio between medium- to long-term assets and liabilities.

The model adopted by the Bank for the management and monitoring of the liquidity risk is based on the construction of the maturity ladder and on the allocation of certain and estimated flows on its various time brackets, for the purpose of proceeding with the calculation of the cumulative gap for each maturity bracket.

The Bank established a number of operating limits for the management of the liquidity in both spheres: operational and structural. In particular, with regard to the management of the operational liquidity, the limits are defined in terms of absolute value of the cumulative GAPS, on the various maturities, while with regard to the management of the structural liquidity the limit adopted is defined in terms of ratio between the assets and liabilities with a maturity of more than one year.

To monitor the liquidity risk, the Bank continually monitors the value of the Counterbalancing capacity (CBC), understood as the availability of assets that can be promptly reimbursed, sold or used in refinancing transactions with the interbank system and that therefore make it possible to generate liquidity rapidly and efficiently.

The bank has also a "Contingency Funding Plan", as an instrument for mitigating the liquidity risk that indicates, in detail, the individuals and the units responsible - if necessary - for the implementation of the extraordinary funding policies, as well as the actions to be adopted to remedy the same, in accordance with the regulatory requirements envisaged by the new regulations under examination.

The implementation as from 1 January 2014 of the Basel II framework by the Supervisory regulations also envisaged the introduction of additional control units for the containment, monitoring and supervision of liquidity risk, mainly focused on a short-term liquidity requirement (Liquidity Coverage Ratio - LCR) and on a longer-term structural balance (Net Stable Funding Ratio - NSFR).

During 2016, the monthly reporting of the liquidity indicator, "Liquidity Coverage ratio" (LCR) was definitely on track on the basis of the matters envisaged by the EU Delegated Regulation 2015/61 issued to supplement EU Regulation No. 575 dated 26 June 2013 of the European Parliament (CRR Regulations), as well as the additional indications and recommendations of the European Banking Authority on the subject. With regard to the "Net Stable Funding Ratio" (NSFR) indicator, the Bank continued to implement an operational-type measurement on the basis of the matters envisaged by the Basel III Framework.

Always during 2016, the quarterly reporting related to the "Additional Liquidity Monitoring Metrics - ALMM", was started as additional to those already envisaged, and aimed at providing the Supervisory Authority with a comprehensive view of the Bank's risk profile.

### **Risk of excessive leverage**

The Bank pursues sustainable growth policies limiting the use of leverage. The Risk Management, Planning & Control Service monitors the risk of excessive leverage also on the basis of the related indicator, calculated on a quarterly basis and subject to specific reporting to the Supervisory Authority.

In particular, the measurement of the risk of excessive leverage aims at identifying the risk aspects that are not included in the measurement of the regulatory capital ratios.

### **Strategic risk**

The strategic risk is the current or future risk of drop in profits or capital of the Bank arising from changes in the operating context or from wrong company decisions, inadequate decision implementation, as well as poor responsiveness to changes in the competitive context.

The Bank adopted a mitigation policy for the strategic risk that is mainly based on the formalisation of an analytical, prudent and shared decision-making process. Decision making is based on the careful and constant observation of the reference market, on the gradual activation of new services and/or products, on a formalised operational and strategic planning process and on a constant measurement and monitoring of company performance and related deviations from previously established targets.

### **Reputational risk**

The reputational risk is the current or future risk of drop in profits or capital arising from the negative perception of the image of the Bank by the customers, counterparts, shareholders, investors or supervisory authorities. It represents the "secondary" risk, or rather it is triggered off by original risk factors ascribable essentially to the operating risk (in particular attributable to the legal and standards non-compliance risk) and strategic risk. Despite being a "secondary" risk, the losses associated with the reputational risk may be much higher than those attributable to the original risk event.

In light of the difficulties associated with the quantification and the measurement of the related risk, a self-assessment process has been implemented aimed at obtaining, on a forecast basis, a qualitative assessment of the exposure to reputational risk.

This process has the purpose of monitoring the areas of operations most exposed to this risk, of raising the awareness of the main players involved and assessing any mitigation action.

The Bank adopted a Code of Ethics aimed at sharing the system of values, principles and rules of behaviour all internal subjects must comply with.

The Bank also updates and implements continuously the internal regulatory framework and related processes in order to ensure a constant monitoring for the mitigation of reputational risk.

An additional control unit aimed at limiting a possible unlawful behaviour by employees is represented by the whistleblowing system, by identifying the subject to whom to converge them in a confidential manner.

Finally, with regard to the recent "Ca.ri.fe event" currently being examined by the Court, we are confident in the activity of the court of law and we are also convinced that we will be able to demonstrate the correctness of our bank's operations and good faith in the face of an investment in a banking business based on a share capital increase authorised by the Bank of Italy and a prospectus approved by Consob. Business partnerships were started with Ca.ri.fe. following the acquisition of Credito Veronese, which was entrusted on a transitional basis with some back office activities related to the bank of Verona.

The investment in Ca.ri.fe. was already completely written down with impact on the income statement in the 2013 - 2014 and 2015 financial statements.

## **14. COMMERCIAL ACTIVITIES**

## **Organisation of the sales division**

After mentioning them in the paragraph of business strategies, we would like to refer briefly to the adjustments introduced in the structures of the sales division in order to rationalise the operating processes and coordinate more effectively the initiatives aimed at developing business.

The need to maintain the high quality of the offer, to acquire new customers and to achieve the fair economic returns is the ultimate responsibility of the sales division when the strategy of growth is shared and carried out on two parallel lines: the intensity of relations and the extension of the served territories. Exactly what Valsabbina is implementing following the expansion of the sales network, reconfigured with the opening of some branches and with the acquisition, mentioned several times, of the seven branches from the Hypo transaction.

This presence paved the way for intensifying profitable relations with businesses, especially small and medium, with professional groups and private individuals, increasingly sensitive to quality products, rapid and efficient services, a competent and reliable financial aid and a simplification of operations through online channels. The effectiveness of the pursued strategy is demonstrated by the increase in the number of customers and the gradual expansion of market shares both in the area of origin and in centres where the Valsabbina name appeared more recently on the newly opened branches: as obvious, in some situations, it is still a fraction of a point, but the objective of gaining new spaces is quite realistic as there is no lack of human resources, will and tools to achieve it.

The newly opened branches have already given signs of success and appreciation but especially significant contributions to the increase in the number of customers and volumes traded: encouraging factors to adequately sustain profitability despite the sluggish performance of production and the continued drop in margins.

The investments incurred are very important because they allow the Bank to be ready and equipped to face the seasons of the economic recovery hoped for with plans, programmes and realistic and efficient organisational structures in terms of cost effectiveness.

In a nutshell, the rationalisation of the sales machinery concerned:

- the creation of the Business Division, headed by the Commercial Sector and the Strategic Planning and Corporate Affairs Sector, active parties in the commercial process of the bank;
- the territorial areas (reduced from 7 to 5) and their branches, which now refer to the newly established Territorial Network Division that has the task to follow its performance by monitoring the assigned targets;
- the bank branches, increased from 61 units of 2015 to 70 at the beginning of 2017 with the execution of the acquisition of 7 branches from Hypo Alpe Adria Bank and the openings through acquisition of the bank branches of Monza and Seregno (MB).

## **The offer dedicated to Shareholders**

Also in 2016, the Bank paid great attention to the shareholder/customer combination since the need to interpret increasingly and better our traditional role of Cooperative Bank is a must.

Ca. 20,000 Shareholders have chosen one the several offer packages at their disposal, all characterised by competitive pricing and by the completeness of the included services that meet all requirements: from the most customised solutions for managing savings to personal loans, from mortgage loans to ancillary services and collection and payment services supported by the versatile applications of the virtual bank.

As part of the renewal and update of the offer, a new service package called "Socio Light" became operational, reserved for customers who are at the same time holders of at least 100 Banca Valsabbina shares.

The new product is added to the already well-known "Socio All Inclusive" and "Socio Plus" agreements, for "private individuals" with a shareholding of 200/500 shares, respectively, and "Socio Azienda" for non-consumer customers of at least 1,000 shares.

## **Current account agreements**

For the year just ended as well, the figure related to acquired customers confirms the constant growth of current account number bases; to date, the bank has 74,212 current account holders compared to 72,394 of

2015 as a sign of the ability to achieve and consolidate appreciable market shares also in contexts characterised by an objectively wide and diversified offer by other competitors.

The growth in this specific area is mainly due to the variety of proposals for current account agreements and communication policies aimed at disseminating the knowledge of services and tools that are created as a result of accurate market analyses and target segmentation.

To date, there are around 50 agreements for specific customer segments, both consumers and non consumers, offered by the Bank to those who are potentially interested in opening a current account.

The size of the catalogue allowed us to increase relations having an agreement from 61,900 in 2015 to 63,800 in 2016.

Among the highest-ranking products, in addition to the above mentioned Shareholder packages, we point out "Conto Giovani" for customers "under 30" looking for a complete and innovative range of services that takes advantage of the versatility and cost effectiveness of online services. The conditions of the above-mentioned account are unusually advantageous.

To date, "Conto Giovani" has approximately 6,300 current account holders: since they are a sure promise of the future, the Bank will not fail to meet their requirements as they will gradually come through.

Always in perspective, "Conto 44 Gatti" - introduced in 2015 and reserved for our "small customers" from birth - is worth mentioning

This product, the result of the partnership with Consorzio tra banche popolari (CoBaPo) is rich in educational content, specially prepared by Istituto Antoniano of Bologna, combined with a series of nice non-banking benefits such as entry free of charge in some of the most famous fun parks in Italy. The formula has proved successful, so much so that in a year the audience of "new" customers doubled.

Great attention is also paid to customers "over 65": "Conto Evergreen" - now used by approximately 1,600 holders - is reserved for them, demonstrating the interest aroused by the product due to its simplicity, affordability and completeness.

Likewise, "Conto Rosa", reserved for female customers, was appreciated with 600 new members during 2016.

"Conto Light", effective tool for acquiring new current account customers, "Conto Zero Spese", recommended for current accounts characterised by a small number of transactions and "Conto Dipendenti Plus" reserved for customers who wish to have a current account with a low-interest rate for crediting their salary are worth mentioning among the agreements offered to private individuals

With regard to the corporate segment, the different agreements reserved for craftsmen, traders and farmers - each designed on the specific nature of the requirements related to their management and accounting obligations - were widely appreciated and widespread.

At the end of the brief discussion on the services and their use within specific agreements, we are pleased to report the success met by an innovative product, not so much the prerogative of traditional commercial banks, but rather to those operating exclusively through sophisticated Web applications. We refer to the initiative called "CiConto": an instrument also called "carta conto", offering the opportunity to benefit from all the major features of a traditional bank current account through a payment card, with Iban details, able to make payments and receive credits of any kind with the possibility to monitor all online transactions from home.

## **Loans and leases**

Also during 2016, the Bank confirmed its primary role in assisting and supporting businesses, both in the field of services and in the area of financial and credit support.

The tested chapter of the loans granted under Italian Law 662/96, backed by guarantee issued by Mediocredito Centrale for 80% of the amount disbursed, in respect of which in 2016 the Bank supported 613 companies including SMEs and microbusinesses for a total amount disbursed of Euro 126 million, was accompanied by new financing initiatives of investments supported by substantial allocations at favourable rates.

It is worth mentioning, among these, the initiatives aimed at accompanying the entrepreneurs in the use of facilities envisaged by the new Stability Law, relating to "Super amortisation" and "Hyper amortisation"; the Bank allocated for this purpose a plafond of Euro 20 million reserved for companies that intend to take

advantage of these new and interesting opportunities, and repeated similar initiatives with regard to the main credit guarantee consortia (Confidi) present on the territory.

Moreover, in collaboration with a specialised company, Banca Valsabbina proposed to the creditor companies of the Public Administration a solution for the assignment of credit without recourse by offering to the interested customers the possibility of monetising their certified credits in advance and at favourable interest rate conditions.

Undoubtedly positive results were recorded in the sector of mortgages for the purchase of first homes, whose reference market was reawakened by the constant growth of subrogations.

The mortgages paid for the purchase of first homes were approximately 1,000 totalling more than Euro 115 million: more than double the volume of the year before.

In fact, in 2016, the success achieved by the products of the "Concerto" package, within which the "Rondò" mortgage established itself with a floating-rate and a spread starting from 0.89% and that with a fixed rate as from 1.39% with variable conditions depending on the duration of the operation and the ratio between the disbursed amount and the estimate of the value of the property used as a guarantee (financed LTV) continued. To complete the offer within the mortgage loans, the products "Armonia", floating rate with a predetermined maximum rate (CAP), and "Ritornello" characterised by a floating rate with a constant monthly instalment were re-proposed.

The Bank's offer - which stands out for its truly competitive conditions - had a wide-ranging consensus, reflected in highly significant results: in 2016, the Bank took out 1,234 mortgage loan transactions for an equivalent value of Euro 194 million.

2016 was also a year full of success also for the Leasing product, offered by the Bank to its own customers thanks to the stable partnership with the company SG Leasing.

287 transactions were signed during the year for a disbursed amount of more than 35 million, compared to 238 of 2015 for an equivalent value of 25 million.

The important increase by 15% in the number of contracts and by 44% of their total volume confirms the Bank's ability to meet market expectation with efficiency and flexibility, also by offering alternative or complementary products of high quality.

Over the last year, the Bank has made its entry in the minibond market as well. In addition to offering its customers, with the support of a leading operator of the sector, the collaboration and the support in the issuing process, a plafond for investments in these instruments was granted for Euro 30 million. To date, minibonds of approximately Euro 6 million are subscribed, all with regard to companies operating in the northeast of the country.

## **Deposits**

2016 was characterised by a trend reversal of customers who, to in allocating their savings, favoured low-risk and shorter-term products.

The Bank expanded the list of the offer in the form of "time deposits" and of the certificates of deposit, favoured by the customers compared to the traditional bond loans very popular in the recent past.

In relation to the increasing demand and in line with market returns, the Bank accompanied the usual "time deposit" offer with a maximum duration of 24 months and with payment of interests on maturity, with new financial products of this kind with a duration up to 60 months and payment of interests through half-yearly coupons, at a fixed rate rather than "step up". These formulas were highly appreciated by customers both for the favourable interest-rate conditions and for the possibility to release the amounts at any time with negligible effects on the agreed return.

This flexibility, in addition to the guarantee provided by the Interbank Guarantee Fund up to Euro 100,000 by depositor, allowed a solid performance of the time deposits within the development policies of the provision by the Bank.

The offer of the certificates of deposit was also enriched by the launch of 24 and 36-month products at particularly competitive rates: the initiative was aimed at acquiring new deposits coming from other banking and financial intermediaries.



Indirect deposits reached in this way the amount of Euro 1.485 billion, confirming the important trends of recent years: within it, the performances of asset management were very positive exceeding Euro 800 million, up by 22%, with a balanced development both of the UCITS component (446 million, +20%) and of the insurance component (337 million, + 24%).

These results were the result of selected and reliable partnerships with product companies, of a careful assessment and selection of the risk profiles of the offered products, as well as of a constant and scrupulous training activity of the sales network personnel.

Finally, it should be noted that, in 2016, the Private Banking service was set up to provide specialist assistance and advice to customers with portfolios of at least Euro 100 thousand. Right from the beginning, the service is proving to be very appreciated by customers, also for the proven qualification and professionalism of the figures involved.

### **Insurance policies and solutions**

The partnership - profitable and well-established since 2001 - between Banca Valsabbina and the Zurich Group for the placement of insurance products characterised by high reliability and by pricing profiles able to compete with major financial and insurance companies present on the market, continued.

The trust relation of close collaboration established from the very beginning of "Bancassurance" allows a greater organisational ease in offering a wide and selected range of products aimed at protecting the person and family through advanced commercial formulas that protect savings and investment.

The partner's prestige, the perfect operational understanding that has come about and the high quality of the list products are among the factors that have led to the progressive and steady growth of the intermediated portfolio that in 2016 reached a total stock of Euro 335 million compared to 270 of 2015.

A special appreciation was recorded for the "Multinvest" product, subscribed for approximately Euro 38 million, up from the favourable result achieved in 2015.

The appeal of the product, which ensures stable returns over time by means of insurance components linked to the Segregated Management scheme "Zurich Trend", is amplified by the ability of the instrument to use the growth opportunities of the markets through the financial component formed by investment funds.

The Unit Linked, called "Z-Platform", with subscribed volumes of approximately Euro 12 million, confirms all its appeal, thanks to its financial insurance component that allows the subscriber to customise its portfolio, choosing among the many funds issued by major Companies, preliminarily selected by the Insurance Company with great accuracy.

To supplement the already extensive package of products available for private and corporate customers, an innovative policy called "Cyber Risk" was introduced during the year, designed as a result of the increasing need for the protection of confidentiality as part of ordinary software applications.

The threat of attacks by hackers is growing in proportion to the development of electronic transactions and to the possibility of direct access to data and online services by users: a circumstance that represents a danger to the very life of the company that actually exposes its data and that of customers, suppliers and third parties to potential threats. The "Cyber Risk" policy is fully satisfactory and with a great sense of precision compared to the chronicles of times in protecting companies from new and feared types of IT risk.

As part of the partnership with the Zurich Group, since February 2016, the placement of the "AzStyle" insurance product was launched, distributed by the company Az Life Ltd of the Azimut Group, already our partner for the segment mutual investment funds and SICAV.

This full-life Unit Linked allows the subscriber to choose from four investment lines that match different and previously defined risk profiles, with investment of the amounts in mutual funds (UCITS).

To complete the review on bancassurance products, the "Amieasy" policy is worth mentioning, promoted by the company Filo Diretto, which meets the safety and protection requirements shown by the customers with a view to "travel safe" and the "CPP" policy, offered in collaboration with "CPP Italia", which protects all the payment cards from risks of theft or loss.

### **E-money services**

E-money services are more and more widespread: in 2016, their steady and strong growth continued confirming the positive trend already shown in the past years and even more highlighted in the table below:

	2010	2011	2012	2013	2014	2015	2016
<b>ATM points</b>	60	60	68	66	66	66	68
Number of transactions carried out	786,021	807,558	862,254	875,207	896,746	928,223	971,803
Amounts transacted (in millions of)	125	133	148	153	159	167	172
<b>POS</b>	1,343	1,484	1,937	1,799	2,008	2,127	2,168
Number of transactions carried out	1,133,43	1,321,36	1,645,40	1,867,78	2,198,20	2,340,51	2,430,95
Amounts transacted (in millions of)	89	108	133	140	159	167	175

“Classic” credit cards were accompanied by innovative products such as “Rebate” cards, characterised by the exemption of the annual cost of the device when the minimum annual cost threshold previously established to take advantage from this benefit is reached.

The Cartasì Light service was also available, which - in parallel with a lower cost profile - envisages a lower maximum expenditure compared to the most commonly used Classic cards.

In addition to these products, a growing market share of rechargeable credit cards is emerging. Among these, “Ci Conto” - already mentioned above - characterised by an electronic payment device with IBAN code for the channelling of credits.

It is also worth mentioning the Europass service - which can be subscribed, like all other e-money services, at all Bank branches - offered thanks to the historical collaboration with Cartasì, which combines the functionality of the credit card with the convenience of the Telepass device of Autostrade per l'Italia.

The more and more complete and up-to-date offer within payment formulas and services helped to increase the stock of cards from 85,000 units in 2015 to approximately 94,000 in 2016, thanks also to the partnership with American Express that led to the issue of 1,400 new devices only in 2016.

Moreover, the Customers who wish to “protect” their payment instruments can subscribe to CPP services offered by the specialised company Card Protection Plan under agreement with the Bank.

By means of this formula, in the event of theft or loss of the cards, making a simple telephone call the Customers holding cards will obtain the immediate block of all the mediums, manifold insurance coverage and accessory protection and security services.

## Digitalisation of banking services

A major new increase in the number of electronic services was achieved in 2016, in parallel with the expansion of the number base of current account relations outlined above.

In this regard, the active home banking contracts amounted to 31,757 against 29,105 last year, an increase of 9% of the stock and in full continuity with the significant growth trend recorded in 2015.

This considerable increase was achieved thanks also to the boost that the Bank wanted to provide in terms of dissemination and promotion, always considering this service as an integration and supplement to the direct and personal relation that is achieved within the branches.

On the other hand, the continuous growth is also attributable to the improved safety control units that provide the customer with greater ease of use thanks to the special protections against possible attempts of computer fraud.

This security level has been achieved by virtue of the introduction of Strong Authentication systems such as the Token OTP device and the Secure Call, which are mandatory for the authorisation of payment orders placed through home banking.

The appreciation of the App launched during 2015 continues and is increasingly widespread among private customers, more and more urged to operate - a sign of the times - on their online account through the use of Smartphones and Tablets.

Many ancillary services that are made available online to customers; these include MyBank, a European-wide service that makes it possible to pay on partner websites by generating a “SEPA credit transfer” from their

home banking in favour of the seller, simply and entirely safely; Ribes S.p.A. that offers its customers a wide range of real estate and commercial information services for credit risk management and CBill, an online consultancy and payment service of bills, realised by the Banks joining the CBI Consortium with the aim of digitalising the bills.

## 15. HUMAN RESOURCES

It is customary to indicate in the annual report presented by the Directors to the shareholders convened in the meeting the characteristics, skills, qualities and commitment that positively define the human component of our Bank.

Albeit with a few notes of pride, this reflection refers to the fundamental contribution made to the constant and harmonious development of the company structure by those who, at various levels of responsibility and in different roles, devote their daily commitment. Our collaborators are all positive people, united by a strong sense of belonging and motivated by a strong identification with the company: these components are of great importance in terms of competitiveness and comparison, since the quality of the work and personal behaviour of our employees does not pass unnoticed by the customers.

Without rhetoric and with a fair analysis, the favourable results achieved over time is first of all due to the passionate contribution of the personnel, as confirmed by the growing importance of our Bank in the national context and in the productivity and efficiency rankings of the top 100 Italian banks.

The good level of productivity that characterises the human resources of our Bank is also due to the stringent selection criteria during recruitment: in this context, basic and technical education, versatility and motivation as well as the knowledge of the territories and the sharing of the values of the communities of reference are particularly important.

By the end of 2016, the company's staff reached a total of 500 units.

The goal, which is undoubtedly rewarding for our Bank, is even more valuable in the current economic period, considering that employees - 415 at the end of 2011 - have grown over five years by more than 20%, supporting the process for strengthening also the commercial network that had 63 branches at the end of the year. This positive trend shows an opposite trend to that of the Italian banking system, in which the turnover, summarised in an indicator equal to 0.7, is less than the replacement value: i.e. there are 7 hires every 10 terminations.

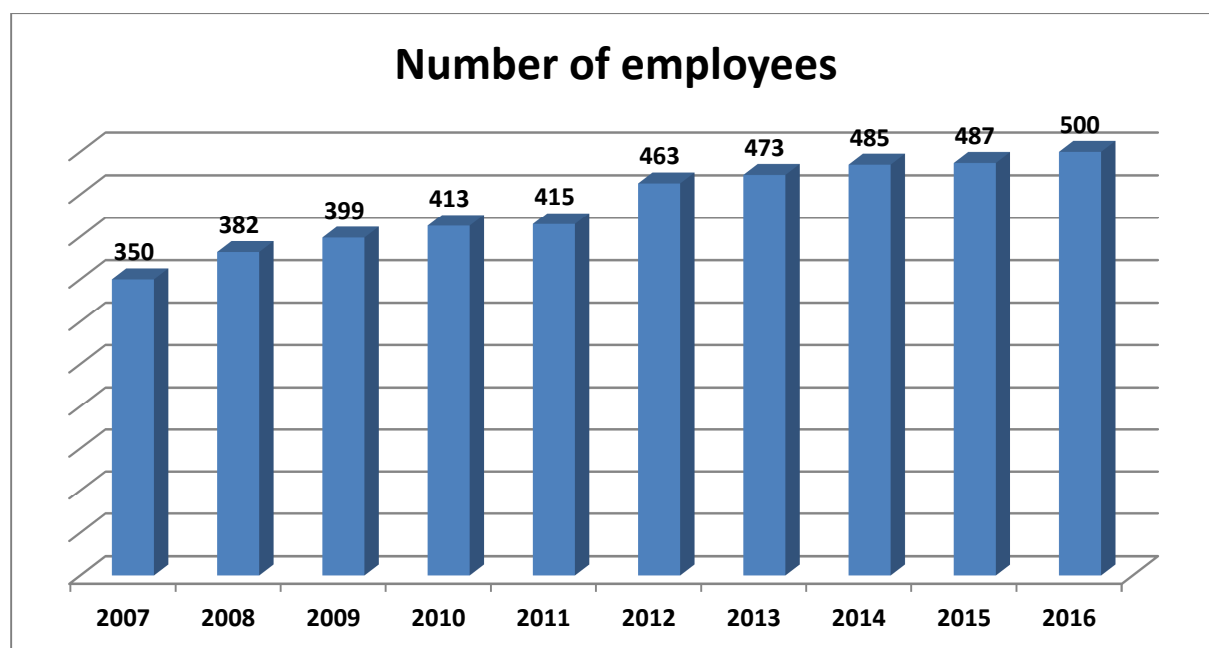
The table below summarises the distribution of the personnel according to the contractual staff level profiles in 2016.

	2016	%	2015	%	2014	%	2013	%
Executives	10	2.00%	9	1.85%	9	1.90%	9	1.90%
3rd and 4th level middle management	107	21.40%	104	21.35%	103	21.20%	100	21.10%
1st and 2nd level middle management	85	17.00%	78	16.02%	76	15.70%	69	14.60%
Remaining personnel	298	59.60%	296	60.78%	297	61.20%	295	62.40%
of which:								
professional training apprenticeships	-	-	-	-	1	0.20%	-	-
under staff leasing	3	0.60%	1	0.21%	2	0.40%	5	1.10%
TOTAL	500	100.00%	487	100.00%	485	100.0%	473	100.00%

Compared to 2015, personnel increased by thirteen units - the difference between 28 new collaborators hired and 15 who left service, two of them for having reached the retirement limits. The highest number of hires compared to the previous year is mainly attributable to the opening of two new branches. The structure of the

staff levels remained more or less unchanged, going against the system trend focusing the personnel towards higher classification levels.

A structure which, compared with the data published in 2016 by the Italian Banking Association in the 23rd Report on the employment market in the lending sector, highlights amongst other aspects within the Bank the minor incidence of the executive positions - 2% compared with 2.2% and of the middle management - 38.4% compared with 41.2% - and a consequent additional percentage-based weight of the white-collars allocated in the various professional areas: 59.6% compared with 56.6% for the system. This configuration, which shows - compared to the average system values - advancement in staff levels in all categories and professional areas, first of all provides a harmonious balancing in the internal roles, but is also a sign of sobriety that characterises all aspects of business management, resulting among other things in a positive impact on labour cost



By focusing on the seniority of bank personnel throughout the system, there is a further rise in the average age of personnel, even if the volume of terminations from 2015 to 2016 concerned significantly subjects who by age or contribution had reached retirement requirements or could converge in the Solidarity Fund of the sector.

By comparing, we note that the age of our 500 employees is 41.8 years, whereas the system data is equal to 46.1 years. The average length of service is by contrast 12.4 years, compared to 12.1 in 2015, increasing progressively on a parallel with that which occurred in the system dynamics due to the lengthening of the pension requirements for permanence in service. 43% of the personnel, equal to 216 units, is aged between 30 and 40. Despite having reached the 120th financial year, it can be said that ours is anything but an old bank, a creature of habit, also due to the vivacity of the policies aimed at the rotation and alternation of the roles for the purposes of enhancing skills and professionalism.

	2016	2015	2014	2013
average age	41.8	41.1	40.5	40
length of service	12.4	12.1	11.6	11.2
males	348	338	333	322
females	152	149	152	151
total	500	487	485	473

The distribution of our personnel between the central headquarters offices and the sales network is confirmed again at the end of 2016 on the values of the past: of the 500 individuals making up the company headcount, 157 operate centrally, while 343 are distributed throughout the branches.

Therefore, almost 69% of the personnel is firmly involved on the market in sales, assistance and customer relations: a measure that, confirming the initial comments in this paragraph, immediately explains the high rate of productivity achieved in the management of the personnel.

We also said this in last year's report: a rate difficult to achieve in the context of small and medium-sized banks. It should in fact be considered that the dimensional growth and the needs to adapt to the incessant legislative and regulatory changes leads to the need to continually reinforce the central apparatus, that serving the satisfactory functioning of the governance.

With regard to the characteristics of the personnel in terms of gender, an essential stability in the distribution between men and women emerges, with a termination rate that obviously affects the former to a greater extent. The female component is made up of 152 workers - 17 of which part-time - with an average age of 40, compared with 43 for the men.

Even if the female component within the Bank is more contained with respect to the system data - according to which women working in the Bank represent 45% of the personnel - the contribution of the female staff remains significant, in the on-going adaptations of the organisational and distribution set ups, who are increasingly present in roles of responsibility both within the branches and the central structures: there are 13 branch managers, in addition to an area manager.

The level of education thus remains high, and even improves further to the recruits taken on during the year: nearly half of the workers, precisely 47.2% of the total, compared with 38.1% of the entire banking population, is in possession of a degree, mainly in economic or legal disciplines, or in any event subjects consistent with the sector operations.

Also during 2016, attention was paid to the personnel in order to refine their professionalism and increase their potential, apparent or latent, in the belief that training and retraining are strategic investments: they cost but pay over time because they return a real competitive advantage. In this sense, the programming and implementation of classroom interventions and initiatives took place in a timely manner and within a spirit of good collaboration also with the trade union component.

In this case, training activities were structured in accordance with the peculiarities of the various roles of the Bank, not only through the definition of specific training content but also by creating modules aimed at developing managerial and relational skills with the aim of supporting the heads both in improving the operating results and above all in the involvement and growth of the employees.

Numbers give an immediate perception of the training activity promoted and delivered during the year.

The hours dedicated to learning in the various realisation methods - classroom, event participation, video conference, e-learning - totalled 20,327. In the presence of this programme, those attending at least one training course numbered 456.

The thematic areas that most affected the annual plan, apart from compulsory training matters, were those of a commercial nature for the need to monitor the operating and procedural aspects of many products and services we have just commented on; then those related to credit - broken down in the various stages of its processes, in particular for what concerns the management of non-performing assets and the changes introduced in July 2016 by the "bank decree" and by "mortgage decree"; and again those concerning investment services, characterised by extensive, constantly evolving and very well-structured regulations due to the obligations concerning the requirement to protect savers.

The chapter of bancassurance absorbed, as in the past, the higher number of hours: 4,575.

Training on anti-money laundering, on legal and corporate matters and on insolvency proceedings was intense, involving systematically extensive groups of collaborators.

Most of the annual plan was then absorbed by regular retraining and training meetings on the new IT and organisational procedures, often with the support of the Cedacri outsourcer.

In order to carry out training interventions, the bank used both internal qualified personnel and teachers of external companies and representatives of the different companies providing products and services distributed by the Bank.

The results of the policies followed in personnel management are very positive, judging from the great ability to press towards the target of the employees at all levels of responsibility, and we want to rightfully acknowledge their dedicated efforts, as well style and attention reserved to customers and other interlocutors.

Many challenges will be faced during the current year, starting from the organisational method for delivering courses also in connection with the increase in personnel acquired following the Hypo transaction, its dislocation on a more extended geographical area, the requirements of close coordination with the Business Division to achieve ambitious commercial goals and for the increasing training obligations deriving from the relentless regulatory production.

The topic of professional requirements that must be met by employees in charge of delivering specific services to customers is becoming more and more important in the training programmes of the current year and of those to follow.

First of all, we would like to mention the ESMA Guidelines of last March that aim to promote a greater convergence in the knowledge and skills of the personnel in charge of investment advisory service or of providing information concerning financial instruments and investment services. ESMA made it clear that, as from 3 January 2018, the entire personnel in direct contact with customers in the provision of services mentioned above must possess the requirements, also through a dedicated training course and passing a final valuation test.

Similar requirements on real estate mortgage to consumers are included in the Consolidated Banking Law. Intermediaries are obliged to ensure that the personnel in charge of assessing creditworthiness, marketing loan agreements, consumer assistance and complaint management has an appropriate professional level. As from 2019, the assessment of the appropriate level of knowledge and competence will not be based only on professional experience, but will require a specific professional qualification, through targeted training initiatives.

## **16. LEGISLATIVE AND REGULATORY CHANGES**

We believe it is useful and appropriate to refer hereunder - as usual - to the cornerstones of the relevant laws and regulations as well as to the underlying logics and the dynamics in the main spheres in which the legislation is evolving, without any claim to wish to provide a complete picture of all the innovations that have already taken place or are still underway.

In summary, the cornerstones of the relevant laws and regulations are as follows:

- the European legislation in the banking sphere is focused in Directive 2013/36/EU (so-called Capital Requirements Directive IV - CRD IV) and in (EU) Regulation No. 575/2013 (so-called Capital Requirements Regulation - CRR), provisions that have introduced new standards of prudent supervision on the subject of access to banking activities, right of establishment of banks and freedom to provide their services, prudent control, capital reserves and own funds, corporate governance and disclosure to the general public;
- At an Italian level, regulations in the banking sphere are represented by the Banking Consolidation Act, as well as by the related supervisory instructions (contained in the Bank of Italy Circular No. 285/2013). The Bank of Italy took the opportunity of the issuance of this circular to carry out a substantial review and an editorial coordination of the entire supervisory regulations in order to ensure and maintain over time their organic unity;
- The cornerstones of European legislation on the subject of investment services and market protection are represented by the Mifid directive (Directive 2014/65/EC of 15 May 2014 and Regulation no. 600/2014 of 15 May 2014) and by the directive on market abuses (Directive 2014/57/EC and EU Regulation No.596/2014);
- at national level, the relevant laws and regulations on investment services and market abuse is contained in the Consolidated Law on Finance, as well as in its implementing provisions, firstly Consob regulations (intermediaries, markets and issuers), package of measures already partly adjusted to the new European regulations and partly to be adjusted by 3 January 2018. Please note that by that date banks have to ascertain and, if necessary, adjust the professional skills of personnel in charge of customer support;
- the EU regulations on the prevention of the risk of use of the financial system for money laundering or financing of terrorism is contained in Directive 2015/849 of 20 May 2015, for the adaptation to the GAFI agreements of 2012, in force since 26 June 2017. The transposition process in Italy of EU Directive IV has already been launched and is still underway.

The international and European banking, financial and insurance regulations are pursuing - with specific intensity since the outbreak of the great economic / financial crisis of the last decade - a number of objectives, of which the following are particularly relevant:

- the protection of customers as consumers, savers and investors;
- the efficiency and integrity of financial markets, place of exchange of financial instruments in which customers invest directly or indirectly;
- the transparency of information relating to issuers and to risk/complexity factors related to financial instruments issued by them;
- the solidity of the banking system with the consequent mitigation of strategic, credit, financial and reputational risks to which the banks are exposed in carrying out their credit brokering activities, offer of financial and investment services to their customers.

The impact on national regulations, from Consolidated Banking Law (TUB) to Consolidated Law on Finance (TUF), to other field regulations, is direct and sometimes immediate. We have witnessed:

- the reform of cooperative banks and cooperative credit banks to increase their size while at the same time reducing their autonomy;
- the entry into force of the bail-in regulation (internal rescue), preceded or immediately followed by the crisis of some Italian banks;
- the constant adjustment of the capital requirements requested from the intermediaries, often due to a decrease in the loans granted by them;
- the need to ensure greater liquidity to the financial instruments issued by unlisted banks, as an indirect consequence of the bail-in regulation, resulting in an “inadequacy” of the investments made by part of the shareholders;
- the need to increase the transparency of certain real estate credit products to consumers as well as to resolve the conflicts that existed in time between banks and customers concerning banking conditions and anatocism;
- the need to allocate up to Euro 20 billion for public support for bank liquidity and capital.

Italian banks are expecting for the 2017/18 two-year period some important changes especially related to the transposition/implementation of the measures mentioned above. The following interventions the process of which has already been started are worthy of note:

- transposition of the MiFID II Directive/MiFIR Regulation on investment services;
- transposition of the 4th EU Directive on the prevention of the risk of involvement in money laundering and/or financing of international terrorism;
- transposition of the EU Directive on payment services in the internal market (PSD2);
- implementation of the EU Regulation on the processing of personal data;
- adoption of recovery plans containing early intervention measures to deal with possible situations of difficulty of the bank;
- adjustment to the ECB guidelines on governance and management of impaired loans.

The regulatory production that already involved or that will shortly involve the banking system is therefore extremely extensive, complex and pervasive. Our Bank is in fact taking steps, as and when, to assimilate the new legal and supervisory provisions referred to previously in internal legislation, from governance to the risk management system, the system of internal controls, the commercial system, the organisational set ups and the information system.

A special attention will be paid to the recovery plan (BRRD Directive) as recently requested by the Bank of Italy to all banks not subject to direct ECB supervision.

## **17. RELATED PARTY TRANSACTIONS**

Related-party transactions are disciplined by specific internal regulations pursuant to Article 2391 bis of the Italian Civil Code, Consob Resolution No. 17221 of 12 March 2010 as amended and Section V, Chapter 5 of the Bank of Italy Circular No. 263/2006.

The internal regulations, published on the Bank's website as required by legislation:

- regulate the identification, approval and execution of the transactions entered into by the Bank with related parties and parties associated with it;
- establish suitable rules for ensuring the transparency and essential and procedural correctness of the transactions;
- define the operating procedures regarding the monitoring and handling of the transactions with related parties and regulate the checks and the reports required by the new supervisory instructions.

It is specified that all the transactions with related parties and parties associated with them have been carried out by Banca Valsabbina and by the group companies in observance of the criteria of essential and procedural correctness and under conditions identical to those applied to best customers; it is also specified that no atypical and/or unusual transactions have been entered into, either with related parties or with the other parties, these being understood to be transactions that, due to significance and/or importance, nature of the counterparts, subject matter of the transaction, method for determining the price and timescale, may give rise to doubts in terms of the correctness and/or completeness of the financial statement disclosure, conflicts of interest, the safeguarding of the integrity of the company assets and the safeguarding of the shareholders.

The independent directors have unanimously expressed their favourable opinion on all the transactions that required their prior, justified and non-binding opinion.

In conclusion, no transactions with related parties and/or parties associated with the same significantly influenced the balance sheet or the Bank's results, nor have there been any changes to or developments of transactions with these counterparties that could have a significant effect in this sense.

As far as data and more detailed information are concerned, please see Section H - Related-party transactions in the Explanatory Notes.

## **18. SUPERVISORY BODY PURSUANT TO ITALIAN LEGISLATIVE DECREE NO. 231/2001**

The Supervisory Body, established in accordance with Article 6 of Italian Legislative Decree No. 231/2001 (hereinafter for the sake of brevity also the "231 Body"), was appointed by the Board of Directors on 24 March 2004. The Supervisory Body has the task of assessing the correct functioning of the organisational control units adopted by the Bank so as to avoid involvement in events that could be subject to sanction pursuant to and for the purposes of Italian Law No. 231 dated 2001. As established by the Organisational Model, it periodically reports to the Bank's Board of Directors.

The 231 Body is made up of an external member of proven experience who covers the role of Chairman, by a member of the Board of Statutory Auditors, by the Head of the Internal Audit Service, by the Head of the Anti-money Laundering Service, by the Head of the Compliance Service, by the Head of the Risk Management, Planning and Control Service and by the Head of the Environmental Monitoring Service.

The presence of the company's different control functions provides assurance of the necessary link between the 231 Body and the internal structures of the Bank and more fully complies with the necessary exchange of information flows envisaged by Bank of Italy regulations contained in circular 263, as amended and supplemented in July 2013.

During the five meetings held during the year, the 231 Body was in a position to dwell, with greater attention, upon adoption by the Bank of the necessary organisational measures advised by the Bank of Italy and in particular those associated with the application of the regulations contrasting money laundering and the financing of international terrorism.

The 231 Body also examined and discussed the annual reports of the various control functions of the Bank, in particular evaluating any critical aspects emerging and the related measures adopted and/or planned by the Bank for their removal.

Special attention was then paid to the examination of the records of the judicial proceedings that also involves the Bank pursuant to and for the purposes of Italian law 231/2001 (Ca.ri.fe. event).

Copies of the reports of the 231 Body, which are recorded in the specific stamped and dated book, are sent to the Chairman of the Board of Directors and the Chairman of the Board of Statutory Auditors.



Also during 2016, no reports were received on the special e-mail that the 231 Body set up to ensure everyone the opportunity to highlight any relevant facts under the law 231/01.

You are hereby reminded that the company website contains all the information regarding the Organisational Model adopted by the Bank as well as the composition of the Supervisory Body.

## **19. ECONOMIC PERFORMANCE**

The 2016 income statement is still affected by the known problems that have been weighing on the national economy for several years and that - for banks - are mainly due to the cost of credit. Even the expansionary monetary policies of the ECB, implemented with particular intensity in autumn 2011, currently result in a certain compression of revenues, both on net interest income and on the formation of capital gains. In terms of costs, despite the attention given to their containment, administrative expenses include contributions to the resolution funds of Euro 4.8 million this year as well.

As previously reported, the important purchase of the branches of Hypo Alpe Adria was accompanied by a significant contribution from the seller, which, according to the accounting standards, was recorded in other operating income/expense.

Net profit amounted to Euro 4.1 million, compared to Euro 8.1 million last year.

<b>RECLASSIFIED INCOME STATEMENT</b> (in Euro 000)	<b>2016</b>	<b>2015</b>	<b>Absolute</b>	<b>% change</b>
Net interest income	49,666	54,711	(5,045)	(9.2%)
Net fee and commission income	27,348	26,779	569	2.1%
Dividends, trading and other income	12,153	38,877	(26,724)	(68.7)
<b>Net interest and other banking income</b>	<b>89,167</b>	<b>120,36</b>	<b>(31,20</b>	<b>(25.9</b>
Net impairment losses on loans and receivables and held-for-sale financial assets and other financial transactions	(38,998)	(49,259)	(10,261)	(20.8%)
Net profit (loss) from financial operations	50,169	71,108	(20,939)	(29.4)
Labour costs	(34,48)	(34,29)	194	0.6%
Other administrative expenses	(36,93)	(35,60)	1,322	3.7%
Net accruals to provisions for risks and charges	(736)	(928)	(192)	(20.8)
Depreciation/amortisation and net impairment losses on tangible and	(2,344)	(2,357)	(13)	(0.6%)
Other operating income/expense/profits or losses	29,498	13,184	16,314	123.7
Operating costs	(45,00)	(60,00)	(15,003)	(25.0)
Losses on equity investments and gain on disposal of fixed assets	(359)	(118)	241	204.2
Profit from continuing operations gross of taxation	4,808	10,985	(6,177)	(56.2)
Income taxes for the year	(660)	(2,923)	(2,263)	(77.4)
<b>Profit for the year</b>	<b>4,148</b>	<b>8,062</b>	<b>(3,914)</b>	<b>(48.5</b>

#### Net interest income

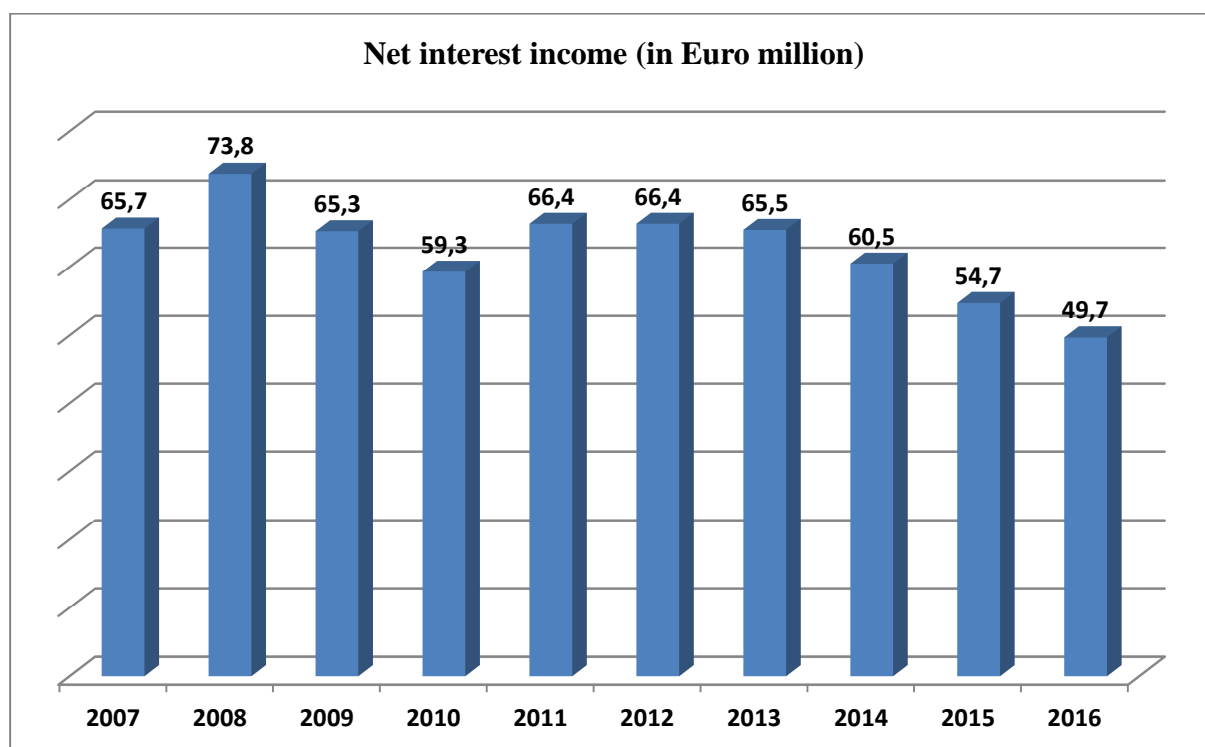
Net interest income amounted to Euro 49.7 million, down by Euro 5 million or 9.2%.

Disaggregate data show the solidity of the contribution of operations with customers. The amount of interest income of Euro 81.5 million net of interest expense on due to customers and on securities issued of Euro 11.5 million and Euro 25.4 million, respectively, led to a net interest income of Euro 44.6 million, amount equal to that of 2015.

The contribution of financial assets decreased in relation to the decrease in interest rates reported on average and to the decrease in average invested volumes compared to last year, aimed at limiting market risks. Interest income accrued on financial assets amounted to Euro 4.1 million compared to 9.6 last year, down by Euro 5.5 million.

The interbank produced a positive net interest income of Euro 1 million, compared to Euro 0.5 million last year.

<b>NET INTEREST INCOME (in Euro 000)</b>	<b>2016</b>	<b>2015</b>	<b>Absolute</b>	<b>% change %</b>
<b>Interest income and similar revenues</b>	<b>86,767</b>	<b>108,968</b>	<b>(22,201)</b>	<b>(20.4%)</b>
- on financial assets	4,071	9,615	(5,544)	(57.7%)
- on loans and receivables with banks	1,183	895	288	32.2%
- on loans and receivables with customers	81,509	98,404	(16,895)	(17.2%)
- on other assets	4	54	(50)	na
<b>Interest expense</b>	<b>(37,101)</b>	<b>(54,257)</b>	<b>(17,156)</b>	<b>(31.6%)</b>
- on due to banks	(226)	(425)	(199)	(46.8%)
- on due to customers	(11,456)	(15,910)	(4,454)	(28.0%)
- on securities issued	(25,418)	(37,901)	(12,483)	(32.9%)
- on other liabilities and provisions	(1)	(21)	(20)	ns
<b>Net interest income</b>	<b>49,666</b>	<b>54,711</b>	<b>(5,045)</b>	<b>(9.2%)</b>



### Service margin

Net fee and commission income amounted to Euro 27.3 million compared to Euro 26.8 million of 2015 (Euro +569 thousand, equal to 2.1%).

In particular, fee and commission income increased from Euro 30.2 million to Euro 30.7 million, while fee and commission expense fell from Euro 3.4 million to Euro 3.3 million.

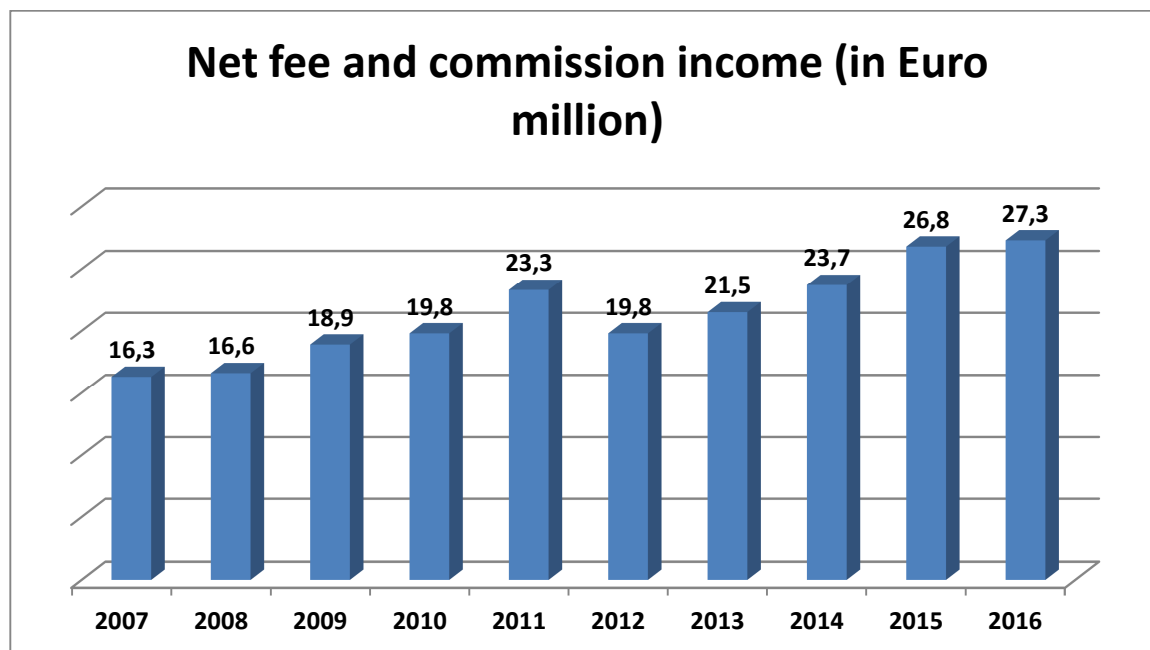
Management and trading services provided the most significant contribution increasing from Euro 10.8 million to Euro 11.5 million equal to 7.2%, in relation to the increase in volumes of asset management and of bancassurance.

In this aggregate, commissions on the placement of securities increased from Euro 4.3 million to Euro 5.3 million (+ 1 million or 23.9%), commissions on the distribution of third party services - which exclusively comprise the commissions relating to insurance policies, amounted to Euro 4.9 million, in line with the previous year.

Other commissions were mainly stable: guarantees given of Euro 1 million, collection and payment services of Euro 5.6 million, servicing for securitisation transactions of Euro 0.4 million, account keeping and management of Euro 8.3 million, other services of Euro 3.8 million. The latter group includes income relating to credit cards, lease brokerage, disbursement of loans and micro-credit loans backed by government guarantees.

Fee and commission expense of Euro 3.3 million refer to management and trading services of Euro 1 million, collection and payment services of Euro 1.3 million and other services of Euro 1 million.

NET FEES AND COMMISSIONS FROM SERVICES	2016	2015	Absolute change	% change %
<b>FEE AND COMMISSION INCOME</b>				
Guarantees given	1,002	1,126	(124)	(11.0%)
Management and trading services:	11,544	10,771	773	7.2%
– <i>currency trading</i>	365	314	51	16.2%
– <i>custody and administration of securities</i>	136	121	15	12.4%
– <i>placement of securities</i>	5,359	4,324	1,035	23.9%
– <i>orders collection</i>	819	1,189	(370)	(31.1%)
– <i>distribution of third party services</i>	4,865	4,823	42	0.9%
Collection and payment services	5,642	5,774	(132)	(2.3%)
Servicing for securitisation transactions	380	233	147	63.1%
Account keeping and management	8,305	8,535	(230)	(2.7%)
Other Services	3,805	3,741	64	1.7%
<b>Total</b>	<b>30,678</b>	<b>30,180</b>	<b>498</b>	<b>1.7%</b>
<b>FEE AND COMMISSION EXPENSE</b>				
Management and trading services	(960)	(891)	69	7.7%
Collection and payment services	(1,341)	(1,316)	25	1.9%
Other Services	(1,029)	(1,194)	(165)	(13.8%)
<b>Total</b>	<b>(3,330)</b>	<b>(3,401)</b>	<b>(71)</b>	<b>(2.1%)</b>
<b>TOTAL NET FEE AND COMMISSION</b>	<b>27,348</b>	<b>26,779</b>	<b>569</b>	<b>2.1%</b>

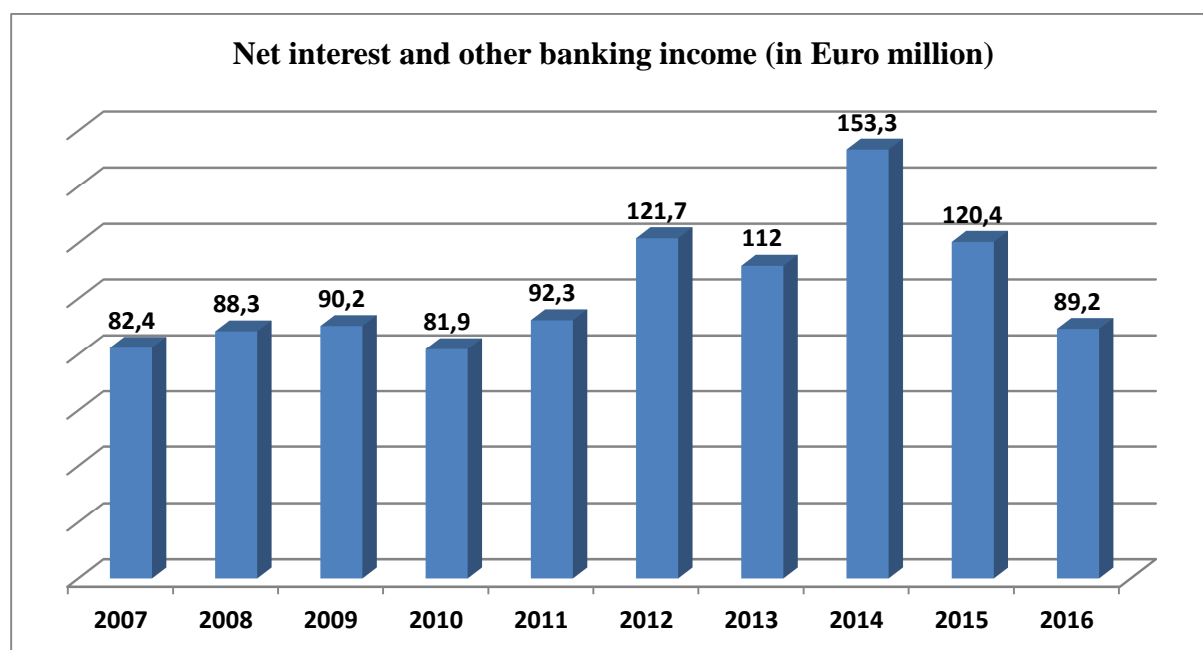


## Net interest and other banking income

Besides the net interest income and net fee and commission income, the following contribute towards the formation of the net interest and other banking income:

- dividends of Euro 3.399 million (compared with Euro 1.415 million in 2015). They include Euro 1.116 million of dividends received on UCIT units, Euro 891 thousand on other shares in the portfolio and Euro 1.392 million as extraordinary dividend with distribution of reserves approved by the shareholders' meeting of Cedacri;
- the profit/loss from trading activities of Euro 520 thousand (compared with Euro 541 thousand in the previous year), of which the exchange gain of Euro 447 thousand, profit of Euro 74 thousand on the valorisation of foreign currency securities and other negative components of Euro 1 thousand;
- the overall negative result of Euro 97 deriving from the transfer of loans, of which losses of Euro 120 thousand and gains of Euro 23 thousand;
- gains on available-for-sale financial assets of Euro 8.768 million, compared with Euro 38.570 million in 2015. The significant decrease is due to the compression of security prices, in particular government bonds, as a result of the increase rates on longer maturities that reduced the opportunities for forming capital gains;
- losses on the repurchase on Bank bonds of Euro 612 thousand, compared to a loss of Euro 584 thousand in 2015;
- valuation gains on insurance policies recorded in financial assets measured at fair value of Euro 175 thousand.

Overall, the net interest and other banking income amounted to Euro 89.2 million, compared to Euro 120.4 million last year.



## Impairment losses

Impairment losses, net of reversals of impairment losses, totalled Euro 39 million compared to Euro 49.3 million in 2015: they refer to loans and receivables with customers of Euro 36.2 million, available-for-sale financial assets of Euro 2.7 million and adjustments on endorsement loans of Euro 0.1 million.

The economic crisis, which resulted in a 10% reduction in Gross Domestic Product and the rescue of several banks, also of considerable size, inevitably weighed down the credit quality in bank assets. Even local banks, as said earlier, those that are closer to the territory, to its households and to its production activities were heavily

affected by it. The banks, which only a decade ago contributed significantly to national wealth, are involved in the reverse phenomenon.

In connection with the debtors' decreased ability to pay, the reduction and in many cases the suspension or closing down of production activities and loss of work, it was necessary to classify the relevant exposures as impaired and take often note that, due to the negative performance of prices during the real estate activities, the recoverable amount of the assets pledged as guarantee is lower than that of the credit exposure. The difference between the credit value and the recoverable amount must be recognised in the income statement as an impairment. The ratio between the total amount of impairment losses and the amount of gross loans and receivables represents the so-called "coverage ratio of the impaired loan", which the market - also interested in the speculative purchase of impaired loans and receivables - currently expects to be the highest possible: we have already mentioned it above, in the chapter dedicated to loans.

The impact on the income statement of impairment losses, net of reversals of impairment losses, amounted to Euro 36.2 million, down compared to Euro 46.2 million in 2015.

The analytical amount of impairments (Euro 55.851 million) and losses (Euro 1.574 million) on new positions classified as non-performing, on new entries under probable default and past due exposures, as well as their adjustment on the receivables already classified under impaired loans in previous years, further to the deterioration of the opinion on the possibility of collection and on the assessment of the assets provided as collateral amounted to Euro 57.425 million.

The analytical write-backs for reversals of impairment losses of discounting interests (Euro 8.596 million) and for reversals of impairment losses due to valuation and to collection (Euro 8.908 million) amounted to Euro 17 million and Euro 504 thousand.

There were also reversals of impairment losses on performing loans of Euro 3.734 million (Euro 1.361 million in 2015) due both to the decrease in loans and to an improvement of the credit quality reported by the scoring system used.

The cost of credit, represented by the percentage-based incidence of the losses and impairments on loans and receivables with respect to the amount of the net loans and receivables recorded in the financial statements, amounted to 1.31%, compared with 1.70% last year.

For the purpose of mitigating the credit risk as far as possible, the Bank thus reinforced the supervisory and supervisory measures on the dynamics of the aggregate in every direction, resorting to the various possible instruments.

The impairment losses of available-for-sale financial assets refer for Euro 2.188 million to shares in portfolio, analytically detailed in the previous section on financial assets and for Euro 545 thousand to mutual investment funds.

The valuation of endorsement loans and receivables disclosed impairment losses of Euro 77 million, equal to the difference between write-backs of Euro 196 thousand and impairment losses of Euro 273 thousand.

As a result of the described entries, the net profit (loss) from financial operations amounted to Euro 50.2 million, compared with Euro 71.1 million in the previous year.

## Operating costs

Operating costs, as detailed in the table below, amounted to Euro 45 million compared to Euro 60 million last year: their amount is affected this year by the classification in this item of the contribution received for the purchase of the 7 branches of Hypo Alpe Adria Bank.

Breakdown (in Euro 000)	2016	2015	Absolute change	% change
Labour costs	(34,489)	(34,295)	194	0.6%
Other administrative expenses	(36,931)	(35,609)	1,322	3.7%
Net accruals to provisions for risks and charges	(736)	(928)	(192)	(20.7%)
Depreciation and net impairment losses on tangible assets	(1,501)	(1,590)	(89)	(5.6%)
Amortisation and net impairment losses on intangible assets	(843)	(767)	76	9.9%
Other operating income/expense	11,998	13,184	(1,186)	(9.0%)

Contribution for the purchase of Hypo Alpe Adria Bank branches	17,500	-	17,500	na
<b>Total operating costs</b>	<b>(45,002)</b>	<b>(60,005)</b>	<b>15,003</b>	<b>(25.0%)</b>

Labour costs recorded a slight increase: they reached the amount of Euro 34.5 million compared to Euro 34.3 million in 2015 (+0.2 million or 0.6%), mainly due to the hiring of personnel for the two new branches opened. The item also includes the remuneration acknowledged, under the form of emoluments, to the members of the Board of Directors and the Board of Statutory Auditors.

The commitment to limit the operating costs - which has always been one of the key features of the Bank's management policies – continued in 2016.

The increases are attributable to the need to ensure suitable standards of technological efficiency, improve the security of IT systems and equipment while ensuring their continuity, resort to external contributions due to the demanding adjustments required by the deep changes in the regulatory framework, in addition to the burdensome internal and external organisation required by credit recovery.

Administrative expenses include expenses for securitisation transactions (Euro 970 thousand) and for professional services related to the purchase of the 7 bank branches of Hypo Alpe Adria Bank.

This item also includes contributions paid or requested by funds for the resolution of bank crisis and deposit protection of Euro 4.8 million, amount equal to that incurred in 2015. In particular, the amount of Euro 2.7 million as a two-year extraordinary contribution, requested in the last few days of the year, was fully entered in the income statement.

Even if Article 25 of Italian Law No. 237 of 23 December 2016 (known as Decreto salva banche (Bank rescue decree)) allows to settle it over a period of time not exceeding 5 years, the request made by the Bank of Italy is a binding and unconditional element for entering the debt.

The items presenting decreases, comprised in administrative expenses, include indirect taxes (Euro -996 thousand) due to the reduction in the average amount of bonds issued by the bank and of time deposits subject to the proportional stamp duty, telephone and postal charges (Euro -192 thousand) and maintenance costs (Euro -151 thousand). For further details, please refer to the explanatory notes, Part C, item 9.5 of the income statement.

The operating costs also include: impairment losses on tangible and intangible assets - totalling Euro 1.501 million (1.590 million in 2015) and Euro 843 thousand (767 thousand in 2015), respectively - and net accruals to provisions for risks and charges, amounting to Euro 736 thousand (Euro 928 thousand in 2015), posted to cover typical banking disputes.

Finally, the positive balance of other operating income/expense amounted to Euro 29.498 million, of which Euro 17.500 million as contribution relating to the purchase of the Hypo Alpe Bank branches and Euro 11.998 million relating to ordinary Other operating income and expense. As better illustrated in part G of the explanatory notes, in a business combination, when the purchaser receives an amount higher than the difference between acquired assets and liabilities, the excess, according to the accounting standards, is recognised in profit or loss immediately upon acquisition, when it is considered a bargain for the purchaser.

The amount of other net income, amounting to Euro 11.998 million (Euro 13.184 in 2015), consists of other income of 12.384 million (Euro 13.616 in 2015) and other costs of Euro 386 thousand (432 thousand).

Other income includes: the recovery of stamp duty of Euro 6.721 million (Euro 7.741 in 2015), fast credit processing fees of Euro 2.432 million, the recovery of insurance premiums of Euro 1.177 million, the recovery of legal costs of Euro 1.634 million and other income and contingencies of Euro 420 thousand. The decrease, amounting to Euro 1.232 million, is mainly due to the decrease in the recovery of stamp on financial assets (Euro -1.020 million), which is related to lower administrative expenses and fast credit processing fees (Euro -346 thousand), in addition to the increase in extraordinary income and other items of Euro 154 thousand.

Other operating expense of Euro 386 thousand consists of the annual portion of costs associated with improvements made to leased properties of Euro 182 thousand (Euro 125 thousand in 2015) and of other expenses and contingent liabilities of Euro 204 thousand (Euro 307 thousand).

Further to the described performances, the cost/income ratio - which expresses the ratio between operating costs and net interest and other banking income - was 50.47% (49.85% in 2015).

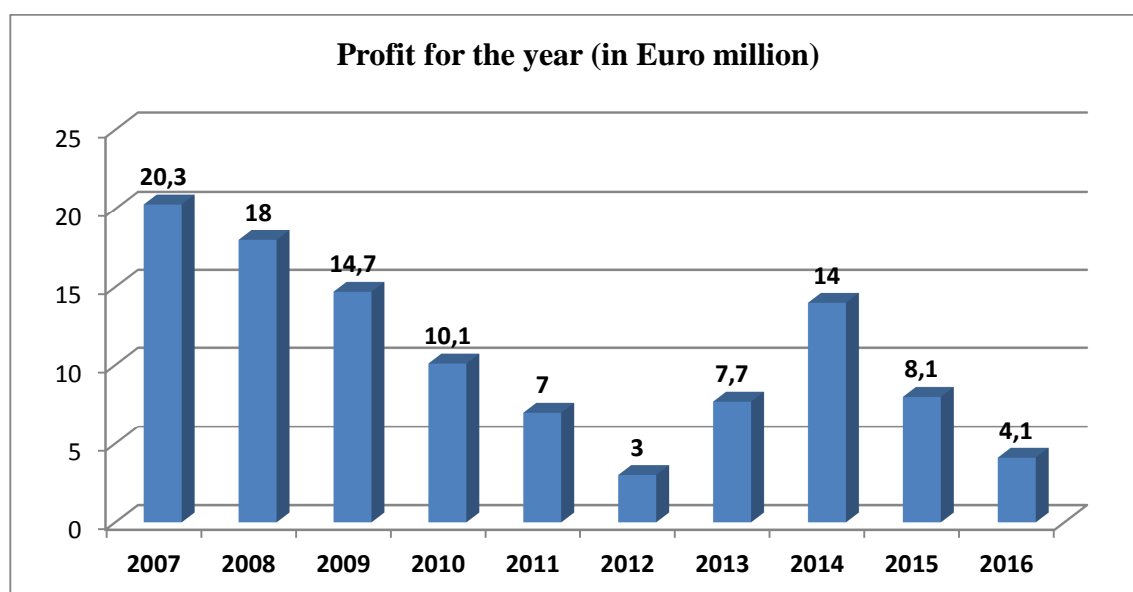
Finally, impairment losses on the subsidiary Valsabbina Real Estate of Euro 193 thousand, on Polis Fondi Immobiliare sgr of Euro 191 thousand and capital gains on the disposal of assets of Euro 25 thousand were recorded in the income statement.

### Income results

With the performance of the income margins commented on above, profit from operations gross of taxation came to Euro 4.8 million, compared with Euro 11 million in 2015.

The tax burden amounted to Euro 660 million, with a tax rate of 13.7% (26.6% in 2015). The decrease in the tax rate is due only to the tax deduction for ACE (Aiuto alla Crescita Economica, (Aid to economic growth) envisaged by the so-called Legge Monti of 2011) on a taxable amount lower than that of the previous year.

Net profit amounted to Euro 4.1 million.



The ROE, which expresses the remuneration of the invested capital, stood at 1.1% (2.1% in 2015) and must be considered to be positive in the light of the reference context.

### Financial statement ratios

Closing and completing the analytical examination of the income statement items, the main structural, productivity, efficiency and profitability ratios are presented below, in accordance with Article 2428 of the Italian Civil Code.

RATIOS	2016	2015
<b>STRUCTURAL RATIOS</b>		
Loans/Tot. Assets	62.7%	65.9%
Loans /Direct deposits	87.6%	89.0%
Average employees per branch (No. of employees /No. of	7.94	7.98
<b>PROFITABILITY RATIOS</b>		
Net interest and other banking income/total assets	2.0%	2.9%
Net profit/average shareholders' equity	1.08%	2.10%
Net profit/average total assets	0.10%	0.19%



Net interest and other banking income/banking product	1.20%	1.64%
Impairment losses on loans and receivables/Net interest and	40.6%	38.4%
Tax rate	13.7%	26.6%
<b>Earnings per share</b>	<b>0.12</b>	<b>0.23</b>
<b>PRODUCTIVITY RATIOS (in Euro 000)</b>		
Banking product per employee (average) (1)	15,229	15,129
Loans per employee (average)	5,684	5,733
Direct deposits per employee (average)	6,489	6,443
Indirect deposits per employee (average)	3,056	2,953
Net interest and other banking income per employee	183	248
<b>EFFICIENCY RATIOS</b>		
Admin. expenses/average total assets	1.66%	1.62%
Admin. expenses/net interest and other banking income	80.1%	58.1%
Cost/income	50.5%	49.9%
Adjusted cost/income (2)	62.2%	54.1%
Admin. expenses/banking product	0.96%	0.95%
Labour costs/average number of employees (in Euro 000)	69.08	69.99
<b>ASSET QUALITY RATIOS</b>		
Net impaired loans/net loans	13.71%	13.98%
Non-performing loans/net loans	7.08%	6.82%
Impairment losses on loans and receivables/net loans	1.31%	1.70%
Impairment losses on non-performing loans/gross non-performing loans	(3) 55.59%	(3) 52.32%
	51.40%	47.09%
Impairment losses on impaired loans/gross impaired loans	(4) 42.45%	(4) 39.06%
	38.92%	35.07%
1. Direct and indirect deposits of customers plus customer loans		
2. Ratio between item 150+170+180 and 120+190		
3 - 4 also including extinguished loans still held by the Bank and default interests		

## 20. SIGNIFICANT EVENTS OCCURRING AFTER THE END OF THE FINANCIAL PERIOD

Pursuant to Article 3, letters d) and e) of Italian Legislative Decree No. 87 dated 27 January 1992, and in accordance with the wording of the regulations, we specify that after the end of the reporting period and up until approval of the draft financial statements by the Board of Directors - which took place on 8 March 2017 -, no significant events took place liable to influence or affect the balance sheet or income statement of the Bank and on a more general note all the aspects that have been illustrated in this document.

On 7 January 2017, the IT migration took place on the Banca Valsabbina systems of the 7 branches acquired from Hypo Alpe Adria Bank and of the mortgage portfolio, which is largely disclosed in this report and in the explanatory notes. Therefore, Banca Valsabbina currently operates with 70 bank branches and 33 employees of the Hypo branches were added to the 500 employees at the end of the year.

## 21. BUSINESS OUTLOOK

In the initial chapters of this report, those dedicated to amounts and macroeconomic trends, we noted that the economic activity in Italy should consolidate this year the moderate growth in GDP achieved in 2016 and then

gradually strengthen in later years, being the intensity of consumption recovery and of investment spending decisive.

Therefore, 2017 could prove to be an important year of transition, pending a more general relaunch of a positive growth.

Also with reference to the Italian banking system, a gradual and specular improvement in its aggregates is expected in 2017, with a return to growth of provision, especially the component related to deposits (+2.3%), and loans, especially in the medium to long term, expected to increase by 1.7%, in support of the financing of investments in the real economy sectors. The forecasts relating to the system of cooperative banks are consistent with the general reference framework, with the estimated provision increasing by 1.5%, deposits by 3.9% and loans by 1.7%.

If these forecasts were to be confirmed, those pressures that generated an incisive erosion of profitability levels and a consequent high structural gap between cost and expected return on capital would gradually ease. Therefore, a scenario such as that outlined should positively affect the Italian bank's income statement, estimated by all to improve.

For our part, we realistically hope that the positive effects expected from a recovery in economic activity and from a gradual normalisation of the trends and processes of the lending activity may be enhanced by the important and widely commented strategic initiatives adopted by the Bank in 2016.

An interesting contribution will be provided by the former Hypo Alpe bank branches and from the purchase of the mortgage portfolio.

Even with all the prudence that the prolonged crisis has suggested us, we are confident in a positive development of the financial year in progress: the expansion in size, the progressive improvement of credit quality, the intensification of incisive and penetrating commercial policies on the old and new areas served will surely have a positive impact on the 2017 operating results.

## **22. PROPOSAL FOR APPROVAL OF THE FINANCIAL STATEMENTS AND OF THE DISTRIBUTION OF NET PROFIT**

Dear Shareholders,

We submit to your examination and to your approval the 2016 Financial Statements, in its equity, economic and financial elements, as well as the Annexes, which are an integral part. The Financial Statements ending with a Net Profit of Euro 4,147,878 were subject to audit by BDO Italia S.p.A.

With regard to the distribution of the profit for the year, the Board of Directors, pointing out the payment of a cash dividend of Euro 0.06 per share, proposes the following to the Shareholders' Meeting:

Net profit for the year	4,147,878
10% to the legal reserve	(414,788)
15% to the extraordinary reserve	(622,181)
Portion to be allocated:	3,110,909
- to shareholders in the amount of Euro 0.06 for each eligible share	(2,131,010)
- to the charity fund	(60,000)
- additional allocation to extraordinary reserve	(919,899)

If this proposal is approved, the amount attributable to reserves and shareholders' equity will total Euro 1,956,868 and Euro 386,928,668, respectively.

The proposal of a dividend per share of Euro 0.06, corresponding to a payout of 51.4%, in line with those of the past year, is made because it is believed that the Bank broadly meets the capitalisation requirements of Basel 3 "fully loaded" (i.e. in their full implementation, expected in 2019) and has an equity that ensures adequate levels also in case of further financial stress.

## 23. ACKNOWLEDGEMENTS

Dear Shareholders,

We would like to end our annual report on the 2016 financial year by expressing a heartfelt thanks to all the Shareholders for the trust they place in us, to Customers for the attention they reserve for us and to all the people who for various reasons come into contact every day with our Bank.

We dedicate a strong emotion of human solidarity to the memory of the Shareholders and Customers who passed away during this last year and we send expressions of condolence to their families and friendly gratitude for being linked to us in time.

We reserve a heartfelt thanks to the General Management for the diligence and intelligent contribution that distinguishes its daily action and to all the collaborators for the enthusiastic commitment in their respective roles to the performance, growth and good reputation of Banca Valsabbina.

We welcome our new colleagues from Hypo Alpe Adria Bank and we are certain they will have the same sense of empathy and belonging that distinguishes and unites all the Personnel of Banca Valsabbina.

We express our sincere appreciation to the Board of Statutory Auditors for its valuable and diligent service rendered when carrying out important and delicate functions that the Articles of Association and the regulations assign to the responsibilities of its members.

Finally, we express our respectful and authentic thanks to the Supervisory Body for its help and guidance during the year, as well as to all the Authorities and Associations with which we have relations that are an indispensable support in daily work activities.

As always, at the end of our report, we express to everyone a heartfelt and affectionate wish for a serene and positive 2017.

Brescia, 8 March 2017

THE BOARD OF DIRECTORS