

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

**FINANCIAL STATEMENTS AS AT 31 DECEMBER 2017**

**TABLE OF CONTENTS**

<b>INTRODUCTION</b>	<b>1</b>
1. INTERNATIONAL ECONOMIC AND FINANCIAL SITUATION .....	3
2. PERFORMANCE OF THE MONETARY AND FINANCIAL MARKETS .....	3
3. ITALIAN ECONOMIC SITUATION .....	4
4. THE ECONOMY IN OUR MARKET .....	5
5. ECONOMIC AND FINANCIAL OUTLOOK .....	8
6. SHAREHOLDING STRUCTURE AND SHARE TRENDS .....	9
7. EQUITY AND CAPITAL RATIOS .....	10
8. CUSTOMER DEPOSITS .....	11
9. LOANS .....	15
10. FINANCIAL ASSETS AND EQUITY INVESTMENTS .....	22
11. BUSINESS STRATEGIES .....	27
12. THE INTERNAL CONTROL SYSTEM .....	29
13. THE RISK MANAGEMENT SYSTEM .....	31
14. COMMERCIAL ACTIVITIES .....	40
15. HUMAN RESOURCES .....	47
16. LEGISLATIVE AND REGULATORY CHANGES .....	50
17. RELATED PARTY TRANSACTIONS .....	53
18. SUPERVISORY BODY PURSUANT TO ITALIAN LEGISLATIVE DECREE NO. 231/2001 .....	53
19. ECONOMIC PERFORMANCE .....	54
20. SIGNIFICANT EVENTS OCCURRING AFTER THE END OF THE FINANCIAL PERIOD .....	61
21. BUSINESS OUTLOOK .....	62
22. PROPOSAL FOR APPROVAL OF THE FINANCIAL STATEMENTS AND ALLOCATION OF PROFIT/(LOSS) FOR THE YEAR .....	63
23. ACKNOWLEDGEMENTS .....	63

## Introduction

Dear Shareholders, as the rule states, we meet punctually at the usual spring meeting to present the financial statements of the year just ended and to comment on the main events, so as to give at the same time continuity and meaning to a company history that after one hundred and twenty years is ever so vital and forward looking.

As we shall see in the following pages, 2017 was full of truly significant initiatives and events, some of which were new, which, in a context of economic recovery, re-launch the solid development prospects outlined in the three-year Strategic Plan from 2017 to 2019 launched by the Bank in the middle of last year.

This was an important moment because the document - drawn up using appropriate analysis and evaluation methods - summarises management profiles, identifies areas for improvement, creates business visions that are consistent with market management and improves the decision-making process within a logical and strategically consistent scenario.

Profitability, efficiency, competitiveness and careful risk management are the central objectives of the Plan and are the key words to favour the construction of a future without seconding fall backs on strategic guidelines with the rational and institutional awareness of being a co-operative bank.

Among those that retain the status of cooperative bank, Valsabbina, our Bank, is in fact at the top in terms of size and wide shareholding base.

The strong but rational plan for territorial expansion, which took shape in 2017 with the integration of the 7 Hypo Bank branches, with the opening at the end of the year of a new branch in Padua and with the consolidation of the operations of the branches opened in 2016 in the Milan area and in the dynamic areas of the north-east were certainly significant in this regard. The sales network, which now comprises 70 branches, is consistent with the ambitious commercial development plan: in fact, all of them have good growth potential and are positioned according to a logic that reconciles effective control of the territory of choice with ambitions to expand into new and important banking centres in the richest districts of the country.

At the same time, the strengthening of the distribution systems was accompanied by a review of the organisational structures and management processes in the production, management and control functions, so as to ensure - through an effective organisational model - the indispensable profiles of efficiency, profitability, transparency of contractual conditions and correctness in relations with customers. The chapter on business risks and the related organisational controls has been the subject matter of daily and systematic supervision, with the clear observation that the growth in volumes and operating relations invariably corresponds to an increase in potential risks typical of the banking company and hence the need for further investments and attention.

The extraordinary commitment dedicated to the search for an improvement in the quality of assets, with particular regard to the stock of impaired loans, was equally significant in the operations of 2017: this is an issue that in recent years has had important and severe repercussions on banks' operating results due to the prolonged and lacerating crisis of the markets.

The income statement of Valsabbina was not with no bearing on this phenomenon, having borne the effects directly on two different levels: the first, internal, for the strict impairment losses on portfolio loans - also made on the instructions of the Bank of Italy during the ordinary inspection held from 23 October 2017 to 17 January of this year; the second, of external origin, as a result of the recognition of the heavy charges deriving from system interventions in Fondo Atlante and in the Voluntary Scheme of the Interbank Guarantee Fund.

Finally, the result for the year in question is certainly unusual at least for our bank and unlike what has been happening in the market and competitors for a number of years. The 2017 financial statements closed with a loss of Euro 5.8 million: an amount not distant in absolute terms from what was incurred by the Bank for the aforementioned extraordinary contributions to stabilise the banking system.

If, on the one hand, we cannot hide our regret at this result - the amount of which appears to be limited if compared to the large size of regulatory capital, amounting to almost 410 million - on the other hand, it is necessary to underline how the company has set up and, in part, has already achieved widespread improvements in the various aspects of its activities: the management of anomalous loans and the trend in coverage rates, the considerable increase in net interest and other banking income, the digital redesign of sales policies, the expansion of operating relations, which are a sign of the confidence enjoyed in the markets, the efficiency of governance, organisational structures and the control system. Finally, in sharing a corporate culture and work discipline strictly based on sound and prudent management: we work and hold a business school.

In the light of these favourable assumptions, which are set out in detail in the following chapters of this report, we have reason to believe that 2018 and the financial years to come will be able to restore to our Bank the conditions of profitability, dynamism and development that the global crisis of the last decade has severely limited.

At the end of this introduction, we point out that, starting from the financial year just ended, the Company's reporting has been enriched by the Non-Financial Statement - which is a separate document from the financial statements - aimed at ensuring an understanding of the Bank's activities, performance, results and impacts with regard to environmental, social, personnel, human rights and the fight against active and passive corruption.

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

The analysis of the trend of the world economy and especially of the Eurozone is of particular importance for our Bank, as we remember from year to year, 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 following is a brief overview of the development of macroeconomic data at international level, without forgetting that 2017 began with the uncertainty of the election of Trump to the US Presidency and ended with a number of fronts opened by the new course of the establishment: from geopolitics to the internal ones, in an overall "reshuffling of the cards" that makes the prospects for 2018 a little more uncertain, to which we dedicate an in-depth analysis in a subsequent paragraph of this report.

In 2017, the international economic cycle continued its favourable trend, at a high pace. The final figures for the year just ended show an overall growth in global economic activity by 3.7%, half a percentage point higher than the previous year (3.2% in 2016).

At the same time, world trade grew at a high pace, supported by investments, which were particularly strong in advanced economies, whereas inflation, which was still moderate, was affected by the reduced production capacity at global level. The trend in oil prices, albeit upward, has not yet been transferred - in 2017 - to labour costs and other guide prices.

A more detailed analysis of the trend in advanced economies shows that US GDP grew at a brisk pace, with an annualised rate of 2.3% (1.5% in 2016), despite the impact of natural disasters.

The growth of the gross domestic product in Japan, by 1.8%, was substantially double compared to the previous year, while in the United Kingdom it recorded a relatively weaker trend, equal to 1.7%, compared to the previous year (1.9% in 2016). The negative impact of the depreciation of the British pound on real household income and consumption was in fact greater than the benefits for the British economy itself, in terms of recovery of competitiveness and, above all, in the presence of a strong and positive impulse linked to the economic expansion of the Eurozone countries.

Looking now at the performance of the other major economies at international level, it can certainly be said that growth in 2017 was strong, in line with the overall trend of the world economy.

In China, GDP grew by 6.8% (6.7% in 2016), slightly more than in India, where the growth rate was 6.7% (7.1% in 2016).

Brazil and Russia showed that they have overcome the previous recession, with a growth rate that has improved significantly; Brazil recorded an increase in GDP by 1.1%, compared to -3.5% in 2016, whereas Russia grew by 1.8% compared to -0.2% in 2016.

In the Eurozone, the expansion of economic activity led to an overall annual growth rate of 2.4% (1.8% in 2016). Inflation also increased to 1.5%, while the unemployment rate fell to 8.8%, the lowest level since January 2009.

Growth, stimulated by the monetary policy measures pursued by the ECB, was characterised by both the development of domestic demand, in terms of increased private consumption and investment, and the development of exports, which benefited from the widespread global recovery.

However, growth rates across countries vary. GDP grew in Spain by 3.1% (3.3% in 2016), in Germany by 2.5% (1.9% in 2016), in France by 1.8% (1.2% in 2016), and in Italy - the tail-end - by 1.5% (0.9% in 2016).

In short, the Eurozone closed 2017 with a growth rate higher than that of the United States, Japan and the United Kingdom itself, struggling with the dramatic exit from the Union: a decidedly flattering result when one thinks of those who - among the large number of Eurosceptics - had predicted the end of the single currency at the end of their respective elections in the various member states.

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

Equity markets in the main advanced countries recorded a growth in 2017, stronger in the United States than in European stock markets, in a decidedly expanding macroeconomic context. The Standard & Poor 500 index, which incorporates the largest companies in the United States, increased by 19.4% (9.5% in 2016) while the DJ Stoxx 50 Europe recorded a lower growth, equal to 6.5% (2.9% in 2016). In both markets, implicit volatility remained very low throughout the year.

Long-term interest rates increased mainly towards the end of 2017, as evidenced by the increase in ten-year bond yields in the US, which rose by about 20 basis points. In the Eurozone, German ten-year bond rates rose by 12 basis points, with sovereign risk premiums falling sharply.

The Euro strengthened against the major international currencies, with expectations of further appreciation, at least in the short term.

This particularly favourable climate could be affected - also as a result of the expected change of the guard at the FED - by less accommodative monetary policies on the part of the US central bank, in a context of progressive overheating of the federal economy. The profit-taking that began to emerge on the stock markets at the beginning of February 2018 could be a first sign of trend reversal on the stock markets.

For economic operators in the Eurozone, the monetary policy implemented by the ECB is an essential point of reference, whose Governing Council, although recalibrating some instruments, also preserves sufficiently expansionary monetary conditions in the future, necessary to achieve the long-awaited and lasting return of inflation to levels below but close to 2%.

The Italian stock market continued to be affected by the performance of bank securities, which account for more than 18% of total capitalisation. The FTSE-MIB index, in which the banks are most represented, rose by 13.6%, while the index composed of a basket of medium-sized companies (FTSE Italia STAR) rose at a much faster rate, by 34.7%. The market confidence was then reflected in Italy in the increase in the number of listed companies, with a record number of 39 new admissions, 32 of which as IPOs.

In 2017, net purchases from abroad of Italian portfolio securities exceeded Euro 25 billion in the presence of foreign investors who showed growing interest in both our public securities (Euro 6.4 billion) and those issued by the private sector. Bank shares and bonds, also in relation to the recent recapitalisation operations of some Italian intermediaries, have certainly benefited from this important flow of international investments.

The purchase of foreign securities by residents was also significant, largely due to investments in mutual fund units by households, insurance companies, pension funds and other financial intermediaries, demonstrating the beneficial effects that asset management products can have in terms of risk diversification, especially for retail investors.

The trend of the Banca Valsabbina share, which was affected by a reduced volume of trading, must refer - albeit with its peculiarities - to this context of reference, also as a result of certain price fluctuation limitations introduced into the regulations of the reference market, Hi-Mtf.

In this regard, we would like to stress once again that it is necessary to distinguish, as more fully described in the chapter "Shareholding structure and share trends", between the actual value of the Bank (represented by its shareholders' equity, the soundness of capital ratios and earnings capacity over time) and its current capitalisation by means of the share price, which is affected by economic factors and by the low trading volume typical of a financial instrument with limited circulation.

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

The Italian economy recorded a good growth rate also in 2017, of 1.5%, which consolidates the recovery path started a few years ago and projects our country towards a further phase of development, albeit at a slower pace, as better illustrated in the following paragraph dedicated to "Economic and financial outlook".

Growth during the year was sustained above all by domestic demand and expanding industrial activity: according to Istat, in 2017 gross fixed investments grew by 3%, fuelled by the continuation of the growth phase of expenditure on plant and machinery and, to a lesser extent, by the recovery of the construction cycle. The turnaround, again according to the bank, occurred in the second quarter of 2017, "when the capital accumulation process returned to a positive tone (+0.9% on a quarterly basis) after the temporary downturn in the first three months of the year". Business confidence indicators were high, partly as a result of favourable conditions for access to credit.

Exports of goods and services have been positively affected by world trade patterns, mainly to European Union (EU) countries outside the Eurozone and in countries outside the EU. The outlook remains positive.

Household consumption, both for purchases of durable goods and for access to services, continued to grow against a higher disposable income, which in turn benefited from improved conditions on the labour market and a climate of confidence that has increased in the perceptions of large sections of the population. The employment rate, although lower than the values in the main economies of the Eurozone, has made significant

progress, mainly in the form of fixed-term contracts: the number of hours worked per person employed, although increasing, is still below pre-crisis levels.

The underlying inflation, slightly recovering, was still at particularly low levels in 2017, below expectations. However, in the last months of the year, the producer prices of industrial goods sold on the domestic market accelerated, mainly reflecting the performance of the energy goods component.

The context in which the recovery path is consolidating, in clearing the mists of the period of crisis that preceded it, is exposing, however, the main challenges that the country is called to meet and resolve.

We note with Governor Visco, at the parliamentary hearing of 19 December 2017, that "today the product is still 6% lower than it was at the beginning of 2008, while in the rest of the Eurozone it is 7% higher.

The past decade has therefore created a gap, especially in terms of productivity, between us and our main European partners, whose crisis period has been shorter and more limited.

The end of the term of office of the legislature, the national elections and the elections in our Lombardy Region suggest a moment of reflection to politics, called to remove the rigidities of the Italian economy and to stimulate competitiveness and change in the country's system.

In this scenario, the financial system is also called upon - and has already made considerable efforts to this end - to renew itself, to take up the main challenges launched by the European Union: on the one hand, the acceleration of the processes of disposal of impaired loans; on the other hand, the creation of a single capital market, with a decisive shift from an essentially "bank-based" system to a more balanced one, where resources between borrowers and fund providers pass more and properly through the financial market.

The more favourable economic context allowed Italian banks to restart improving their profitability and efficiency, continuing to operate traditionally in loan brokerage activities in favour of the real economy, but at the same time developing commissions from investment services and asset management.

However, some of the points of attention that have already been pointed out in recent years remain open. While, on the one hand, there was a strengthening of the expansion of lending to the private sector and a general reduction in the stock of gross non-performing loans, on the other hand, there continued to be a sharp contraction in long-term deposits and difficulties related to the reorganisation/rationalisation of the presence of branches in the territory.

For the co-operative banks, their presence and proximity to local economies are still an essential point of reference, and the results reported by banks in this category in 2017 show that these values still represent the real strength today, provided that their sister banks are able to reinterpret their own offer model according to the specific needs of the business world, as well as the lifestyles of customers who live and work in these areas.

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

The growth in size recorded by our Bank in recent years, both through the opening of new branches and through the acquisition of branches already operating from another bank, has also led to some changes in the geographical area, with a greater presence in provinces near Brescia or, in some cases, in other regions of the country.

A few reflections are set out below on this wider and more heterogeneous geographical area.

##### **An overview of our territories**

At national level, as noted above, the economic situation is encouraging. GDP accelerated sharply in 2017, employment started to rise again, the unemployment rate fell to its lowest level since August 2012, hours worked per person employed showed a moderate upward trend, inflation remained low and still below the target set by the ECB.

In this favourable context, 2017 has given the new year an increase in the disposable income of households and a reduction in the unused capacity of businesses, with an increase in consumption and a marked acceleration in investment. Moreover, the conformation of the country's production system has changed significantly, with a sharp increase in innovative start-ups registered in the register of companies (currently more than 8,000 units, a number more than four times that of 2014).

The beneficial effects of the favourable economic situation had an impact on credit demand and therefore on banks.

With reference to the North/North East area, there was an increase in loan applications for businesses, supported by companies in the manufacturing and tertiary sectors: these requests originated mainly from the

need to finance productive investments and to support working capital. On the contrary, requests for the restructuring of debt positions have been greatly reduced. On the other hand, intermediaries continue to adopt a cautious approach towards construction companies, also in relation to greater risks in the sector.

There is also a further expansion in home loan applications by households, albeit to a lesser extent. According to the forecasts of the Bank of Italy, the terms of the offer for 2018 are expected to remain broadly unchanged. With regard to bank deposits, the growth in demand for deposits by households in the North/North East was further perceived, albeit at a slower pace than in the past, and especially those for smaller brokers. On the other hand, request for government securities and bank bonds continued to fall, while the request for assets under management products, mainly relating to mutual investment funds (UCITS), strengthened all-in-all.

### **A look at Lombardy**

Albeit thanks to our sales network we are also active in three other regions - Veneto, Trentino Alto Adige and Emilia Romagna - the mainstay of the Bank is still the Lombardy economy, whose dynamics summarise the underlying trends of other territories where the Bank is present.

We would like to point out again this year that Lombardy is one of the four driving forces of the European economy, together with Baden-Wurttemberg (Germany), Rhone-Alpes (France) and Cataluña (Spain).

The opening of our Milan branch is a very significant sign of our Bank's strong determination to increase its commercial relations with companies based in the regional capital, the engine of the Lombardy economy and an advanced point of contact with the dynamics of the continental economy.

For this brief examination of the development of the Lombardy economy in 2017, we rely, as usual, on the precious information of Unioncamere Lombardia. The overall picture will be drawn up - at the end of the paragraph - with the help of the analyses of the Bank of Italy on the economic performance of the Region.

According to the survey data of Unioncamere Lombardia concerning the fourth quarter of 2017 on a sample of 2,700 manufacturing companies, divided into industrial enterprises (more than 1,500) and crafts businesses (almost 1,200), the annual average growth in industrial production was 3.7%, significantly higher than the annual average in 2016 (1.3%).

The average annual growth is also strongly developing for crafts business, equal to 2.6%, more than double that of 2016 (+1.2%).

The good overall trend in turnover is the result of a marked increase in orders from the domestic market, which further accelerate growth compared to the same quarter of previous year, and the development of foreign demand, especially for craft businesses, which shows a more lively acceleration in relation to change compared to the same quarter of the previous year. Nevertheless, the gap compared to pre-crisis data remains significant, although it is progressively narrowing: the industrial production index, which rose to 109.7 (base year 2010=100), reduced the gap from its pre-crisis peak to 3.5 percentage points (113.2 in 2007).

From a sectoral point of view, 2017 closed with expansive profiles in all the main industrial sectors, from iron and steel industry (+5.9%) to leather-footwear (+5.8%), from engineering (+4.7%) to rubber-plastic (+4.4%), from chemicals (+4.2%) to non-ferrous minerals (+4.2%). The development of the wood-furniture sector was more limited, but decidedly positive (+3.4%), followed by sundry industries (+2.3%) and food industries (+2.3%).

There was a smaller increase in paper-publishing sector (+1.6%), clothing sector (+1.3%) and means of transport (+0.9%), while the textile sector (-0.8%) continued to show a negative trend.

With regard to the production of craft companies, the index for 2017, at 97.3 (base year 2010=100), is still below 100. However, 2017 was also a positive year for the crafts sector as a whole. Iron and steel industry (+5.0%) and engineering (+4.9%) grew significantly, followed by non-ferrous minerals (+3.5%). Sundry manufacturing companies and rubber-plastic products (+2.1%), textiles (+1.2%) and clothing (+0.4%) are slightly below average. Other three sectors (wood-furniture, food and paper-publishing) showed stable results (-0.1%); only the leather-footwear sector showed a significant decline (-4.4%).

With regard to the investment trend, the companies that declare that they have made investments during the year are growing both for industry (64%) and for crafts (34%) and the number of those that are planning to implement them is also increasing. The decisions taken by industrial companies, which increased investment in machinery and information technology at the expense of property, were driven by the incentives envisaged by the Industry 4.0 National Plan. In the crafts sector, investments in value are increasing, especially for buildings, while the percentage of companies that have decided to invest in machinery and information technology is increasing.

The balance of employment in industry is zero.

In providing an overall picture of the Lombardy economy in 2017, information from Bank of Italy surveys is helpful. These data confirm the cyclical recovery scenario already outlined, revealing - for a large number of companies - a significant increase in turnover and expectations that suggest a further increase in production and orders in the coming months.

In the plans for 2018, investment spending is expected to continue to expand, driven primarily by expected drives in demand and, for a smaller number of businesses, by tax incentives.

The improvement in the economy had a positive effect on credit quality: the flow of new positions with repayment difficulties decreased, although insolvencies remained high.

With the expansion of economic activity, there was an increase in employment and a decrease in the unemployment rate to 6.6% (11.5% in Italy). The contribution of the service sector was the driving force behind this significant result.

### **A look at the Veneto region**

The decision of our Bank to intensify its presence in the Veneto region is not only the result of the favourable coincidence related to the relocation of the branches acquired in 2016, but also of a clear desire to increase the development opportunities of relations and business in that territory. In this sense, we are starting this year, as part of this report to the financial statements, to share with our Shareholders some reflections on the performance of the regional economy.

For this brief overview of the development of the Veneto economy in 2017, we rely on the valuable information of Unioncamere Veneto. At the end of this section, the overall picture will be drawn up with the help of analyses by the Bank of Italy on the performance of the regional economy.

We anticipate immediately that the industrial production of Veneto in 2017 recorded a 3.3% increase on an annual basis, up compared to the previous year, as shown by the survey carried out on a sample of 1,459 companies with at least 5 employees.

Breaking the figure down by company size profile, growth was most significant in the sector of small enterprises (+3.7%), followed by medium-sized enterprises (+3.2%) and finally by micro enterprises (+1.9%). At the level of business sectors, changes in the metal and metal products (+4.8%), rubber and plastic (+4.7%), machinery and mechanical equipment (+3.9%), food and beverages (+3.6%) sectors were definitely positive. On the other hand, the performance of the marble, glass and ceramics sector showed negative trends (-1.6%).

The positive trend in turnover was mainly due to the vivacity of the internal market, which increased by 4.2%. Sales abroad also increased by 2.2%, although less than in the previous period.

Entrepreneurs' confidence is mainly reflected in orders from abroad, while expectations of domestic orders appear weaker.

In providing an overall picture, information from Bank of Italy surveys is helpful. These data confirm the growth of the Veneto economy, supported both by the good performance of domestic demand and by the development of international trade. These trends have a positive effect on the process of accumulating business capital, on employment - seeing that the number of employees returned to pre-crisis levels - and on the economic situation of households, which is also related to a consolidation of recovery in consumption. The performance of industrial and service enterprises is also encouraging, as they expect to close 2017 in profit, up from 71% to 78% in the 2016 survey.

The trend of bank loans to the regional economy started to grow again, albeit moderately, after five years of uninterrupted decline, sustained by demand for investments. The dynamics differed according to the sectors of economic activity: loans to the services sector increased while that to the manufacturing sector and, more intensely, to the construction sector decreased.

Loans to households, which account for more than two thirds of total loans granted to this segment, increased significantly by 2.4%.

Since 2017, the trend in loans to regional economic operators has been aligned with the national average, reducing the negative spread, attributable above all to the well-known crisis situation of the two Veneto banks that went into compulsory administrative liquidation. With regard to the qualitative profiles of the aggregate, with the improvement in income results recorded in all production sectors, the quality of credit granted to businesses also improved considerably.

### **A few thoughts**



Over the last few years, the perimeter of our territory of reference expanded, along the axis from Padua to Milan, from the Brianza to the Modenese regions, with a growing ramification especially eastwards. However, our way of being a bank has not changed in each of our areas of establishment, whether old or new.

The decision, adequately considered, to focus again on a selective increase in the physical presence of branches in direct contact with reference customers, whether households or businesses, is fully consistent with the mission of Banca Valsabbina, on the solidity of which the 2017/2019 Strategic Plan was built in the spirit of the principle of "consolidation of a cooperative bank in the form and tradition, but innovative in the way of serving the customer and the territory of reference".

In other words, our history and our experiences confirm our conviction that mutual knowledge is developed and consolidated especially with the bank-customer proximity and that it can be enriched - in the current times - by the opportunities offered by a business that is also based on the support of the digital paradigm. The chapter below dedicated to the commercial policy of Banca Valsabbina dilates - demonstrating its adequacy - on the peculiarities and the opening of relations with customers in specific markets.

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

The challenge that all the world's major economies are facing - according to the most recent analyses contained in the International Monetary Fund's World Economic Outlook - is to extend the expansionary trend already underway beyond the economic trends, triggering structural reforms capable of sustaining growth in the medium term.

In such a scenario, the support of a stronger and more dynamic financial system, able to withstand potential crisis factors and innovate in its way of providing support to the real economy, is crucial.

All-in-all, global growth is expected to remain broadly stable at least over the 2018 and 2019 time horizon; in particular, forecasts indicate an international economic cycle capable of continuing the favourable trend shown in recent years, reaching 3.9% annually in the two-year period, before gradually returning to 3.7% in 2020.

The reforms and tax incentives introduced by the Trump administration in its first year of operation are expected to further raise the US growth rate, at least in the short term (2.7% in 2018 and 2.5% in 2019), with beneficial effects on US trading partners, primarily Canada and Mexico.

In Japan, economic expansion is expected to remain robust, supported by internal and external factors. The country's growth has been revised upwards by the latest IMF estimates (1.2% in 2018 and 0.9% in 2019), although less than the year just ended, in the presence of a strong expansion in foreign demand and a continuation of the beneficial effects, higher than expected, deriving from the public finance measures adopted in recent years. In the United Kingdom, the trend is expected to be relatively weaker, with a 1.5% growth in both 2018 and 2019, pending the completion of the Brexit process.

The expansion of other international non-Eurozone economies, also driven by the growth of the world economy as a whole - from China (6.6% in 2018 and 6.4% in 2019) to India (7.4% in 2018 and 7.8% in 2019), from Brazil (1.9% in 2018 and 2.1% in 2019) to Russia (1.7% in 2018 and 1.5% in 2019), is also expected to continue in the two-year period under review.

According to expert forecasts in the Eurozone, the growth trend in economic activity should also be favourable in 2018 (2.2%) and 2019 (2.0%), with projections in line with the year just ended, although the incentives deriving from the ECB's expansionary monetary policy will be progressively reduced.

In this scenario, we will also see a gradual recovery in inflation and employment.

With regard to the estimates per country, Spain's GDP is expected to fall in 2018 (2.4%) and 2019 (2.1%), compared to 2017, and a similar slight decrease will be seen in Germany for 2018 (2.3%) and 2019 (2.0%); whereas in France, it is expected to grow substantially in line with 2017 (1.9% in 2018 and 2019), while in Italy, compared to 2017, a smaller increase is expected both in 2018 (1.4%) and 2019 (1.1%).

Lastly, if we consider the main risk factors at international level, the greatest uncertainties are attributable to the more strictly political level, due to the strong presence of protectionist forces in the United States, as well as possible uncertainties in the emerging economies related to the normalisation of monetary policy announced by the FED. Turbulence may also be related to the process of reform and liberalisation in China, as well as to the risks of geopolitical instability in the various international areas, including those concerning future relations between the United Kingdom and the European Union.

In the Eurozone, the imminent political agreement between the two main German parties seems to make it possible to put an end to the tensions that emerged in the post-election phase in Germany, while potential stress factors could arise in the Italian political framework in the presence of the round of voting at the beginning of March, taking into account the prolonged phase of stagnation that the new electoral law could determine, with negative implications in terms of governability, in the absence of winners capable of reaching the binding relevance thresholds.

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

The shares of Banca Valsabbina, officially codified as "BANCA VALSABBINA - ISIN IT0000220449", have been traded since 18 July 2016 on the HI-MTF market managed by HI-MTF Sim Spa, the Order Driven equity segment, an external platform set up in compliance with the MiFid Directive and recognised by Consob. The transition – in view of the entry into force of the new regulations in 2018 - to the trading of the security on the HI-Mtf market represents an important step forward to encourage trade, with the intent to improve the liquidity of the security.

This market is a multilateral trading facility (known as Mtf) alternative and complementary to regulated markets, access to which is reserved to investment firms, banks and operators of regulated markets, authorised and subject to Consob supervision. The share listed therein may be purchased/sold on the market also through other banks or intermediaries as envisaged by them.

The choice of the price, made by the Bank with a view to providing additional liquidity and transparency to the share in the interest of its shareholder base, is consistent with CONSOB recommendations and with the provisions of the so-called MIFID II directive, implemented by the MIFIR Regulation in force as from 1 January 2018.

During 2017, 842,219 shares were traded for an equivalent value of Euro 4.924 million at an average price of Euro 5.846, in a range between a maximum of Euro 7 at the beginning of 2017 and Euro 5.15 at the last auctions of the year.

In line with what we wrote in last year's report and with what has been said above, the distinction between the intrinsic value of the share (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 current share price, affected by economic factors, must be confirmed. In other words, regardless of the level of the share price contingently recorded, the Bank's assets and its potential for management and value creation over time are not affected.

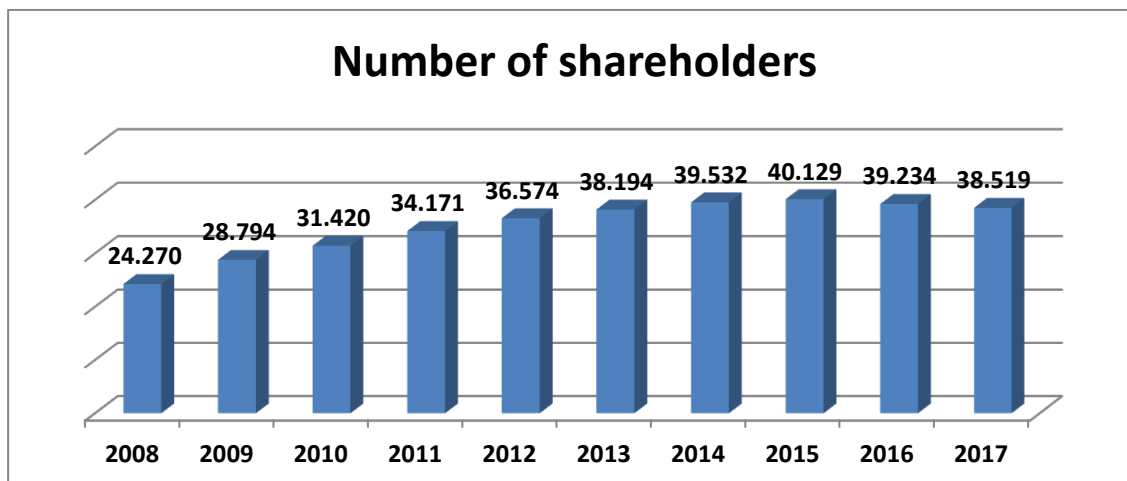
During the year, the Bank intervened in the negotiations with the relevant Fund, in support of the liquidity of the security, by virtue of the authorisation of the Bank of Italy, pursuant to the CRR and shareholders' meeting regulations that envisage interventions to the price recorded in the last auction. As a result, 430,100 shares were purchased for an equivalent value of Euro 2.535 million.

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 Bank, as well as for purchases envisaged by the Articles of Association in cases of Shareholder exclusion. All-in-all, the Fund was used to purchase 507,780 thousand shares for an equivalent value of Euro 3.003 million.

As at 31 December, portfolio shares amounted to 961,555 for an equivalent value of 8.185 million; they were 453,775 for an equivalent value of 5.182 million as at 31 December 2016.

Despite the complex economic situation of the banks, reflected in the price values, and the critical position of some shareholders in the internal dialogue, the shareholding structure has not registered significant changes in its number compared to the previous year.

At the end of 2017, the number of partners was 38,519 (39,234 at the end of 2016), in addition to 1,730 shareholders (1,043 at the end of 2016), including holders of less than 100 shares. The number of holders of shares of the Bank - partners and shareholders - was therefore 40,249 (40,277 at the end of the previous year).



## 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 complied with - in most cases - in an increasing proportion until 2019, the date by which they will be fully applied. At the same time, capital instruments that no longer comply with the regulations will be gradually excluded from the financial aggregate, useful for supervisory purposes, by 2021.

The minimum regulatory requirements for 2017 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 Bank of Italy regulations, is 1.25% for 2017 compared to 2.5 % envisaged for 2016.

At the end of the prudent review procedure for the year 2016, in a letter dated 22 August 2017 the Bank of Italy issued the following capital requirements for our Bank:

- CET 1 Ratio equal to 6.30%, of which 4.5% for the minimum regulatory requirement, 0.55% for the additional SREP requirement and 1.25% by way of capital conservation reserve;
- Tier 1 Ratio equal to 8%, of which 6% for the minimum regulatory requirement, 0.75% for the additional SREP requirement and 1.25% by way of capital conservation reserve;

- Total Capital Ratio equal to 10.25%, of which 8% for the minimum regulatory requirement, 1% for the additional SREP requirement and 1.25% by way of capital conservation reserve.

The regulatory own funds amount as at 31 December 2017 to Euro 408.945 million (416.879 million at the end of 2016), made up of Euro 373.785 million of Common Equity Tier 1 (CET 1) and Euro 35.160 of Tier 2 Capital, mainly consisting of two accountable subordinated loans.

With risk weighted assets amounting to Euro 2.464 billion, the Tier 1 capital ratio, determined by the ratio between the Tier 1 capital and the risk weighted assets, comes to 15.17% as against 15.11% in December 2016, while the Total capital ratio, which expresses the ratio between total own funds and risk weighted assets stands at 16.6% compared with 16.83%.

Therefore, both ratios are significantly higher than the minimum requirements for 2017, as mentioned by 8% and 10.25%, respectively.

The increase in loans to customers compared to 31 December 2016, amounting to Euro 277.5 million, did not involve any increase in solvency ratios because it was contextualised in regulatory portfolios with lower capital absorption, such as exposures secured by real estate or by the Government through the instrument of Italian Law 662/96 and such as securitisations of loans to the Public Administration. The reduction of impaired loans also made a positive contribution to the ratio.

In the calculation of own funds, still in transitional regime until the introduction of IFRS 9, both capital gains and losses relating to government securities of EU countries included in the portfolio of available-for-sale financial assets ("AFS") have been neutralised.

The main capitalisation ratios present the following trend:

	31/12/2017	31/12/2016	31-12-2015	31/12/2014
shareholders' equity / customer deposits	12.08%	12.34%	12.55%	12.13%
shareholders' equity/loans and receivables with customers	12.56%	14.09%	14.11%	13.34%
shareholders' equity/total assets	8.88%	8.83%	9.30%	8.98%
net impaired loans/own funds	78.09%	90.84%	94.83%	103.80%
net non-performing loans/own funds	44.42%	46.92%	46.24%	43.89%
total capital ratio	16.60%	16.83%	16.33%	14.75%
Tier 1 capital ratio	15.17%	15.11%	14.94%	14.72%

The considerable amount of equity and the large surplus of the capital ratios with respect to the minimum regulatory requirements makes it possible to plan the decisive development action envisaged in the three-year strategic plan, in the total absence of capital requirements that could entail 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, which when fully operational (i.e. from 1 January 2018) must be greater than 100%. 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 153%, equal to the ratio between the liquidity buffer of Euro 356.2 million and the expected net outflow (30 days) of Euro 232.2 million (net liquidity outflow); by that date, the indicator must be at least 80%.

## 8. CUSTOMER DEPOSITS

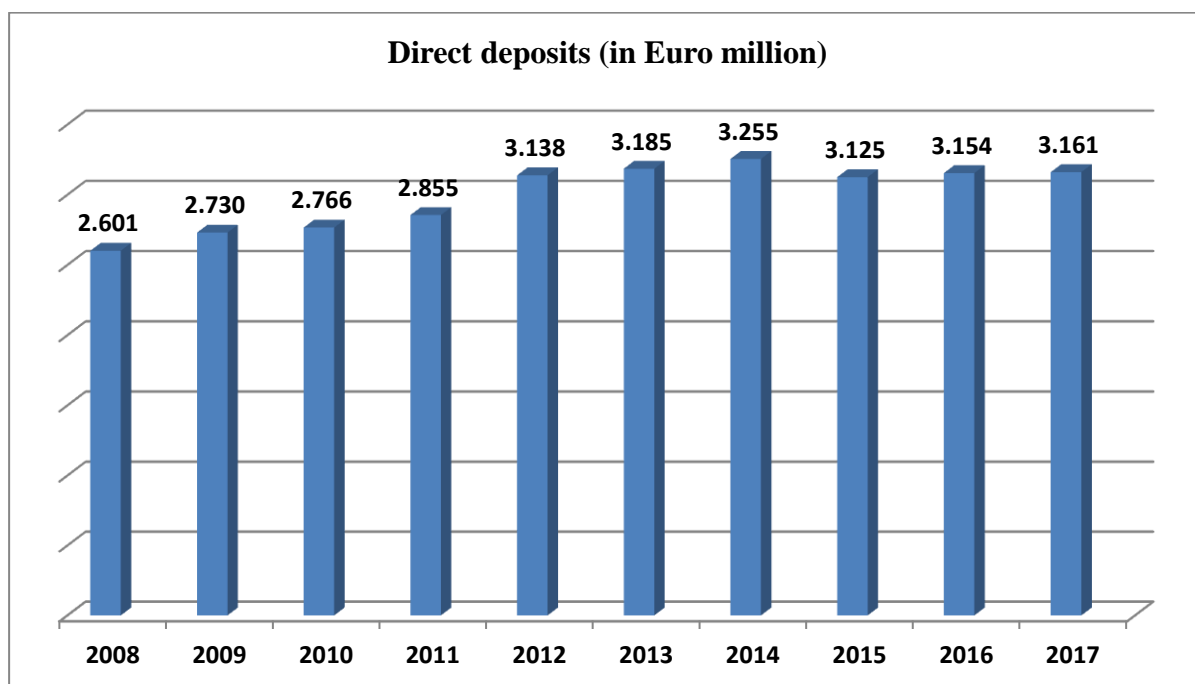
At the end of 2017, direct deposits from customers amounted to Euro 3.161 million, up by 0.22%. Net of deposits from institutional investors, which fell from Euro 310 million to Euro 120 million, actual growth was almost 7%.

The result, which was particularly positive, made it possible to recover certain outflows that had occurred in previous years, years in which the phenomenon had been tackled through greater recourse to institutional entities.

Moreover, the disorientation of savers caused by the approval at the end of 2015 of the bail-in regulations and the simultaneous use of resolution funds to rescue some banks administered through an external commissioner, as well as the extraordinary intervention with regard to two important banks in the Veneto region, slowly disappeared. In addition to the signals coming from many parts of a comforting recovery in the Italian economy, there was also the increase in the volume of bank deposits because, with the growth in income, the availability of funds on the accounts also increased.

The bonds issued, which were not covered by the deposit guarantee fund, were lower than those maturing. However, in order to stabilise compulsory deposits, time deposits with different maturities were offered to savers; time deposits existing at year end, with a duration of more than 18 months, amounted to Euro 64,219 million.

The development of the aggregate over the last few years is represented by the following chart:



The comparison of individual components of the item with respect to 2017 is shown in the following table.

<b>Customer deposits</b>	<b>31/12/2017</b>	<b>31/12/2016</b>	<b>Change</b>	
<b>(in Euro 000)</b>			<b>Absolute</b>	<b>%</b>
Savings deposits	34,274	35,813	(1,539)	(4.30%)
Current accounts	2,132,303	1,872,031	260,272	13.90%
Time deposits	322,934	188,431	134,503	71.38%
Other deposits	450	539	(89)	(16.51%)
Deposits from institutional investors	119,994	309,979	(189,985)	NS
<b>Due to customers</b>	<b>2,609,955</b>	<b>2,406,793</b>	<b>203,162</b>	<b>8.44%</b>
Bonds	446,070	636,208	(190,138)	(29.89%)
Subordinated bonds	65,782	69,587	(3,805)	(5.47%)

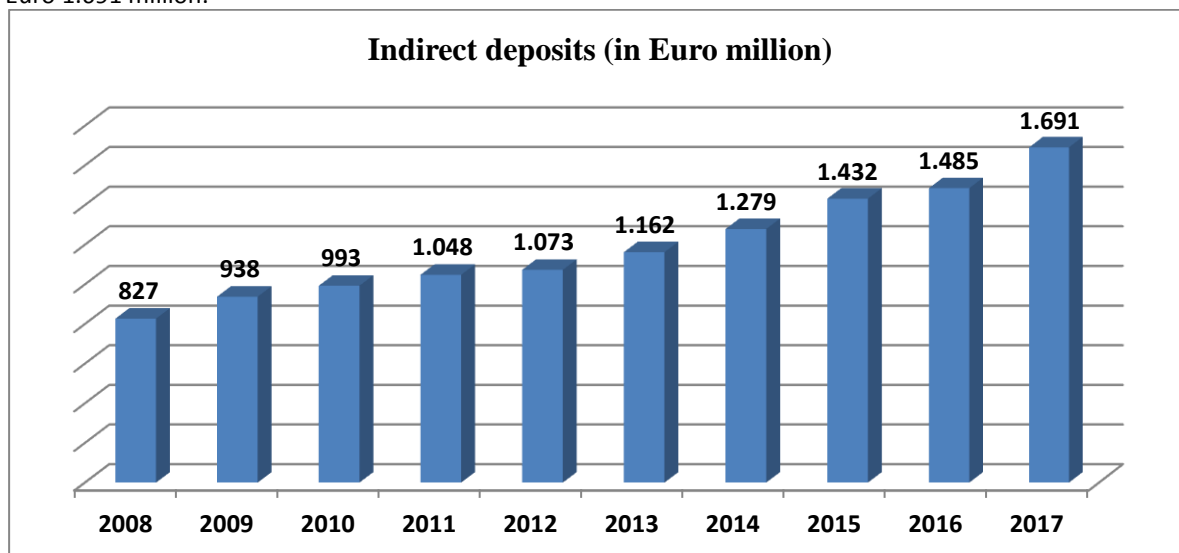
Certificates of deposit	38,951	41,154	(2,203)	(5.35%)
<b>Securities issued</b>	<b>550,803</b>	<b>746,949</b>	<b>(196,146)</b>	<b>(26.26%)</b>
<b>Total direct funding</b>	<b>3,160,758</b>	<b>3,153,742</b>	<b>7,016</b>	<b>0.22%</b>

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.

On the other hand, the amount of "securities issued" decreased, for the said reasons, from 747 million at the end of 2016 to 551 at the end of 2017. The issued subordinated bonds amounted to Euro 65.7 million; those with the characteristics of accountability in own funds amounted to a nominal value of Euro 49.828 million.

On the other hand, particular emphasis was placed on indirect deposits, in particular managed deposits, for which a dedicated organisational unit was created, with the aim of converting both dossiers under simple administration and maturing and not renewed bonds.

The results are very important, also in terms of commissions: indirect deposits rose from Euro 1.485 million to Euro 1.691 million.

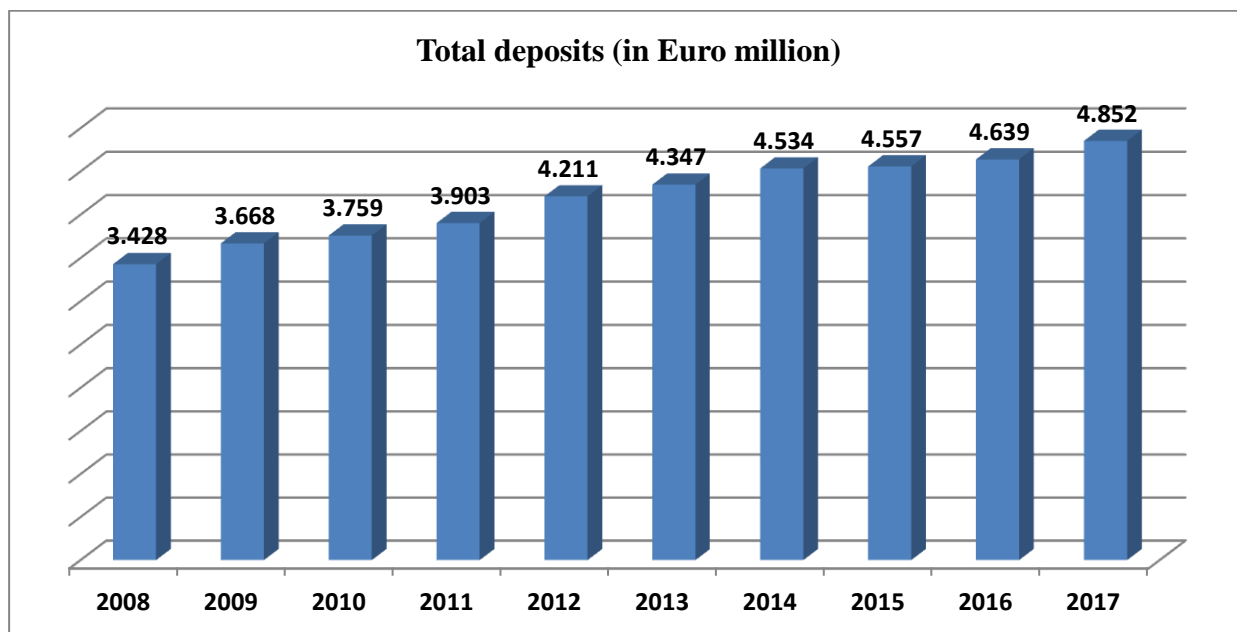


The increase in mutual funds and management (to Euro 579 million, +23.6%) was considerable like the one recorded in life insurance policies, which at the end of the financial year reached the consistency of Euro 403 million (+19.5%).

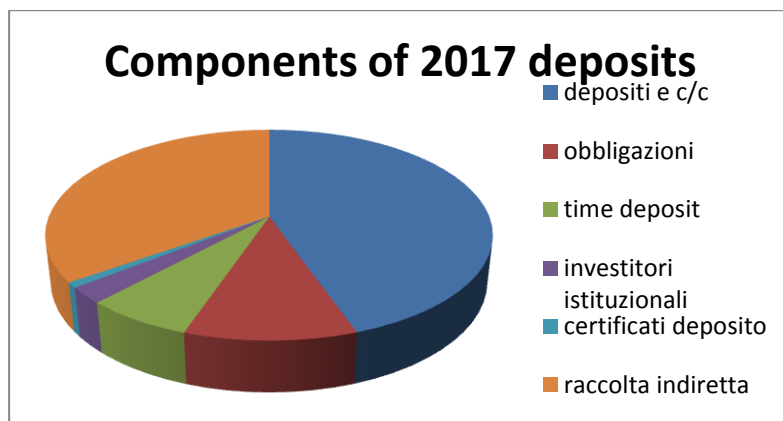
The managed component as a percentage of total indirect funding therefore reported significant progress, increasing year on year from 54.3% to 58.1%, by shifting the Bank considerably closer to the system indicators entirely to the benefit of the expansion in net revenues from services, the priority objective of business strategies.

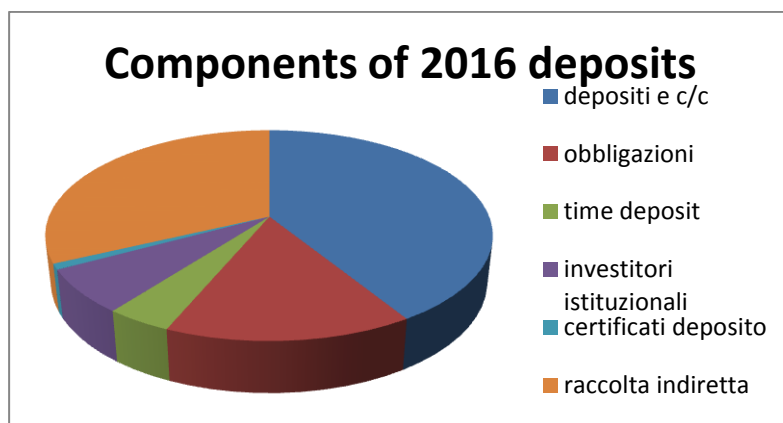
Indirect deposits from customers (in Euro 000)	31/12/2017	31/12/2016	Change	
			Absolute	%
Bot (T-bills) Government securities	292,299	307,607	(15,308)	(4.98%)
Italian and foreign shares	270,080	223,726	46,354	20.72%
Corporate and foreign bonds	146,389	147,934	(1,545)	(1.04%)
Mutual funds	579,447	468,680	110,767	23.63%
Insurance policies	402,900	337,179	65,721	19.49%
<b>Total indirect funding</b>	<b>1,691,115</b>	<b>1,485,126</b>	<b>205,989</b>	<b>13.87%</b>

As a result of the significant growth in indirect funding, the balance of total deposits came to Euro 4.852 million, with an increase of 4.6% when compared with 31 December 2016 (Euro 4.639 million).



The breakdown of total deposits as at 31 December 2017 is structured as follows. The graphic comparison with 2016 shows visually what has been reported previously.





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

## 9. LOANS

After several years of decline, the improvement in the situation of the economy led to a greater demand for credit, to which the bank responded promptly, making available to operators and households, in addition to the usual attention and sensitivity in listening, a variety of forms of financing.

At year-end, loans and receivables with customers amounted to Euro 3.040 million, an increase of Euro 278 million or 10% on the previous year.

In this new macroeconomic scenario, lending policies were in line with the new commercial strategies, which opened up an expansion of operations on markets. While priority was given to the requests of households and operators in the area of choice, there were many initiatives to expand the Bank's presence in the new areas in which it operates, using prudent competitive approaches based on risk spreading. In the same effort to strengthen the structure and quality of the offer, the most qualified instruments have also been conceived, such as loans under Italian Law 662/1996 or with the guarantee of the European Investment Fund (EIF).

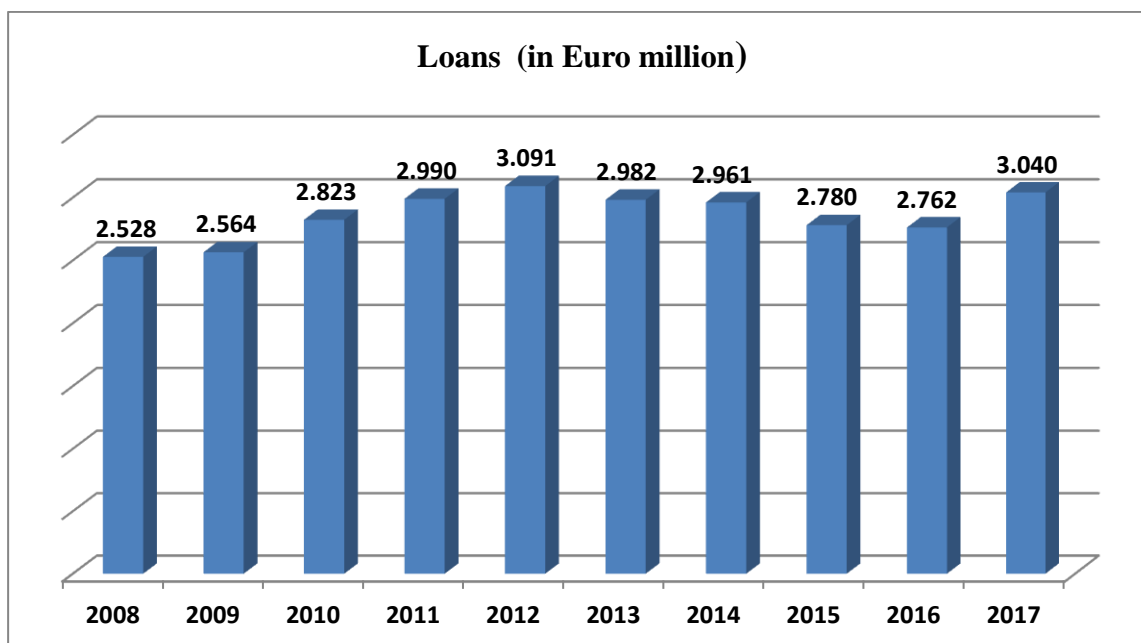
Continuous and careful attention has been paid to credit quality. The results obtained are positive and the expectations on the returns of the initiatives launched and underway allow us to face the future with moderate optimism.

The crisis that began in 2008 had deep repercussions on the economic and social system. Companies that had been for decades a point of reference on the territory disappeared: construction and building companies, companies in the textile and steel sector, commercial businesses, with serious consequences also for employment.

The recovery is also taking place under new names; legislative measures are in favour of what is commonly defined as the Industry 4.0 plan, that is, an integrated combination of mechanics, industrial automation, robotics and software.

As in previous years, the commentary on the subject of credit includes a brief overview of the various technical forms, a summary of medium and long-term disbursements, as well as the breakdown of loans by sectors of economic activity and by category of credit facility and, lastly, an in-depth analysis of credit quality.



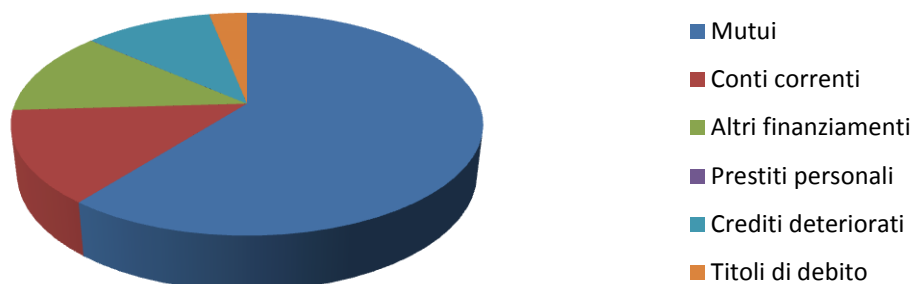


The change in the breakdown of loans by technical form in 2017 compared to 2016 is presented as follows:

Loans to customers (in Euro 000)	31/12/2017	31/12/2016	Change	
			Absolute	%
Current accounts	408,887	409,795	(908)	(0.22%)
Mortgages	1,843,064	1,570,100	272,964	17.39%
Personal loans	830	874	(44)	(5.03%)
Other loans	373,964	388,574	(14,610)	(3.76%)
Impaired loans	319,355	378,683	(59,328)	(15.67%)
Debt securities	93,885	14,424	79,461	NS
<b>Total loans to customers</b>	<b>3,039,985</b>	<b>2,762,450</b>	<b>277,535</b>	<b>10.05%</b>

The most significant increase concerns the item mortgages. In addition to traditional mortgage loans for the purchase of properties, this item includes all instalments, including loans backed by government guarantees. Debt securities include the security Valsabbina Investimenti of Euro 86.768 million in nominal value. This is a bond fully subscribed by the Bank, issued by a securitisation vehicle against the purchase of loans and receivables originally claimed by third parties from the Public Administration. 67.72% of loans and receivables acquired by the vehicle consist of local governments, 15.04% of central governments, 9.25% of local health centres and the remaining 7.99% of other public administration bodies. 68.36% is made up of loans and receivables originating from relations with energy service providers.

## Breakdown of 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 also in 2017. 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 1,040 for an equivalent value of Euro 220 million.

Approximately 1,100 transactions were completed for the purchase of the house for a total amount of more than Euro 125 million.

Ordinary land, building and mortgage loans totalled 1,428 amounting to Euro 254 million, compared to 1,284 for Euro 226 million in 2016.

Finance leasing operations intermediated by means of the partner company SG Leasing recorded very positive results: 313 contracts were finalised for Euro 38 million, compared to 287 for Euro 35 million in 2016.

MEDIUM/LONG-TERM DISBURSEMENTS (in Euro 000)	2017		2016		% change	
	Trans. No.	Amount	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	1,040	220,696	613	126,587	69.66%	74.34%
Artisan loans backed by surety of the Credit Guarantee Consortiums making reference to the various Trade Associations	113	5,279	150	6,606	(24.67%)	(20.09%)
Ordinary mortgage, building and land loans	1,428	254,387	1,284	226,020	11.21%	12.55%
Loans and mortgages to Shareholders of the Bank	1,120	33,445	845	18,694	32.54%	78.91%
Mortgage-secured current accounts	7	1,797	6	1,505	16.67%	19.40%

<b>B) Indirectly as intermediary of specialised Institutes</b>						
Lease transactions	313	38,406	287	35,058	9.06%	9.55%

The breakdown of customers granted credit by category of credit facility confirms what was mentioned 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 for our model of cooperative bank. Subjects granted credit increased by 8.1%: from 25,697 at the end of 2016 to 27,790 at the end of 2017.

The credit facilities of more than Euro 1 million decreased in percentage terms from 41.8% to 40.6% of total credit facilities. On the other hand, credit facilities of less than Euro 500 thousand increased from 45.1% to 46.2%.

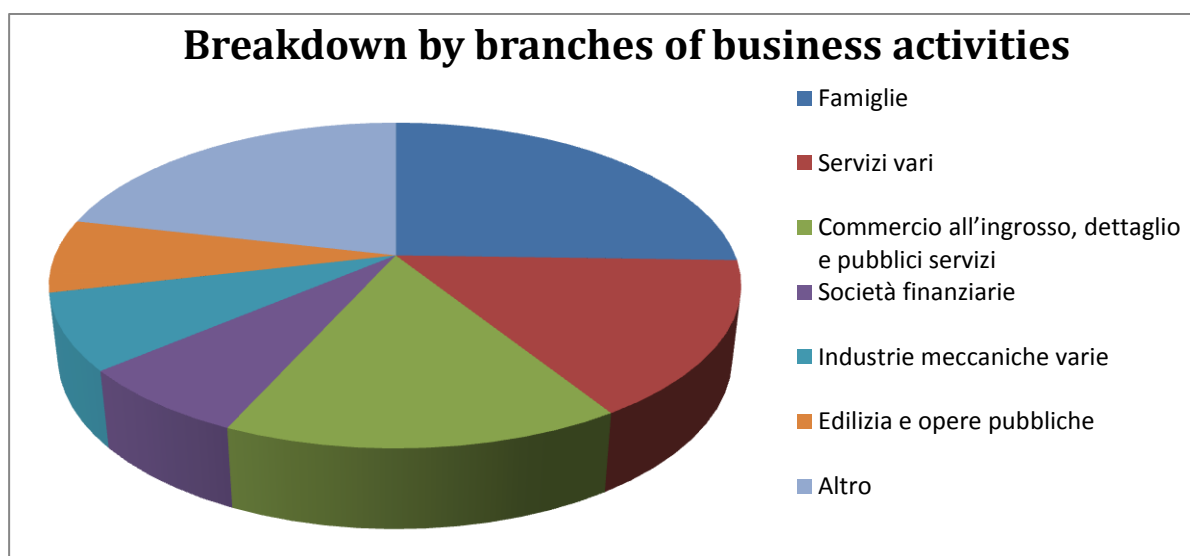
<b>Number of customers granted credit facilities broken down by credit facility category</b>						
	<b>2017</b>	<b>% of total credit facilities</b>	<b>2016</b>	<b>% of total credit facilities</b>	<b>2015</b>	<b>% of total credit facilities</b>
Up to Euro 40,000	14,944	4.6	14,434	4.7	14,312	4.5
From Euro 40,001 to Euro 125,000	7,228	15.0	6,222	14.3	6,107	13.7
From Euro 125,001 to Euro 250,000	2,987	13.9	2,699	13.8	2,707	13.4
From Euro 250,001 to Euro 500,000	1,350	12.7	1,176	12.3	1,184	12.0
From Euro 500,001 to Euro 1,000,000	702	13.2	633	13.1	647	13.1
From Euro 1,000,001 to Euro 5,000,000	527	26.9	486	27.7	492	27.4
Over Euro 5,000,001	52	13.7	47	14.1	57	15.9
<b>Total</b>	<b>27,790</b>	<b>100.0</b>	<b>25,697</b>	<b>100.0</b>	<b>25,506</b>	<b>100.0</b>

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.

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 25.48% of the aggregate.

<b>Sectors of business activities</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
Households	25.48	23.81	23.05	22.45	23.30
Other services	15.56	16.76	17.10	16.76	18.07
Wholesale trade	10.56	9.70	9.18	9.37	9.11
Other mechanical engineering businesses	7.55	8.00	8.58	8.63	10.25
Construction and public works	7.27	7.34	7.86	8.05	8.72
Financial companies	7.06	8.04	6.24	6.58	2.56
Retail trade and public services	5.13	4.60	4.73	4.78	4.99
Agricultural and industrial machinery	2.18	2.10	2.34	2.49	2.17

Foodstuffs and beverages	2.15	2.21	2.22	2.26	2.42
Agriculture, forestry and fishing	2.04	2.23	2.48	2.53	2.57
Iron and steel industries	1.84	1.85	2.13	2.36	1.44
Wood, furniture and other industrial products	1.76	1.86	1.84	1.80	1.83
Textile products and clothing	1.70	1.69	1.68	1.75	1.88
Construction materials	1.69	1.72	1.65	1.49	1.73
Transport services	1.51	1.36	1.38	1.34	1.51
Electricity, energy and chemical products	1.17	1.24	1.66	1.59	1.40
Electrical supplies and materials	1.17	1.20	1.19	1.16	1.13
Rubber and plastic products	1.00	0.99	1.01	1.13	1.39
Vehicle repairs and sundry articles	0.74	0.68	0.75	0.70	0.72
Public administration authorities	0.60	0.65	0.69	0.70	0.75
Paper and publishing	0.57	0.60	0.78	0.68	0.55
Glass and ceramic industries	0.51	0.48	0.61	0.62	0.60
Means of transport	0.40	0.43	0.40	0.36	0.44
Fine and precision engineering	0.25	0.17	0.16	0.16	0.15
Non-ferrous metal industries	0.11	0.29	0.29	0.26	0.32
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 further refined to avoid incurring the risk of a quality decline in the portfolio, also by using risk mitigation instruments through a more careful selection of collaterals or with government guarantees. In parallel, 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 - with inevitable repercussions on the risk profiles of the bank assets.

As a result, the management and valuation of impaired loans has been intensified to meet the obvious need to safeguard the quality profile of credit assets, but also to take account of the strict guidelines that the ECB is preparing for the valuation of impaired loans. The Board of Directors approved even stricter measurement criteria than in the past for all categories falling within the definition of impaired loans within the scope of these operating and management policies: non-performing, unlikely to pay, and past due exposures, with detailed indication of the prudential criteria to be used when examining individual positions, with reference to the evaluation and updating of guarantees, the determination of the recoverable amount and timing of periodic revision of the defaulting counterparties.

The rigorous evaluation of real estate collaterals has also been strengthened in terms of quality, with the addition of a number of suitably experienced professionals.

The results obtained from the significant commitment dedicated to containing the stock of NPLs proved positive even without resorting to complex sales transactions in favour of operators specialised in the specific sector, 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.

The outcome of the work activities was an increase in receipts from property enforcement and in full and final settlement transactions, as well as a favourable interest of third parties in the auctions at which the subsidiary Valsabbina Real Estate participated. Targeted transactions were also carried out to sell some loans and receivables and others were identified in order to sell a gross amount of approximately Euro 22.7 million in the first few months of 2018.

The gross amount of impaired loans decreased by Euro 27 million compared to 2016, from Euro 620 million to Euro 593 million. Gross non-performing loans increased by Euro 8.9 million, whereas defaults and past due loans decreased by Euro 30.1 million and Euro 5.8 million, respectively.

The amount of forbore performing exposures is also less significant than last year, i.e. measures that change contractual conditions in favour of customers, such as moratoria, extension of maturities and rescheduling of instalments; as at 31 December 2017, the forbore amounted to Euro 94.1 million, down compared to Euro 105 million at the end of 2016.

The amount charged to the 2017 income statement for impairments on loans and receivables, net of reversals of impairment losses, was Euro 44.9 million compared to Euro 36.2 in 2016, up by Euro 8.7 million, in addition to losses on sale of Euro 754 thousand (losses on sale of loans and receivables of Euro 1,765 thousand, gains on sale of loans and receivables of Euro 723 thousand and gains on sale of securities recorded in the loan portfolio of Euro 288 thousand). There were impairment losses on endorsement loans and receivables of Euro 1.399 million.

The coverage of impaired loans rose from 38.92% to 46.14% and reached 49.25% including the extinguished loans and receivables, with the related default interests, still held by the Bank. Broken down by category, the coverage on non-performing loans was 55.84% (59.41% with those extinguished and default interests), compared to 51.40%; that on unlikely to pay was 26.93% (compared to 17.20%) and that on past due loans was 7.94% in line with the previous year (8.1%).

In conclusion, as a result of the action taken on collections and sales and additional provisions made in the income statement, net impaired loans fell by Euro 59.3 million, or 15.7%, from Euro 378.7 million to Euro 319.4 million. Their incidence on total net loans and receivables was 10.52%, compared to 13.71% of 2016.

Specifically, net non-performing loans amounted to Euro 181.7 million, down by Euro 13.9 million and represent 5.98% of net loans and receivables (7.08% in 2016).

Defaults fell from Euro 153.5 million to Euro 113.5 million, decreasing from 5.56% of loans and receivables to 3.74%.

Past due loans decreased from Euro 29.6 million to Euro 24.2 million. They represent 0.8% of net loans and receivables, down from 1.07% in 2016.

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

<b>31/12/2017</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	411,342	229,674	-	181,668	5.98%
b) Unlikely to pay	155,286	41,825	-	113,461	3.73%
c) Past due loans	26,315	2,089	-	24,226	0.80%
Total impaired loans	592,943	273,588	-	319,355	10.51%
d) Performing loans	2,732,895	-	12,265	2,720,630	89.49%
<b>Total</b>	<b>3,325,838</b>	<b>273,588</b>	<b>12,265</b>	<b>3,039,985</b>	<b>100.00%</b>

<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) Unlikely to pay	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%
<b>Total</b>	<b>3,016,672</b>	<b>241,339</b>	<b>12,883</b>	<b>2,762,450</b>	<b>100.00%</b>

The cost of credit, represented by the percentage-based incidence of the losses on sale and impairments on loans and receivables with respect to the amount of the net loans and receivables recorded in the financial statements, amounted to 1.51%, compared with 1.31% last year. The percentage of coverage of the performing loans - calculated using the model made available by the IT outsourcer Cedacri - came to 0.45% 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>31/12/2017</b>	<b>31/12/2016</b>	<b>31-12-2015</b>	<b>31/12/2014</b>	<b>31/12/2013</b>
Non-performing loans	181,668	195,606	189,500	162,122	167,765
Unlikely to pay	113,461	153,523	169,491	193,370	179,135
Past due loans	24,226	29,554	29,636	27,944	56,627
<b>Total impaired loans</b>	<b>319,355</b>	<b>378,683</b>	<b>388,627</b>	<b>383,436</b>	<b>403,527</b>
Performing loans	2,720,630	2,383,767	2,391,804	2,577,142	2,578,643
<b>Total net loans and receivables</b>	<b>3,039,985</b>	<b>2,762,450</b>	<b>2,780,431</b>	<b>2,960,578</b>	<b>2,982,170</b>

<b>CREDIT QUALITY RATIOS</b>	<b>31/12/2017</b>	<b>31/12/2016</b>	<b>31-12-2015</b>	<b>31/12/2014</b>	<b>31/12/2013</b>
<b>on gross loans and receivables</b>					
% of non-performing loans out of total gross loans and receivables	12.37%	13.34%	11.91%	9.30%	8.28%
% of unlikely to pay out of total gross loans and receivables	4.67%	6.15%	6.93%	7.32%	6.39%
% of past due loans out of total gross loans and receivables	0.79%	1.07%	1.06%	0.95%	1.89%
% of impaired loans out of total gross loans and receivables	17.83%	20.55%	19.90%	17.57%	16.56%

<b>coverage percentages</b>					
Non-performing loans	*59.41% 55.84%	*55.59% 51.40%	*52.32% 47.09%	*52.30% 44.64%	34.87
Unlikely to pay	26.93%	17.20%	18.66%	16.12%	9.80
Past due loans	7.94%	8.10%	7.37%	6.14%	3.70
Total impaired loans	*49.25% 46.14%	*42.45% 38.92%	*39.06% 35.07%	*36.10% 30.68%	21.64
Performing loans	0.45%	0.54%	0.69%	0.69%	0.61
*also including extinguished loans still held by the Bank and default interests					
<b>percentages out of net loans and receivables</b>					
% of non-performing loans out of total net loans and receivables	5.98%	7.08%	6.82%	5.48%	5.62
% of unlikely to pay out of total net loans and receivables	3.73%	5.56%	6.10%	6.53%	6.01
% of past due loans out of total net loans and receivables	0.80%	1.07%	1.06%	0.94%	1.90
<b>% of impaired loans out of total net loans and receivables</b>	<b>10.51%</b>	<b>13.71%</b>	<b>13.98%</b>	<b>12.95%</b>	<b>13.53</b>

## 10. FINANCIAL ASSETS AND EQUITY INVESTMENTS

Financial assets and liabilities comprise:

<b>Financial assets (in Euro 000)</b>	<b>31/12/2017</b>	<b>31/12/2016</b>
20. Financial assets held for trading	174	394
30. Financial assets measured at fair value	9,380	9,175
40. Available-for-sale financial assets	939,254	1,257,014
60. Loans and receivables with banks	129,372	212,026
100. Equity investments	1,121	1,121
<b>Total</b>	<b>1,079,301</b>	<b>1,479,730</b>
<b>Financial liabilities (in Euro 000)</b>	<b>31/12/2017</b>	<b>31/12/2016</b>
10. Due to banks	687,269	795,650

Loans and receivables with banks amounted to Euro 129.4 million, down Euro 82.6 million compared to the previous year which included the amount of Euro 104.7 million paid at the end of the year for the purchase of the loan portfolio from Hypo Alpe Adria Bank, which has been mentioned several times.

Due to banks amounted to Euro 687.3 million and consisted mainly of loans received from the ECB as part of the TLTRO2 programme (Targeted Longer-Term Refinancing Operations), net of accrued negative interest. The Bank participated in three of the four auctions envisaged by the programme (the first in June 2016 of Euro 250 million, the third in December 2016 of Euro 150 million and the fourth in March 2017 of euro 290 million) using almost the entire amount allocated of Euro 694 million.

These are loans that can be obtained, 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 applied interest rate will initially be the same as that on the main refinancing operations in force at the time of allocation (0.00%), can be reduced, until reaching the rate (-0.40%), currently negative, on deposits with the central bank; the final rate will be calculated on the basis of the achievement of a benchmark target based on the net disbursements/repayments flow recorded in the period from 1 February 2016 to 31 January 2018.

On the basis of the disbursements made during the above-mentioned period, the target set by the ECB to benefit from the negative interest rate of 0.40% was reached, therefore as per IAS 39, the Bank was able to

ascertain interest income of Euro 3 million at the end of 2017, allocating the related amount to the net interest income. The amount includes interest for 2016, equal to Euro 500 thousand, not allocated at the time of preparation of the relative financial statements in the absence of the conditions that allowed its receipt.

Two capitalisation insurance policies issued by two important operators are recorded in financial assets measured at fair value: since they are not listed securities, these policies were allocated to this portfolio according to the same criteria adopted last year.

"Available-for-sale financial assets" (AFS) - which form the main component of the financial assets of the Bank - amounted to Euro 939 million, decreasing by Euro 317.8 million compared to the previous year and are broken down as follows:

Available-for-sale financial assets (in Euro 000)	31/12/2017	% of portfolio	31/12/2016	% of portfolio
Italian government securities (BTP, CCT)	724,636	77.15%	1,019,880	81.14%
Other bonds	42,067	4.48%	6,491	0.52%
<b>Total Bonds and government bonds</b>	<b>766,703</b>	<b>81.63%</b>	<b>1,026,371</b>	<b>81.65%</b>
Units in stock & share	96,107	10.23%	169,234	13.46%
Real estate UCITS units	47,449	5.05%	35,324	2.81%
Fondo Atlante units	610	0.06%	3,098	0.25%
Equity securities	28,385	3.02%	22,987	1.83%
<b>Total UCITS and equity securities</b>	<b>172,551</b>	<b>18.37%</b>	<b>230,643</b>	<b>18.35%</b>
<b>Total</b>	<b>939,254</b>	<b>100.00%</b>	<b>1,257,014</b>	<b>100.00%</b>

At the end of 2017, the fall in interest rates recorded on the fixed income market and the simultaneous increase in prices made it possible to generate capital gains. In line with the objectives, a part of the securities portfolio was disposed of and the related gains accounted for.

The item "gains on sale of available-for-sale financial assets" amounted at the end of the year to Euro 15.1 million, compared to Euro 8.8 million in 2016: it includes, as explained below, Euro 5.2 million deriving from the sale of part of the shares held in the outsourcing company Cedacri.

At the end of the financial year, the bond portfolio consisted in Government securities of Euro 725 billion - of which long-term treasury bonds (BTP) of Euro 234 million and treasury certificates of credit (CCT) of Euro 491 million - and in corporate bonds of Euro 42 million, with an average duration of 2 years compared to 3 years last year.

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

Duration	31/12/2017	% of aggregate	31/12/2016	% of aggregate
up to one year	4,946	0.65%	136,733	13.32%
between 1 and 2 years	2,938	0.38%	73,998	7.21%
between 2 and 3 years	73,849	9.63%	61,894	6.03%
between 3 and 5 years	239,662	31.26%	184,908	18.02%
between 6 and 10 years	441,997	57.65%	567,299	55.27%
beyond 10 years	3,311	0.43%	1,540	0.15%
<b>Total</b>	<b>766,703</b>	<b>100.00%</b>	<b>1,026,371</b>	<b>100.00%</b>

Units of equity funds decreased from Euro 169.2 to Euro 96.1 million.



The units of closed-end real estate alternative investment funds were recorded for Euro 47.4 million (+ 12.1 million) and comprise funds set up by the investee company Polis Fondi sgr of Euro 19.9 million, by the Finint Fenice fund of Fenice Investments sgr of Euro 21.5 million, by Fondo Leopardi of Euro 0.3 million, originating from the restructuring of Aedes, and by Fono Namira of Euro 5.7 million.

Investments are made mainly via the contribution of real estate property assets recognised by the subsidiary Valsabbina Real Estate to support the debt collection activities or by subscribing units in connection with the participation of the funds in auctions or the purchase of impaired mortgages. Impairment – i.e. checking the value of the asset recognised in the financial statements - on real estate funds resulted in the recognition in the income statement of Euro 1.17 million under item 130 b) "impairment on securities available for sale".

A specific comment, within "available-for-sale financial assets", must be dedicated to the item "Fondo Atlante". As you will recall, in 2016 the Bank, like almost all Italian intermediaries, subscribed units of Fondo Atlante, closed-end equity alternative investment fund, for a total investment of Euro 5 million. This fund, set up to support banks in difficulty and to purchase impaired bank loans, was used for about 80% of the funds committed to rescuing Banca Popolare di Vicenza and Veneto Banca.

Unfortunately, the extent of the default of the two banks was much greater than the initial scope of the project and the Fund's chances of recovery. At the end of June 2017, the two banks were placed under compulsory administrative liquidation and the amount paid to the Fondo Atlante at that time was substantially written off. As a result of this unexpected negative circumstance that affected all the banks subscribing to the Fund's units, it became necessary to record a write-down of approximately Euro 4 million, with a negative impact that affected the income statement by a corresponding amount. Subsequently, further payments were made to the fund for approximately Euro 600 thousand, payments that were used to purchase impaired loans; a further commitment of Euro 391 thousand is still required for our bank.

There were capital losses of Euro 5.164 million, of which Euro 1.167 million on real estate funds and Euro 3.997 million on the Fondo Atlante, on equity and real estate investment funds as whole.

Capital instruments and shares amounted to Euro 28.4 million compared to Euro 23 million in 2016. The most significant changes concern:

**CEDACRI.** The company, the Bank's IT outsourcer, was the subject matter of expressions of interest on behalf of institutional investors. At the end of the year, an overall agreement was reached with which the Fondo strategico italiano (Italian strategic fund) acquired a minority shareholding of 27% of Cedacri's capital, while the remaining 73% was held by some of the banks already present in the capital. The investment of the FSI (Italian strategic fund) simplifies the governance of Cedacri, favours its growth and positions it for a possible future listing.

Our Bank took part in the various events that involved this important restructuring operation and the evaluations carried out led to the decision to sell about two thirds of the equity investment and to maintain a 1.05% stake in the share capital. The sale generated a capital gain of Euro 5.169 million. In accordance with accounting standards, the remaining shares were valued at their sale price of Euro 3.9 million, recognising the amount of Euro 2.489 million as an offsetting item in valuation reserves, net of taxes.

**BANK OF ITALY.** After the initial purchase in 2016 for Euro 7.5 million, the investment was further increased by another 300 units for Euro 7.5 million. The units are now held for the total amount of Euro 15 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 restructuring operations in the credit system, some subjects are in the condition of having to reduce their participation.

For our Bank, the investment takes on a completely rare and positive feature, not only because of the undoubted profiles of institutional visibility, but also because of the profitability profiles related to the appreciable measurement of dividends.

**ARCA SGR.** 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 446 thousand was recorded in the valuation reserves

net of the tax effect. As a whole, against the amount recorded at the end of 2017 of Euro 8.307 million, gross valuation reserves of Euro 6.431 million and net valuation reserves of Euro 5.984 million are recognised.

**VOLUNTARY SCHEME OF THE INTERBANK GUARANTEE FUND** To prevent the state of crisis of Cassa di risparmio di Cesena, Cassa di risparmio di Rimini and Cassa di risparmio di San Miniato from degenerating into a new application of the resolution procedures (bail in) with further negative effects on the system, both in terms of costs and reputation profiles, the Voluntary Scheme of the Interbank Guarantee Fund asked member banks for an extraordinary payment to be used for recapitalisation to cover the losses of the three banks and for the purchase of mezzanine and senior bonds against a securitisation of their impaired loans.

Therefore, in addition to Euro 550 thousand paid in 2016, a further Euro 1.104 million was added during 2017 for a total of Euro 1.654 million. The overall sale of the three banks and the measurement of the bonds, carried out by an independent external expert, resulted in capital losses totalling Euro 1.55 million recognised in the income statement (including the amount of Euro 135 thousand recognised in 2016 in valuation reserves).

According to the instructions of the Bank of Italy, the amounts paid to the Fund are recorded in this item in that the intervention has substantially the same risk characteristics as an equity investment.

The impairment of equity securities also led to other capital losses of Euro 648 thousand, of which Euro 642 thousand on the shares of Banca Popolare di Cividale.

Total impairment losses recognised in Item 130 b) of the income statement amounted to Euro 7,362 million.

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

Description				Capital gains	Impairment	Change			%
(amounts in Euro 000)	Value as at 31/12/2016	Purchases	Sales		to income statement	in shareholders' equity	Value as at 31/12/2017	No. of shares	% of holding
Arca Sgr Spa	7,861	-	-	-	-	446	8,307	755,442	1.51%
Bank of Italy	7,500	7,500	-	-	-	-	15,000	600	0.20%
Cedacri Spa	3,601	-	7,542	5,169	-	2,675	3,903	133	1.05%
B.ca Pop. Cividale	1,656	-	-	-	(642)	-	1,014	84,500	0.50%
VOLUNTARY SCHEME - F.I.T.D.	415	1,103	-	-	*(1,415)	-	103	NS	0.19%
Unione Fiduciaria SpA	28	-	-	-	-	-	28	4,320	0.40%
Consulting SpA	24	-	-	-	-	-	24	22,500	15.00%
Other equity investments	10	-	-	-	(4)	-	6	NS	NS
UBI Leasing SpA	1,784	-	1,850	66	-	-	-	-	-
Aedes	108	-	121	13	-	-	-	-	-
<b>TOTAL SHARES</b>	<b>22,987</b>	<b>8,603</b>	<b>9,513</b>	<b>5,248</b>	<b>(2,061)</b>	<b>3,121</b>	<b>28,385</b>	-	-

\* in addition to Euro 135 thousand in the income statement for transfers from reserves

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. for an amount of Euro 1.014 million and of 100% of the subsidiary Valsabbina Real Estate srl (Euro 107 thousand).

As a result of the impairment, Euro 295 thousand were recognised in item 210 of the income statement "Net gains (losses) on equity investments", for Valsabbina Real Estate, better specified below.

#### **Valsabbina Real Estate**

The eighth financial year of Valsabbina Real Estate ended on 31 December 2017, during which the Company continued its institutional activity by participating in numerous auctions.

In many cases, the activity of Valsabbina Real Estate acted as an incentive for higher bids that allowed not to reduce the selling prices by 25% and/or to sell the property at prices higher than the starting prices themselves. In fact, for six auctions, the property was assigned to third party bidders for an equivalent value of Euro 909,800, against starting prices for a total of Euro 809,800 and minimum bid values for a total of Euro 607,400. This confirms the usefulness of having a practical tool aimed at better protecting the loans related to mortgage transactions through the direct participation in auctions to avoid passively undergoing the speculative effects that often characterise them.

As at 31 December, the company owns 35 residential properties, including 4 garages and a shop, recognised for Euro 5,449 thousand, gross of expenses relating to the acquisition, including tax expenses.

During the year, 9 purchase contracts were signed, 1 sales contract with lien agreement for a total of Euro 1,520 thousand, resulting in a total capital loss of Euro 132 thousand (capital gains of Euro 27 thousand, capital losses of Euro 159 thousand). During the year, two notarial private purchase agreements were also signed with a duration of five years.

The company is waiting to receive the assignment decree or to exchange deeds for other 2 properties for residential use, as well as an industrial shed to be demolished with land pertinent to the auctions it participated in during 2017 with the payment of advances totalling Euro 302,576 million.

Moreover, loans and receivables with customers are recognised in assets for sales with lien agreement of Euro 176 thousand, amounts due from tax authorities of 23 thousand and loans and receivables from the parent company for tax consolidation of Euro 88 thousand.

The amount due to the Bank is recognised in liabilities for the credit facility of Euro 5,865 million gross of interests of Euro 69 thousand that will be debited in 2018, in addition to due to suppliers of Euro 46 thousand and tax or social security payables of Euro 14 thousand.

The value of production amounted to Euro 1,158 thousand, of which Euro 1,152 thousand for sales and Euro 6 for other revenues.

The 2017 financial year closed with a loss of Euro 291 thousand as indicated in the reclassified income statement below, compared with the previous financial year:

(amounts in Euro 000)	31/12/2017	31/12/2016
Value of production	1,157	195
Costs for services	(120)	(87)
Costs for use of third-party assets	(3)	(3)
Operating expense	(33)	(23)
Difference between costs for purchases of properties and the change in inventories	(1,283)	(196)
<b>Total net of interest and taxes</b>	<b>(282)</b>	<b>(114)</b>
Interest expense	(69)	(41)
Taxation	60	28
<b>Loss</b>	<b>(291)</b>	<b>(127)</b>

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, amounted to Euro 115 thousand. During the year, the Parent Bank made two capital contributions and covered losses for a total of Euro 295 thousand.

The financial statements as at 31 December 2017 – 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 6,039 thousand) is

lower than the limits envisaged by the Supervisory instructions for the consolidated indications (financial statement assets less than Euro 10 million).

## **11. BUSINESS STRATEGIES**

At the meeting held on 28 June 2017, the Board of Directors of Banca Valsabbina approved the 2017-2019 Strategic Plan.

### **The cornerstones of the 2017-2019 Strategic Plan**

The new Strategic Plan approved by the Bank identified the business development guidelines for the three-year period and identified some measures to be implemented to achieve important objectives of efficiency, profitability, competitiveness and risk management, in a scenario of consolidation and growth oriented towards the creation of value over time for shareholders, customers and the entire community of reference.

The change in the regulatory and competitive environment requires a careful assessment of the impact of these changes on the operating model and the actions to be taken in the coming years, in order to consolidate the Bank's position as a cooperative bank both in historical areas and in new areas. Banca Valsabbina has recently expanded its network of branches, with the aim of increasing revenues, exporting its business model to new territories and further increasing its customer base.

The 2017-2019 Strategic Plan identified the actions underlying the updated and implemented redefinition of the Bank's mission, aimed at confirming the model of autonomous cooperative bank, capable of serving customers and the areas of reference in an innovative way, taking into account the opportunities and new trends underway, also as a result of a progressive digitalisation of the offer.

Therefore, the plan initiatives for the next three years are focused on the following strategic lines:

- Improving credit quality
- Increased commercial effectiveness
- Increased profitability

### **Improving credit quality**

The reduction of impaired loans, whose incidence on total loans and receivables in Italy is among the highest in Europe, is an issue that the Italian banking sector is facing and will be the subject of specific and further initiatives in the coming years. Governor Visco, at the Assim Forex meeting of 10 February 2018, informed us that, in relation to total loans, the flow of new impaired items had fallen to levels lower than those prior to the financial crisis and that they had been falling, for two years now, even in their size, with an acceleration due to the significant transfers completed last year. Compared to the highs of 2015, total impaired loans net of impairment losses fell from Euro 200 billion to Euro 140 billion (7.8% of total loans), with non-performing loans alone falling from Euro 86 billion to Euro 60 billion (3.5%).

The reduction of impaired loans is necessary to reduce the risks and financing costs of banks. This objective can be achieved both by improving the current recovery processes and by evaluating their transfer to specialised operators or investors, with the aim of optimising the internal management strategy for non-performing loans. In this respect, the European Commission will shortly present a proposal for the establishment of national companies, also with public support, specialised in the management of impaired assets. These companies could achieve economies of scale in their recovery processes and have strong bargaining power in the transfer of impaired loans on the market, including through their securitisation.

In order to reduce the incidence of impaired loans on the total loan portfolio and reduce the level of impairment of new disbursements, the Bank identified "derisking" measures to be implemented in the coming years, aimed at improving the recovery processes and performance of impaired loans, as well as the implementation of control systems to identify anomalous positions already within the performing loans portfolio.

In fact, the corporate objective will be, on the one hand, to contain the impairment of the loan portfolio, improving the positive results already achieved in recent years in terms of lower default rates, and on the other hand, to increase the flows of return to performing. Moreover, taking into account the conditions that will characterise any market transactions involving the sale of impaired portfolios of other operators, the Bank will assess on a case-by-case basis the advisability of carrying out potential disposal transactions, which, thanks to

the capital strength that distinguishes it, can be addressed in an efficient and balanced manner. The Plan also provides for the implementation of management and monitoring procedures designed to further improve credit quality through rigorous selection of the new positions granted and further vigilant monitoring of existing positions.

### **Increased commercial effectiveness**

The profitability of banks in the coming years can play not only on the reduction in impairment losses on loans and on the drop in operating costs mentioned below, but also on the increase in net interest income and above all by asset management services, which represent the typical sectors of the banking business.

The Bank's commercial policies in the coming years - in line with the above indications - will be aimed at increasing efficiency in historical areas and implementing initiatives in the new areas in which it operates, in order to achieve satisfactory objectives in terms of customers, volumes and profitability, while also ensuring full integration of the branches acquired into the distribution network.

From this point of view, the bank believes it is essential to develop a multi-channel strategy that focuses on the direct method of territorial presence through the network of branches, which are rationally structured and streamlined with new openings, but also with possible repositioning, with the simultaneous development of forms of digital banks or remote banks, in order to increase the level of use of products and services by customers.

The process of credit disbursement cannot disregard a special focus on the quality of the target customer base, which will continue to be represented by households and small and medium-sized enterprises in the territory.

The increase in lending volumes (1.5 billion new disbursements are expected over the three-year period) will be pursued with the objective of spreading risk over both individual borrowers and geographical areas. Moreover, the development of the channel of loans backed by Medio Credito Centrale will continue, with a special attention to businesses, as well as to the channel of home mortgages for households.

Specific commercial actions are also envisaged to recover the volumes traded of the on-demand component, as well as the granting of loans with a guarantee from the European Investment Fund. In order to further support its customer companies, the Bank will continue to purchase public administration loans through the use of the Valsabbina Investimenti Special purpose vehicle.

Funding policies will instead comply with prudent liquidity risk management criteria, through consolidation of the on-demand component and specific actions on the network aimed at transforming maturing bonds and time-deposits mainly into new time-deposits with extension of the maturities of the current portfolio.

In the light of the current market context characterised by the fall in margins deriving from traditional loan brokerage activities, commercial action aimed at increasing commission flows for the Bank will continue over the three-year period, with an increasing focus on asset management, responding to the demand from households, which is increasingly oriented towards instruments that allow greater diversification of the sources of investment and the risk profile.

In this sense, the Strategic Plan envisages actions aimed at increasing indirect deposit volumes, with a special focus on asset management products, from mutual funds to insurance products with a financial content, currently offered by the Bank's commercial network.

### **Increased profitability**

The Bank's Strategic Plan bases its prospects of increasing business profitability in the coming years above all on the growth of revenues, through the two components represented by net interest income and commissions on products and services.

With regard to the first profile, the harmonious growth of volumes of loans and deposits, together with an expected rise in interest rates, should ensure a recovery of the traditional profitability of the banking business in the coming years, whereas a significant increase is expected with regard to revenues from commissions and services, also in view of the growing advisory role that banks are required to play. The aforementioned improvement in credit quality could also have a positive effect on profitability in both directions: that of better pricing and that of lower adjustment costs on the managed positions. More generally, actions aimed at reviewing and completing the list of products and services and the related pricing will be further intensified.

In order to improve profitability, the Bank - as already mentioned - will pursue actions aimed at optimising its distribution network, devoting more resources to the development of branches with greater potential and those recently opened.

The 2017-2019 Strategic Plan envisaged the opening of a new branch in one of the major provincial capitals of the Northeast area, the city of Padua that, with about 210,000 inhabitants and a per capita income of over Euro 25 thousand, represents a market outlet whose characteristics and customer base appears consistent with the strategy of growth in large centres pursued in recent years. The Bank will also consider new branch openings in other large cities in northern Italy. It is believed that a balanced but significant development of the territorial presence also with traditional physical structures - but equipped with all the innovative solutions to favour the most extensive use - can be the key to ensure profitability in the profile of growth of revenues and in obtaining economies of scale that require a minimum size of a certain amount.

Finally, the Bank will continue to analyse potential areas of efficiency improvement, as well as take the most appropriate initiatives to contain operating costs, such as optimal staff size and standardised order management.

### **Summary of economic and financial projections and prudential indicators**

The Strategic Plan indicates quantitative objectives that are fully compatible with the lines of action previously mentioned.

In 2019, loans and receivables with customers are expected to reach Euro 3.4 billion, direct deposits Euro 3.5 billion and indirect deposits Euro 1.9 billion.

In terms of income, an average annual growth in net interest and other banking income of 7% is required, supported by an increase in both net interest income and net fee and commission income, with the ROE target for 2019 being 2%.

The 2017-2019 Strategic Plan confirms the Bank's willingness to operate by maintaining adequate overcapitalisation, compared to the minimum requirements set by the Supervisory Authority, based on a sound and prudent management, also in order to be able to put in place planned interventions - especially derisking - without incurring tensions connected with the Bank's capital strength.

The CET1 target for 2019, determined according to a "fully phased" logic, is estimated at 13.8%. The fully phased leverage ratio is estimated at 7.3%, compared to the regulatory minimum of 3% expected from 1 January 2018.

With reference to prudential liquidity indicators, the Strategic Plan guarantees a level well above the regulatory requirement both for the LCR (target 150%) (Liquidity Coverage Ratio given by the ratio between the reserve of liquid assets and the expected net outflow of liquidity over a 30-day stress period) and for the NSFR (target 120%).

## **12. THE INTERNAL CONTROL SYSTEM**

The system of internal controls is a set of rules, procedures and company functions whose purpose is to achieve the effectiveness and efficiency of company processes, ensure the reliability and integrity of accounting and management information, guarantee compliance with regulations and risk management. It is the Bank's main internal support for understanding the source and relevance of the risks to which it is exposed in the development of its business (e.g. credit risk, reputational risk, penalty risk, risk of involvement in money laundering, etc.), assessing the adequacy and effectiveness of the measures adopted with a view to reducing/containing their impact, and measuring the level of risk that cannot be mitigated.

The system of controls can also be considered as the "critical conscience" of the Bank, which forces it to analyse its deficiencies in depth and implement remedies. The prerequisite for the proper functioning of the internal control system is the ethical and legal behaviour of individuals and of the Bank as a whole, based on the concepts of correctness, transparency, diligence and confidentiality, on which the trust of customers is based. Therefore, the effectiveness of the system depends on the compliance with the values of the Bank, which is constantly committed to nourish in each employee and collaborator an awareness of their role, motivation in their work and a sense of belonging.

In this delicate transition of the Italian banking system, spurred on to develop the methods of customer service and to achieve satisfactory economic balances, there are many issues on which the Bank's internal control system is called to deal: from the development of the requirements of the segments of customers served, to

the renewed role of the branch in the territory as a driving force for consulting services, to the development of multi-channelling and the use of digitalised services, to the redesigning of processes to make them more efficient/faster, risk-conscious, in compliance with the law.

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 on the following three level is built according to a model that implements the indications of the Bank of Italy Circular no. 285/2013.

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 make it possible to intercept the anomalies at the same time they occur. The controls assigned to the network structures are also aimed at ensuring the correct performance of operations as part of the offer of banking and financial services, payment and investment. The first level of control also includes the so-called "second level" controls, aimed at ensuring that the operating flow relating to the provision of individual services is promptly observed and the related supporting documentation is properly signed, collected and stored.

During 2017, the Bank continued to raise staff awareness in order to cross-identify the risks related to customer relations. 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 and checking 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 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 and in drawing up the recovery plan required by European Regulation No. 2016/1075 containing early intervention measures to deal with possible situations of difficulty of the bank;
- 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 36 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 2017, significant critical issues or important malfunctions were not reported as far as each function is concerned and on the basis of the work plan previously assigned by the Board of Directors. The Compliance activity concerned, more specifically, the control of the risk of non-compliance concerning investment services and also analysed the issues of customer relations in banking services. 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.

With regard to the operations of the Anti-Money Laundering Service, called upon to prevent the risk of the Bank's involvement in money laundering and/or the financing of international terrorism, the latter focused its attention on the implementation of the supervisory provisions on customer due diligence and began implementing the provisions of Italian Legislative Decree no. 90 of 25 May 2017, implementing Directive (EU) 2015/849 (known as IV Anti-Money Laundering Directive) in its internal regulations. A constant 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.

In 2017, the Internal Audit Service focused - in observance of the agenda established in the annual and multi-year plans - 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, making it possible to carry out verifications concerning specific operating processes. Line controls were monitored and constantly implemented in relation to regulatory developments and in the presence of new operating processes.

The results of the checks of the second and third level control units – which directly report to the corporate bodies – were analysed using the internal structured concerned and 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.

In March 2018, the Board of Directors approved the control plan proposed by the company's control functions for the new financial year.

With reference to the checks carried out by the Supervisory Body, established pursuant to Article 6 of Italian Legislative Decree 231/2001, reference is made to a subsequent paragraph called "Supervisory Body pursuant to Italian Legislative Decree No. 231/2001".

### **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 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.

As part of the process of adapting to the provisions of IFRS 9, which came into force on 1 January 2018, the Bank took part in a specific project organised by the outsourcer Cedacri to implement the loan assessment logics in line with the new regulatory provisions. Specifically, in calculating the Expected Loss on performing loans, a method for calculating the probability of default was defined, which also takes into account the impact of the development of macroeconomic scenarios in a forward looking logic. Criteria have also been defined to identify any loan positions for which there has been a “significant increase in credit risk” to be classified in the so-called “stage 2”. For these positions, the method for calculating the expected loss in a Life Time logic has been defined.

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 makes it possible 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 unlikely to pay.

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.

Effective as from 5 February 2018, the Bank, following the change in its organisational structure, set up the Anomalous Loan Division, including the Trend Monitoring, Pre-dispute, Legal and Disputes Services. The main purpose of this change in the organisational structure is to improve synergies and coordination between the various services as part the debt collection activities by optimising the reporting process with regard to corporate bodies.

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 counterparts belonging to the same business sector or the same geographic area (geo-sectoral 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-sectoral 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 CCM (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).

In the light of the issuance by the Bank of Italy in January 2018 of the "Guidance on the management of non-performing loans for Italy's Less significant institutions", the Bank launched a specific project aimed at further strengthening and implementing its internal credit risk control framework. In particular, the activity aims to improve the effectiveness and efficiency of the process of managing and recovering non-performing loans, also with a view to gradually reducing and disposing of the current stock, in line with the strategy outlined in the 2017-2019 Business Plan.

## **Market risk**

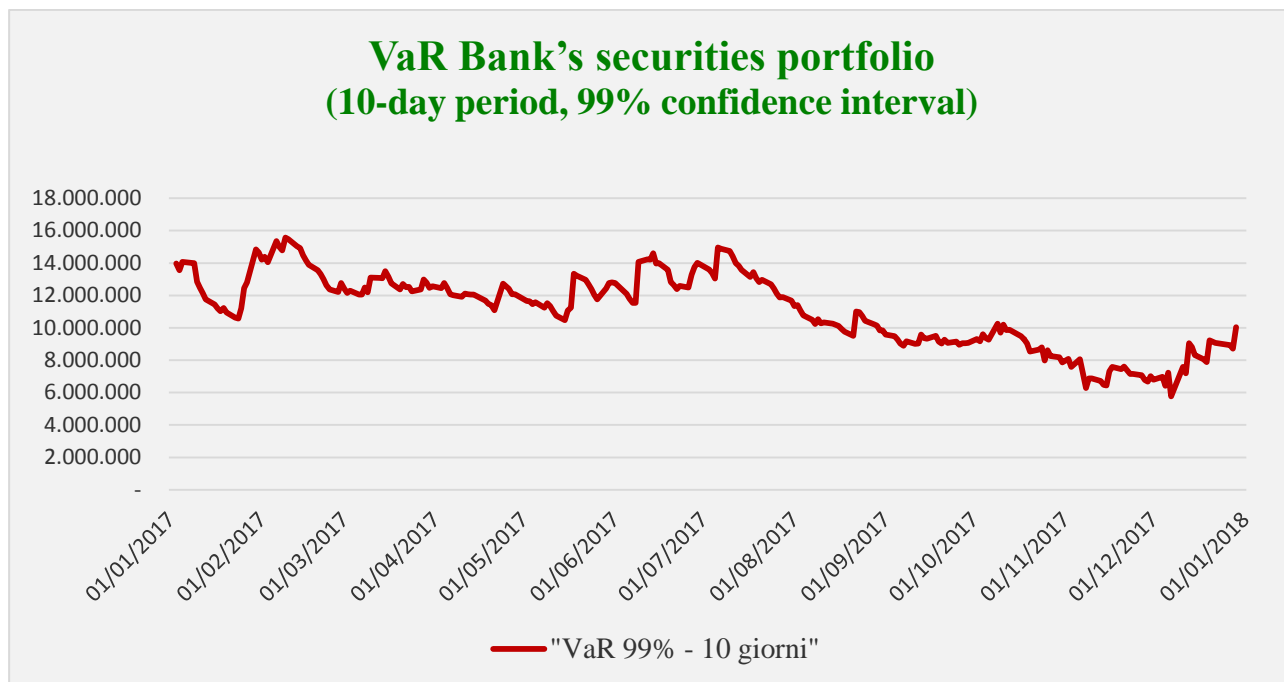
The Bank has developed methods for the measurement of market risks that include price, interest rate and exchange risk on a consistent basis with the strategies adopted and with the characteristics of the financial assets held.

During the year, 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). Moreover, 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 mainly invest in stock & share units and in corporate bonds. The portfolio entrusted under management amounted as at 31 December 2017 to Euro 133 million, of which Euro 94 million invested in UCIT units and Euro 39 million in corporate bonds.

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.

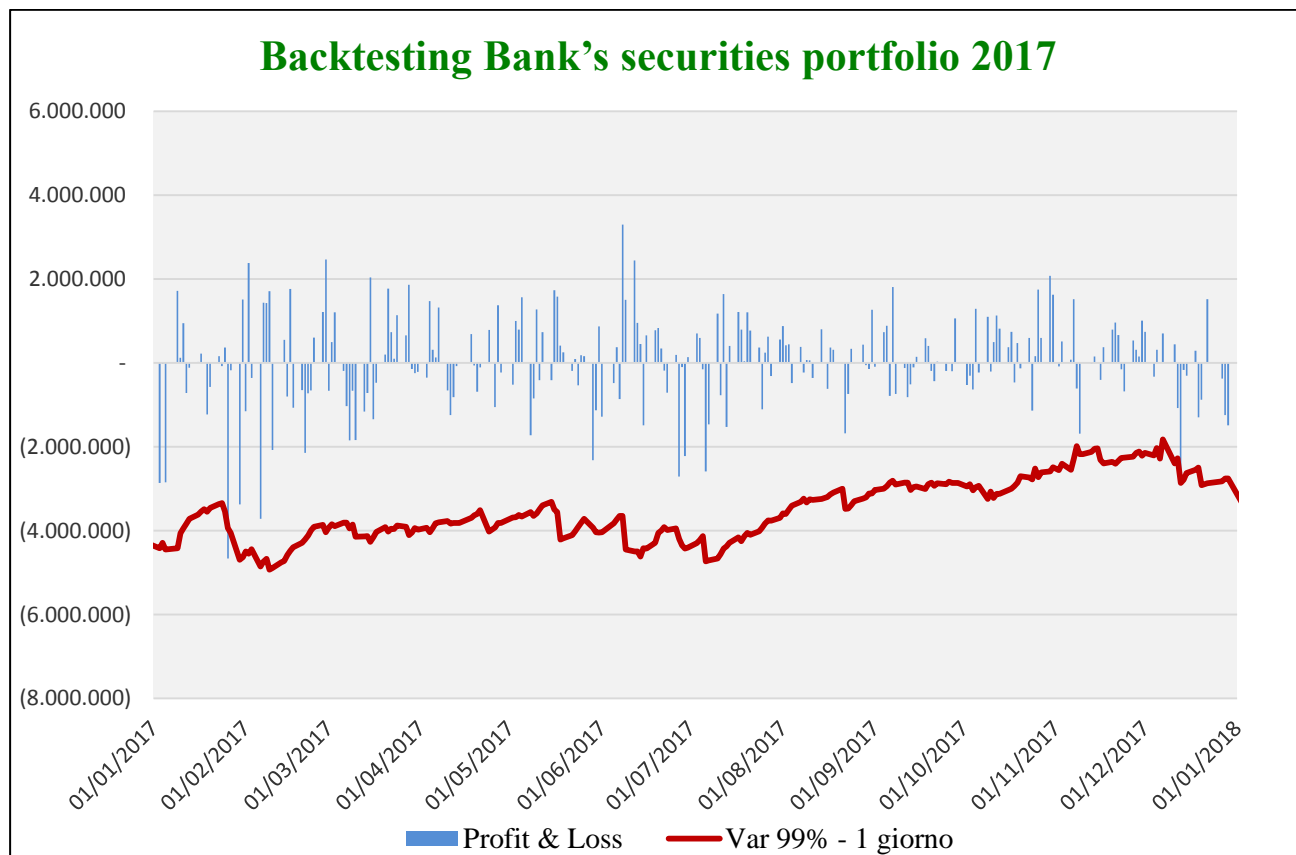
For the calculation of the VaR, the Risk Management, Planning and Control Service uses the ERMAS application. The financial information necessary for the determination of VaR (volatility, correlations, forward structure of the interest rates, exchange rates, stock and benchmark indices) is provided by 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 managed internally during the year was as follows:



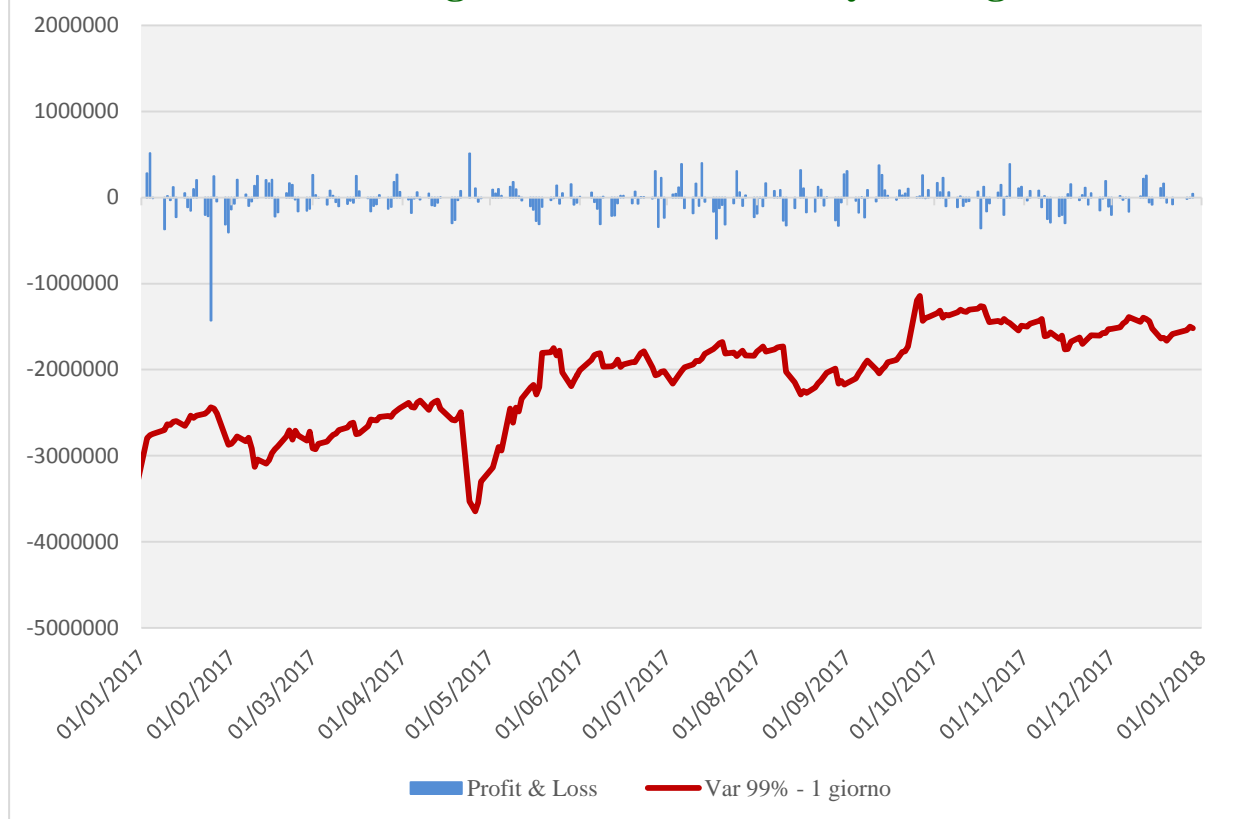
The VaR trend, from the moment that the securities portfolio is entirely made up of Italian government securities, aligned itself with the fluctuations and volatility registered on the related markets as well as with the choices of investment made during the period. In the last few months of 2017, the VaR decreased also following the improvement in market conditions and a reduction in invested capital, as well as the average duration of the portfolio, which at the end of the year was 1.84 years.

According to the “back-testing” analysis carried out in 2017, as shown in the graph, VaR was exceeded in 1 case, recorded in January.



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 back-testing. The figure shows the 1-day VaR trend and the back-testing analysis; the latter, in particular, did not reveal any cases of exceeding of the VaR thereby confirming the reliability of the measurement made.

## Backtesting and VaR Third-Party Management 2017



### 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.

For the purpose of supplementing the operations that are already carried out afterwards with the collection of the operating losses, the Bank implemented a self-assessment process functional for estimating on a forecast basis its 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 IT risk is also monitored, assessing the reliability and security of company information and IT procedures, in particular. 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 analysis is updated annually also on the basis of specific assessments made by IT outsourcers. The outcome of the assessment for 2017 confirmed a low risk exposure, consistent with the Bank's risk appetite.

### **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 banking book is also calculated against non-parallel shifts in the yield curve.

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.

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 for management purposes via 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.

Moreover, 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".

As part of interest rate risk measurement techniques, the bank uses behavioural models estimated internally for on-demand items on the basis of historical data.

### **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).

In particular, the Bank transmits the regulatory reporting of the liquidity indicator "Liquidity Coverage Ratio" (LCR) on a monthly basis. With regard to the "Net Stable Funding Ratio" (NSFR) indicator, the Bank implemented an operational-type measurement on the basis of the matters envisaged by the Basel III Framework.

In 2017, the quarterly reporting related to the "Additional Liquidity Monitoring Metrics - ALMM" continued 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 and to identify the risk events with the greatest impact on the company.

As part of this process, the areas of operations most exposed to this risk are monitored, by 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 whistle-blowing system, by identifying the subject to whom to converge them in a confidential manner.

## **14. COMMERCIAL ACTIVITIES**

By keeping its territorial network firmly at the centre of the commercial relation, Banca Valsabbina increased, year after year, the solutions offered to private individuals for using their savings and to households and businesses for collecting funds in response to the increasingly specific needs of its customers, in accordance with the development of their requirements, professions and lifestyles.

The design of new products, the correct identification of reference targets and the strong interaction between producers and distributors constitute an important cornerstone of the new regulatory framework of reference, both in terms of the offer of banking and financial products and in terms of investment services.

In preparing for the presentation of the Bank's commercial offer, to which this extensive paragraph is dedicated, we feel it is important to inform our shareholders in advance that last August the Board of Directors adopted an Ethical Policy for the management of relations with companies operating in the arms sector, in line with the principles of social responsibility and listening to the territory that characterise it.

With the Ethical Policy, Valsabbina undertakes not to support banking and financial transactions with companies operating in the production, storage and marketing of controversial weapons. The Ethical Policy also provides for the exclusion of any type of banking and financial transaction related to the supply of weapons to those countries against which a total or partial embargo of military supplies has been declared by the United Nations or the European Union (EU) or whose governments have been declared responsible for serious violations of international conventions on human rights, ascertained by the competent bodies of the United Nations, the EU or the Council of Europe.

### **Territorial structure**

The distribution network is currently divided into 5 territorial areas: the North West area (which includes Franciacorta, Bergamo, Milan and Brianza), the Brescia City area, the Brescia South and Hinterland areas, the Valsabbia and Valtrompia areas and the North East area (which includes the municipality of Desenzano and the provinces of Verona, Vicenza, Padua and Modena).

In 2017, the network's structural model favoured the progressive integration of the 7 branches acquired from Hypo Alpe Adria Bank in the markets of Bergamo, Brescia, Verona, Vicenza, Schio and Modena, with appreciable results, as well as the rationalisation of two licences that made it possible to open the branches in Milan and Padua.

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.

Considering the centrality of the branch in the service model on which the Bank's offer is based, the efficiency of the distribution network will continue to be pursued in the coming years, also evaluating new openings in areas adjacent to the historical ones, also in consideration of the positive results recorded by the Monza and Seregno branches, opened in 2016 and in Milan in March 2017.

The investments incurred up to now allow the Bank to be active 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.

#### **The offer dedicated to Shareholders**

Also in 2017, the Bank paid great attention to the shareholder/customer combination by offering its shareholding base a particularly appreciated package of conditions.

More than 19,000 Shareholders have chosen one of 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 means of payment.

There are four packages reserved for shareholders: these packages offer, for private individuals, increasing services depending on their share ownership (100, 200 or 500 shares) and, for companies, a dedicated solution with a minimum of 1,000 shares.

The conditions offered to shareholders are particularly remunerative for current account deposits, which are attractive in a context of market rates close to zero or even negative.

#### **Direct deposits: 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 79,527 current account holders compared to 74,212 of 2016 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 63,800 in 2016 to 67,100 in 2017.

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 more than 7,600 current account holders of which 1,300 acquired in 2017: 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 200 "small" customers have already entered our branches.

Also in the younger segment, during the year, the "Primo Conto" agreement was introduced, reserved for children up to the age of 17, who can approach banking services in complete safety; the initiative was a considerable success, with the opening of 552 new relations.

Great attention is also paid to customers "over 65": "Conto Evergreen" - now used by approximately 2,000 holders - is reserved for them, demonstrating the interest aroused by the product due to its simplicity, affordability and completeness.

Even greater interest was shown in "Conto Rosa" reserved for female customers, which exceeded 5,000 members.

“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.

#### **Direct deposits: time deposit**

In 2017, direct deposits grew, thanks also to the desire, on the part of both private individuals and institutional investors, to identify safe and financially sound banks in which to deposit their cash with serenity.

The main instrument for direct deposits was the “time deposit”, preferred by customers compared to traditional bonds. 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”.

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 financial instrument within the development policies of the provision by the Bank.

#### **Indirect and managed deposits – The private banking service**

Indirect deposits grew significantly and reached in this way the amount of Euro 1.691 billion, confirming the important trends of recent years: within it, the performances of asset management were very positive, now close to the € 1 billion threshold, up by 22%, with a balanced development both of the UCITS component (561 million, +25%) and of the financial insurance component (401 million, + 19%).

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

In this area, a special appreciation was recorded for the “Multinvest” product, subscribed for approximately Euro 40 million, up from the already favourable result achieved in 2016.

The Unit Linked, called “Z-Platform”, the volumes of which amounted to Euro 92 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.

Supplementing 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).

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, also for the proven qualification and professionalism of the figures involved. Thanks to constant training of the personnel and promotion carried out in the area, 170 customers, for a total amount of 300 million, have already chosen to use the personalised private banking service of Banca Valsabbina.

The business plans already envisage an increase in the number of professionals dedicated to the development of private banking over the next few years and, also in line with the regulatory provisions of MiFID 2, in the number of customers who will take advantage of the advanced consultancy service.

### **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.

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 could represent 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 recent chronicles in protecting companies from new and feared types of IT risk.

### **Loans to businesses and leases**

In 2017, the Bank, boosted by its extensive network and functional distribution model, issued more than 5,100 new loans for a total amount of almost Euro 600 million: a concrete support to the economies of the territory.

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 2017 the Bank supported 1,100 companies including SMEs and micro-businesses for a total amount disbursed of Euro 220 million, was accompanied by new financing initiatives of investments supported by substantial allocations at soft rates.

The Bank has also launched a new tool that helps companies achieve the objectives contained in the Government's "Industry 4.0" project (use of intelligent, interconnected and Internet-connected machines; connection between physical and digital systems; complex analyses through the use of Big Data). Industry 4.0 envisages, among other facilities, important benefits for businesses, such as hyper-amortisation at 250% and the extension of the super-amortisation at 130%. In particular, hyper-amortisation aims to stimulate investments in the sectors of industry 4.0, with the addition of precision technologies for agriculture and for the reduction of energy consumption.

To make the most of this important opportunity, the Bank has set up a ceiling of Euro 20 million to take out loans that businesses may sign to use this facility; entrepreneurs can make the purchase until 30 June 2018, provided that the order with the related advance payment is more than 20% and has been paid by December 2017.

In order to disseminate the important opportunities deriving from the Industry 4.0 plan, the Bank also participated with enthusiasm in the "itinerant" initiative of the Brescia newspaper, which promoted close examinations and round tables.

The meetings were held at major industrial companies in the area and saw the participation of entrepreneurs and professionals who explained their views on the new industrial revolution. One of the events, which was a major participation, took place at the Bank's historical headquarters in Vestone.

To enrich its product range, the Bank, assisted by FISG (Banca Finint Group), signed a guarantee agreement last June with the European Investment Fund (EIF), which makes available to Italian innovative companies a ceiling of Euro 50 million in loans, payable over the next two years, 50% backed by the Fund itself.

The agreement was signed during a ceremony held at the head office in Brescia, attended by Pier Luigi Gilibert, Chief Executive of the EIF, Renato Barbieri and Tonino Fornari, Chairman and General Manager of Banca Valsabbina, respectively. This agreement is part of the "Horizon 2020" research and innovation programme of the European Union and is part of the "InnovFin - EU finance for innovators" initiative, financed by the European Commission.

The initiative aims to support the local economic fabric and provides a guarantee from the EIF for loans for research, development and innovation activities by SMEs and Small Mid-Caps (companies with less than 500

employees). The coverage percentage is fixed and equal to 50% of the residual debt existing each time, and a guarantee fee of 50 bps for SMEs and 80 bps for medium capitalisation companies is envisaged.

The agreement, on the one hand, confirmed the solidity and dynamism of our bank and, on the other, gave the Bank a new tool to concretely support the activities of the small and medium enterprises of our territories, which continue to be the heart of the country's production system and are at the centre of the Bank's business strategies.

More than Euro 10 million of loans has so far been provided to innovative companies through the EIF ceiling.

The Bank was also one of the first to sign the "Bando al Via" (Tender at the Start) promoted by the Lombardy Region. The aim of the project is to relaunch the production system, by facilitating the phase of exit from the economic and productive crisis.

The initiative finances investments - including the purchase of machinery, plant and specialist consultancy - included in adequate business development plans aimed at restoring optimal production conditions, maximising energy efficiency, healthy workplaces, safety of processes and growth on the markets of Lombardy companies, by promoting plans aimed at relaunching disused production areas.

In concrete terms, companies will be able to benefit from a loan backed by a guarantee of up to 70% from the Guarantee Fund managed by Finlombarda and from a capital contribution granted by the Lombardy Region (from 5 to 15% depending on the size of the company, the amount requested and the line of intervention). The Bank also offers, in collaboration with a specialised partner, the advice necessary for the presentation of the application file, at really competitive cost conditions. Again, the application files submitted via the Bank exceeded Euro 10 million.

With regard to support for corporate finance, in the wake of the positive experience started in 2016, the Bank has also intensified the dissemination of its own proven initiative: in collaboration with a specialised company, it confirmed the proposal to the creditor companies of the Public Administration of a solution for the assignment of credit without recourse by offering to the interested counterparties the possibility of monetising their certified credits in advance and at favourable interest rate conditions. The equivalent value of receivables disinvested through this formula exceeded Euro 110 million and among the customers who used it, in addition to many SMEs, there were also some of the most important Italian utilities.

Finally, 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 of Euro 30 million was set aside for investments. To date, minibonds of approximately Euro 7 million are subscribed, all with regard to companies operating in the northeast of the Country.

At the end of the review reserved for technical forms that are complementary to traditional credit facilities, it should be noted that 2017 continued to be 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: disbursements exceeded the considerable amount of Euro 38 million.

### **Mortgages to households**

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 1,100 totalling more than Euro 125 million. In fact, in 2017, 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.

### **Consumer credit**

Banca Valsabbina and Cofidis - European specialist in consumer credit, part of the Credit Mutuel Group - signed a multi-year partnership agreement at the end of 2017 for the distribution of financing products for households. These products will be offered by our 70 branches under the Valsabbina brand.

The partnership - which responds to a widespread need of customers to satisfy their personal or family projects preferably through the banking channel - starts in a positive and promising season of the market because of the low cost of money and a reduced risk of credit facilities.

The agreement allows the Bank to diversify its range of products and services and to make repayment methods more flexible and agile for a specific target of customers who, thanks to Cofidis' expertise in consumer credit, appreciate the fiduciary tone of the relation as well as the speed of the assessment and disbursement of loans. Although the partnership has just been launched, according to the first contracts, it is expected to bring well-deserved satisfaction for customers, first and foremost, but also for the counterparties who have decided to implement it.

As part of its ongoing search for products and services to meet new customer requirements and ensure a significant contribution to commission margins, the Bank has recently signed an agreement with Vivibanca Spa, an intermediary specialising in the granting of loans in the form of salary-backed loans (hereinafter CQS) and salary deductions.

The CQS is a widespread type of loan for employees (ministerial, civil servants, state/controlled bodies, private individuals employed by companies in the form of SPA/SRL and with a minimum of 20 employees) and retired persons, i.e. those who can count on a pay slip or a pension certificate to which the instalment of the loan can be charged.

The peculiarity of this type of loan is that the risk of voluntary insolvency of the debtor is strongly mitigated for two substantial reasons: first of all because the instalments due are deducted directly from the pay slip or the pension payroll and secondly because the loan is obligatorily covered by a life and employment insurance policies by the borrower customer.

For both these new product launches - consumer loans and salary backed loans - the Business Division's valuations are absolutely positive and reasonably suggest interesting developments already in the near future.

### E-money services

E-money services showed a constant and considerable growth, confirming the positive trend already observed in past years. The growth trends in the number and movement of cards indicate - as confirmed by the table below - an extraordinarily strong acceleration during the 2017 financial year.

	2011	2012	2013	2014	2015	2016	2017
<b>ATM points</b>	60	68	66	66	66	68	79
Number of transactions carried out	807,5	862,254	875,207	896,746	928,223	971,803	1,038,703
Amounts transacted (in millions of Euro)	133	148	153	159	167	172	180
<b>POS</b>	1,484	1,937	1,799	2,008	2,127	2,168	2,565
Number of transactions carried out	1,321,	1,645,40	1,867,78	2,198,20	2,340,51	2,430,95	2,555,905
Amounts transacted (in millions of Euro)	108	133	140	159	167	175	190

In the wake of a phenomenon that seems unstoppable in the economic behaviour of consumers and that, for this very reason, urges the operators of payment systems to constantly innovate their services, the Bank has pushed commercial and communication initiatives to make the use of ATMs and POSs as easy and convenient as possible and their dissemination to the benefit of user customers, but also of the bank itself for the related commissions. Consistent with the above, "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.

In 2016, the Cartasì Light service that - in parallel with a lower cost profile - envisages a lower maximum expenditure compared to the most commonly used Classic cards, was also available.

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 Nexi S.p.A. (former Cartasì): the formula

combines the functionality of the credit card with the convenience of the Telepass device of Autostrade per l'Italia.

The lively commercial campaigns aimed at developing payment services helped to increase the stock of cards in circulation under the Bank's brand from 86,000 units in 2016 to 94,000 in 2017, thanks also to the partnership with American Express that led to the issue of 1,500 new devices only in 2017.

#### **Banca OnLine and telematic services**

In the light of the new business models, aimed at a growing digitalisation of banking services - while safeguarding the centrality of the direct relation with the customers of the 70 branches - the most careful attention to the development of IT services and "Banca Online" was confirmed during the year: an attention legitimated by the high levels of service rendered by the provider Cedacri and by new initiatives expected in the context of research and development programmes of the provider itself. Within this favourable context, Valsabbina's plans include the launch of an online deposit account at the end of the current financial year: an ambitious but realistic project, functional to the objective of strengthening the entire commercial offer reaching new customers throughout the country.

A major new increase in the number of telematic services was achieved in 2017, 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 36,322 against 32,049 last year, an increase of 13% 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 to and completion of the direct and personal relation that is achieved within the branches. On the other hand, the continuous growth was favoured by greater ease of use and by the improved safety control units against possible attempts of computer fraud: the introduction of sophisticated Strong Authentication systems, such as the Token OTP device and Secure Call, which are mandatory for the authorisation of home banking payment orders, was the most convincing response to data protection and security problems.

The appreciation of the App launched during 2015 and renovated in 2017 continues to be 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.

At the end of the chapter dedicated to commercial policies, due to the close relationship between the Bank and the territory, we would like to highlight an initiative that shows the Bank's attention and presence on social issues.

Socialvalsability, the competition created and organised by Banca Valsabbina, aimed at associations operating in the provinces where the Bank has branches, kicked off last summer. The project aimed to create a greater social integration and to support those who work for the development of the territory.

To achieve these objectives, the Bank established three prizes in the amount of Euro ten thousand each.

57 projects took part in the initiative, presented by associations active in the provinces of Brescia, Verona, Monza-Brianza, Trento, Bergamo and Milan.

The initiative was very popular on social media.

#### **Communication**

Communication activities were very intense also in 2017: both institutional and in support of commercial initiatives aimed at disseminating - through specific advertising and promotional campaigns - information concerning new products and services, the most important ones rather than those undergoing restyling.

To this end, the main means of communication used were, first and foremost, the Bank's website, local radio and television stations and relations with the press, with the addition of advertisements in local newspapers, as well as by organising conferences open to associations and trade associations aimed at presenting new

products that from time to time are of particular interest to those organisations. The mentioned cycle of meetings on the novelties introduced by the Industry 4.0 government measure was significant because it caused quite a stir.

## 15. HUMAN RESOURCES

"Italian banks are now called upon to change in order to bring profitability back to adequate levels", is the challenge launched by Governor Visco to the banking system as part of the Final Considerations of 2017. The areas of intervention indicated here are different, from the rationalisation of costs to the development of new business opportunities, to the control of risks related to the digitalisation of services.

At the same time, customer requirements and lifestyles are changing: customers are faced with a varied and well-structured range of financial products, new and advanced payment services and alternative channels for accessing credit, alongside traditional banking services.

In this context, the very role of our Bank evolves, called upon to assist and accompany customers towards new services, to fully understand their needs, to assess in an integrated manner the risks and opportunities of the various options that can be activated.

Consultancy becomes the central plank of the relation, requiring - from our appointed personnel - the development of new and transversal professional knowledge and skills, the creation of relational and individual skills able to understand and meet the needs of customers in a timely manner.

Therefore, the usual practice to indicate in the annual report to the shareholders convened in the meeting the characteristics, skills, qualities and commitment that positively define the human component of our Bank is the basis for the issues mentioned above.

Never as in this context have human resources assumed a strategic role and function, because it is only through them that companies can manage with flexibility and immediacy the deep changes imposed by the reference market for their economic survival, in an increasingly complex and competitive context.

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 comparison with other intermediaries on the market, since the quality of the professional and personal behaviour of our employees does not pass unnoticed by the customers and does not elude their assessment.

Equally fundamental is the ability to grow professionally that our collaborators are called upon to express and with it the possibility of ensuring a high quality contribution to the constant and harmonious development of the corporate structure, in the scenario of strong change already underway.

The good level of professionalism and interpersonal skills that characterises the human resources of our Bank is first of all 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.

We shall now move on to a more detailed analysis of the trends and composition of the Bank's workforce.

By the end of 2017, the company's staff reached a total of 561 units, with a net increase of 61 resources. There were 79 new hires, of which 33 as a result of the acquisition of Hypo Bank branches and 46 for new hires; 18 employees left the company, 10 of them due to resignations and 8 due to retirement age limits being reached.

The importance of the above figures bears witness to a year of great commercial and organisational turmoil that also affected the local network: a year that began with the IT migration to Banca Valsabbina systems of the 7 branches acquired from Hypo Bank and the related mortgage portfolio. With this acquisition, the branches that make up the sales network became 70.

Recruitment mainly concerned the staffing of the two new branches in Padua and Milan, as well as a strengthening in the various business areas.

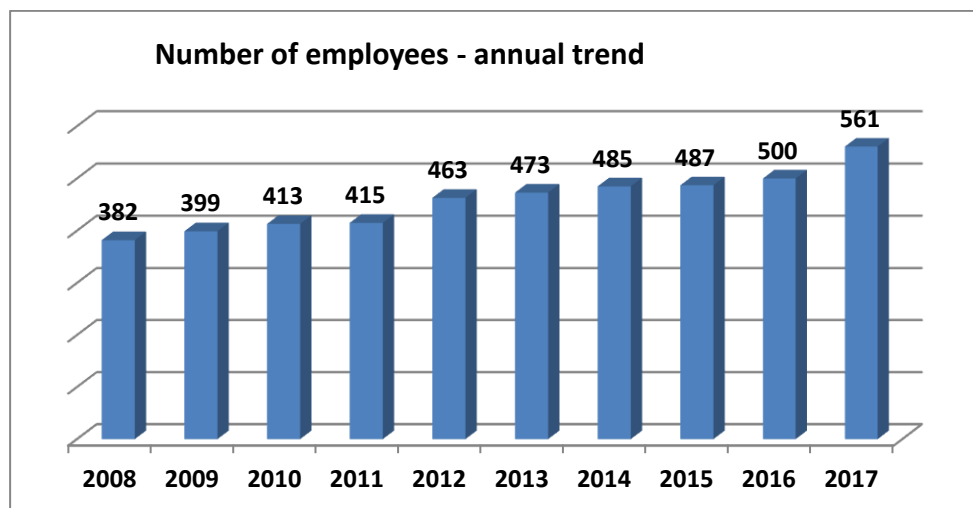
The new hires also led to the consequent effects on the percentage composition of the various areas of staff levels as well as in terms of average age and average seniority of service.

The goal of 561 resources, which is undoubtedly rewarding for our Bank in terms of dynamism and development, is even more valuable in the current economic period, considering that employees - 415 at the end of 2011 - have grown during the period by more than 35%, supporting the process for strengthening also the commercial network that had 54 branches at the end of that year.



In this regard, it is worth noting that this growth in the personnel component was constantly accompanied by the maintenance of an adequate level of productivity, which represents for the company an essential reference point for the development lines of its production facilities.

The following table summarises the development of the number of employees of the Bank in recent years and the significant growth recorded in 2017.



This positive trend shows an opposite trend to that of the Italian banking system, in which the turnover, in the same period, is expressed in an indicator equal to 0.7, therefore lower than the simple replacement value. In other words, at the level of the national banking system, i.e. there are 7 hires every 10 terminations. Of course, the overall figure reflects the different characteristics of the individual Italian banks, also in terms of market positioning, growth potential of the sales network and volumes traded, and the need to adopt policies to contain costs.

The table below summarises the distribution of the personnel according to the contractual staff level profiles in 2017.

<i>Personnel – Contractual staff level</i>	2017	%	2016	%	2015	%	2014	%
Executives	10	1.8%	10	2.0%	9	1.8%	9	1.9%
3rd and 4th level middle management	117	20.8%	107	21.4%	104	21.4%	103	21.2%
1st and 2nd level middle management	106	18.9%	85	17.0%	78	16.0%	76	15.7%
Other Personal Areas	328	58.5%	298	59.6%	296	60.8%	297	61.2%
of which:								
professional training apprenticeships	-	-	-	-	-	-	1	0.2%
under staff leasing	3	0.6%	3	0.6%	1	0.2%	2	0.4%
<b>TOTAL</b>	<b>561</b>	<b>100.00%</b>	<b>500</b>	<b>100.0%</b>	<b>487</b>	<b>100.0%</b>	<b>485</b>	<b>100.0%</b>

The number of Executives remained unchanged in absolute terms, while there was a decrease in percentage terms compared to the previous year. The total number of middle managers increased, with a significant increase in the first two levels. Compared to the overall percentage structure, the personnel of the other Professional Areas decreased by almost 1 percentage point.

In its contractual expression, this trend in staff levels points out a further overall growth in the professionalism of the personnel themselves, also linked to the need to cover the roles of responsibility related to the increase in the number of branches and to the other roles of responsibility within the organisational structure.

However, this trend confirms the company's internal dynamism, which cannot fail to have a positive effect on the achievement of performance objectives.

A comparison with the figures in the "2017 Report on the labour market in the financial industry" recently published by ABI shows - particularly for the banking sector - some of the system trends mentioned above, i.e. a trend that shows our Bank engaged in a very balanced growth phase whereas the sector shows reflexive trends.

The incidence of the executive positions in the Bank is substantially in line with that of the banking system (which has fallen to 1.7%); the percentage of Middle Managers is still below the system level (41.8%), while the percentage of other professional areas is higher (the system stands at 56.5%).

This comparison also expresses the above considerations in terms of the development scenario of the banking system in the size of resources, where only banks with potential for expansion and management under conditions of economic equilibrium continue to strengthen their growth structures.

As regards the seniority of the banking system's personnel, despite the high number of terminations over the last three years due to retirements or access to the sector's solidarity funds, the average figure is 50 years (53 for Executives), while the average age of the 561 employees in service is 41.7 years.

The average length of service at our Bank is 11.4 years, compared to 12.4 in 2016, decreasing due to the effect of new young people hired. More precisely, 42.6% of the personnel, equal to 239 units, is aged between 30 and 40.

The following table summarises the trends described above.

Personnel - age and length of service	2017	2016	2015	2014
average age	41.7	41.8	41.1	40.5
length of service	11.4	12.4	12.1	11.6

Despite its almost 120 years of history, the Bank shows its liveliness in terms of structure and dynamics of its personnel: the policies aimed at the rotation and alternation of the roles for the purposes of enhancing skills and professionalism are the best guarantee of continuous adaptation to the needs of the areas where the bank operates and of its customers.

Moving on to the distribution of personnel between the head offices and the sales network in 2017, the figures and distribution are in line with those of recent years: of the 561 people who make up the company's workforce, 166 work for the central structures (29.6% of the total, with an average annual increase of 9 resources), while 395 units (70.4%, with an increase of 52 resources) are distributed within the sales network.

Therefore, a prevailing part of the company's entire workforce is permanently engaged on the market in consulting services, activities offering products and services, assistance and customer relations.

This measure explains with immediacy how the high rate of productivity and managerial efficiency, also in virtue of the high technological and organisational standards of the company, can allow almost three quarters of the personnel to be assigned to the service of the timely management and development of the business.

This is even more valuable for a bank of our size, which does not benefit from the production and scale economies of some of our competitors.

On the other hand, the need to adapt to the incessant production of laws and regulations means that the Bank needs to continuously strengthen its central structures, in order to ensure the best functioning of its governance structures and to offer its customers products and services with excellent quality levels.

In terms of gender, in 2017 there were 29 new female employees, bringing the number of female employees to 181, 16 of whom part-time.

The percentage incidence on the total of employees is 32.3%, with an increase of almost 2 percentage points compared to 2016. The average age of female employees is 39.6 years, compared to 42.7 years for men.

The following table summarises the trends described above.

Personnel – breakdown by gender	2017	2016	2015	2014
Males	380	348	338	333

Females	181	152	149	152
Total	561	500	487	485

Although the female component within our company is even smaller than the system data, according to which women represent 45.2% of the workforce by 2017, this gap is gradually narrowing.

Moreover, the contribution of female personnel, who are increasingly present in positions of responsibility both in the central structures and in the sales network, grew significantly as the Bank's organisational and distribution structure continues to adapt.

The latter has 14 branches entrusted to the responsibility of female personnel, in addition to an Area manager structure.

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 49% of the total, compared with 38.8% 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 2017, 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.

Therefore, a significant contribution to the development of human resources was ensured by the professional and managerial training activities promoted and provided by the Bank, stimulated by increasingly high quality standards codified in the same supervisory provisions, and enriched by the strong interaction between teachers and course attendees.

In 2017, 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 of organisational units 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 31,483, 50% more than in the previous year, partly as a result of the acquisition of the former Hypo branches and the related training requirements of their personnel as well as new hires. Those attending at least one training course numbered 505 (456 in 2016).

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 offered; 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; those related to innovations introduced by the Mifid II regulations, with particular reference to consultancy regarding investment services and the related investor protection obligations.

The chapter of bancassurance absorbed, as in the past, the higher number of hours: 4,575 and 317 colleagues.

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 by the great ability of employees at all levels of responsibility to press towards the common target of the Bank's development. We want to rightfully acknowledge their dedicated commitment, but also the style and attention reserved for customers and their respective interlocutors.

## 16. LEGISLATIVE AND REGULATORY CHANGES

We feel it would be useful to open this paragraph dedicated to new laws and regulations with some reflections by the President of the Consob at the hearing held on 14 December 2017 at the Parliamentary Commission of Inquiry into the banking and financial sector.

*"The change in the rules governing the stability of the financial system, adopted in response to the economic crisis, has further increased the pressure on banks". "The regulatory and supervisory infrastructure on the financial system at European level has undergone a real revolution".*

There is no doubt that the close link between the economic crisis, risks to the stability of the financial system and the need to protect it has led to more penetrating and incisive regulation of the sector, largely translated into pressure on the banking system.

Recalling the fundamental steps of this process, we reserve the right to formulate some reflections at the end of this paragraph, both with regard to this regulatory cycle that is about to be completed, and with regard to the new pressing challenges that the regulation of the sector will have to face (and related impacts for banking and financial intermediaries).

The main regulatory changes introduced in recent years to protect the stability of the financial system, some of which are still in the process of being adopted, concern the following measures:

- Directive (EU) 2013/36 (CRD IV) and Regulation (EU) No. 575/2013 (CRR) introduce, as from 26 June 2013, the new European regulation on prudential requirements for banks, in implementation of the Basel 3 agreements. Bank of Italy Circular 285/2013 has made these provisions fully operational in Italy. In this regulatory context, between 2014 and 2017, the Italian banks subject to European supervision carried out capital increases of approximately Euro 40 billion;
- Directive (EU) 2014/59 (Bank Recovery and Resolution Directive - Brrd) introduces the "bail-in" principle at European level. The main novelty of the bail-in is to charge the cost of bank bail-outs to investors, shareholders and bondholders of banks in crisis, even involving holders of deposits over Euro 100 thousand. Italian Legislative Decrees 180 and 181 of 2015 of transposition have deeply changed the perception of the solidity of banking institutions with regard to their shareholder structure and the market;
- since November 2014, the Single Supervisory Mechanism (SSM) has entrusted the European Central Bank with the direct supervision of significant banks. There has been a sudden transition from a process of slow convergence of national banking supervisory systems to the establishment of a completely new model, the Banking Union, based on a centralised and integrated supervisory system at supranational level. The transition to a single supervisory authority led to new rules for the analysis of non-performing loans (NPLs), which had a strong impact on the financial statements of banks, especially Italian banks;
- the document of the Bank of Italy dated September 2017, concerning "Guidance on the management of non-performing loans for Italy's Less significant institutions", approved at the end of January 2018, specifies the expectations of the Supervisory Authorities on the management of NPLs. Banks are required to adopt a formalised strategy aimed at optimising the management of NPLs, maximising the current value of recoveries and the effectiveness of forbearance practices, intervening on loan classification with a view to ensuring the accurate identification and representation of risks, and formalising comprehensive credit and guarantee valuation policies that ensure the consistency of the criteria applied.

In 2017, the regulatory chapter represented by the so-called Recovery Plan proved to be of particular importance for all intermediaries. In February 2017, the Bank of Italy laid down the implementing provisions for Title IV, Chapter 01-I of the Banking Consolidation Act and Title IV, Chapter I-bis of the Consolidated Law on Finance (Measure concerning recovery plans), envisaging simplified procedures for the fulfilment of the related obligations.

In particular, the Bank of Italy, consistently with the EBA Guidelines on the application of simplified obligations in relation to recovery plans (EBA/GL/2015/16), defined the ordinary compliance procedures, specifying the minimum list of qualitative and quantitative indicators of the recovery plans and the series of scenarios to be used in the plans, in compliance with the scheme provided by the Supervisory Authority.

Continuing with the in-depth analysis of new regulations, the set of provisions that come into force in 2018, aimed at protecting investors and, more generally, consumers, also plays an important role, both by imposing more stringent rules of conduct on the intermediaries that provide their services and by establishing,

upstream, principles and rules of transparency and fairness for those who produce the services or instruments that then make up the portfolio of customers.

In 2018, the following regulations come into force:

- Directive (EU) 2014/65 (known as MiFID II) and the related Regulation (EU) no. 600/2014 (known as MiFIR), implemented in Italian Legislative Decree no. 129 of 3 August 2017, which amended the Consolidated Law on Finance, as well as in the implementing regulations, both at European and national level. The objective is to strengthen the measures of transparency and protection for investors. The main innovations concern: the management of new products; the assessment of the adequacy over time of the risk profile of the investors' portfolio; the provision of investment advice; the management of conflicts of interest and incentives; communications to customers on costs and charges; the knowledge and competence of the personnel involved in the provision of investment services to customers; the regulation of financial markets;
- Regulation (EU) no. 1286/2014 (known as PRIIPs Regulation), the main innovation of which is the obligation to prepare a document containing the so-called "Key Information Document" (KID), designed to provide, with respect to the investments underlying the pre-assembled product (e.g. unit-linked), "better" information transparency on risks and associated costs;
- Directive (EU) 2016/97 (known as IDD) aimed at harmonising the provisions on insurance distribution, with the introduction of more efficient and simplified systems for the management of registers and the supervision of intermediaries. In particular, it represents a significant increase in the level of consumer protection and in many respects consolidates into European law principles and rules already present in Italian regulations;
- Directive (EU) 2015/2366 (known as PSD2) on payment services in the internal market. It aims to promote the development of an efficient, secure and competitive internal market for retail payments by strengthening the protection of payment service users, supporting innovation and increasing the level of security of electronic payment services.

Other regulatory areas monitoring the risks of intermediaries and protecting their customers, which show their full impact in 2018, by innovating significantly compared to the previous supervisory provisions, are:

- Italian Legislative Decree no. 90 of 25 May 2017, implementing Directive (EU) 2015/849, which amended Italian Legislative Decree no. 231/2007 relating to the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. Some of the new rules have been in force since 4 July 2017, as they are immediately applicable, while the other provisions falling under the competence of the sector's Supervisory Authorities have been in force since 31 March 2018; the new regulatory framework will only be fully updated once they are in place.
- Regulation (EU) no. 2016/679 (known as GDPR) on the protection of personal data, immediately applicable, in force since 25 May 2018, the main contents of which are aimed at improving the information and rights of the person concerned, increasing the control units for risk mitigation through the appointment of a data protection officer, introducing legal requirements to keep a register of processing operations and carrying out impact and risk assessments.

The new regulatory and supervisory framework, almost entirely completed, has already shown its effectiveness in containing risks, especially systemic risks, while it has not yet been possible to assess its flexibility in encouraging concrete responses to the new needs of the real economy, renewed in its critical success factors after the long period of recession.

The survey on the adoption of technological innovations applied to financial services (known as "Fintech"), carried out by the Bank of Italy in December 2017, shows how the current regulation, and the one in progress previously, is perceived by operators in the various disciplinary areas as an obstacle and a brake to financial innovation made possible by technological innovation. For example, the regulatory framework on privacy protection would impose excessive constraints, suggesting the need to standardise ad hoc rules for the use of biometrics and for customer authentication.

Therefore, the regulatory production that has already affected and continues to affect the banking and financial system is more extensive, well-structured, pervasive, but still not complete on how to regulate the many ideas related to technological innovation, taking into account the benefits that can derive for customers and industry as a whole.

Even in this evolving scenario, as it was during the economic crisis, there is a risk that this regulatory production will be a "non-neutral" variable that will be decisive in the choices made by operators in the sector. Our Bank is in fact taking steps, with due time and accuracy, 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.

## **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.

With a resolution dated 12 July 2017, the Board of Directors set up the Committee of Independent Directors in order to encourage greater coordination between them and improve information flows. Where requested, a prior, justified and non-binding opinion was always unanimously expressed first by the Independent Directors and then by the Committee. The opinion was always favourable for all the transactions proposed.

In conclusion, no transactions with related parties and/or parties associated with them had a significant impact on 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") has the task of assessing the correct functioning of the organisational safeguards 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 of 2001. As established by the Organisational Model, it periodically reports to the Bank's Board of Directors.

During the meetings held during the year, the 231 Body was in a position to dwell, with greater attention, upon the adoption by the Bank of the necessary organisational measures associated with the application of the regulations contrasting money laundering and the financing of international terrorism in the light of the changes that occurred with Italian Legislative Decree 90/2017.

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.r.i.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.

During 2017, the Body received a number of written communications indicating alleged irregularities in the management of the bank; following the relative and appropriate investigations, these communications were responded to where deemed necessary.

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.

The function of Supervisory Body, established pursuant to Italian Law 231/01, has been assigned to the Board of Statutory Auditors as from 15 November 2017. Previously, the Supervisory Board consisted of seven members, including the Chairman of the Board of Statutory Auditors, the heads of the control functions and a Bank official who also carried out the role of secretary, whereas the Chairman of the Supervisory Body was an outside professional.

Following the unavailability communicated by the external professional to continue the collaboration, the Board of Directors implemented the provisions of Article 14 of Italian Law no. 183 of 12 November 2011 and Circular 285/2013 of the Supervisory Body that provide for the functions of the Supervisory Body to be normally assigned to the Board of Statutory Auditors.

Since the regulations require the Board of Statutory Auditors to check the correct adoption of the Organisational Model by the Bank, the assignment of the Supervisory Body to it completes the range of duties of the Board, which by law and by the articles of association is called upon to monitor the adequacy of the organisational, administrative and accounting structures of the company, simplifies the structure and allows for more timely controls. Moreover, for the sole purposes of Italian Legislative Decree 231/2001, the Board of Statutory Auditors must not be considered among the top management and, as such, cannot be included among those who can commit the offences envisaged by the Decree in question.

The Organisational Model, approved by the Board of Directors at its meeting of 1 July 2015, is currently being revised to bring its content into line with best practices, guidelines and case-law principles regarding the suitability of the organisational, management and control model pursuant to Italian Legislative Decree 231/2001, as well as with the guidelines of the authorities, also taking into account the development of the Bank's internal control system.

## **19. ECONOMIC PERFORMANCE**

A review of the 2017 income statement shows, first of all, the positive trend in the bank's net interest and other banking income, which rose from Euro 89.2 million to Euro 106 million, up by Euro 16.8 million or 18.8%, well above the results planned at the beginning of the year.

Impairments on loans and receivables and guarantees and commitments, which became necessary as a result of the effects of the economic crisis of recent years on the Bank's loan positions, accounted for Euro 43.6 million (compared to Euro 36.3 million the previous year). Moreover, capital losses of Euro 7.4 million were recorded on securities, so as to achieve net profit (loss) from financial operations of Euro 55 million, an increase compared to 50.2 in 2016, but strongly affected in its numerical expression by the aforementioned adjustments.

Operating costs came to Euro 65.6 million. Compared to last year, operating expenses were Euro 20.6 million higher, but 2016 included the extraordinary contribution of Euro 17.5 million received for the purchase of the former Hypo Bank branches, which also resulted in a difference in the scope of comparison in terms of size between the two years. After the write-down of Valsabbina Real Estate for Euro 295 thousand and positive taxes for approximately Euro 5 million, the income statement for the year showed a loss of approximately 5.8 million.

For the first time, this circumstance also applies to the profit (loss) for the year of our bank after having made in recent years an extensive appearance in many companies in our sector.

According to our forecasts, the loss for the year is contextualised with the end of one season and, as from the current 2018 financial year, another season starts, creating the conditions to face with commitment, but also with great confidence and serenity the coming years which, according to the most reliable forecasts, should allow the return to satisfactory economic results. As already mentioned, the loss of Euro 5.8 million was also affected by external factors, such as write-downs of Fondo Atlante of approximately Euro 4 million and of the Voluntary Scheme of the Interbank Guarantee Fund for an additional Euro 1.5 million, as a result of actions taken in favour of the banking system in which we had to participate.

<b>RECLASSIFIED INCOME STATEMENT (amounts in Euro 000)</b>	<b>2017</b>	<b>2016</b>	<b>change</b>	<b>% change</b>
Net interest income	57,154	49,666	7,488	15.1%
Net fee and commission income	30,379	27,348	3,031	11.1%
Dividends, trading and other income	18,431	12,153	6,278	51.7%
<b>Net interest and other banking income</b>	<b>105,964</b>	<b>89,167</b>	<b>16,797</b>	<b>18.8%</b>
Net impairment losses on loans and receivables and guarantees and commitments	(43,555)	(36,264)	7,291	20.1%
Impairment losses on available-for-sale financial assets	(7,362)	(2,734)	4,629	169.4%
<b>Net profit (loss) from financial operations</b>	<b>55,047</b>	<b>50,169</b>	<b>4,877</b>	<b>9.7%</b>
Labour costs	(36,421)	(34,489)	1,931	5.6%
Other administrative expenses	(36,695)	(36,931)	(236)	(0.6%)
Net accruals to provisions for risks and charges	(569)	(736)	(166)	(22.7%)
Depreciation/amortisation and net impairment losses on tangible and intangible assets	(2,624)	(2,344)	280	11.9%
Other operating income/expense/profits or losses	10,718	29,498	(18,780)	(63.7%)
Operating costs	(65,591)	(45,002)	20,589	45.8%
Losses on equity investments and gain on disposal of fixed assets	(312)	(359)	(47)	(13.1%)
Profit from continuing operations gross of taxation	(10,856)	4,808	(15,665)	NS
Income taxes for the year	5,035	(660)	5,695	NS
<b>Profit (loss) for the year</b>	<b>(5,821)</b>	<b>4,148</b>	<b>(9,970)</b>	<b>NS</b>

### Net interest income

Net interest income amounted to Euro 57.2 million, up by Euro 7.5 million or 15.1%.

Disaggregate data show a significant improvement of the contribution of operations with customers. The amount of interest income of Euro 77.1 million net of interest expense on due to customers and on securities issued of Euro 10.5 million and Euro 19.8 million, respectively, led to a net interest income of Euro 46.8 million, up Euro 1.8 million (4.0%) compared to 2016 and equal to Euro 44.6 million.

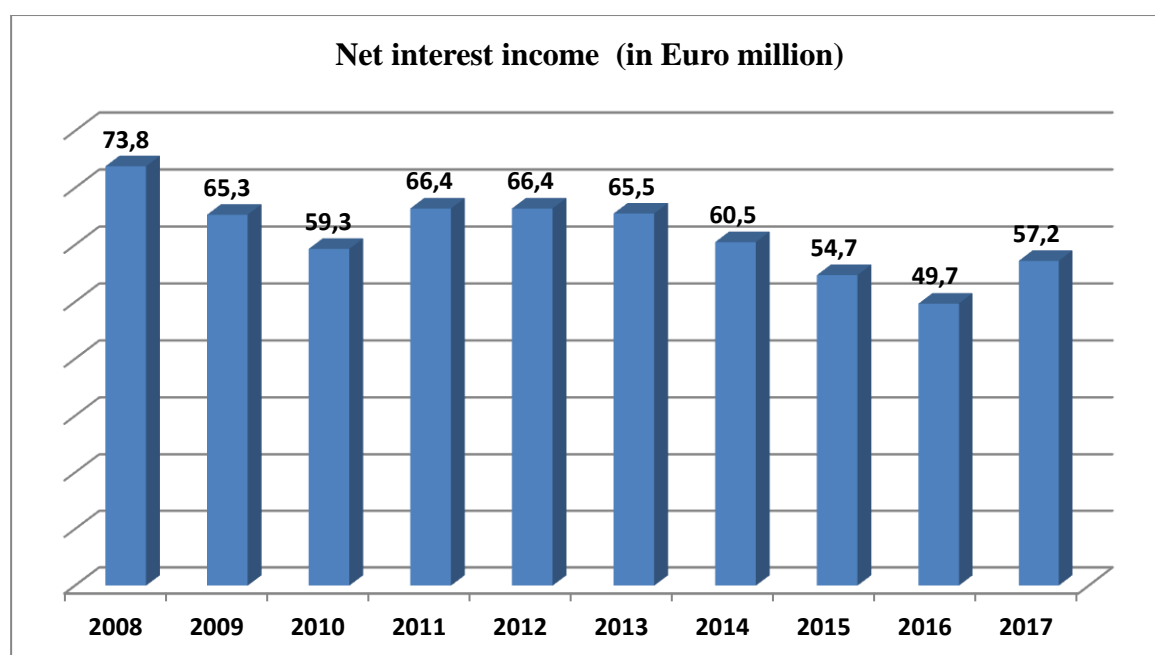
The contribution of financial assets increased by Euro 1.6 million in relation to a fractional increase in interest rates on invested assets.

Interest income from banks amounted to Euro 926 thousand, while interest expenses amounted to Euro 47 thousand. As required by the supervisory instructions, interest income on other assets includes negative interest on loans payable; Euro 3.04 million equal to the amount accrued under the TLTRO2 programme, at a negative rate of 0.4%, on the loans received from the ECB for Euro 690 million and the remaining amount in respect of loans obtained on the NewMic Market and via repurchase agreements.

<b>NET INTEREST INCOME (in Euro 000)</b>	<b>2017</b>	<b>2016</b>	<b>Absolute</b>	<b>% change</b>
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<b>Interest income and similar revenues</b>	<b>87,699</b>	<b>86,767</b>	<b>932</b>	<b>1.1%</b>
- on financial assets	5,653	4,071	1,582	38.9%
- on loans and receivables with banks	926	1,183	(257)	265.4%
- on loans and receivables with customers	77,095	81,509	(4,414)	(5.4%)
- on other assets	4,025	4	4,021	NS
<b>Interest expense</b>	<b>(30,545)</b>	<b>(37,101)</b>	<b>(6,556)</b>	<b>(17.7%)</b>
- on due to banks	(47)	(226)	(179)	(79.2%)
- on due to customers	(10,543)	(11,456)	(913)	(8.0%)
- on securities issued	(19,811)	(25,418)	(5,607)	(22.1%)
- on other liabilities and provisions	(144)	(1)	143	NS
<b>Net interest income</b>	<b>57,154</b>	<b>49,666</b>	<b>7,488</b>	<b>15.1%</b>



#### Service margin

Net fee and commission income amounted to Euro 30.4 million, up by Euro 3 million (11.1%) compared to the previous year and refer to the difference between fee and commission income of Euro 34.8 million (+4.1 million) and fee and commission expense of Euro 4.4 million (+1.1 million).

Management and trading services provided the most significant contribution increasing from Euro 11.5 million to Euro 13.6 million equal to 17.7%, in relation to the increase in amounts of asset management and of bancassurance. Over the last few years, their growth has been remarkable and at the end of 2017 the aggregate represented 39% of fee and commission income,

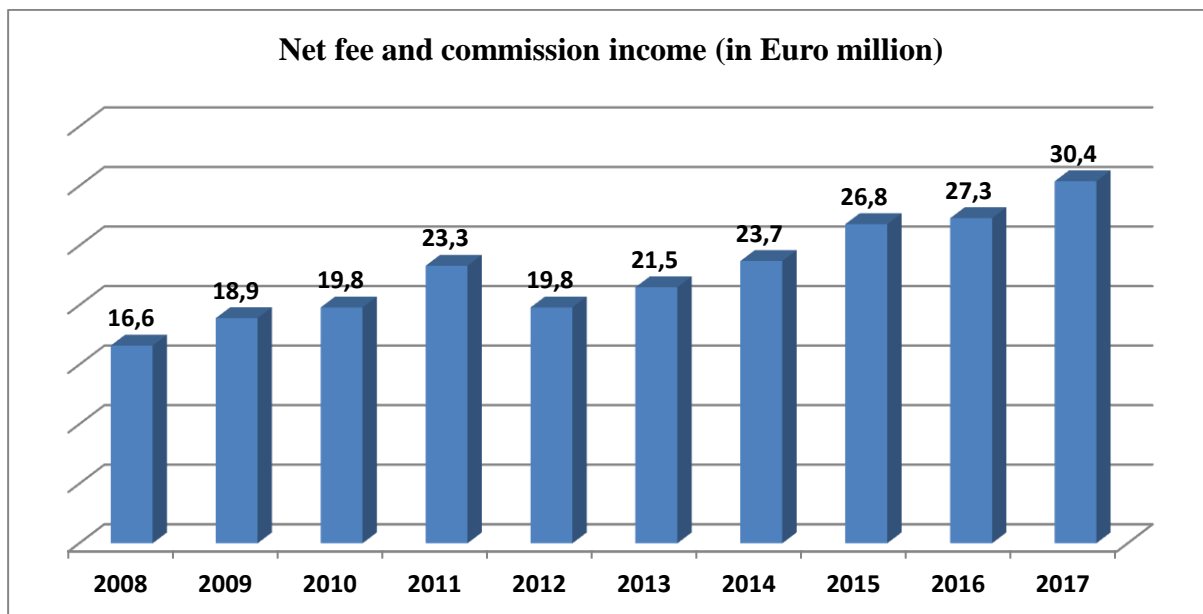
Commissions on the placement of securities increased from Euro 5.4 million to Euro 6.7 million (+ 1.3 million or 24.1%), commissions on the distribution of third party services - which exclusively comprise the commissions relating to insurance policies - amounted to Euro 5.5 million compared to Euro 4.9 million in 2016.

Commissions for other services, which mainly include income from the issue of credit cards, lease brokerage, disbursement of third-party loans, loans under Law 662/96 backed by government guarantees, amounted to Euro 5.7 million, compared with Euro 3.8 million in 2016.

Other commissions were mainly stable: guarantees given of Euro 1 million, collection and payment services of Euro 5.8 million, servicing for securitisation transactions of Euro 0.5 million, account keeping and management of Euro 8.2 million.

Fee and commission expense refer to management and trading services of Euro 1.2 million, collection and payment services of Euro 1.3 million and other services of Euro 1.9 million.

<b>NET FEES AND COMMISSIONS FROM SERVICES (in Euro 000)</b>	<b>2017</b>	<b>2016</b>	<b>Absolute change</b>	<b>% change</b>
<b>FEE AND COMMISSION INCOME</b>				
Guarantees given	966	1,002	(36)	(3.6%)
Management and trading services:	13,586	11,544	2,042	17.7%
- <i>currency trading</i>	363	365	(2)	(0.5%)
- <i>custody and administration of securities</i>	163	136	27	19.9%
- <i>placement of securities</i>	6,652	5,359	1,293	24.1%
- <i>orders collection</i>	872	819	53	6.5%
- <i>consulting services</i>	70	-	-	NS
- <i>distribution of third party services</i>	5,466	4,865	601	12.4%
Collection and payment services	5,800	5,642	158	2.8%
Servicing for securitisation transactions	458	380	78	20.5%
Account keeping and management	8,256	8,305	(49)	(0.6%)
Other Services	5,730	3,805	1,925	50.6%
<b>Total</b>	<b>34,796</b>	<b>30,678</b>	<b>4,118</b>	<b>13.4%</b>
<b>FEE AND COMMISSION EXPENSE</b>				
Management and trading services	(1,176)	(960)	(216)	22.5%
Collection and payment services	(1,340)	(1,341)	1	(0.1%)
Other Services	(1,902)	(1,029)	(873)	84.8%
<b>Total</b>	<b>(4,418)</b>	<b>(3,330)</b>	<b>(1,088)</b>	<b>32.7%</b>
<b>TOTAL NET FEE AND COMMISSION INCOME</b>	<b>30,379</b>	<b>27,348</b>	<b>3,031</b>	<b>11.1%</b>

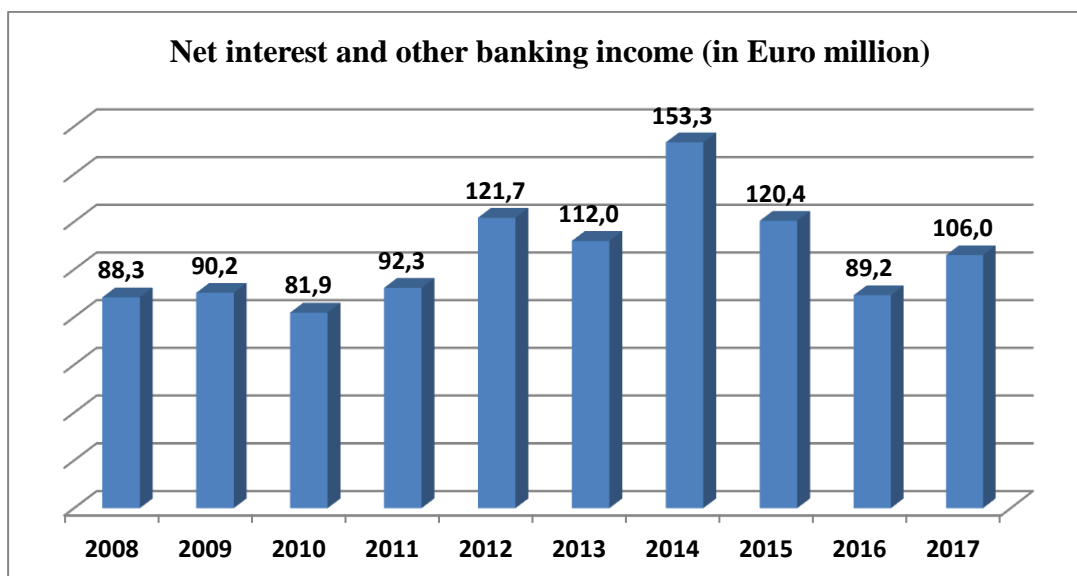


#### **Net interest and other banking income**

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 3.767 million (compared with Euro 3.399 million in 2016). They include Euro 1.138 million of dividends received on UCIT units and Euro 2,628 thousand on shares in the portfolio;
- the profit/loss from trading activities of Euro 553 thousand (compared with Euro 520 thousand in the previous year), mainly for exchange gain;
- a negative result of Euro 754 thousand, as the difference between sales of loans and receivables that generated losses of Euro 1,765 thousand and profits of Euro 722 thousand, and sales of bonds recognised as loans and receivables with profits of Euro 289 thousand;
- gains on available-for-sale financial assets of Euro 15.125 million, compared with Euro 8.768 million in 2016. The amount includes the capital gain on the sale of Cedacri of Euro 5.169 million, as previously mentioned;
- losses on the repurchase on Bank bonds of Euro 464 thousand, compared to Euro 612 thousand in 2016;
- valuation gains on insurance policies recorded in financial assets measured at fair value of Euro 204 thousand (Euro 175 thousand in 2016).

Overall, the net interest and other banking income amounted to Euro 106 million, compared to Euro 89.2 million last year.



### Impairment losses

Impairment losses, net of reversals of impairment losses, totalled Euro 50.9 million compared to Euro 39 million in 2016: they refer to loans and receivables with customers of Euro 44.9 million, available-for-sale financial assets of Euro 7.4 million, whereas reversals of impairment losses Euro 1.4 million were recognised on endorsement loans.

As already mentioned, the amount of impairment losses on loans and receivables with customers, net of reversals of impairment losses, was Euro 44.9 million, up by 8.8 million compared to the previous year. The amount reflects the prudence of the loan assessment policy adopted and also includes the observations received during the inspection of the Bank of Italy.

With impairment losses on loans and receivables charged to the income statement, the coverage ratio for impaired loans reached 46.1% compared to 38.9% the previous year and reached 49.2% including extinguished loans and default interests.

The economic crisis, which in recent years led to a strong decrease in the Gross Domestic Product, and the need to contribute to the bail-in initiatives of various banks, even with significant interventions, affected inevitably the quality of credit in banking assets and the income results. Local banks that are closer to the territory, to its households and to its production activities were even more affected by it; banks, which live in the economy and on the economy of their own territories, are themselves heavily involved in the recession.

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 reclassify the relevant exposures of credit facility 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 was often lower than that of the credit exposure. Hence, also the need to make impairment losses on loans and receivables in order to maintain the ratio between the total amount of these impairment losses and the amount of gross loans and receivables (known as "coverage ratio of the impaired loan") at values that the market currently requires to be kept at high levels.

There were also reversals of impairment losses on performing loans of Euro 618 thousand (Euro 3,734 thousand in 2016) 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 1.51%, compared with 1.31% last year.

For the purpose of mitigating the credit risk as far as possible, the Bank thus reinforced the supervisory and control 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 4 million to Fondo Atlante, for Euro 1.5 million to the intervention in the Voluntary Scheme of the Interbank Guarantee Fund, for Euro 1.2 million to real estate funds and for Euro 0.7 million to equity securities held in portfolio, already analysed in detail in the previous section on financial assets.

The valuation of endorsement loans and receivables disclosed reversals of impairment losses of Euro 1.4 million, equal to the difference between reversals of Euro 1.5 million and impairment losses of Euro 0.1 million.

As a result of the described entries, the net profit (loss) from financial operations amounted to Euro 55 million, compared with Euro 50.1 million in the previous year, with an increase of Euro 4.9 million or 9.7%.

## Operating costs

Operating costs, as detailed in the table below, amounted to Euro 65.6 million compared to Euro 45 million last year due to 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)	2017	2016	Absolute change	% change
Labour costs	(36,421)	(34,489)	(1,932)	5.6%
Other administrative expenses	(36,695)	(36,931)	236	(0.6%)
Net accruals to provisions for risks and charges	(569)	(736)	167	(22.7%)
Depreciation and net impairment losses on tangible assets	(1,710)	(1,501)	(209)	13.9%
Amortisation and net impairment losses on intangible assets	(914)	(843)	(71)	8.4%
Other operating income/expense	10,718	11,998	(1,280)	(10.7%)
Contribution for the purchase of Hypo Alpe Adria Bank branches	-	17,500	(17,500)	NS
<b>Total operating costs</b>	<b>(65,591)</b>	<b>(45,002)</b>	<b>(20,589)</b>	<b>45.8%</b>

Labour costs amounted to Euro 36.4 million, up by 1.9 million compared to the previous year; this increase is due to the increase in the number of employees, from 500 to 561.

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.

Administrative expenses, analysed in detail in the explanatory notes to part C, item 9.5 of the income statement, amounted to Euro 36.7 million, down by Euro 236 thousand compared to the previous year.

Contributions to the resolution funds decreased by Euro 2,460 thousand, indirect taxes decreased by Euro 492 thousand (in particular for the stamp duty recovered from customers and other indirect taxes relating to debt collection), and securitisation expenses decreased by Euro 887 thousand (in 2017 there were no new transactions).

Net of these three expense items, residual administrative expenses amounted to Euro 26,870 thousand compared to Euro 23,263 thousand in the previous year, up by Euro 3,607 thousand or 15.51%.

Expenses increased in relation to the operation of the branches due to the entry of the former Hypo business unit, of the two new agencies that were opened and of the reorganisation with relocation of the premises for Mazzano, Molinetto and Rovato, to the need to ensure suitable standards of technological efficiency for the network and the internal offices and to improve the security of IT systems and equipment while ensuring their operational continuity. Data processing costs also increased, including the cost of IT migration of ex-Hypo branches, as well as the cost of external contributions for the demanding adjustments required by the deep changes in the regulatory framework and accounting standards. Legal expenses remained substantially stable.

The operating costs also include: impairment losses on tangible and intangible assets - totalling Euro 1.71 million (1.5 million in 2016) and Euro 914 thousand (843 thousand in 2016), respectively - and net accruals to provisions for risks and charges, amounting to Euro 569 thousand (Euro 736 thousand in 2016), posted to cover typical banking disputes.

Finally, the positive balance of other operating income/expense amounted to Euro 10.718 million, as detailed in the table below:

<b>Breakdown (in Euro 000)</b>	<b>2017</b>	<b>2016</b>	<b>change</b>	<b>% change</b>
<b>Other operating income</b>				
recovery of stamp duty	6,393	6,721	(328)	(4.9%)
fast credit processing fees	1,790	2,432	(642)	(26.4%)
recovery of insurance premiums from	1,145	1,177	(32)	(2.7%)
recovery of legal costs	1,344	1,634	(290)	(17.7%)
other income and contingencies	486	420	66	15.7%
Hypo Alpe Bank contribution	-	17,500	(17,500)	NS
<b>total income</b>	<b>11,158</b>	<b>29,884</b>	<b>(18,726)</b>	<b>(62.7%)</b>
<b>Other operating expense</b>			-	
leasehold improvements	(249)	(182)	(67)	36.8%
Other extraordinary expense	(191)	(204)	13	(6.4%)
<b>total expenses</b>	<b>(440)</b>	<b>(386)</b>	<b>(54)</b>	<b>14.0%</b>
<b>Balance of operating income (expense)</b>	<b>10,718</b>	<b>29,498</b>	<b>(18,780)</b>	<b>(63.7%)</b>

Other operating income amounted to Euro 11,158, compared to Euro 29,884 thousand last year, an aggregate that included the extraordinary contribution received with the purchase of the business unit of the seven Hypo Alpe Bank S.p.A. branches.

It includes the recovery of the stamp duty (6,393 thousand), the fast credit processing fees (1,790 thousand), the recovery of insurance premiums from customers (1,145 thousand), the recovery of legal costs (1,344 thousand) and other income and contingencies (487 thousand).

Other operating expense of Euro 440 thousand consists of the annual portion of costs associated with improvements made to leased properties of Euro 249 thousand and of other expenses and contingent liabilities of Euro 191 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 61.9%, on the up, net of the extraordinary contribution received, compared to 70.1% in 2016.

Finally, impairment losses on the subsidiary Valsabbina Real Estate of Euro 295 thousand and capital losses on the disposal of assets of Euro 17 thousand were recorded in the income statement.

#### **Income results**

With the performance of the income margins commented on above, loss from operations gross of taxation came to Euro 10.856 million, compared to a profit of Euro 4.808 million in 2016.

Considering positive taxes of Euro 5.035 million (an expense of Euro 660 thousand in 2016), the net loss was Euro 5.821 million (a profit of Euro 4.148 million in 2016).

## **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 14 March 2018 - no events took place liable to affect the truthfulness, clarity or correctness of the accounting representation provided in this report accompanying the 2017 financial statements.

We would also like to highlight a passage that has already been mentioned in the previous pages of this report. On 17 January, the Bank of Italy completed an inspection, which began on 23 October 2017, in accordance with banking and financial regulations and concerning the main areas of risk and the technical profiles of the intermediary.

After 5 years, between October 2017 and January 2018, the Bank underwent an ordinary inspection by the Bank of Italy. The activity of the inspection team concerned the general activities of the Bank and ended without the adoption of any measure or sanction for corporate representatives.

## **21. BUSINESS OUTLOOK**

On the basis of the information provided in other sections of this report, we believe that the Bank's operations in the coming periods will be able to follow the consolidated policy of cooperative bank of the territory, in a reference context that is certainly challenging but more favourable than in the recent past.

On the one hand, the economic situation seems to have consolidated the basis of a recovery process in Italy as well, in line with what has been recorded by the most proactive international economies in this field. On the other hand, the expected recovery in interest rates, determined by modest growth in the inflation rate and a less accommodating monetary policy, could restore value to the primary brokerage activity, which finds the prices of its business in rates. The Bank also intends to place itself in this context with initiatives aimed at its own development, in a balanced manner but with a determination to adopt the most appropriate growth strategies. The Strategic Plan referred to above provides a detailed description of the lines of this activity.

The growth in volumes, sustainable in terms of the quality of new investments and profitability, represents a primary objective, which it is believed can be achieved also through further development of the areas in which the Bank operates, while at the same time maintaining the specific management features that the Bank has followed in recent years: rigorous selection of customers, particular attention to small and medium-sized enterprises and households, appropriate diversification of investments by category and technical form of the financial instruments used.

To this end, it was noted that a further and reasoned growth of the sales network structure, with a limited number of new branch opening in cities and geographical areas of strategic interest, as well as the rationalisation of existing branches, represent an important supporting lever to the aforementioned objectives. Another aspect to which particular attention will be paid is the further commitment to improving credit quality in its various aspects: diversification of new investments, careful monitoring of positions, further efficiency in the management of anomalous loan positions.

The recovery of profitability in the ordinary management will also be a fundamental objective, taking into consideration that the positive economic result is indispensable on the one hand to ensure the due recognition to the shareholders of the support granted to the Bank and on the other to create those flows of self-financing that prove fundamental to maintain and further strengthen the level of capital strength and liquidity that represent one of the strong points of Valsabbina.

We believe that the aforesaid guidelines of business outlook also comply with the appropriate observations and useful indications provided by the Supervisory Body to the entire system of Italian banks and, in particular, also to our own system during the recent inspection, which we gave notice of in another part of this report.

Although still limited in time, we believe that the first periods of the current 2018 are confirming what we outlined. With the prudence in valuation that has always distinguished us, but also with the strength and determination that come from the awareness of operating with the utmost commitment and loyalty, we see in 2018 the first of a series of periods of solid recovery for the Bank, in the interests of its shareholders, its customers and the entire community of reference.

## **22. PROPOSAL FOR APPROVAL OF THE FINANCIAL STATEMENTS AND ALLOCATION OF PROFIT/(LOSS) FOR THE YEAR**

Dear Shareholders,

We submit to your examination and to your approval the 2017 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 Loss of Euro 5,820,515 were subject to audit by BDO Italia S.p.A.

With regard to the profit/(loss) for the year, the Board of Directors proposes to fully cover the Loss through the use of the Extraordinary Reserve.

With the approval of this proposal, the Shareholders' Equity will amount to Euro 381,969,184.

## **23. ACKNOWLEDGEMENTS**

Dear Shareholders,

We have come to the end of this report of ours which, year by year, becomes wider and more structured so as to be able to receive, with the precision required by the regulations, the report on the management activities of an increasingly large and important Bank in its vocation as a cooperative bank, in its numbers and in the extension of relations in the various markets served.

Therefore, we would like to close this meeting by expressing a heartfelt thanks to all our Shareholders and Customers who follow us, support us, assure us of their preference and encourage us to improve and distinguish ourselves in the crowded market of competitors.

We would like to express our heartfelt and touching thought to the Shareholders and Customers who passed away during this last year and we send expressions of condolence to their families.

We express our gratitude to the Board of Statutory Auditors for the diligent work carried out in the exercise of its delicate functions, just as we express our gratitude to the General Management for the commitment dedicated to the company and for the daily example of fairness in the performance of its main responsibilities.

We reserve for personnel of all levels and category a feeling of admiration for the intelligent and passionate contribution they make in every circumstance to the achievements of their Bank.

We express our gratitude to the Supervisory Authorities for the important guidance and stimulation they have provided us through the people who represent them authoritatively and in the various offices.

We would like to extend our warmest thanks to all the other authorities as well as category and trade association bodies, whose closeness has been precious and reassuring in our daily work.

And with the clear conscious of having carried out our institutional task with the utmost commitment and the most respectful dedication to the good of the Company, we express to everyone a heartfelt wish for a serene and positive 2018.

Brescia, 14 March 2018

THE BOARD OF DIRECTORS