EUROPEAN COMMISSION

Brussels, 27.11.2013
C(2013) 8427 final

In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].		PUBLIC VERSION This document is made available for information purposes only.

Subject : State aid n° SA. 36175 (2013/N) – Italy
MPS - Restructuring

Madam,

1. PROCEDURE

(1) On 17 December 2012, by decision C(2012) 9660 final (the "**rescue decision**") the Commission temporarily approved the notified State recapitalisation of Banca Monte dei Paschi di Siena S.p.A. ("**MPS**") of EUR 3.9 billion in newly issued hybrid capital instruments (so-called "**Monti bonds**").[1] The approval was provided for six months or, in case of a submission of a restructuring plan by 17 June 2013, until the adoption by the Commission of a decision on the restructuring aid.

(2) On 28 February 2013 the Italian Ministry of Economy and Finance granted the aid by a subscription of the Monti bonds.

[1] OJ C 50, 21.2.2013, p. 4. On 12 February 2013 the Commission rectified some minor formal errors contained in the rescue decision by decision C(2013) 693 final.

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(3) On 17 June 2013 the Italian authorities notified the restructuring plan of MPS.

(4) An exchange of correspondence took place in June and July 2013 between the Italian Minister of Economy and Finance and the Commission Vice-President responsible for competition policy about the content of the notified restructuring plan.

(5) In addition several meetings, conference calls and electronic mail exchanges took place between the Italian authorities and the Commission between June and October 2013.

(6) Updated versions of the restructuring plan were submitted on 18 October 2013 and on 11 November 2013 including a catalogue of commitments undertaken by the Italian Republic in relation to the implementation of the MPS restructuring plan.

(7) The Commission also received market information from various sources with respect to the allegedly incorrect representation of the source and origin of the capital shortfall recorded by MPS (as of 30 September 2011) in relation to requirements laid down by the European Banking Authority ("**EBA**") and the related negative impact on MPS's balance sheet. A non-confidential version of the information was transmitted to the Italian authorities on 23 May 2013. On 10 September and 18 October 2013, the Italian authorities submitted their comments in that respect.

(8) For reasons of urgency, the Italian Republic has accepted that exceptionally this decision is adopted in English.

2. FACTS

2.1 Description of the beneficiary

(9) MPS is a bank incorporated in Italy. It is listed on the Italian Stock Exchange. MPS had been privatised in 1995 by transferring the banking business and assets from the existing public credit institution to a newly established private stock company (MPS) and by transforming the public credit institution into a private and not-for-profit foundation (Fondazione Monte dei Paschi di Siena – "**the Foundation**"), subject to the supervision of the Ministry of Economy and Finance. The members of the board setting the guidelines of the Foundation ("*Deputazione Generale*") are appointed by different local authorities and are statutorily bound to pursue exclusively social welfare projects. The Charter of the Foundation providing that members of the *Deputazione Generale* shall neither represent the bodies appointing them nor report to them. The members of the administrative body of the Foundation (*i.e.* the "*Deputazione Amministratrice*") are appointed by *Deputazione Generale*.

(10) MPS has raised capital several times on the market since its privatisation. Moreover, it amended its Article of Association on 18 July 2013 in order to, *inter alia*, remove any minority protection rights for the Foundation. As a result, the ownership of the Foundation, which held originally 100% of MPS, has been progressively and significantly diluted.

(11) The Foundation remains the major shareholder of MPS with a stake of 33.50% as of 18 July 2013. The other main shareholders as of that date are Finamonte S.R.L. (4.00%), Unicoop Firenze S.C.R.L. (2.72%), J.P. Morgan Securities Limited (2.53%) and various companies under the influence of AXA SA (3.73%). The remaining 53.52% is floating and belongs to shareholders with a stake lower than 2%.

(12) MPS is the parent company of the Monte dei Paschi di Siena Banking Group (the **"Group"**), which is composed of a number of national and foreign companies. In particular, as of 31 December 2012, MPS had the sole control of Banca Antonveneta S.p.A, Italy (100%) and MPS Gestione Crediti, Italy (100%; now incorporated in MPS); Consum.it S.p.A., Italy (100%); MPS Capital Services; MPS Leasing & Factoring; Magazzini Generali Fiduciari di Mantova S.p.A., Italy (100%); MPS Tenimenti Poggio Bonelli e Chigi Saracini Soc. Agricola S.p.A., Italy (100%); and some securitisation and trust vehicles and financial intermediaries as well as some banking subsidiaries in France, Belgium, Ireland and Luxembourg. MPS has also a non-controlling stake in Banca Popolare di Spoleto S.p.A., Italy (26.01%; in relation to which. MPS has exercised a put option).

(13) As of 31 December 2012 the Group was the third-largest Italian banking group in terms of total assets, with EUR 218 billion of total assets. It had market shares of 6.85% in direct funding and 7.12% of customer loans. It had 2,671 branches (equal to a market share of 8.3%), 270 specialised retail and corporate centres, 138 financial advisory offices and 30,265 employees. Abroad, the Group operates through a foreign network articulated into two banking subsidiaries (Monte Paschi Banque SA, with 17 branches in France, and Banca Monte Paschi Belgio SA, with 8 branches in Belgium), four operational branches (based in London, New York, Hong Kong and Shanghai) and ten representative offices (located in "target areas" of the European Union, Central-Eastern Europe, North Africa, China and India).

(14) MPS offers financial services to private, corporate and institutional customers and public authorities. It operates across Italy and in several international markets, including lending to retail and corporate customers (including leasing, factoring and consumer credit), asset management (through equity interest in AM Holding), private banking, investment banking and corporate finance. MPS also provides bancassurance and pension products through a strategic partnership with the French insurance company AXA. The main activity of the Group relates to commercial banking, with a focus on the retail segment. On the basis of the contribution to total revenues as at 30 June 2013 the Group's business lines are classified as follows: *i*) *Commercial banking* (77%): lending, traditional banking services, insurance and welfare-related products (through the strategic partnership with AXA), financial advisory, asset management, investment products (also through the associated company AM Holding); *ii*) *Investment banking and proprietary finance* (9%): finance, trading, global markets; *iii*) *Consumer credit* (5%): special-purpose loans, personal loans, credit cards (option and revolving); *iv*) *Corporate finance* (3%): medium- and long-term credit facilities, corporate finance, capital markets, structured finance; *v*) *Foreign banking* (2%): products and services supporting commercial expansion and investments by Italian companies abroad; *vi*) *Leasing & Factoring* (1%): integrated packages of leasing and factoring services for businesses, artisans and professionals; and *vii*) *other* (3%): which includes IT and telecommunication systems, non-performing loans

management, value enhancing of real estate property, activity of centralised Treasury and equity accounted companies.

(15) The financial situation of MPS from 2006 onwards was as follows:

Table 1 - 2006-2012 MPS Key figures

Volumes, in (EUR MM)	2006	2007	2008	2009	2010	2011	2012
Net interest income	**2,714**	**2,945**	**3,821**	**3,639**	**3,592**	**3,500**	**2,830**
Net fee income	**1,491**	**1,515**	**1,569**	**1,893**	**1,912**	**1,801**	**1,633**
Dividends and similar income	149	156	4	110	92	72	75
Trading income	218	115	-266	18	-52	-9	119
Net income from hedging (*)	-18	27	71	-23	-31	-29	48
Other banking income (*)	323	210	74	71	60	96	-4
Impairment losses	-586	-590	-940	-1,510	-1,194	-1,464	-2,894
Total income and impairment losses	**4,291**	**4,378**	**4,334**	**4,197**	**4,377**	**3,967**	**1,807**
Purchased price allocation			-67	-134	-111	-94	-50
Impairment of goodwill, intangibles and participations	-1	-1	-512			-4,514	-1,654
Total expenses	-2,907	-2,901	-3,499	-3,665	-3,431	-3,503	-3,296
Other components	27	512	-202	-76	543	-294	-362
Net income before tax	1,411	1,989	55	322	1,379	-4,437	-3,555
NET INCOME	**910**	**1437**	**922**	**220**	**986**	**-4,685**	**-3,170**
Assets	158,556	161,984	213,796	224,815	244,279	240,702	218,882
RWA (Risk weighting assets)	100,237	113,385	132,408	120,899	109,238	105,189	92,828
Net interest margin (%)	63.3	67.3	88.2	86.7	82.1	88.2	158,1
Number of branches	1,903	2,094	3,104	3,088	2,918	2,915	2,671
Full time employees	24,348	24,863	32,867	32,003	31,495	31,170	30,265
COST INCOME RATIO (%)	**59.6**	**58.4**	**66.3**	**64.2**	**61.6**	**63.6**	**66**
ROE AFTER TAX (%)	**13.3**	**19.9**	**6.6**	**1.5**	**6.9**	**[…]***	**[…]**

(*) Excluded incomes from assets liability management.

2.2 Significant historical losses

(16) MPS started showing losses in the year 2011 of EUR [4,685-4,694] million after significant losses in loan and goodwill impairments (EUR 1,309 million and EUR 4,257 million, respectively). In the year 2012 MPS recorded losses of EUR 3,170 million, mainly originated by loan and goodwill impairments (EUR 2,667 million and EUR 1,528 million, respectively).

Impairments relating to the purchase of Antonveneta

(17) In 2008 MPS acquired Banca Antonveneta S.p.A., the eighth-largest Italian banking group by assets (EUR 50 billion) with 1,000 branches and 10,800 employees for a price of around EUR 9 billion from Banco Santander which in

* Confidential information […]

turn had bought it several months before from ABN AMRO for around EUR 6 billion. The purchase resulted in impairments of goodwill in 2011 and 2012 (approximately EUR 5.5 billion).

Net Equity impact of the retrospective restatement carried out in 2012 accounts because of the material errors found in the accounting treatment of the structured transactions named "Alexandria" and "Santorini"

(18) In 2008 and 2009, MPS entered into two-long term repo (**"LTR"**) transactions with Nomura (a transaction referred to as "Alexandria") and Deutsche Bank (a transaction referred to as "Santorini"), with underlying a total EUR 5.05 billion long-term Italian sovereign bonds (*Buoni del Tesoro Poliennali* – "**BTPs**"). In summary, the transactions included:

- the purchase of EUR 3.05 billion of BTPs with maturity in 2034 and EUR 2,0 billion of BTPs with maturity in 2031;
- the sale of BTPs through total return swaps or repo transactions;
- the hedging of interest rate risk through interest rate swaps.

(19) So-called "Alexandria notes", issued by Alexandria Capital PLC, were purchased by MPS in 2005. In 2009 Nomura replaced at par, with higher quality assets, the original underlying of the Alexandria notes, whose market price in 2009 was far below nominal value. In the same period MPS agreed with Nomura to enter into a structured transaction with the purpose of compensating Nomura. The structured transaction comprised the purchase of a nominal value of EUR 3.05 billion of BTPs with maturity in 2034, a LTR for the same nominal amount with Nomura, and interest rate swaps to hedge interest rate risk. In October 2012, according to MPS's new management[2], the link between the two transactions was discovered, and made it apparent that the LTR entered into with Nomura was in exchange for replacement of the Alexandria notes' underlying assets. The two transactions, originating as linked transactions, should therefore have been considered jointly for the purpose of correct accounting. Therefore the liability representing the LTR, booked at initial recognition on the basis of the consideration received, should have been booked at a higher value, because the LTR occurred under off-market conditions, with a negative impact on 2009 accounts, inclusive of tax effects, of EUR 308 million. Considering the redetermination of the amortized cost of the liability associated with the LTR, the negative adjustment on the net equity as at 31 December 2011 amounts to EUR 284 million and as at 31 December 2012 amounts to EUR 274 million, inclusive of tax effects.

(20) The "Santorini" special purpose vehicle was created with a 49% shareholding by MPS and 51% by Deutsche Bank. In December 2008 a structured transaction between Santorini and Deutsche Bank was signed that comprised three Total Return Swaps (**"TRSs"**) on long-term BTPs for a nominal amount of EUR 2 billion; in the same period MPS and Deutsche Bank entered into three TRSs on long-term BTPs for the same nominal value. In substance, the term and conditions

[2] The management of MPS changed in 2012 with Mr. Profumo appointed as Chairman from 27 April 2012 and Mr. Viola appointed General Manager from 12 January 2012 and CEO from 3 March 2012 (Mr. Viola combines the two positions).

of the three TRSs entered into between MPS and Deutsche Bank coincided with those of the three TRSs entered into between Santorini and Deutsche Bank; in contrast to Santorini, MPS's TRSs resulted in losses. As with the Alexandria transaction, TRSs were booked by MPS in the same way as LTRs, and the financial liabilities representing the LTRs were booked at initial recognition on the basis of the consideration initially received instead of the higher fair value. As a consequence, an error amounting to EUR 429 million was identified in the initial recognition of the liabilities associated with LTRs in MPS's 2008 accounts. Considering the redetermination of the amortized cost of the liability associated with the LTRs, the negative adjustment on the Net Equity as at 31 December 2011 amounts to EUR 328 million and as at 31 December 2012 amounts to EUR 305 million, inclusive of tax effects.

(21) The total gross negative impact of the restatement of the accounting of the Alexandria and Santorini transactions on MPS's net equity amounts to EUR 612 million as at 31 December 2011 and to EUR 579 million as at 31 December 2012.

2.3 Acquisition of Italian government bonds

(22) Table 2 presents the acquisition of Italian government bonds by MPS from 2006 onwards and the ECB funding levels.

Table 2 – Increase in sovereign bond holding and ECB funding from 2006 to 2012 in EUR million

	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Italian government bonds in Available for Sale	244	689	2,486	11,627	18,449	18,760	22,729
Variation in Italian bonds in Available for Sale		*445*	*1,797*	*9,141*	*6,822*	*311*	*3,969*
Thereof increase related to Alexandria and Santorini transactions				*5,050*			
Italian government bonds in Held for trading	*2,807*	*2,326*	*1,626*	*4,275*	*6,297*	*4,235*	*3,162*
Variation in bonds in Held for trading		*-481*	*-700*	*2,649*	*2,022*	*-2,062*	*-1,073*
TOTAL holding of Italian bonds	**3,051**	**3,015**	**4,112**	**15,902**	**24,746**	**22,995**	**25,891**
ECB funding	**1,054**	**1,642**	**1,561**	**9,002**	**14,330**	**30,000**	**27,500**
Increase in ECB funding		*588*	*-81*	*7,441*	*5,328*	*15,670*	*-2,500*

2.4 The first State recapitalisation measure (the "Tremonti bonds")

(23) In 2009 the Italian State purchased EUR 1.9 billion of so-called "Tremonti bonds" issued by MPS (the "**old instruments**"), under the first Italian recapitalisation scheme approved by the Commission on 23 December 2008.[3] The old instruments were hybrid capital instruments eligible as Tier 1 capital and with a fixed remuneration in case of profit.

(24) The terms of the old instruments have been summarised in the rescue decision and include amongst others: *i*) the same subordination as ordinary shares where

[3] Recapitalisation measures in favour of the financial sector in Italy, Case N 648/08, as modified by decision in Case N 97, OJ C 88, 17.4.2009.

losses reduce the beneficiary's supervisory capital beyond 8%; *ii*) non-cumulative interests, paid whenever and to the extent of the bank's distributable profits; *iii*) a step-up mechanism for the calculation of the interest rate; *iv*) early redemption option for the beneficiary of the recapitalisation, with an increasing cap to the redemption price (expressed in term of percentage of the nominal value) depending on the date of the redemption (the highest cap would be 160% of the nominal value, if redemption were to occur after 1 July 2022).

2.5 The second State recapitalisation measure (the "Monti bonds")

(25) On 8 December 2011, EBA issued a recommendation for banks to have a Core Tier 1 (**"CT1"**)[4] capital ratio of 9%, after accounting for an additional temporary buffer against sovereign risk holdings as of 30 September 2011. For MPS that recommendation meant it had a capital shortfall of approximately EUR 3.3 billion.

(26) In the first half of 2012 MPS sought to implement a capital plan in order to address the shortfall. On 22 June 2012 MPS informed the Bank of Italy ("**BoI**") that it would not be able to fill the remaining shortfall by 30 June 2012 as envisaged.

(27) As a result the BoI determined that MPS had a capital shortfall between EUR 1.3 billion and EUR 1.7 billion as measured against the EBA requirements. Those estimates have been subsequently increased to cater for potential capital needs related to incorrect accounting representation of the financial transactions entered into by MPS that are described in recitals 18 to 21.

(28) Against that background, the board of directors of MPS authorised the issuance of so-called Monti bonds, which are hybrid capital instruments referred to in article 23-*sexies* of Law Decree n. 95 of 6 July 2012 (hereinafter the "**new instruments**"). The new instruments are eligible as CT1 capital (in compliance with the EBA Recommendation of 8 December 2011) and can be considered as common equity tier 1 under CRR/CRD IV. The authorised amount of the issuance was set at the level necessary to allow the outstanding EUR 1.9 billion of old instruments to be replaced with the new instruments. The new instruments were subscribed by the Italian Ministry of Economy and Finance on 28 February 2013 for an overall amount of EUR 4.071 billion.

(29) The new instruments are perpetual hybrids, ranking in principle *pari passu* with common shares (however, common shares will absorb losses until the capital ratio is equal to 8%). The new instruments bear a 9.0% annual coupon with a "step-up" clause of 0.5% every two years (up to a maximum of 15%). Coupon payment is ensured through an alternative coupon satisfaction mechanism (**"ACSM"**), obliging MPS to pay in kind the part of coupon not paid in cash due to losses or

[4] That definition is based on EBA's own definition of Core Tier 1, which differs in a number of points from the Tier 1 definition in the current EU legislation in the Capital Requirements Directive (CRD) comprising Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, OJ L 177, 30.6.2006, p. 1, and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast), OJ L 177, 30.6.2006, p. 201.

insufficient distributable profits.[5] The Italian Republic committed, as recorded in recitals 18 and 19 of the rescue decision, that MPS will pay the ACSM in principle in shares at market price, and may only pay the first coupon by issuing new instruments (as indicated in recital 30). That commitment is reflected in the repayment schedule of the new instruments, which excludes in principle the possibility to pay the coupons on new instruments accrued in 2013 through the issue of further new instruments (except if immediately redeemed).

(30) For the coupon accrued on old instruments in the year 2012, MPS issued and assigned to the Italian Republic an additional amount of EUR 171 million of new instruments, in lieu of a cash payment. As noted in the rescue decision that step resulted in Italy receiving Monti bonds for a total amount of EUR 4.071 billion.

(31) Moreover, as already provided for the old instruments, MPS has the option to carry out an early redemption of the new instruments. The redemption price is capped at 160% of the nominal value of the instrument and will be equal to the higher of: *i*) 100% of the nominal value of the instrument in the case of redemption by 30 June 2015, a percentage increased by 5% every two years up to a limit of 160% in case of redemption after that date; *ii*) the product of "underlying shares" (as defined in the term sheet of the new instruments)[6] and the price paid by the bidder in the event of a public tender offer on the ordinary shares of MPS; *iii)* the product of "underlying shares" and the consideration which the Foundation announces it has received for the sale of the ordinary shares of MPS (for that purpose sales of ordinary shares for an amount lower than 10% of MPS capital measured over 12 months are not considered).

(32) The new instruments are also totally or partially convertible into newly issued ordinary shares of MPS. The conversion price is fixed at a 30% discount on the theoretical ex-rights price (**"TERP"**), in accordance with the terms and conditions set forth in the Decree of the Ministry of Economy and Finance of 21 December 2012.

2.6 Liquidity guarantees

(33) The Italian Republic has also provided liquidity guarantees in favour of MPS on the basis of the Italian scheme of 2011[7]. The first annual guarantees of EUR 10 billion were granted in December 2011 for 3 months and have been replaced by EUR 13 billion of guarantees in February and March 2012 with a duration of 3 to 5 years; thus the cumulated outstanding amount is EUR 13 billion. The remuneration required for the State guarantees is 79 basis points ("**bps**") per annum.

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[5] The term sheet of the new instruments provides *inter alia* that interest accrued on the new instruments in 2013 exceeding the profit of such year may be paid in whole or in part also through the assignment to the Italian Ministry of Economy and Finance of additional new instruments having a nominal value equal to the amount of interest not paid in cash.

[6] Being the number of MPS's shares resulting by dividing "initial nominal value" of MPS's ordinary share by the average "reference price" of MPS's ordinary shares in the 10 trading days preceding the issue date of the new instruments.

[7] See State Aid case SA. 34032 (2011/N), Reintroduction of the Italian Guarantee Scheme, OJ C 141, 7.05.2012, p.2.

2.7 Additional market information received

(34) The Commission has obtained market information from Codacons, an Italian consumer association, as well as from an advisor of the latter. Inter alia they supplied several documents, notes and information describing practices of MPS and on-going litigation between the association and MPS[8], aimed at putting into question the viability of MPS.

(35) The main allegation transmitted to the Commission is that the information provided and representations made by the Italian authorities about the origin of the capital shortfall recorded by MPS in terms of EBA requirements (as of 30 September 2011) were not correct. In fact, it is alleged that MPS's capital shortfall was generated by two derivatives positions (Alexandria and Santorini, see above section 2.2) still outstanding in MPS's balance sheet and mis-accounted as transactions on Italian government bonds. It is argued that MPS's investments in EUR 5 billion of Italian government bonds and the connected swap and term structured repo transactions executed in 2008 and 2009 should be accounted for as a synthetic credit default swap (**"CDS"**) and not as the bonds and respective liabilities. As a result it is argued that MPS's shortfall in terms of EBA requirements and the following need for the State recapitalisation were essentially due to the negative impact of those transactions whose mis-accounting sought to present MPS as a fundamentally sound bank negatively affected by the sovereign debt crisis. Instead MPS's problems were not exogenous but essentially due to excessive risk-taking and poor asset-liability management, so triggering the need of a far-reaching restructuring.

3. THE RESTRUCTURING PLAN OF MPS

(36) The restructuring plan is based on a five-year restructuring period ending on 31 December 2017 and the implementation of restructuring measures is revolving around the following main pillars: improved capital adequacy of the bank; structurally rebalanced liquidity profile; improved profitability and reduction of sovereign exposure as well as general risk reduction on the “trading book”.

(37) The assumptions of the restructuring plan in the base case scenario are presented below in section 3.1. The resulting projected profitability is dealt with in section 3.2. The capital planning is detailed in point 3.3. Risk profile reduction through asset quality improvement, sovereign and trading risk reduction, liquidity profile rebalancing and changes in corporate governance is described in section 3.4. The worst case scenario and the resulting capital situation is presented in section 3.5 and finally the risk related to the legacy derivative transactions is described in section 3.6.

[8] Codacons had lodged an appeal before the Italian administrative courts alleging that the subscription by the Italian State of the new instruments (and the administrative acts implementing the second State recapitalisation measure) was unlawful. The Regional Administrative Tribunal of Lazio (**"TAR Lazio"**) and the Italian Council of State (acting as administrative tribunal of second instance) rejected Codacons' application for an interim injunction in relation to the State recapitalisation of MPS. In particular, on 21 February 2013 the TAR Lazio rejected the request for an interim injunction on the ground that the existence of serious and irreversible detrimental effects of those acts had not been proved. On 22 March 2013 the Italian Council of State rejected the appeal of Codacons against the decision of the TAR Lazio on the ground that Codacons’ legal capacity is limited to consumer protection and no detrimental effects for consumers had been alleged in the court proceedings.

3.1 Assumptions of the restructuring plan (base case)

(38) The key macro-economic and financial assumptions, as well as external benchmarks provided by Italian authorities are presented in Tables 3 and 4.

Table 3 – Key macro-economic assumptions of the base case

	2013	2014	2015	2016	2017
GDP (*annual change*)	-1.8%	0.7%	1.2%	1.4%	1.4%
Inflation rate (*annual average*)	1.5%	1.8%	1.7%	1.7%	1.9%
1-month Euribor (*annual average*)	0.1%	0.2%	0.5%	0.9%	1.4%
ECB Rate (*end of year*)	0.50%	0.50%	0.50%	1.00%	1.50%
Spread 10y BTP – Bund (*end of year*)	295 bps	251 bps	196 bps	196 bps	164 bps

(39) The cut to the ECB official fixed rate for its "main refinancing operations" announced on 13 November 2013 (from the previous 0.50% to the current 0.25%) will only have a limited impact on MPS's 2013 net interest income compared to the base case assumption for 2013. The impact will mainly consist of a reduction of interest expense of around EUR 9 million.

(40) Table 4 sets out the restructuring plan's assumptions as to the level of interest rate swaps (**"IRS"**), and the yields on 10-year Italian government bonds. It also sets out the assumptions as to the difference between the yield on 10-year Italian government bonds and 10-year German government bonds (**"Bund"**). That difference is referred to as the "**BTP-Bund spread**".

Table 4 – Comparison of key financial assumption with external sources, as provided by Italian authorities (Bloomberg refers to data of 25 October 2013 on forward rates, Focus Economics and Prometeia refers to data by respective research companies dated October 2013)

Macroeconomic assumptions - Comparison	2013	2014	2015	2016	2017
3 month Euribor - annual average (Updated Restructuring Plan)	0.21%	0.23%	0.60%	1.04%	1.56%
3 month Euribor - end of period (Bloomberg)	0.27%	0.50%	0.82%	1.40%	1.98%
3 month Euribor - end of period (Consensus by Focus Economics)	0.23%	0.43%	1.01%	1.77%	2.26%
10 year IRS - annual average (Updated Restructuring Plan)	1.94%	2.36%	2.67%	2.70%	3.00%
10 year IRS - end of period (Bloomberg)	2.10%	2.41%	2.70%	2.94%	3.13%
10 year BTP - end of year (Updated Restructuring Plan)	4.77%	4.70%	4.35%	4.61%	4.54%
10 year BTP - end of year (Prometeia)	4.51%	4.67%	4.83%	5.21%	
10 year BTP - end of year (Consensus by Focus Economics)	4.40%	4.41%	4.49%	4.73%	4.91%
Spread BTP vs Bund (Updated Restructuring Plan)	2.95%	2.51%	1.96%	1.96%	1.64%
Spread BTP vs Bund (Prometeia)	2.60%	2.50%	2.06%	1.91%	
Spread BTP vs Bund (Consensus by Focus Economics)	2.48%	2.01%	1.91%	1.94%	1.86%

3.2 Financial projections in the base case, profitability and improved operational efficiency

- Profitability

(41) Based on the assumptions presented in section 3.1, the return on equity (**"RoE"**)[9] of MPS is planned to reach [7-9]% in 2017, and the return on tangible equity (**"RoTE"**) to reach [8.0-9.5]%, through the combined effect of an increase in revenues, resulting from a significant increase in productivity, and a reduction of costs, due to a more rigorous asset quality policy and operational efficiency gains.

[9] Calculated as "net income" of the year divided by: [(average equity) – (dividend accrued in the year and to be paid in May next year)].

(42) Financial projections over the restructuring period are presented in Table 5 :

Table 5 – Projected P&L and profitability indicators over the restructuring period

Mln Euro, Per Cent	2013	2014	2015	2016	2017
Net interest income	**[…]**	**[…]**	**[2,000-2,500]**	**[…]**	**2,490**
Net interest income (without NFI)	**[…]**	**[…]**	**[2,100-2,600]**	**[…]**	**[2,300-2,800]**
- Net fee and commission income	[…]	[…]	[2,000-2,400]	[…]	2,400
Income from banking activities	**[…]**	**[…]**	**[4,000-4,900]**	**[…]**	**4,890**
- Dividends, similar income, gains (losses) on inves.	[…]	[…]	[0-100]	[…]	[0-200]
- Net profit (loss) from trading and hedging	[…]	[…]	[100-300]	[…]	[100-300]
Income from financial and insurance activities	**[…]**	**[…]**	**[4,300-5,200]**	**[…]**	**5,189**
- Net impairment losses	[…]	[…]	[-1,100-1,400]	[…]	-1,018
a) loans	[…]	[…]	[-1,100-1,400]	[…]	-1,018
Net income from financial and insurance activities	**[…]**	**[…]**	**[3,100-3,800]**	**[…]**	**4,170**
YoY change	[…]	[…]	[…]	[…]	[…]
- Personnel expenses	[…]	[…]	[-1,500-1,900]	[…]	-1,701
- Other administrative expenses	[…]	[…]	[-700-800]	[…]	-674
- Net impairment losses on tangible and intangible assets		[…]	[-100-300]	[…]	-208
Operating expenses	**[…]**	**[…]**	**[-2,300-3,000]**	**[…]**	**-2,583**
Net operating income	**[…]**	**[…]**	**[700-900]**	**[…]**	**1,587**
- Non operating items	[…]	[…]	[…]	[…]	[…]
Profit (loss) before tax	**[…]**	**[…]**	**[600-800]**	**[…]**	**[1,500-1,800]**
Group net profit (loss)	**[…]**	**[…]**	**[200-250]**	**[…]**	**900**
Cost of credit (bps)	[…]	[…]	106 bps	[…]	90 bps
Cost / Income ratio	[…]	[…]	56.0%	[…]	50.0%
ROTE (including cost NFI)	[…]	[…]	[2-3]%	[…]	[8.0-9.5]%
ROE	[…]	[…]	[2-3]%	[…]	[7-9]%

(43) In order to increase its productivity, MPS will move toward a more "fee-based" business model. Income from services is expected to grow from 34% (in 2011) to 50% (in 2017) of total banking income as a result of some management actions encompassing: the increase of human resources dedicated to sales development (at least […] people); the full integration of remote banking channels; the revamp of private banking and greater value from joint ventures with insurance companies and asset management companies; and the launch of new on-line banking services with at target of […] new on-line banking customers and EUR […] million of revenues by […].

- *Operational efficiency*

(44) As stipulated in detail by the commitments provided by the Italian Republic and MPS, operational efficiency is to be improved through the planned implementation of a simplified business model focused on either the divestment of subsidiaries or the integration of other business entities currently operating as separate legal entities.

(45) The main transactions executed so far include:

- the disposal of the 60.4% stake held in Biverbanca S.p.A. (120 branches, 700 employees) for a consideration of approximately EUR 209 million with an impact on Tier 1 regulatory capital of approximately 10 bps;
- the exercise of the put options on the 26% stake held in the regional bank Banca Popolare di Spoleto and the 29.5% stake held in its controlling company Spoleto Credito e Servizi having an aggregate value of approximately EUR 100 million;
- the mergers by absorption in MPS of two fully-owned subsidiaries, namely Banca Antonveneta (370 banking branches located in North Eastern Italy, of which 45 will be closed) and MPS Gestione Crediti Banca (specialised in problematic loans management and recovery), both of which will lead to economies of scale and organisational efficiencies.

(46) Further planned actions include:

- the divestiture of Consum.it (consumer credit).
- the divestiture of MPS Leasing&Factoring (leasing business);
- the divestiture of two foreign banking subsidiaries, Monte Paschi Banque (17 branches throughout France; 300 employees) and Banca Monte Paschi Belgio (8 branches in Brussels; 110 employees);[10]

(47) As regards the divestiture of the consumer credit and leasing activities carried out by Consum.it and MPS Leasing & Factoring, if the market conditions are not favourable for an outright sale, the exit from those businesses may also be achieved through a progressive deleveraging of assets accompanied by a

[10] The Irish subsidiary Monte Paschi Ireland Limited will be merged into MPS.

commercial distribution agreement with third parties and the possible merger by absorption of the companies by MPS.

(48) The plan also includes the divestiture of equity stakes in non-strategic or non-core companies. Following a review of its equity investments portfolio MPS identified approximately 180 companies as potential divestitures having a total book value of approximately EUR 470 million.

(49) The rationalisation of MPS's local footprint will result in the closure of approximately [500 – 600] branches by 31 December 2105[Δ], bringing the number of branches from 2,730 as of 31 December 2012 to [2130-2230] as of 31 December 2015. The New York branch will be closed by [...].

(50) Besides the planned reorganisation of governance and control functions and rationalisation of organisational structure and processes, the restructuring plan also envisages the outsourcing of back-office activities in order to reduce the baseline of fixed costs.

(51) The combined effect of the implementation of planned management measures and of staff early retirement will lead to a reduction of approximately 5,300 employees, from approximately 28,500 in 2013 to approximately 23,200 in 2017 (equal to a reduction of 8,000 employees between 2011 and 2017), resulting in a cost saving of EUR [100-200] million. At executive level the restructuring plan envisages a headcount reduction of approximately 150 executives (equal to approximately 30% of the total).

(52) A structural reduction of [...]% in operating expenses is also planned from 2013 to 2017 (-26.2% from 2011 to 2017) both through a EUR [...] million reduction ([...]%) of personnel costs (22.5 % from 2011 to 2017) and EUR [...] million reduction ([...]) of other administrative expenses (-39.4% from 2011 to 2017). The latter reduction will partially result (EUR 75 million) from the disposals of certain assets (i.e. disposal of the 60.4% stake in Biverbanca, disposal of MPS Leasing&Factoring; disposal of Consum.it, disposal of the 26% stake in Banca Popolare di Spoleto and of the 29.5% stake in Spoleto Crediti e Servizi, disposal of foreign subsidiaries and closing of the New York branch). The total consolidated personnel and administrative costs will not be above the levels set in Table 6. In 2013-2016, the targets will be achieved with a tolerance margin of 2%.

Table 6– Reduction in personnel and administrative costs.

Data in EUR million	**2013**	**2014**	**2015**	**2016**	**2017**
Personnel and administrative costs	[...]	[2,400-2,900]	[2,200-2,700]	[2,200-2,700]	2,375

[Δ] Clerical errors - Should read "31 December 2015"

(53) If in 2015 or in 2016 the projected fee income and the projected net income are not achieved, then additional cost cutting will be implemented unless MPS's RoE[11] is equal to the target provided for in the restructuring plan.

(54) According to the sensitivity analysis provided by MPS, an increase of 0.5% of 3M Euribor would lead to an increase in net income and RoE (respectively projected at EUR 901 million and [7-9]% at 31 December 2017) of approximately EUR 100 million and of approximately 1.0%, respectively. A reduction of 25 bps of loan loss provisions would lead to an additional increase in net income and RoE of approximately EUR 200 million and 2.0%, respectively.

3.3 Capital adequacy, capital raising and repayment of State capital

(55) As regards the increase in quantity and quality of capital, a structural alignment with regulatory requirements will be pursued through the asset disposals described in section 3.2 and actions to optimise capital management and risk weighted assets (**"RWA"**). MPS plans a selective deleverage of its loan book aimed at increasing its quality while continuing to support local economy across the country.

(56) In particular, over the restructuring period MPS will achieve a reduction of RWA as presented in Table 7, mainly through deleveraging.

(57) MPS intends to increase its capital by at least EUR 2.5 billion (the **"capital increase"**). If the underwriting agreement related to the capital increase is not successfully executed by 31 December 2014 and the capital increase is not fully implemented at the latest by 31 March 2015, the new instruments will be converted at the request of MPS into ordinary shares in accordance with the terms and conditions set forth in the Decree of the Ministry of Economy and Finance of 21 December 2012.

(58) Subject to prior consent by the competent supervisor and pursuant to applicable laws and regulations, MPS will repay the new instruments – if not already converted into ordinary shares – in line with the schedule set out in Table 7 (with a tolerance margin of 10%):

[11] Calculated as "net income" of the year divided by: [(average equity) – (dividend accrued in the year and to be paid in May next year)].

Table 7 – Repayment schedule and capitalisation levels

Data in EUR million	2013	2014	2015	2016	2017
Opening balance	**1,900**	**4,071**	**1,071**	**471**	**321**
New issuance	2,171	0	0	0	0
Repayment	0	-3,000	-600	-150	-321
Closing balance	**4,071**	**1,071**	**471**	**321**	**0**
Resulting capitalisation and capital ratios					
Common Equity (in EUR million)	[...]	[...]	[7,500-8,500]	[...]	[7,500-9,000]
RWA (in EUR billion)	[...]	[...]	[80-90]	[...]	80.9
Common Equity Ratio (in %)	[...]%	[...]%	[8.5-10.5] %	[...]%	10.0%
Common Equity Ratio (BIS 3 fully phased-in in %)	[...]%	[...]%	[6-8.5]%	[...]%	9.3%
Core Tier 1 Ratio (in %)	[...]%	[...]%	[8-10]%	[...]%	9.8%
Tier 1 Ratio (in %)	[...]%	[...]%	[8.5-10.5]%	[...]%	[9-11]%
Total Capital Ratio	[...]%	[...]%	[12-15]%	[...]%	[13.5-16.5]%
Core Tier 1 Ratio (Net Sovereign Buffer)	[...]%	[...]%	[7-9]%	[...]%	[8.5-10.5]%
Core Tier 1 Ratio (Net Sovereign Buffer – EBA 30/09/2011)	[...]%	[...]%	[...]%	[...]%	[...]%
AFS Reserve (in EUR million)	- [...]	- [...]	- [...]	- [...]	- [...]

(59) The capital adequacy projections also account for the phase-in mechanism which will move some deductions from Tier 1 capital to deductions from common equity. In particular, while in the first years of the Basel III framework the difference between common equity and Tier 1 capital tends to be relatively high that difference falls over time due to the phase-in mechanism, as deductions are gradually moved from Tier 1 to common equity.

3.4 Risk profile reduction

(60) The projected accounting balance sheet of MPS is presented in Table 8.

Table 8 – Projected balance sheet in EUR million

Assets

Mln Euro, Per Cent	2012	2013	2014	2015	2016	2017
Customer loans	142,015	[…]	[…]	[110,000-135,000]	[…]	[105,000-125,000]
Mortgages (retail)	45,509	[…]	[…]	[40,000-45,000]	[…]	[35,000-45,000]
Current accounts	8,494	[…]	[…]	[5,000-15,000]	[…]	[5,000-15,000]
Consumer credit	5,999	[…]	[…]	[0-5,000]	[…]	0
Leasing	5,252	[…]	[…]	[0-5,000]	[…]	0
Corporate	57,201	[…]	[…]	[45,000-55,000]	[…]	[40,000-50,000]
Other loans	19,560	[…]	[…]	[15,000-20,000]	[…]	[15,000-20,000]
Loans to banks	11,225	[…]	[…]	[5,000-10,000]	[…]	[5,000-10,000]
Financial assets held for trading	23,514	[…]	[…]	[20,000-25,000]	[…]	[20,000-25,000]
Financial assets available for sale	25,649	[…]	[…]	[20,000-30,000]	[…]	[20,000-25,000]
Cash and cash equivalents	2,433	[…]	[…]	[0-5,000]	[…]	[0-5,000]
Other assets	14,046	[…]	[…]	[10,000-15,000]	[…]	[10,000-15,000]
TOTAL ASSETS	**218,882**	**[…]**	**[185,000-225,000]**	**[175,000-215,000]**	**[170,000-205,000]**	**180,733**

Liabilities

Mln Euro, Per Cent	2012	2013	2014	2015	2016	2017
Customer deposits	81,303	[…]	[…]	[80,000-100,000]	[…]	[75,000-90,000]
At sight deposits - retail	36,844	[…]	[…]	[30,000-40,000]	[…]	[30,000-40,000]
Time deposits - retail	3,609	[…]	[…]	[5,000-10,000]	[…]	[5,000-10,000]
Corporate deposits	20,121	[…]	[…]	[25,000-30,000]	[…]	[25,000-30,000]
Loans and other liabilities	20,729	[…]	[…]	[20,000-25,000]	[…]	[10,000-15,000]
Deposits from banks	14,323	[…]	[…]	[15,000-20,000]	[…]	[10,000-15,000]
ECB	29,000	[…]	[…]	0	[…]	0
Financial liabilities held for trading	21,517	[…]	[…]	[15,000-20,000]	[…]	[15,000-20,000]
Senior debt	46,729	[…]	[…]	[30,000-40,000]	[…]	[30,000-40,000]
Senior debt - retail	33,893	[…]	[…]	[30,000-40,000]	[…]	[30,000-40,000]
Senior debt - institutional	12,836	[…]	[…]	[0-5,000]	[…]	[0-5,000]
Subordinated debt	5,386	[…]	[…]	[0-10,000]		[5,000-10,000]
Other liabilities	12,270	[…]	[…]	[10,000-15,000]		[10,000-15,000]
Tremonti Bonds	1,900	0	0	0	0	
Monti Bonds		4,071	1,071	471	321	
Net equity	6,455			[9,000-11,000]		[11,000-13,000]
TOTAL LIABILITIES	**218,882**	**[…]**	**[185,000-225,000]**	**[175,000-215,000]**	**[170,000-205,000]**	**180,733**

(61) The projected reduction of the total assets in 2017 compared to 2011 is 25%.

3.4.1. Asset quality improvement

(62) In order to improve its asset quality MPS will strengthen its risk management and monitoring and will apply more rigorous credit policies to new lending. As a result MPS plans to reduce its cost of credit (for consumer/corporate lending) from 191 bps in 2012 to 90 bps in 2017. A centralised unit will be set up within the "Credit Division" in order to optimise the monitoring and management of problematic loans. The efficiency improvement in the collection of non-performing loans ("**NPLs**") is expected to lead by 2017 to an increase of [150-250] bps in the recovery rate (measured as the ratio of collection on NPLs for the year and stock of gross NPLs at the beginning of the year).

(63) Italian banks report four categories of loans to which a specific provision is attached, which will be referred to as "impaired loans" in this decision. Those four categories comprise loans past due, restructured loans, substandard loans

("*incagli*") and doubtful loans ("*sofferenze*")[12]. The level of impaired loans of MPS has increased between 2012 and 2013, from 19.1% as a percentage of gross customer loans as of 31 December 2012 to 21.3% as of 30 June 2013. The coverage ratio of the impaired loans (that is the level of specific provision over gross impaired loans) remained stable at 41%. Impaired loans net of provision amounted to EUR 19 billion.

(64) The BoI conducted an asset quality review on impaired assets of MPS, which led to approximately EUR […] million additional impairments included in December 2012 results.

3.4.2. Sovereign and trading risk reduction

(65) The plan envisages a progressive reduction of Italian government bonds held in the available for sale (**"AFS"**) portfolio. As a result their outstanding amount throughout the restructuring period will not exceed EUR [21-25] billion in nominal value (with a tolerance margin of EUR [0-500] million) and at 31 December 2017 it will not exceed EUR 17 billion in nominal value. If the relevant condition is met[13], the maximum amount of Italian government bonds held in the AFS portfolio at 31 December 2017 will be further reduced to EUR [10-20] billion in nominal value.

(66) At no point in the restructuring period will the outstanding amount of Italian government bonds held in the AFS portfolio exceed EUR [21-25] billion in nominal value (with a tolerance margin of EUR [0-500] million). The Italian government bonds held in the AFS portfolio may be replaced with other bonds subject to certain limitations depending on their maturity date.

(67) Trading risk will be significantly limited in terms of exposure and in terms of scope. First of all, the value at risk (**"VaR"**) for market price changes of the overall MPS's trading book will be limited to an amount not higher than EUR [15-25] million/daily and EUR [10-20] million/daily average, 99% confidence. The level of monthly stop loss on proprietary trading will be EUR [25-35] million. Second, in terms of products, proprietary trading will be limited to a defined set of liquid instruments and instruments with limited degree of complexity. In particular, instruments traded will only feature a single layer of optionality (i.e. no derivatives on derivatives) with the exception of swaptions. In addition, MPS will not hold positions in instruments which are not in the scope of its ordinary course of business or on derivatives having exotic underlying.

3.4.3. Liquidity profile rebalancing

(68) The liquidity profile of MPS will be structurally rebalanced essentially through the phasing out of the Group's interbank position and the full exit from the long-term repurchase operation (**"LTRO"**) with the European Central Bank (**"ECB"**) by 31 December 2015. As a result MPS's negative net interbank position will

[12] For reporting purposes, the last two categories are referred to in different terms by different Italian banks. In this paragraph, "impaired" refers collectively to all four categories having a specific provision. A specific provision is a provision attached to an identified exposure, as opposed to generic provisions calculated using probability of default on a portfolio of exposures and not triggered by a loan-specific risk..

[13] Namely the unwinding of either or both of the Alexandria and Santorini transactions further to favourable outcome in court proceedings.

decrease from EUR [25,000 – 30,000] million in […] to EUR [0 – 5,000] million in […].

(69) The reduction of the loan-to-deposit (**"LTD"**) ratio (excluding wholesale funding) from 131% in 2011 to approximately 100% in 2017 and of the total LTD ratio to around 90% in 2017 are expected to be attained also through the implementation of an asset disposal plan and the deleverage of negative value added loan book.

(70) MPS's net stable funding ratio is targeted to reliably exceed 100% throughout the restructuring period.

(71) The balance sheet reduction over the restructuring period as presented in Table 8 contributes to the reduction of funding needs.

3.4.4. Corporate governance measures

(72) The general shareholders meeting of MPS in its extraordinary session held on 18 July 2013 decided to remove the limit previously provided for in Article 9 of MPS's Articles of Association, according to which no shareholder other than the Foundation could own ordinary shares exceeding 4% of share capital and that the right to vote on any share indirectly or otherwise held in excess of such percentage could not be exercised.

(73) Moreover, MPS will submit, at a general shareholders meeting to be held as soon as practicable, a proposal to introduce in its Articles of Association a specific provision requiring that at least one-third of the members of the Board of Directors shall meet the independence requirements under applicable Italian rules and regulations.

3.4.5. Other behavioural safeguards

(74) The Italian Republic provided a set of behavioural commitments comprising inter alia a commitment that MPS will during the restructuring period not acquire any stake in any undertaking, covering both undertakings which have the legal form of a company and packages of assets which form a business, subject to some exceptions as specified in the Annex. Moreover MPS commits to a dividend ban until the capital increase has been completed as well as a coupon ban, a ban on advertisement and aggressive pricing strategies and some restrictions on liability managements; those commitments are detailed in the Annex.

(75) Moreover, the Italian Republic commits that MPS will comply during the entire restructuring period with the provisions on incentives and remuneration policies stipulated in paragraph 6 ("Banche che beneficiano di Aiuti di Stato") of the BoI's *Provvedimento* of 30 March 2011 ("*Disposizioni in materia di politiche e prassi di remunerazione e incentivazione nelle banche e nei gruppi bancari*").

(76) The Italian Republic in particular committed that during the restructuring period the total remuneration (excluding social contributions payable by MPS) to any board member and senior manager will be restricted to an appropriate level.

Remuneration exceeding EUR [...][14] including all possible fixed and variable components for a year will in principle be considered inappropriate. That restriction will cease to apply when MPS implements the capital increase foreseen in the restructuring plan or, alternatively, when the new instruments have been fully reimbursed. In order to ensure compliance with Italian civil law, MPS has concluded in one case compromise agreements related to the renegotiation of the employment contracts of a selected manager. The Italian Republic committed that any payments to be made by MPS to affected board members or senior managers under such compromise agreements will be lower than the amounts which would otherwise become payable by MPS in the event of termination without cause of their existing contracts.

3.5 Stress case scenario

(77) MPS performed a stress test on the restructuring plan, assuming:

- an extraordinary two notches downgrade on the credit portfolio in 2013;
- a constant BTP-Bund spread over the duration of the restructuring plan, being equal to the value of 280 bps;
- no dividend distribution (and consequently no payments of coupons on instruments whose remuneration is linked to dividends).

(78) In comparison with the base case scenario the two notches downgrade would imply:

- higher loan loss provisions of approximately EUR [...] million or an increase of approximately [...] % of the provisioning, with an estimated net capital loss of EUR [...] million in […];
- higher capital deductions of EUR [...] million due to “shortfall of provisions to expected losses” in […] (to be carried forward in the restructuring period);
- an [...] % increase in credit risk RWA of approximately EUR [...] million in […], only half of which (EUR […] million) is gradually reduced during the restructuring period.
- In comparison with the base case scenario, the assumption of a constant BTP-Bund spread would imply a higher negative capital impact due to the negative AFS reserve, increasing throughout the years due to Basel 3 phasing-in, The negative AFS reserve also affects deductions through related deferred tax assets **("DTA")**. In 2017 (80% Basel 3 phased-in) the higher capital impact of a constant BTP-Bund spread would amount to EUR [...] million due to the direct impact of the AFS reserve and EUR [...] million due to the corresponding DTA deductions.

(79) The overall cumulative capital impact on common equity tier 1 would be EUR -[...] million in […].

[14] After informing the monitoring trustee, MPS may adjust the above maximum limit for the annual remuneration in line with Italian inflation.

(80) Under those stressed assumptions, the capital ratios of MPS are represented in Table 9

Table 9 – Stress case solvency of MPS

BMPS	2013E	2014E	2015E	2016E	2017E
Net Income	[…]	[…]	[…]	[…]	[…]
AFS Net Reserve (Gov. Bonds)	[…]	[…]	[…]	[…]	[…]
RWA	[…]	[…]	[…]	[…]	[…]
Common Equity Ratio	[…]	[…]	[5-10] %	[…]	[5-10] %
Tier 1 Ratio	[…]	[…]	[5-10] %	[…]	[5-10] %
Total Capital Ratio	[…]	[…]	[10-15] %	[…]	[10-15] %

3.6 Impact of a possible different accounting treatment of derivative transactions

(81) MPS has recognised the Alexandria and Santorini transactions described above on a "gross" basis following derecognition rules of International Accounting Standards (IAS) 39. According to those rules and given the structure of the transactions, MPS has retained substantially all risks and benefits of ownership of the transferred BTP. As a consequence, consideration received has been accounted as a liability and interest rate swaps have been classified in hedging portfolio.

(82) However, if the transaction were to be accounted for on a "net" basis the purchase and sale of BTP along with total return swap/repo transaction would be accounted as credit default swaps (CDS); as a consequence, interest rate swaps would treated as trading derivatives.

(83) MPS has decided on that accounting treatment after assessment of business purpose, numbers of counterparties involved, timing of single transactions and other indicators.

(84) That analysis has been shared with and agreed to by the auditors of MPS and had been previously also communicated to the *Commissione Nazionale per le Società e la Borsa* (CONSOB)[15] as part of the discussions on disclosure adopted by MPS in its accounts for 2012 and 1H2013 regarding the restructuring of the Santorini and Alexandria transactions.

(85) At the request of the Commission, the Italian authorities have nevertheless provided a detailed impact assessment of a possible restatement under the assumption regarding BTP-Bund spread and 10-year Italian government rates presented in Table 4.

(86) In that scenario the impact on the net result and on the capital adequacy is presented over the restructuring period.

Impact on profitability

[15] CONSOB is the public authority responsible for regulating the Italian securities market.

(87) CDS accounting would introduce significant volatility in the profit and loss accounts, due to the changes in the value of Italian CDS. The restructuring plan assumes a gradual reduction of the BTP-Bund spread. The accounting treatment of the Alexandria and Santorini transactions as synthetic derivatives based on that assumption would produce a positive impact on net income, due to changes in the fair value of the CDS.

Table 10 – Impact of possible derivatives restatement on income

Montepaschi Group - Data in € million	2013E	2014E	2015E	2016E	2017E
Net Income (Updated Restructuring Plan)	[...]	[...]	[...]	[...]	[...]
Delta Net Income	[...]	[...]	[...]	[...]	[...]
Net Income (CDS accounting)	[...]	[...]	[...]	[...]	[...]

Impact on regulatory capital

(88) From a regulatory capital perspective, a different accounting treatment would produce a negative impact in the short-term mainly due to the cumulative effect on retained earnings, whereas the additional regulatory requirement on market risk (due to the reclassification of the hedging derivatives as trading derivatives) would be negligible. In 2017, the impact on regulatory capital (net of taxes) is estimated at approximately EUR [...] million made up of:

- around - EUR [...] million of cumulative retained earnings.
- around - EUR [...] million of additional market risk, estimated on the basis of a methodology applied also by the BoI.
- around + EUR [...] million from the difference in the fair value of the AFS net reserve (phase in at 80%).

(89) The impact would be mostly gradually absorbed over time, in line with the phase-in of the Basel III regulatory framework, and would be reduced from approximately - EUR [...] million in […] to approximately – EUR [...] million in […] (fully phased).

Table 11 – Impact of possible derivative restatement on capital adequacy over the restructuring period

Montepaschi Group -Data in € million	IIIQ 2013E	2013E	2014E	2015E	2016E	2017E	Fully phased*
A. Cumulative negative effect on retained earnings (**)	[...]	[...]	[...]	[...]	[...]	[...]	[...]
B. Additional requirement on market risk	[...]	[...]	[...]	[...]	[...]	[...]	[...]
C. Adjustment to AFS net reserve	[...]	[...]	[...]	[...]	[...]	[...]	[...]
D. Adjustment to AFS net reserve - BIS III - phase in (***)	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Total regulatory impact (A+B+D)	**[...]**	**[...]**	**[...]**	**[...]**	**[...]**	**[...]**	**[...]**
Total accounting impact (A+C)	**[...]**	**[...]**	**[...]**	**[...]**	**[...]**	**[...]**	**[...]**

* Fully phased is illustrative and estimated assuming net income and AFS reserve equal to 2017 figures
** In IIQ 2013A, cumulative negative effect on retained earnings is estimated based on actual data. Projections are based on simplified assumptions that take into account the main effects
*** 20% phase in in 2014E, 40% in 2015E, 60% in 2016E, 80% in 2017E, 100% in fully phased

(90) Furthermore the total regulatory impact does not change significantly under EBA requirements, as the EBA sovereign buffer already includes the negative amount of the AFS reserve.

4. POSITION OF THE ITALIAN AUTHORITIES

(91) The Italian authorities accept that the second State recapitalisation measure constitutes State aid to MPS but consider that it is compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("the TFEU"), as it is necessary to remedy a serious disturbance in the Italian economy.

(92) The Italian authorities submit that the restructuring plan is apt to ensure that the long-term viability of MPS is restored, that MPS provides appropriate own contribution to the restructuring costs and that distortions of competition are limited by compliance with structural and behavioural measures.

(93) In that regard, the Italian Republic and MPS have undertaken a number of commitments related to the implementation of the restructuring plan which are presented in the Annex to this Decision.

(94) In addition in the event of conversion of the new instruments into MPS's ordinary shares, the Italian Republic commits to exit majority ownership of MPS within five years from the date of conversion. For that purpose, majority ownership will be deemed to be exited if the majority of ordinary shares has been sold to an entity or entities that are not State-owned or controlled and the Italian Republic does not exercise control over MPS within the meaning of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.[16]

(95) With respect to the mitigation of distortions of competition, the Italian authorities claim that MPS's capital shortfall should at least to some extent be seen in the context of the marking down to market of sovereign bonds, which was reflected in the assessment of EBA's capital exercise. With reference to the restoration of long-term viability of MPS, Italian authorities have stated that the issuance of the new instruments is linked to the need to cover the shortfall resulted from that capital exercise, which is almost entirely attributable to the sovereign buffer in Italian government bonds held in the AFS portfolio. With this regardsit has highlighted that the acquisitions of Italian public debt securities had occurred mainly before the emergence of the sovereign crisis. With this regards, in relation to a wide part of those investments the policies implemented by MPS have a risk profile no different from that of other Italian commercial banks that in recent years have also increased the acquisition of Italian State securities, benefiting from the high yields offered. Therefore, the Italian authorities argue on the basis of the third sentence of point 14 of the 2011 Prolongation Communication[17] that the amount of restructuring and compensatory measures should be considered sufficient.

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[16] OJ L 24, 20.1.2004, p. 1.
[17] OJ C 356, 6.12.2011, p. 7.

(96) The Italian authorities also submit arguments why the information provided by Codacons should not alter that assessment. They recall the outcome of the judicial proceeding following the application by Codacons to the TAR Lazio with reference to the alleged unlawfulness of the subscription by the Italian State of the Monti bonds. The TAR Lazio and the Italian Council of State both rejected Codacons' application for an interim injunction in relation to the MPS's State recapitalisation. The submitted information has not led, so far, to the adoption of initiatives or measures under the national criminal law.

(97) The Italian authorities also point out that the accounting treatment of those repo transactions had also been examined by the BoI following an on-site inspection conducted at MPS. Following the findings of supervisory interventions, on 8 March 2013, the different Italian financial regulators issued a joint communication providing guidance on the correct accounting treatment of long-term investments financed through repo transaction of equal maturity (so-called term structured repo) as opposed to a CDS with physical delivery of the underlying assets. The Italian authorities point out that MPS's auditors confirmed, also under the criteria provided in that joint interpretative communication, the correctness of the accounting treatment. Following that guidance MPS published in its annual report information on the quantitative impact in the form of pro-forma accounts if the securities were be accounted for as CDS.

(98) The Italian authorities also submitted that, after having verified the adequacy of the restructuring plan and of the accelerated repayment schedule of the new instruments provided therein the BoI has confirmed that the plan appears credible, subject to the main condition of the successfully implementation of the planned capital increase and also provided that the macroeconomic and financial assumptions underlying the restructuring plan occur. In the expected scenario, taking as reference the projections of the restructuring plan regarding the evolution of regulatory ratios, the ratios would remain above the minimum regulatory requirements assumed in the plan during the whole restructuring period, even if a different accounting treatment were applied for both the Alexandria and Santorini transactions (i.e., if they were accounted as CDS instead of as long-term repos). In the stressed scenario – taking as reference the projections of the restructuring plan – MPS’s capital ratios would remain above the minimum regulatory requirements assumed in the plan during the whole restructuring period.

5. ASSESSMENT OF THE AID

5.1 Existence of State Aid

(99) According to Article 107(1) TFUE, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

(100) The qualification of a measure as State aid requires the following conditions to be met: (i) the measure must be financed through State resources; (ii) it must grant an advantage liable to favour certain undertakings or the production of certain goods; (iii) that advantage must be selective; and (iv) the measure must distort or

threaten to distort competition and have the potential to affect trade between Member States. Those conditions being cumulative, they must all be present before a measure is qualified as State aid.

(101) In that respect the Commission observes that those conditions are all met for both the recapitalisations of MPS with the new and the old instruments as already established in the rescue decision.

(102) In fact, the new instruments have been exclusively subscribed by the Italian Republic. The measure therefore entails State resources.

(103) Moreover, the recapitalisation through the new instruments allows MPS to comply with the EBA requirement of a CT1 ratio of 9%. In the circumstances prevailing at the moment of that recapitalisation and given the results posted by MPS no private investor would have provided MPS with such capital resources. For those reasons the subscription by the Italian Republic of the new instruments entails an advantage to MPS. It has only been offered to MPS and is therefore selective.

(104) Given that MPS is and will be active in the financial sector, which is open to intense international competition, any advantage from State resources to a bank may affect trade between the Member States and distort competition. It is therefore confirmed that the State recapitalisation measure in favour of MPS through the subscription of the new instruments constitutes State aid within the meaning of Article 107(1) TFEU.

(105) The aid amount is EUR 3.9 billion. Although the Italian Republic received bonds in the amount of EUR 4.017 billion, the additional EUR 171 million of new instruments did not entail any additional aid as it was merely given as a consideration in kind paying for the remuneration agreed in connection with the replacement of the Tremont bonds with the Monti bonds as described in recital (30).

(106) In addition, MPS has received guarantees on its liabilities from the Italian government and so from State resources. The maximum outstanding amount is EUR 13 billion. That existence of aid in those guarantees as has already been established in the Commission decision approving that scheme.[18] The guarantees were granted at a time when market conditions were deteriorating and it was difficult for banks to raise funding. Therefore, those guarantees would not have been provided by a market investor and given that MPS is in cross-border competition with other banks and that measure distorts competition, they constitute additional restructuring aid, possibly up to the nominal amount.

5.2 Compatibility of the aid

5.2.1. Application of Article 107(3)(b) of the Treaty on the Functioning of European Union

(107) Under Article 107(3)(b) TFEU State aid can be found compatible with the internal market if it serves to "remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial

[18] Decision of 15.12.2011, in case SA. 34032 (2011/N), OJ C 141, OJ C 141, 7.05.2012, p. 2.

crisis can create a serious disturbance in the economy of a Member State and that State measures supporting banks are suitable to remedy that disturbance. That position has been successively detailed and developed in the six Crisis Communications[19] as well as in the 2013 Banking Communication applicable from 1 August 2013[20].

(108) In respect of the Italian economy that analysis has been confirmed in the Commission's approval of various measures undertaken by the Italian authorities to combat the financial crisis[21] and, with specific reference to MPS, in the rescue decision. Any uncertainty regarding the fulfilment of regulatory requirements by a bank could directly affect the financial markets and thus the entire economy of a Member State. In light of the current fragile situation of the financial markets, the Commission therefore continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

(109) Given the relevance of MPS in the Italian banking sector and for the financing of the real economy, the Commission accepts that MPS's failure to satisfy strengthened capital requirements would have threatened financial stability and that the State intervention was therefore necessary to avoid a serious disturbance in the economy.

(110) The Commission therefore considers that the State recapitalisation measure in favour of MPS through the subscription of the new instruments has to be examined under Article 107(3)(b) TFEU.

5.2.2. Compatibility of the restructuring aid

(111) The State recapitalisation measure in favour of MPS through the subscription of the new instruments has been provided in the context of the restructuring of MPS. The Restructuring Communication sets out the rules applicable to the granting of restructuring aid to financial institutions in the current crisis. According to the Restructuring Communication, in order to be compatible with the internal market under Article 107(3)(b) of the Treaty, the restructuring of a financial institution in the context of the current financial crisis has to (i) lead to the restoration of the viability of the bank, (ii) include sufficient own contribution by the beneficiary (burden-sharing) and ensure that the aid is limited to the minimum necessary and (iii) contain sufficient measures limiting the distortion of competition. The Commission will examine the restructuring plan to ensure that those requirements

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[19] Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (*"2008 Banking Communication"*), OJ C 270, 25.10.2008, p. 8; Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (*"Recapitalisation Communication"*), OJ C 10, 15.1.2009, p. 2; Communication from the Commission on the treatment of impaired assets in the Community financial sector (*"Impaired Assets Communication"*), OJ C 72, 26.3.2009, p. 1; Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (*"Restructuring Communication*"), OJ C 195, 19.8.2009, p. 9; Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis (*"2010 Prolongation Communication"*), OJ C 329, 7.12.2010, p. 7 and the 2011 Prolongation Communication.

[20] OJ C 216, 30.7.2013, p. 1. Notifications registered by the Commission prior to 1 August 2013 are to be examined on the basis of the criteria in force at the time of the notification.

[21] Cf. Reintroduction of the Italian Guarantee Scheme, SA. 34032, OJ C 141, 17.12.2012.

are fulfilled as regards that State recapitalisation measure. Moreover, MPS has obtained a significant amount of State guarantees which must be taken into account in establishing if there are sufficient measures to limit the distortion of competition.

5.2.2.1. Restoration of long-term viability

(112) In assessing a restructuring plan the Commission needs to determine whether the bank is able to its restore long-term viability without State aid (section 2 of the Restructuring Communication).

(113) According to the Restructuring Communication, long-term viability is achieved when a bank is able to compete in the marketplace for capital on its own merits in compliance with the relevant regulatory requirements. For a bank to do so includes covering all its costs and providing an appropriate return on equity taking into account the risk profile of the bank. Achieving long-term viability further requires that any State aid received is either redeemed over time or is remunerated according to normal market conditions, thereby ensuring that any form of additional State aid is terminated. The return to viability should firstly derive from internal measures and be based on a credible restructuring plan and should second identify the causes of the bank's difficulties and weaknesses and explain how the restructuring is addressing them. In particular, successful restructuring entails withdrawal from all activities which would remain structurally loss making in the medium-term.

- Plan assumptions

(114) Point 13 of the Restructuring Communication requires that the restructuring plan is based on assumptions which are compared with appropriate sector-wide benchmarks, adequately adjusted to take account of the new elements of the current crisis in financial markets and incorporate a sufficient degree of stress.

(115) First, the Commission will assess the assumptions underlying the financial projections on the basis of which the return to profitability is presented. In that respect it is observed that the gross domestic product assumptions as presented in recital (38) for 2013 and 2014 are in line with the current projections of the International Monetary Fund covering the period until the end of 2014 and that thereafter the growth is projected to be moderate. The interbank interest rate assumptions are in line with forward rates presented in Table 4. In fact, given the sensitivity of MPS to interbank interest rates as presented in recital (54), the interbank interest rate assumptions are more conservative than the future prices observed on Bloomberg.

(116) It is observed that the level of the AFS reserve which is reflected in accounting equity and also in regulatory capital with the progressive phasing in of the Basel 3 regime is highly dependent on the spread between Italian and German government ten-year bonds. Therefore the assumption on the BTP-Bund spread is central to the restructuring plan. The assumptions by MPS are more conservative than the projections by two research companies presented by Italian authorities in

Table 4. Further the Commission refers to projections recently published by market participants and presented in Table 12 [22]:

Table 12 – Projections of spread between Italian and German 10 year government bonds by market participants

Spread BTP-Bund (in bp)	2013 (end year)	2014 (end year)	2015 (1Q)
Citi	225	175	175
Intesa Sanpaolo	243	193	na
Natixis	230	170	160

(117) On that basis the Commission observes that the projections by MPS on the BTP-Bund spread are consistently more conservative than recent projections by many market participants and observers.

- Return to profitability

(118) The restructuring plan projects a progressive return of MPS to profitability through a moderate increase in income accompanied by cost-cutting measures as illustrated in recital (41).

(119) The plan provides also for a structural reduction ([...]%) of operating expenses from 2013 to 2017 (-26.2% from 2011 to 2017) both through a reduction of personnel costs and of other administrative expenses leading to a cost/income ratio of 49.8% at 31 December 2017. That level is consistent with the business model of MPS which is essentially a retail bank and which, notwithstanding the new focus on the development of on-line banking and the planned cuts in the number of branches, will still operate a nationwide network of retail branches.

(120) The projected levels of income appear to be prudent and broadly in line with levels achieved in the past (presented in recital (15)), with the exception of "net fee and commission income". The latter is projected to significantly increase (rising from 34% to 49% of total banking income) as a result of the new business model and revenue diversification measures that MPS is aiming at implementing.

(121) In that respect the Commission observes that if the projected fee income and the projected net income are not achieved in 2015 or in 2016, then additional cost cutting will be implemented unless the RoE is equal to the target. The additional cost cutting will be equal to the lower of (i) the difference between the projected and the effective fee income; (ii) the difference between the projected and the realised pre-tax income; or (iii) EUR [...] million. Therefore if the fee income increase is not achieved, overall profitability will be preserved through adjusted costs.

(122) Point 13 of the Restructuring Communication indicates that long-term viability is achieved when the bank is able to provide an appropriate return on equity, taking into account the risk profile of the bank. The return on equity of 8% is therefore to be assessed in view of the risk profile of MPS at the end of the restructuring period.

[22] Citi 15 November 2013, G10 Rates Weekly, Intesa Sanpaolo, Views on the Italian Economy, Research department, October 2013, Natixis, 1 November 2013, Daily round up, Economic research.

- Reduction of risk profile of MPS

(123) In line with point 10 of the Restructuring Communication, the commitment to reduce the Italian sovereign bond holdings described in recital (68) contributes to addressing the sources of MPS's difficulties. The sovereign exposure in the context of the EBA stress test was the initial trigger of the need for State aid. In the same vein, the limits on the proprietary trading activities as translated into strict VAR limits of the trading book described in recital (70) should limit the risks related to financial production.

(124) The quality of MPS's assets has been worsening over the past accounting periods with increasing amounts of impaired loans. In that respect the Commission notes that MPS has been subject to a comprehensive overview of its loan looks by the BoI at the end of 2012. Further the Commission notes the significant resource reallocation towards stricter credit risk management described in recital (65).

(125) The comparatively high level of impaired loans in proportion to the overall size of MPS's portfolio is to some extent addressed by a provisioning policy which is, when contrasted with that of the peers of MPS as presented in Table 13, relatively conservative and translates into a coverage ratio of 41%. That level is considerably higher than other Italian banks of comparable size, except those of the two largest banks whose coverage ratios are slightly higher. The coverage ratio level is assessed in view of the type of underlying loan. As presented in recital (63) around one-third of MPS's customer loans are composed of mortgage loans, which given the evolution of house prices in Italy do not require a high level of coverage

Table 13 – Comparison of impaired loans levels and coverage of a certain Italian banks at 30 June 2013

	[...]	[...]	[...]	[...]	[...]	[...]
gross impaired loans / total loans to customers	14.4%	13.8%	21.3%	17.7%	12.5%	13.4%
specific provision /gross impaired loans	44.1%	44.2%	41.1%	25.7%	26.3%	33.3%

(126) Nevertheless in view of the increasing provision charges it is prudent for MPS to hold a sufficient buffer of capital to be able to face increased loan loss provision charges in an unfavourable case. The capital buffer is in particular enhanced through the capital increase described in recital (57).

(127) In respect of funding, the challenge ahead for MPS is mainly the phasing out of the current reliance on ECB LTRO funding for an amount of EUR 28 billion. MPS will address that challenge in particular through deleveraging by EUR 38 billion from 2012 to 2017 as presented in recital (62). A significant part of the deleveraging takes place in financial assets through the reduction of the AFS with no impact on real lending.

(128) Further, the Commission positively assesses the objective to reduce the LTD ratio (commercial) to around 100% in 2017 and the total LTD ratio to 90% in 2017. Moreover, it also takes positive note of the progressive increase in the duration of

liabilities resulting from maturity transformation policies which is expected to allow MPS to have a net stable funding ratio reliably exceeding the threshold of 100%. The liquidity rebalancing resulting from the deleveraging and the improved LTD ratio contribute to reducing liquidity risk.

(129) Another aspect to be considered in the assessment under the Restructuring Communication is whether any existing or potential weaknesses in the corporate governance structure are addressed by the restructuring plan. The Commission finds that the measures already implemented after and as a result of the granting of the State aid through the new instruments and those envisaged in the restructuring plan comprise significant changes in MPS's organisational structure and corporate governance which will make MPS less vulnerable to potential undue influence by shareholders and will increase corporate oversight.

(130) The removal of the 4% cap on voting rights of shareholders other than the Foundation as described in recital (70) is a key corporate governance measure of the restructuring plan which will introduce market discipline through effective shareholder control of the management actions.

(131) The resulting re-focusing of the business, the rebalancing of the liquidity profile, the reduction of the sovereign risk and the restraints on trading activities and acquisitions will result in a significant reduction of the relative level of risk and reinforce MPS's status as a commercial bank mainly active in the retail segment. Against that background the projected RoE of around [7-9]% can be considered as acceptable.

- Solvency of MPS in the base and in the stress case

(132) Point 13 of the Restructuring Communication requires that the bank is sufficiently capitalised at the end of the restructuring. Accordingly current and prospective capital adequacy should be in line with applicable supervisory regulation based on prudent valuation[23]. The Commission has established that the assumptions can be considered prudent and incorporate a range of stress in line with point 13 of the Restructuring Communication. The capital projections provided as described in recital (57) and as endorsed by the competent Italian supervisory authority are based on a repayment schedule for the new instruments that shows that the current and the prospective capital adequacy levels satisfy the relevant regulatory requirement throughout the restructuring period. That evaluation also holds true in a stress case scenario. They also ensure compliance with Basel 3 rules.

(133) In particular the plan to proceed with a repayment of the new instruments, while keeping the capital adequacy ratios of MPS at comfortable level, is to be considered as a positive measure contributing to the restoration of a sustainable level of profitability of MPS. The new instruments bear high coupons (higher than the RoE) and a step-up clause applies to both their coupon and redemption price, which would represent a burden for the profitability of MPS (for example, without the new instruments in 2013 the net interest income of MPS would have increased from EUR [...] billion to EUR [...] billion). The actual repayment of the new instruments is nevertheless subject to compliance with capital requirements

[23] See point 11 of the Restructuring Communication.

and the prior consent to each annual repayment by the competent authorities, as well as to the successful implementation of the planned capital increase.

(134) The mere fact that the competent supervisory authority prohibits or does not authorise the repayment of the new instruments should not automatically dispense MPS from the repayment obligation and requires action by MPS. If MPS is unable to repay the new instruments, MPS commits to re-notify a modified restructuring plan with additional measures. The Commission welcomes that commitment as it underlines the credibility of the repayment plan.

(135) If capital increase is not successful, the capital position of MPS would not allow for a repayment of the new instruments and the payment of coupons on them would burden its return to profitability. Therefore in case of a failure of the capital increase the new instruments should be converted. The conversion at discount to the TERP based on a prevailing market price will result a majority ownership by the State and will ensure adequate remuneration to the State to be received in the form of dividends and in the form of the sales price of MPS within five years of the conversion.

(136) Further as illustrated in recital (78) and confirmed by the Italian regulator, the projected solvency is also preserved in the stress case. In particular, the stress case assumes a significant worsening of credit quality and the maintenance of the spread of the Italian government bonds over German government bonds (which are a central assumption for the solvency position as explained at recital (116)) at crisis levels over the entire restructuring period.

(137) Finally, the Commission has taken into account the risk of a possible restatement of Alexandria and Santorini transactions, for which detailed simulations were provided in addition to the stress case. According to figures submitted by the Italian authorities as described in recital (87) and as confirmed by the Italian banking supervisor in recital (96), even if the accounting treatment of those transactions were changed, the capital ratios of MPS would not fall below the regulatory minimum throughout the restructuring period, […].

(138) In terms of capital, such a restatement would *de facto* bring forward the phasing-in of Basel 3 rules on the regulatory treatment of AFS reserves whereby the negative value of AFS reserves associated with the EUR 5 billion of BTP would have to be deducted from regulatory capital. By the end of the restructuring period the difference between the restatement scenario and the current accounting treatment would be very small. Moreover, an accounting restatement of the Alexandria and Santorini transactions as CDS would not change the underlying economic risk which relates to those legacy positions. It would also not affect materially the accounting equity because the loss is recorded for accounting purposes in the AFS reserve which is subtracted from the International Financial Reporting Standards equity as opposed to the regulatory capital.

(139) Consequently, the Commission considers that the restructuring plan fulfils the requirements of the Restructuring Communication with regard to the restoration of the long-term viability of MPS.

5.2.2.2. Own contribution (burden-sharing) and limitation of the aid to the minimum

(140) As provided in the Restructuring Communication, banks and their stakeholders need to contribute to the restructuring as much as possible in order to ensure that aid is limited to the minimum necessary. Thus banks should use their own resources to finance the restructuring, for instance by selling assets, while the investors in the bank should absorb the losses of the bank where possible.

(141) The restructuring plan does not contain any elements that suggest that the aid exceeds the means required to restore the long-term viability of MPS. The aid received is required to ensure MPS's capital adequacy in relation to EBA requirements in the base case (which has been developed in the context of an already stressed macroeconomic scenario) and in a stress scenario.

(142) The Commission positively observes that MPS commits to implement a capital increase whose successful execution will allow for the repayment of the new instruments in line with the accelerated repayment schedule included in the restructuring plan (providing for a repayment of 74% of their outstanding amount already by 2014). That accelerated repayment schedule contributes to limiting the buffer of capital that MPS may hold. It thereby contributes to keeping the aid to the minimum necessary and to avoiding undue distortions to competition. The repayment schedule should be considered as one of the key elements of the restructuring plan. As a result, any deviation from it, even if minimal, should be promptly notified in advance to the Commission for its possible approval, which could be granted only following the prior consent of the authority responsible for the prudential supervision of MPS and on the basis that commitments offering further alternative compensatory restructuring measures would be offered and implemented.

(143) In respect of the contribution to restructuring costs through internal resources generated by MPS, the Commission notes that MPS plans to implement significant cost-cutting measures. The cost-cutting measures will result in a reduction of the operating expenses ([...]% from 2013 to 2017 and -26.2% from 2011 to 2017), both through a reduction of personnel costs and of other administrative expenses (amounting to [...]% and -29.8% respectively from 2013 to 2017 and - [...]% and -39.4% from 2011 to 2017). The number of employees will be reduced by [10-20]% from 2013 to 2017 (-25.7% from 2011 to 2017). Consequently MPS is to achieve a cost-income ratio of 49.8% (compared to its [...]% level in 2013 and 63.6% in 2011). Such increased operational efficiency contributes to limiting the amount of aid to the minimum necessary as well as to facilitating the exit of the Member State from the capital of MPS.

(144) Further, the divestments of non-core national and foreign subsidiaries will generate proceeds, which can be used to finance the restructuring costs. Those disposals should result in a structural reduction of EUR 75 million in "other administrative expenses" stemming from the divestment of Biverbanca, the disposal of the leasing business, the deleverage of Consum.it, the disposal of Spoleto, the disposal of banking subsidiaries in Belgium and the closing of the New York branch.

(145) Point 24 of the Restructuring Communication states that an adequate remuneration of the State capital is also a mean of achieving burden-sharing. In that context the Commission recalls that as indicated in recitals (28) and (29) the new instruments bear a 9.0% annual coupon with a step-up clause of 0.5% every two years (up to maximum 15%) and that where coupons cannot paid in cash an

ACSM applies which is based on the market price of MPS's shares[24]. The minimum redemption price of the new instruments is also subject to a step-up mechanism providing for a percentage increase of 5% every two years up to a limit of 160%. In case of conversion of the new instruments into newly issued ordinary shares of MPS, the conversion price is based on a 30% discount to the TERP in accordance with the terms and conditions set forth in the Decree of the Ministry of Economy and Finance of 21 December 2012. Therefore, in line with its finding in the rescue decision, the Commission considers that the cumulative effect of those features of the new instruments gives rise to an appropriate level of remuneration of the State recapitalisation measure in favour of MPS. That is also true with respect to the remuneration of the guarantees which is in line with the formula stipulated in the Italian guarantee scheme.[25]

(146) Moreover, in order to ensure that the owners of and investors in MPS participate to the maximum extent in the reconstitution of an adequate capital basis over the restructuring period, MPS will retain dividends. In case of conversion of all of the outstanding new instruments the dividend ban will only apply to the financial years 2013 and 2014, given that the ban would otherwise reduce the remuneration of the Italian Republic as the aid provider.

(147) Furthermore MPS will not pay any coupons on hybrid capital instruments during the restructuring period unless MPS has a legal or contractual obligation to proceed with coupons' payment, until the implementation of the capital increase.[26]

(148) A one-time exception will be made for a coupon on an Upper Tier II instruments due by 31 December 2013. The coupon payment is closely linked to the capital increase allowing for the repayment of the aid and the exception should be permitted only to the extent that it is required in order to ensure optimal conditions for the capital increase. Given the significant dilution of existing shareholders and hence the amount of burden-sharing produced by the capital increase, that derogation from the coupon ban, which also itself is limited in time and scope, can exceptionally be considered proportionate when set against the objective of not unduly hindering MPS's ability to implement the planned capital increase and to repay the aid. Since MPS seems able to raise such a significant amount of capital from the market in the very near future by a credible capital raising strategy combined with a clear alternative in case of failure (conversion of the new instruments), that one payment can be exempted from the coupon ban on the basis that it does not threaten the implementation of the restructuring plan.[27]

(149) Therefore the Commission considers that it is adequately ensured that MPS does not use State aid to make unnecessary payments on own funds in line with point 26 of the Restructuring Communication.

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[24] The market price will be calculated on the basis of the average of market price of the shares over ten consecutive days preceding the approval of MPS's balance sheet by its Board of Directors.

[25] See State Aid case SA. 34032 (2011/N), Reintroduction of the Italian Guarantee Scheme, OJ C 141, 7.05.2012.

[26] The Commission notes positively that this approach is in line with the standard rules now laid down in point 47(a) of the Banking Communication.

[27] A similar reasoning was accepted in case SA.28855 (N 373/2009), ING – restructuring aid, at recital 196, where the Commission accepted the payment of a coupon (in December 2008) just before ING was to announce a capital increase.

(150) In view of the contribution of MPS by cost reduction and by all shareholders through profit retention, adequate remuneration for the States recapitalisation measure and possible dilution of the shareholders' stake in case of application of the ACSM or conversion of the new instruments, and having taken into consideration the term of the commitment on the repayment schedule and conversion of the new instruments, the restructuring plan can be considered as providing for an appropriate own contribution and burden-sharing.

5.2.2.3. Measures limiting the distortion of competition.

(151) The Restructuring Communication requires that the restructuring plan proposes measures limiting distortions of competition and ensuring a competitive banking sector. Moreover, the measures should also address moral hazard issues and ensure that State aid is not used to fund anti-competitive behaviour.

(152) MPS has received an aid amount of around EUR 3.9 billion in the form of capital support. It should be recalled that the Commission had already concluded in the rescue decision that the new measure replaces the EUR 1.9 billion of the old instrument and to that extent did not provide MPS with further resources but instantly replaced the old instruments. Moreover, of the new instruments EUR 171 million were not assigned to the Italian Republic in exchange for additional State resources but represents payment in kind for the interests accrued (but legally not due according to the conditions set forth in their term sheet) on the old instruments. Altogether, MPS has thus received aid in the form of a State recapitalisation for an amount of about 3.7% of its RWA in 2011[28]. Moreover, MPS has obtained a significant amount of other support, in the form of EUR 13 billion of State guarantees.

(153) That significant amount of State aid must be adequately reflected in measures to mitigate distortions of competition in line with point 31 of the Restructuring Communication, although account must be taken of the amount of burden-sharing. In the present case, the Italian Republic has committed to a capital increase which would result in an extraordinary repayment schedule. That capital increase and the associated repayment of new instruments significantly limit the duration of the existence of aid and thereby greatly contribute to burden-sharing. They are similar in effect to a conversion of the new instruments into MPS's ordinary shares which would also result in far reaching burden-sharing given that in such a case MPS's existing shareholders would be de facto expropriated.

(154) The Italian Republic has further submitted various commitments in order to mitigate the distortions of competition resulting from the State aid granted to MPS.

(155) First, regarding structural measures the restructuring plan envisages a number of structural measures as indicated in recitals (47) and (48). MPS has also committed to reduce its nationwide branch network by closing approximately 550 domestic branches by 31 December […]. The combined effect of the implementation of planned management measures will lead to a reduction of balance sheet of 20% and a staff reduction of [5,000-5,500] employees.

[28] The aid amount would represent 4.2 % of RWA of end 2012.

(156) Second, the Italian Republic and MPS agreed to several behavioural constraints such as an advertisement ban, an acquisition ban, a dividend and hybrid coupon ban, a ban on aggressive pricing strategies and a cap on the remuneration of the executives of MPS.

(157) It should also be noted that the new recapitalisation measure is related to requirements set out by EBA[29], which required banks to raise their core tier 1 ratio to 9% by June 2012, after setting an additional buffer against sovereign debt exposures to reflect market prices as at the end of September 2011.[30] Those EBA requirements were directly linked to a confidence crisis in relation to sovereign debt.

(158) The Italian Republic has therefore submitted that those measures should be subject to proportionate treatment in line with the third sentence of point 14 of the 2011 Prolongation Communication which specifies that the Commission will "*undertake a proportionate assessment of the long term viability of banks, taking full account of elements indicating that banks can be viable in the long term without the need for significant restructuring, in particular where the capital shortage is essentially linked to a confidence crisis on sovereign debt, the public capital injection is limited to the amount necessary to offset losses stemming from marking* [… European …] *sovereign bonds to market in banks which are otherwise viable, and the analysis shows that the banks in question did not take excessive risk in acquiring sovereign debt.*"

(159) It is certainly the case that MPS's capital shortfall against the CT1 ratio of 9% was identified following the EBA "EU capital exercise". That shortfall was quantified by the BoI and EBA as amounting to EUR 3.267 billion, in addition to the contribution of the old instruments issued for an amount of EUR 1.9 billion. Following the implementation of a capital plan aimed at addressing that shortfall, MPS informed the BoI that it would not be able to fill the remaining shortfall by 30 June 2012 as envisaged. The BoI then determined that MPS had a residual capital shortfall in the light of the EBA requirements in the range of EUR 1.3 billion to EUR 1.7 billion (plus an additional potential capital need related to incorrect accounting representation of the Alexandria and Santorini transactions entered into by MPS before 30 September 2011, which were under investigation at time of the rescue decision).

(160) It follows that the EBA "EU capital exercise" gave rise to the need for MPS to have recourse to State aid. Without the requirement for a sovereign buffer and on basis of historic accounting treatment there would have been no shortfall. It is true that had MPS not acquired the EUR 5.1 billion of long-term Italian sovereign bonds the consequences of the EBA "EU capital exercise" would have different in scope but that exercise would have still led to a request for State aid.

(161) Notwithstanding a nexus of the recapitalisation with the new instruments with the EBA exercise and the sovereign crisis, the Commission also has to assess whether MPS took excessive risk in acquiring sovereign debt. In that respect it needs to be observed that MPS had, as noted in recital (22), been acquiring significant amounts of its government's bonds before the outbreak of the sovereign crisis in

[29] Stemming from both: EBA stress test and EBA capital exercise.
[30] That element was already noted in recital 37 of the rescue decision.

2010. Such a strategy should not in principle be considered as excessive risk-taking. The status of such a strategy is less evident in case of the bonds acquired after 2010. However, given that the Italian authorities only seek partial application of the proportionate assessment approach, and in light of the fact that MPS has undertaken to carry out the burden-sharing measures described in recitals (142) to (147) as well as behavioral safeguards set out in recital (156) and a 25% balance sheet reduction, the partial application of that approach should suffice in the present case and a full assessment can be left open.

(162) The measures provided for in the restructuring plan are, in view of the partial application of a proportionate assessment foreseen under the third sentence of point 14 of the 2011 Prolongation Communication, sufficient to mitigate the distortions stemming from the restructuring aid and the restructuring aid can hence be found compatible.

(163) The compliance with the commitments in the Annex will be monitored by a monitoring trustee.

5.2.3. Conclusion on the compatibility of the restructuring aid

(164) The Commission finds that the restructuring aid in the form of a State recapitalisation of EUR 3.9 billion and guarantees of EUR 13 billion constitute restructuring aid in favour of MPS. That restructuring aid ensures the viability of MPS, is limited to the minimum necessary and competition distortions are sufficiently addressed. That restructuring aid is therefore compatible with the internal market for reasons of financial stability on the basis of Article 107(3)(b) of the Treaty on the Functioning of European Union, in light of the commitments set out in the Annex to this Decision.

6. CONCLUSIONS

The Commission concludes that the State recapitalisation of MPS through new instruments of EUR 3.9 billion and guarantees of EUR 13 billion constitute restructuring aid in favour of MPS. In view of the commitments undertook by the Italian Republic regarding the restructuring and the repayment of the aid measures, the Commission concludes that the restructuring aid is compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of European Union.

The Commission notes that the Italian Republic exceptionally accepts the adoption of this Decision in the English language

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

Joaquín ALMUNIA

Vice-President

ANNEX I

COMMITMENTS OF THE REPUBLIC OF ITALY TO THE EUROPEAN COMMISSION

The Republic of Italy (hereinafter "the Republic") commits to the Commission for the purpose of the State aid procedure SA 35.137 to ensure that Banca Monte dei Paschi di Siena S.p.A. (hereinafter "BMPS") fulfills the following commitments, which it has provided to the Republic and which are enlisted in the Annex to the Restructuring Plan approved by BMPS as of 7 October 2013.

Restructuring period - The restructuring period will end on 31 December 2017.
The following commitments will apply starting from the date of the Commission decision during the entire restructuring period, unless explicitly provided otherwise hereinafter.

1 **Repayment of State aid** – Subject to prior consent of each single annual repayment by the competent supervisor pursuant to applicable laws and regulations and unless converted in line with the commitment provided in paragraph 16 below, BMPS commits to repay the New Financial Instruments according to the following schedule (each annual repayment with a tolerance margin of 10%):

Million euro	**2013**	**2014**	**2015**	**2016**	**2017**
Opening balance	**1,900**	**4,071**	**1,071**	**471**	**321**
New issuance	2,171	0	0	0	0
Repayment	0	-3,000	-600	-150	-321
Closing balance	**4,071**	**1,071**	**471**	**321**	**0**

If on any given year the competent supervisor gives its consent to a repayment lower than the one provided for in the above schedule, the shortfall shall accumulate to the repayment amount due in the following year.
If on any given year the competent supervisor fails to give its consent to repayment according to the above schedule, the repayment provided for in the above schedule shall be suspended. In that event the corresponding obligation to pay those amounts shall be deferred until the competent supervisor does not prohibit the relevant repayment. If repayment of the amount initially deferred is not approved in the following year cumulatively with the repayment amount of that year, the Republic shall notify a modified restructuring plan to the Commission which, in principle, shall contain additional measures.
With respect to the repayment scheduled in 2014 only, should (i) the Capital Increase (as defined below) not be completed by the end of 2014; and (ii) the conversion of the New Financial Instruments not be required in accordance with paragraph 16 below, the repayment scheduled in 2014 will be automatically deferred to the first quarter of 2015.

2 **Monitoring Trustee** – Full and proper implementation of all commitments will be continuously and thoroughly monitored in detail by an independent (of the Republic and BMPS) and suitably qualified Monitoring Trustee, that shall neither have nor become exposed to a conflict of interest.

The Trustee shall be remunerated by BMPS in a way that does not impede the independent and effective fulfillment of its mandate and will be appointed by BMPS following endorsement of the trustee by the Commission (in line with a separate Agreement). The mandate will end when the restructuring period finishes.

3 **Reduction of balance sheet total** – BMPS will reduce the total assets of its consolidated audited balance sheet according to the following table. In 2013-2016, the targets will be reached with a tolerance margin of 10%.

Data in EUR billion	**2013**	**2014**	**2015**	**2016**	**2017**
Total assets	[…]	[185-225]	[175-215]	[170-205]	181

4 **Reduction of Italian sovereign bonds in the AFS category** - The outstanding amount of Italian sovereign bonds held in the AFS balance sheet category will progressively be reduced to Euro 17 billion in nominal value at the end of 2017.

4.1 At no point of the restructuring period, the outstanding amount of Italian sovereign bonds held in the AFS category will exceed Euro [21-25] billion in nominal value, with a tolerance margin of Euro [0-500] million.

4.2 The Italian sovereign bonds held in the AFS category

(a) coming to maturity in the period 2013-201 7, can be replaced only with bonds having a maximum duration of [0-5] years, with a tolerance margin of 1 month;

(b) not coming to maturity in the period 2013-2017, can be replaced only with bonds having, at the time of purchase, an equal or shorter duration.

4.3 In case of unwinding of the "Alexandria" and/or "Santorini" transactions further to favorable court proceedings outcome, then there will be a further reduction in the Italian sovereign bonds portfolio held in the AFS category up to Euro [0-5] billion in nominal value (i.e. the overall portfolio would therefore be reduced from Euro 17 billion in nominal value to Euro [10-20] billion in nominal value at the end of 2017).

5 **Disposal of participations** - BMPS will divest the following participations if not already (partially) divested, at the very latest within the deadlines set out below at the best possible price and with a view to preserving the company's assets. Thereby the main value - determining elements of the holdings' present volume of business will be preserved until they are offered for sale.

(a) Consum.it – by […]

(b) MPS Leasing & Factoring (leasing business) – by […]

(c) Monte Paschi Banque – by […]

(d) Banca Monte Paschi Belgio – by […]

5.1 BMPS may postpone a sale of the participations referred for not more than 12 months if it can demonstrate that the price that would be obtained by the transaction is lower than the book value of the participation in BMPS's individual accounts, or would result in losses in the Group accounts in accordance with International Financial Reporting Standards.

5.2 If BMPS has not concluded a sales agreement for any given participation by the end of the divestiture period determined in

accordance with point 5.1, it will grant the divestiture trustee an exclusive mandate to sell the divestment business within the trustee divestiture period. Should the divestiture trustee not succeed in selling the business without creating an excessive loss (a loss that would endanger the viability of the Bank), then BMPS will be entitled to propose alternative divestiture measures to the Commission.

5.3 As regards the disposal of the consumer credit and leasing activities, carried out by subsidiaries Consum.it and MPS Leasing & Factoring, respectively, should the market conditions not be favorable for an outright sale, the exit from such businesses could be achieved through a progressive deleveraging of assets accompanied by a commercial distribution agreement with third parties and the possible merger by absorption of the companies in the Bank.

6 **Closure of foreign branches** - BMPS will close its New York branch as soon as possible, but no later than […].

7 **Closure of domestic branches** - BMPS will close further [150 to 250] branches by 2015 (in addition to the 335 branches already closed between December 2012 and June 2013) so as to bring the total number of branches to [2130-2230] at the end of 2015.

8 **Financial markets / proprietary trading** - For the whole restructuring period, under no circumstances will BMPS carry out trading activities that will significantly increase the risk profile of the Bank. Specifically, the value at risk for market price changes of the overall trading portfolio (i .e. "trading book" as defined per Regulation no. 263 of Bank of Italy of 27 December 2006, and subsequent amendments) will not exceed Euro [15-25] million/daily and Euro [10-20] million/daily average, 99% confidence, where "daily average" means the daily average on any three-month rolling period. The monthly stop loss limit on proprietary trading is set at Euro [25-35] million.

8.1 BMPS's proprietary trading will be limited to liquid instruments. Liquid instruments are those with reliable quotes provided by a reasonable number of market participants (i.e. minimum 5) and that can be traded with small transaction costs (i.e. maximum bid / ask spread of […]% of notional).

8.2 A list of liquid instruments on which BMPS will be allowed to continue trading in the future under this commitment is set out in the Appendix to this List of Commitments. BMPS may trade in those instruments provided that traded products are allowed only to the extent that their underlying reflects the aforementioned liquidity requirements under all circumstances. In addition, BMPS will not hold positions in instruments which are not in the scope of the BMPS's ordinary course of business or on derivatives having exotic underlying. Instruments traded will only feature a single layer of optionality (i.e. no derivatives on derivatives (with the exception of swaptions) / structured products).

8.3 BMPS may ask for a revision of Value at Risk (VaR) and stop loss limit on proprietary trading in case of significant changes in market conditions. A change in market conditions is considered occurring when one of the conditions set below is met: (i) the value of the Eurostoxx 50 equity index changes by more than [10-20] per cent in a period of ten working days; (ii) the yield offered by the Buoni Ordinari del Tesoro

with 6 months maturity changes by more than […] basis points over a period of ten working days; (iii) the volatility of Euro interest rates, measured by the means of swaptions price on a 10 Fix for Variable Interest Rate Swap, increases by more than […] per cent in a period of ten working days. In this case, the Monitoring Trustee will assess BMPS' request and provide a comprehensive report that will be submitted for endorsement of Commission's services.

9 **Ban on acquisitions** - BMPS will not acquire any stake in any undertaking. This covers both undertaking which have the legal form of a company and package of assets which form a business.

9.1 **Duration:** The above commitment will apply during the restructuring period. The acquisition ban will continue automatically if by that date BMPS has not repaid the State aid until full repayment of the State aid.

9.2 **Exemption requiring Commission's prior approval:** Notwithstanding this prohibition, BMPS may, after obtaining the Commission's approval, acquire businesses if that is in exceptional circumstances necessary to restore financial stability or to ensure effective competition[31].

9.3 **Exemption not requiring Commission's prior approval:** BMPS may acquire stakes in undertakings provided that the purchase price paid by BMPS for any acquisition is less than Euro [0-50] million and that the cumulative purchase prices paid by BM PS for all such acquisitions over the whole restructuring period is less than Euro [0-100] million.

9.4 **Activities not falling under the acquisition ban:** 1) Acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms; 2) Acquisitions that take place in the ordinary course of business, provided that the transaction fits with the Restructuring Plan; 3) Subscription of newly issued shares of Società Autostrada Tirrenica S.p.A. within the limits and under the conditions strictly necessary for the due performance of contractual agreements entered into on or prior to 17 December 2012; 4) Acquisitions or establishment of special purpose vehicles in the context of structured funding transactions of BMPS; 5) Acquisitions or establishment of special purpose vehicles or undertakings for the purpose of (or as contemplated by) the Restructuring Plan; for the avoidance of doubt, the acquisition of Perimetro Gestione Proprietà Immobiliari and the establishment and/or the acquisition of an undertaking for the purpose of providing online banking services do not fall under the acquisition ban.

10 **Coupon payments** – For the whole restructuring period and except as specified below, BMPS will not pay coupons on hybrid capital instruments unless it has a legal or contractual obligation to proceed with such payment even in the absence of distributable profits.

10.1 As an exception to the above restriction, BMPS is allowed to pay coupons on Upper Tier 2 instruments falling due by 31 December 2013.

[31] See point 41 of the Commission communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9

10.2 The ban on all coupon payments shall cease at the date in which an irrevocable underwriting agreement relating to the Capital Increase (as defined below) or any other irrevocable agreement relating to a commitment to underwrite the Capital Increase have been entered to.

11 **Liability Management Exercise -** BMPS will not undertake any Liability Management Exercise (including calls) unless it is implemented at conditions by which it occurs at a […] discount in percentage points from nominal value and at no more than […]% above the market price. Any Liability Management Exercise will be timely submitted to the Commission services for approval.

12 **Payment of dividends/retention** - BMPS will not pay dividends. This applies only as long as BMPS has not completed the Capital Increase. In case of conversion of all the outstanding New Financial Instruments, the dividend ban will apply in relation to the financial years 2013 and 2014.

13 **Ban on advertising** - BMPS will not use the granting of the aid measures or any advantages over competitors arising therefrom for advertising purposes.

14 **Sustainable commercial policy** - BMPS's commercial policy will be prudent, sound and oriented towards sustainability.

15 **Ban on aggressive pricing strategies** - BMPS will not implement any aggressive commercial strategies which would not take place without State aid support.

16 **Cost reductions** - The total consolidated personnel and administrative costs will not be above the levels set in the table below. In 2013-2016, the targets will be achieved with a tolerance margin of 2%.

Data in Euro million	**2013**	**2014**	**2015**	**2016**	**2017**
Personnel and administrative costs	[...]	[2,400-2,900]	[2,200-2,700]	[2,200-2,700]	2,375

16.1 If, in 2015 or in 2016, the projected fee income and the projected net income are not achieved, then additional cost cutting shall be implemented unless the Return on Equity (ROE) is equal to the target provided for in the Restructuring Plan. The additional cost cutting will be equal to the lower of (i) the difference between the projected and the effective fee income; (ii) the difference between the projected and the realised pre tax income; and (iii) Euro […] million. The targets referred to in this paragraph are considered to be achieved with a 2% tolerance margin.

17 **Capital increase** - BMPS will execute a capital increase of Euro 2.5 billion (such amount may be subject to rounding up or down as per market practice in order to have an appropriate subscription ratio with respect to the subscription price) (the "Capital Increase") in 2014. In the event that the Capital Increase is not completed by the end of 2014 and an underwriting agreement relating to the Capital Increase to be completed by the end of the first quarter 2015 is not signed in 2014 or, if signed, is then terminated and/or resolved, BMPS shall exercise the conversion of the outstanding New Financial Instruments in

accordance with the terms and conditions set forth in the Decree of the Ministry of Economy and Finance of 21 December 2012.

18 **Staff remuneration –** For the whole restructuring period, provisions of paragraph 6 ("Banche che beneficiano di Aiuti di Stato") of the Bank of Italy's Provvedimento of 30 March 2011 ("Disposizioni in materia di politiche e prassi di remunerazione e incentivazione nelle banche e nei gruppi bancari") will be complied with.
In any case, for the whole restructuring period, to the extent possible under civil law, the total remuneration (excluding social contributions payable by BMPS) to any board member and senior manager will be restricted to an appropriate level. A remuneration exceeding EUR […][32] including all possible fixed and variable components for a year will in principle be considered inappropriate. The restriction of the last sentence will cease to apply in case BMPS has succeeded in increasing capital in line with point 17, or, alternatively, in the event that the New Financial Instruments have been fully reimbursed. In order to be able to enter into such commitment in full compliance with Italian civil law, BMPS will be entitled to enter into compromise agreements with selected affected board members or senior managers. Any payments to be made by the BMPS to affected board members or senior managers under such compromise agreements will be lower than the amounts which would otherwise become payable by the Bank in the event of termination without cause of their existing contracts.

19 **Commitments of Corporate Governance** - BMPS will submit, at a general shareholders meeting to be held as soon as practicable, a proposal to introduce in its Articles of Association a specific provision requiring that at least one third of the members of the Board of Directors shall meet the independence requirements under applicable Italian rules and regulations.

In the event that, pursuant to par.17, BMPS exercises the conversion of the outstanding New Financial Instruments, the Republic commits to exit majority ownership of BMPS within five years from the date of conversion. The majority ownership will be deemed to be exited if the majority of ordinary shares has been sold to a non State-owned or controlled entity (or entities) and the Republic does not exercise control over BMPS within the meaning of Council Regulation EC/139/2004 of 20 January 2004 on the control of concentrations between undertakings.

[32] After informing the Monitoring Trustee, BMPS may adjust the above maximum limit for the annual remuneration in line with Italian inflation

Appendix TO COMMITMENT 8

We hereby provide a list of liquid instruments on which the Bank is allowed to trade in the future, under the agreed commitment 8 ("Financial markets / proprietary trading"), provided that derivative instruments are allowed only to the extent that the concerned underlying reflects the liquidity requirements referred to in paragraph 8.1 and 8.2 of said commitment under all circumstances.

No position will be allowed on products which are not used in the ordinary course of business.

Ordinary course of business includes: providing hedging products on FX and rates exposure for corporate clients having import/export business, hedging retail and institutional investment products distributed for Anima and Axa or other issuers through our retail network, providing liquidity on bonds/notes sold by BMPS to our client base or sold to BMPS by our clients in which case BMPS would close the resulting position very shortly, always within the limitation in terms of VaR, risk and liquidity provided in commitment 8.

Interest rate/inflation:
Products allowing linear exposure: futures, forwards, swaps
Products allowing convex/volatility exposure: swaptions, caps/floors, futures options

FX:
Products allowing linear exposure: futures, forwards, swaps
Products allowing convex/volatility exposure: plain vanilla and barrier options

Equity and equity indexes:
Products allowing linear exposure: cash equities, futures, forwards, swaps
Products allowing convex/volatility exposure: plain vanilla and barrier options, variance swaps

Credit and credit indexes:
Products allowing linear exposure: cash bonds, forwards, CDS on single names and CDS leading indices to be listed and updated with the agreement of the Trustee
Products allowing convex/volatility exposure: bond options, credit options on leading indices to be listed and updated with the agreement of the Trustee
Commodities:

Products allowing linear exposure: futures, forwards, swaps Products allowing convex/volatility exposure: plain vanilla options