

Glossary of the most common financial terms

ABS (Asset Backed Securities)

Financial instruments issued in the event of securitisation transactions whose return and refund are guaranteed by the assets of the originator, intended exclusively to satisfy the rights incorporated in the financial instruments themselves. Technically, the debt securities are issued by a vehicle company (SPV). The portfolio underlying the securitisation transaction can be constituted by mortgages, loans, bonds, trade receivables, debts arising from credit cards or others.

ALM (Asset & Liability Management)

Integrated management of assets and liabilities directed to allocate resources in a framework of optimising the risk/yield ratio.

Asset Management

The activities of management of the financial investments of third parties.

ATM (Automated teller machine)

Automatic apparatus that allows customers to execute banking operations such as, for example, cash withdrawal, payment of cash or cheques, request for account information, utilities payments, telephone top-ups, etc. The machine is activated by the introduction of the magnetic card and typing of the personal identification code.

Weighted-risk assets

These are cash and off-balance sheet assets (guarantees and commitments) multiplied by a decreasing coefficient by risk class, from 150% for impaired loans to 0% for government securities with high rating. The ratio between own funds (surveillance) and the risk weighted assets for banks not belonging to banking groups must be higher for 2017 at 9.25% and at 9.875% for 2018, notwithstanding additional requests of Banca d'Italia in the context of the SREP.

Backtesting

Retrospective analysis to verify the reliability of risk measurements associated with positions in the portfolio of assets.

Bail-in (literally "internal savings")

This is a tool introduced by the BRRD Directive that enables the Resolution Authorities to dispose over, in the event of a serious crisis within a bank, a reduction in the value of the shares and any liabilities or their conversion into shares to absorb losses and recapitalise them adequately. "Bail-in" is applied following a hierarchy whose rationale provides that investors in more risky financial instruments will be the first to sustain any losses or a conversion into shares. Only after exhausting all the resources in the most risky category, can other categories be considered. The new rules in particular aim to reduce the risk of bankruptcy of the banks (strengthening assets, risk management, supervision and control activities, etc.) in an effort thus to reduce the probability of public bailouts.

Bancassurance

Products offering insurance typically through the operational network of credit companies.

Banking book

Usually refers to securities or, in any case, to financial instruments in general, identifying that part of the portfolio intended as "proprietary" assets.

Basis Swap

Contract which provides for the exchange between two counterparties, of payments linked at variable rates based on a different index.

Best practice

Usually identifies conduct commensurate with the highest degree of skills expected within a certain technical/professional field.

BRRD (Bank Recovery and Resolution Directive)

Concerns Directive No. 2014/59/EU implemented in Italy via Legislative Decree No. 180 of 16.11.2015 establishing a framework for remediation and resolution of credit institutions and investment companies and via Legislative Decree No. 181 of 16.11.2015 which makes further modifications to the T.U.B. (Legislative Decree No. 385 of 1.9.1993) and the CLF (Legislative Decree No. 58 of 24.2.1998). The legislation stipulates, *inter alia*, the drafting by the banks of a recovery plan containing measures for early intervention to tackle any difficult situations.

Securitisation

Operation of transferring risk related to real or financial assets to a vehicle company (SPV), effected by means of transfer of the underlying assets or through the use of derivative contracts. In Italy, this is governed primarily by Act No 130 of 30.4.1999.

Compliance

Concerns the activities related to "non-compliance" risk, regulated by the supervisory provisions issued by Banca d'Italia. Compliance activities relate, for example, to methodological rules for the management of non-compliance risk, such as advice and assistance in all matters relevant to such risk; compliance with the MiFID requirements; the management of conflicts of interest and the monitoring of the client transactions for purposes of prevention of market abuse; compliance with the money laundering legislation; tax risk.

Corporate governance

This term relates to the composition and functioning of bodies internal and external to the corporate structure with the relative distribution of rights, responsibilities, tasks and decision-making powers between participants in corporate life.

Cost Income

Economic indicator defining the ratio between operating costs and the intermediation margin.

Credit Protection Insurance (CPI)

Credit protection Insurance policies of that may be underwritten by debtors of financial loans (personal loans, mortgages and credit cards) to ensure their (as the insured) ability to make payment of the residual debt/or in a certain number of installments in the event of negative events, either temporary or permanent (involuntary loss of job, sickness, accidents, permanent disability or death). These policies can also be combined to finance companies with an insurance coverage for events that may affect the company, directors or key persons in the company.

Amortised cost

Differs from the cost as it provides for the progressive amortisation of the difference between the book value and the nominal value of an asset or liability on the basis of the effective rate of return.

Credit crunch

Literally credit tightening. Represents a significant decrease in the offer of credit or a sudden worsening of conditions imposed at the end of a prolonged period of expansion, which to emphasise the recession phase.

Default

Identified as a situation of declared inability to honour its own debt and/or the payment of the relevant interest.

Duration

Indicator of the interest rate risk to which a security or a bond portfolio is subject. It is most frequently calculated as a weighted average of the maturities of the payments for interest and capital associated with a bond.

EBA (European Banking Authority)

It is made up of representatives of the banking supervisory authorities of the Member States of the European Union and started its operations on 1 January 2011. The EBA safeguards the stability of the banking system and the transparency of the markets and financial products and the protection of depositors and investors.

ETC (Exchange Traded Commodity)

Financial instruments concerning the investment by the issuer either for a commodity in physical form (in this case they are defined as physically-backed ETCs) or derivative contracts on raw materials. The price of ETCs is therefore linked directly or indirectly to the underlying performance. Similar to the ETFs, ETCs are traded on a stock exchange as shares, passively replicating the performance of the raw material or the indices of raw materials to which they refer.

ETF (exchange-traded funds)

A particular type of investment fund traded on the Stock Exchange as a share, having, as its only investment objective, following the index to which it refers (benchmark) through a totally passive management. The ETF incorporates the characteristics both of a fund and a share, allowing investors to take advantage of the strengths of both instruments through diversification and the reduction of the risk to their funds, while ensuring the flexibility and transparency of information of trading in real time of the shares.

Euribor (Euro interbank offered rate)

Interbank interest rate at which primary banks will exchange deposits in euro with different maturities. It is calculated on a daily basis as the simple average of the listings at eleven o'clock on a sample of banks with high creditworthiness selected periodically by the European Banking Federation. Various loan contracts are linked to the Euribor variable rate (e.g. mortgages).

Factoring

The contract of sale, without recourse (with credit risk borne by the transferee) or with recourse (with credit risk borne by the transferor), commercial credits to banks or specialised companies, for the purposes of management and collection, which can be linked to a financing in favour of the transferor.

Fair value

Amount for which an asset can be exchanged, or a liability transferred in a regular transaction between market operators. On the basis of IAS accounting principles, banks apply fair value in the evaluation of financial instruments (assets and liabilities) held for trading and held for sale as well as derivatives and it can be used for the valuation of shareholdings and of tangible and intangible assets (with different effects on the income statement for the different assets considered).

Own funds (formerly Supervisory Capital)

From 1 January 2014, the rules on own funds are contained in Regulation No. 575/2013/EU. They are constituted by Common Equity Tier 1 (CET1), by Additional Tier 1 (AT1) and by shareholders' equity of Tier 2 (T2)

Forbearance

Term used to indicate situations where the debtor, due to financial difficulties, it is not considered to be able to meet the deadline for repayment or other contractual conditions. In these circumstances, the creditor decides to change the due date and the conditions of the contract to enable him to honour its debt or refinance it fully or partially.

Funding

Supply, under various forms, of the funds needed to finance the business or particular financial transactions.

Future

Standardised fixed-term contracts in which the parties agree to exchange, at a predetermined price and on a future date, securities or commodities. Such contracts are normally traded on organised markets, where their execution is guaranteed.

GACS

Guarantee on Securitisation of Non-Performing Bank Loans Concerns the public guarantee facility for the securitisation of non-performing loans introduced via Legislative Decree No. 18 of 2016. It provides for the issue of the State guarantee on the senior tranches of the securitisation of non-performing loans sold by banks to vehicle companies pursuant to Act 130/1999. The guarantee may be issued if the senior class has a rating no less than investment grade and will not be effective unless the transferring bank has not transferred to the market any junior securities and any mezzanine securities sufficient to allow the derecognition of the transferred assets from the financial statements

of the bank. The State guarantee is remunerated with commissions which provide a mechanism for increases after the third year, to provide a strong incentive to repay the obligations in the shortest possible time.

Goodwill

Identifies the goodwill paid for the acquisition of an equity interest equal to the difference between the cost and the corresponding share of equity, for that part not attributable to the assets of the company acquired.

Haircut

Measure for the control of risks applied to eligible assets used in temporary financing transactions. The Central Bank determines the value of the pledged assets by deducting from the market value of the share a certain percentage (haircut), the amount of which is in relation to the specific characteristics of the assets concerned.

Hedge fund

Mutual Investment fund that has the possibility - denied to traditional managers - to use instruments or sophisticated investment strategies, such as short selling, derivatives (options or futures, even beyond 100% of equity), financial leverage (indebtedness in order to invest money borrowed).

IAS/IFRS

International Accounting Standards issued by the International Accounting Standards Board (IASB), a private international institution established in April 2001, involving the accounting professional in the main countries as well as observers in the European Union, the IOSCO (International Organisation of Securities Commissions) and the Basel Committee.

IBAN (International Bank Account Number)

International standard used for identifying the user bank. From 1 July 2008 use of the IBAN - composed of 27 characters - is required not only for foreign payments, but also for those made in Italy.

Impairment

The term, within the scope of IAS, indicates the loss in value of a balance sheet asset, recognised in the event that the book value is greater than the recoverable value i.e. the amount that can be obtained with the sale or use of the asset. The impairment test must be carried out on all assets, except for those valued at fair value, for which any losses (and gains) of value are implied.

Likely defaults

Since January 2015, with the entry into force of the new regulations of the EBA, impaired credit exposures are defined as those for which the bank deems it unlikely that the debtor shall comply in full (for capital and/or interest) with their credit obligations, without there being a need to put in place measures to preserve the proceeds of the receivable, for example, the enforcement of a guarantee. This valuation is performed by the Bank independent of the presence of any outstanding where there are elements that suggest a situation of potential indebtedness by the debtor.

Index Linked

Life insurance policy whose performance at maturity depends on the performance of a reference parameter that can be a stock index, a basket of securities or another indicator.

Internal audit

Function which is institutionally charged with internal auditing activities.

Joint venture

Agreement between two or more companies for carrying out a certain economic activity through, usually, the constitution of a company limited by shares.

Junior

In a securitisation transaction, this is the tranche that is most subject to securities issued, which supports, primarily, losses that may occur in the course of the recovery of the underlying assets.

Leasing

Contract through which a party (landlord) grants the other (tenant) for a given time, the use of an asset, purchased or constructed by the lessor at the instance and request of the lessee, which will enable the latter to acquire ownership of the asset on predetermined conditions at the end of the lease.

LCR (Liquidity Coverage Ratio)

Concerns the index that expresses the ratio between the value of the stock of liquid assets of high quality in conditions of stress and the total number of outflows of net cash calculated according to certain parameters of the scenario. The value of the ratio, initially equal to 60%, must not be less than 100% when operational (1.1.2018). The index is aimed at the retention, by the bank, of an adequate level of high-quality, non-binding liquid assets which can be converted into cash to meet its liquidity needs within 30 calendar days, in a stress scenario.

LGD (Loss Given Default)

Estimated loss rate in the case of a default by the borrower.

Mark Down

The difference between the average interest rate for composition of direct funding considered and the interbank rate (Euribor).

Mark up

The difference between the average loan rate for technical forms of investment considered and the Euribor.

Mezzanine

In a securitisation transaction, this is the tranche with an intermediate subordinate ranking between that of the junior tranche and senior tranche.

MiFID (Markets in Financial Instruments Directive)

This concerns the legislation that has, as its main purpose, the regulation of the execution of investment services or activities, including those relating to financial instruments. The directive redesigns the obligations of execution of client orders under the best conditions (so-called best execution), providing that intermediaries establish their own execution policy ("Policy Enforcement"), which indicate, for each type of instrument, the execution venues where orders will be executed for purchase and the factors for execution that will be considered for the choice of location that provides the best possible result. The control functions are delegated to the compliance structures, i.e. internal supervisory bodies as well as intermediaries themselves tasked with verifying compliance with the rules.

It is the task of intermediaries to take all reasonable steps to identify conflicts of interest that may be harmful to customers to make them more visible.

Subprime Mortgages

The subprime concept does not refer to the loan transaction in itself, but rather to the borrower (borrower). Technically, subprime refers to a borrower who does not have a positive credit capacity and the existence of negative situations such as: the presence of unpaid instalments on previous loans, unpaid and disputed cheques, etc. These past events are symptomatic of a greater intrinsic riskiness of the counterparty, which corresponds to a higher remuneration required by the intermediary granting the mortgage.

Operability with subprime customers is particularly developed in the US money market where, even the conclusion of such loans, usually corresponds to a securitisation business and issue of securities.

New MIC (New Collateralised Interbanking Market)

The market segment of the e-MID platform, in which interbank deposits are exchanged on an anonymous basis and guaranteed against credit risks, managed by the Cassa di Compensazione e Garanzia (CCG), a joint stock company that performs the function of a central counterparty in spot equity and derivatives markets managed by Borsa Italiana and the telematic market for government securities.

Non-performing

Term generally referring to loans with irregular performance.

Structured bonds

Bonds whose interests and/or redemption value depends on a parameter of real nature (connected to the price of assets or goods) or by the trend of indices. In such cases, the implicit option is recognised separately from the host contract. In the event of benchmarking at rates or inflation (e.g. Treasury Credit Certificates) the implicit option is not recognised separately from the host contract.

UCITS (Undertakings for Collective Investments in Transferable Securities)

This item includes undertakings for collective investment in transferable securities (UCITS), investment companies with variable capital (Sicav) and other investment funds (real estate investment funds, closed mutual investment funds).

Option

Represents the right, but not the obligation, acquired with the payment of a premium to buy (call option) or sell (put option) a financial instrument at a particular price (strike price) within (American option) or at a determined future date (European option).

Originator

Subject that sells its portfolio of shares against payment deferred to a SPV to be securitised.

Outsourcing

Use of operational support activities carried out by external companies.

Over the counter (OTC)

Transactions concluded directly between the parties, without the use of a regulated market.

Past due

Expired and/or overdue exposures continuing for over 90 consecutive days, in accordance with the definition provided for in the existing Supervisory Instructions.

PD (Probability of Default)

The probability that the debtor falls into a default condition within an annual time period.

Plain vanilla swap

Contract in which, calculated on the same notional amount, a party receives a variable interest payment based on the interbank rate (usually the rate at six months) and pays to the other counterparty interest calculated at a fixed rate (e.g. obtained by adding a spread on the performance of a type of government bond).

Point of sale (POS)

Automatic apparatus by means of which it is possible to carry out, with debit, credit or pre-paid card, payment for goods or services by a supplier.

Price sensitive

Term that generally refers to information or data not in the public domain that may, if made public, significantly influence the listing of a security.

Private equity

Activities aimed at the acquisition of equity interests and their subsequent transfer to specific counterparties, without public trading.

ICAAP process (*Internal Capital Adequacy Assessment Process*)

Identifies the self-assessment process that banks, pursuant to Circular No. 285 of 17 December 2013 of Banca d'Italia, must carry out in order to verify the adequacy of its capital base, both current and prospective (Internal Liquidity Adequacy Assessment Process- ICAAP) and the system of government and management of liquidity risk (Internal Liquidity Adequacy Assessment Process- ILAAP), in relation to the risks assumed and business strategies. The Supervisory Authority has the ability, through the review of the ICAAP AND ILAAP, to formulate an overall judgement on the bank and activate, where necessary, appropriate corrective measures.

RAF (*Risk Appetite Framework*)

The document that contains the metrics for the quantification of risk, the objectives in terms of risk profile desired (risk appetite), risk tolerance (absolute deviance from the desired objectives) and the operational limits.

Rating

Assessment of the quality of a company or of its issue of debt securities on the basis of the financial soundness of the company itself and its prospects.

Risk Management

Activities of acquisition, evaluation, assessment and overall management of various types of risks related hedging and instruments of risk mitigation.

ROE (Return on Equity)

Financial indicator defined by the ratio between the profit for the year and the net equity.

Senior

In a securitisation transaction, this is the tranche with the greatest degree of privilege in terms of priority of remuneration and reimbursement.

Servicer

In a securitisation transaction, this is the subject that, on the basis of a special contract for servicing, continues to manage the credits or the assets subject to securitisation after they have been transferred to the vehicle company responsible for issuing the licences.

Non-performing loans

Loans in respect of insolvent entities (though not judicially recognised) or in situations that are substantially comparable.

SREP (Supervisory Review and Evaluation Process)

Identifies the prudential activities of the Supervisory Authorities with which the process of determining the capital adequacy conducted internally by the supervised banks is reviewed, the system of corporate governance is evaluated, the functionality of the bodies, the organisational structure and the system of internal controls and compliance complex of prudential rules is verified. At the end of the SREP, the authorities make an overall judgement on the bank and have the power, pursuant to Article 104 of the CRD IV, to impose, where necessary, a wide range of surveillance measures (organisational, capital, liquidity).

Spread

This term normally refers to:

- the difference between the two interest rates;
- the difference between bid and offer quotations (supply and demand) in dealings in securities;
- the increase that the issuer of securities agrees in addition to a reference rate.

SPE/SPV

The Special Purpose Entity (SPE) or Special Purpose Vehicle (SPV) - also referred to as the "conduit" are vehicles (Company, "trust" or other entities) that are specially established for the attainment of a specific objective, well defined and delimited, or for the performance of a specific transaction.

The SPE/SPVS have a legal structure independent of other entities involved in the transaction and generally do not have operating and managerial structures of their own.

Stress test

Quantitative and qualitative techniques to evaluate the effects of exceptional events with plausible parameters for measuring risk: both for specific risks (sensitivity analysis) and for interlinked risks (scenario analysis).

Swap (on interest rates and foreign currencies)

Transaction consisting of the exchange of financial flows between operators according to certain contractual arrangements. In the case of an interest rate swap, the counterparties exchange flows of payment of interest calculated on a notional capital amount on the basis of differentiated criteria (e.g. one counterparty pays a flow at a fixed rate and the other at a variable-rate). In the case of a currency swap, counterparties exchange specific amounts of two different currencies, repaying them over time according to predetermined modes that affect both the capital and the interest.

Risk-free rate

Rate of interest used on a translation free of risk. Used in practice to indicate the rate of the short-term government securities, which also may not be considered risk free.

Tax rate

Effective tax rate obtained by the ratio between the tax and the profit before tax.

Texas ratio

Soundness index that is given by the ratio between the net impaired loans and net tangible shareholders' equity (equity net of intangible assets). Also used is the ratio between the gross amount of impaired assets and the sum of the primary capital tangible and value adjustments on loans.

Online trading

The system of trading of financial assets on the stock exchange, implemented by telematic means.

Unit-linked

Life insurance policies with benefits linked to the value of investment funds.

VCR (value at risk)

Measures the maximum potential loss that a position in a financial instrument or a portfolio may suffer with a probability defined (confidence level) in a reference period.

Warrant

Negotiable instrument that gives the holder the right to purchase from the issuer, or to sell to the latter, fixed-income securities or shares in accordance with specific procedures.

Zero-coupon

Obligation without coupon, the efficiency of which is determined by the difference between the issue price (or purchase) and the redemption value.