Agenda

I	The challenges posed by the SSM
II	Comprehensive Assessment as a first example of the new data-driven supervisory approach
III	BCBS 239 requirements and regulatory roadmap for risk reporting

Single Supervisory Mechanisms – a new scenario with material impacts for banks

1 What will change? [Approach]

1a Supervisory scenario

- **The SSM formally into force**; when fully implemented (2016), there will be periodic complete formal assessments (2-3 years) and "standard" review on KPIs
- **The harmonization of regulations & methodologies will be an** essential **priority** for the SSM

1b Off-site/ on-site assessment

- **The future methodology** for the supervision of the SSM **will be a 360°assessment of the bank's strategy** with respect to the current risk profile and Risk Appetite decisions

1c SREP

- **Top-down approach,** intensity of supervision **based on rating**
- SREP will ultimately change Pillar II logic: **ICAAP is expected to mirror SREP framework in the future**

1d Stress Test

- With the entry in full force of the SSM, **stress tests will be annual** (starting from 2016) **with an increasing focus on qualitative aspects** (like CCAR)

2 Which impact on banks? [Implications]

- **Risk governance & Operating Model**
- **Data quality and aggregation**
- **Board of Directors Role**
- **Stress Test becomes a managerial tool**

1a SSM changing scenario will imply a significant supervisory interaction change especially for large multinational institutions

From …	… to
Multiple "local" points of contact with NCAs • Independent supervisor per country	**One leading "point" of contact with ECB** • In "hub & spoke model" with local NCAs
Different methodologies and approaches • Driven by national specificities	**Homogeneous set of rules and requirements** • Based on single rulebook and guidelines
Country specific view of risks • Driving different requirements at LE level	**Strong integration of risks view across Group** • With consistent requirements for all LEs
Focus on prudential supervision at local level • Non financial risks in focus more recently	**Strong focus on conduct/customer protection** • At local level, under responsibility of NCAs

UniCredit will likely fall into **Category 1** (Large or systemically important Institutions)

- Complete **SREP** assessment: **Annual**
- Monitoring of **key indicators**: **Quarterly**

1a Harmonization of regulations and methodologies in the various EU member states will be an SSM priority

Areas	Status
Capital requirements, RWA calculation	▪ **One of the initial objectives of the AQR/Stress Test** ▪ **Strong market expectations** after the recent public analyses of the BCBS/IIF indicating major differences in the capital absorption of banks not justified by the risk levels of the underlying portfolios ▪ **Harmonization** to be pursued **especially in the application of criteria for supervisory approval of the internal models,** more than formal rules (already aligned with CRD IV)
Accounting and reporting	▪ **Marked misalignments of accounting criteria** (particularly on calculating impairments and classifications) **only partially mitigated in the Comprehensive Assessment** through a top-down methodology ▪ Introduction of **IFRS 9 as a possible lever to force substantive harmonization**
Internal control system	▪ **Lack of clarity** on the internal control system and the 3 lines of defense ▪ **Isolated regulatory indications by a few national regulators** ▪ In the absence of an EU standard, **internal controls are a pillar of the SREP**
Compliance, conduct and anti-laundering	▪ Broad **regulatory gap vs. US and UK,** where the criteria of extraterritoriality begin to be important

1b Emphasis on off-site supervision, driving on-site inspections

Country	Today's approach
Austria Germany Ireland Netherlands	1. Emphasis on off-site analysis 2. Strict on-site inspection mandates driven by off-site analysis 3. Infrequent, narrow inspections
Italy France Portugal Spain	1. Intense on-site inspections 2. Broad inspection mandates 3. Variable inspections scope and length based on on-site findings

Possible new approach

Off-site assessments:

- ✓ Heavy Banks' prioritization
- ✓ Reliance on quantitative methods and economic capital

On-site inspections:

- ✓ Driven by off-site analyses
- ✓ Intense visits, defined mandate
- ✓ Thematic reviews

Note: In Spain permanent supervisory teams are co-located with the largest banks
Source: EBA – Draft guidlines on common procedures and methodologies for the SREP; Unicredit, BCG

1c The new SREP logic will force institution to re-think Risk Management approach

SREP main sections

- Categorization of the institution (periodic review)
- Monitoring of key indicators
- All four building blocks will be periodically assessed (Business model, governance, capital and liquidity)
- Overall SREP assessment (from "*No discernible risks*" to "*Failing or likely to fail*"
- Supervisory measures and communication to the institution

New logic

- **Priority on harmonization and standardization of metrics and regulation (e.g. RWA calculation, default definition)**
- **Stability of earnings and sustainability of the strategy** over a 3 years horizon
- **Systematic benchmarking with peers**
- Enhanced **coherence between Risk Appetite, capital allocation and budgeting**
- **Forward looking risk assessments**
- **Promptness of Bank reactivity to external changes** as key factor to assess risk mitigation capabilities
- **360°integrated revision of full Bank infrastructure** as backbone of the supervision
- Deep review of **risk governance**
- Strong focus on **economic capital (Pillar II)**

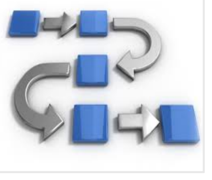
Source: EBA – Draft guidelines on common procedures and methodologies for the SREP – Sept 2014

1d The stress test of the ECB/EBA is expected to converge gradually toward the CCAR model used in the US

	ECB/EBA	US CCAR
Objective	▪ **Quantitative assessment of capital adequacy**	▪ **Quantitative and qualitative assessment of the robustness of the risk infrastructure**
Methodology	▪ **Top-down, simplified methodology** with a moderate level of granularity on credit but low on funding costs, other P&L elements, market risk and operational risks ▪ **Limited requirements** in terms of data quality, process governance and completeness of documentation: typical documentation 80-120 pages	▪ **High level of granularity:** 3 scenarios by the regulator and 3 by the bank + granular modeling of credit, market, P&L, funding cost and operational risks ▪ **Strict requirements** in terms of data quality, process governance, model validation, independent challenge of top management, and completeness of documentation: typical documentation up to **5,000 pages**
Focus	▪ **Top-down Quality Assurance process** based primarily on automatic controls with limited timetable for a critical review of consistency of results	▪ **Bottom-up Quality Assurance process largely delegated to the banks** which have the burden to prove they have ensured a critical review of input, methodologies, and output, involving the control functions and top management to provide adequate documentation

SSM supervisory approach will clearly influence Banks' risk governance, operating model and BoD role, but it will be, above all, strongly driven by a structured information basis

2

Dimensions	Ongoing evolutions
Risk governance & operating model 	**Risk Operating Model integration across three dimensions** • Between HC and LEs – centralizing risk activities in order to deal with a single reference point • Within CRO – with cross-risk governance and reporting units • Between CRO and CFO – enrich cooperation and reciprocal challenge based on common understanding of risk and finance data
Data quality & aggregation 	**Comprehensive review of risk & finance data quality & aggregation** • Standards and policies for data ownership • Metadata dictionary showing how data are built • Data governance responsibilities and committees • IT architecture to align risk, accounting and business data
Board of Directors Role 	**Strengthened Board risk ownership and education** • Increased expectation of risk & related technicalities understanding **Streamlined and frequent Board communication on risk matters** • More effective and comprehensive reporting to drive the decision making process **Informed sessions on risk strategic choices** • More frequent and in depth discussions on risk topics

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The Comprehensive Assessment has made clear what the SSM expectations are on data deliveries

AQR Pillars	Key Data Requirements
Loan Tape Creation	• Granularity (up to facility /collateral level for Retail) • Extended data dictionary (only few data on a best effort basis) • Integration of different systems /data sources • Reconciliation both with Regulatory and Financial data • New definitions to be applied (eg. NPE EBA simplified) • Timely delivery • View based on country of original debtor in addition to LE view
Data Integrity Validation	• Structured DIV process based on reconciliation checks, field-specific checks, cross-field/cross-time checks, sense-checks of distribution • Timely remediation actions (integrations/refinements) depending on the outcome of data quality checks
Credit File Review	• Enhanced data and document collection at granular level • Timely delivery
Challenger Model	• Implementation of an "external model" based on internal data for Collective provisioning

The **Comprehensive Assessment** can be considered **the first example** of the emphasis **of the "new" supervisory approach** on data completeness, quality and governance and a real "stress test" on financial institution capabilities to timely aggregate and report data according to common standards.

The AQR exercise has been particularly challenging for UCG given the Group international breadth and has required a strong centralized program management with local involvement

UCG Approach

Common Standard Definition

- Central definition of rules and data taxonomies to be applied for the Loan Tape and Challenger model fields
- Management of consistency issues, owing to different accounting treatments (eg. IFRS vs Local GAAP) and not harmonized regulatory rules

Leverage on central Management Information System

- Central MIS and risk reporting databases used for regulatory purposes have been utilized as a main data source

Centrally supported data deliveries

- IT central support for data production and data integration from other systems (customer information files; balance sheet data; etc.)

Strengthened internal coordination across entities

- Strong coordination process between the Holding Company and the relevant geographic hubs

Legal Entities data certifications

- Validation of data extractions/collection

UCG AQR figures

Perimeter

- **3 Region, 231 Legal Entities**
  - Italy, Germany, Austria&CEE
- **#Products: ~** 500
- **# Segments:** 16
- ***Non Retail tapes:***
  - **# Debtors/Clients: ~** 500.000
  - **# Facilities: ~** 600.000
  - **# Collaterals: ~** 1.200.000
- ***Retail tapes:***
  - **# Debtors/Clients: ~** 3.400.000
  - **# Facilities: ~** 5.500.000

Data

- **# Loan Tape:** 6 (***# Selected portfolio:*** 67)
- **# Fields:** 55
- **# Additional Fields:** 45
- **# Snapshot dates:** 3 (o/w 1 for UAT)

Data Quality Test

- **Technical:** ~ 230 controls run daily over 55 Loan Tape fields
- **Functional: ~** 70 controls on final Loan Tape run daily over the main 40 LEs

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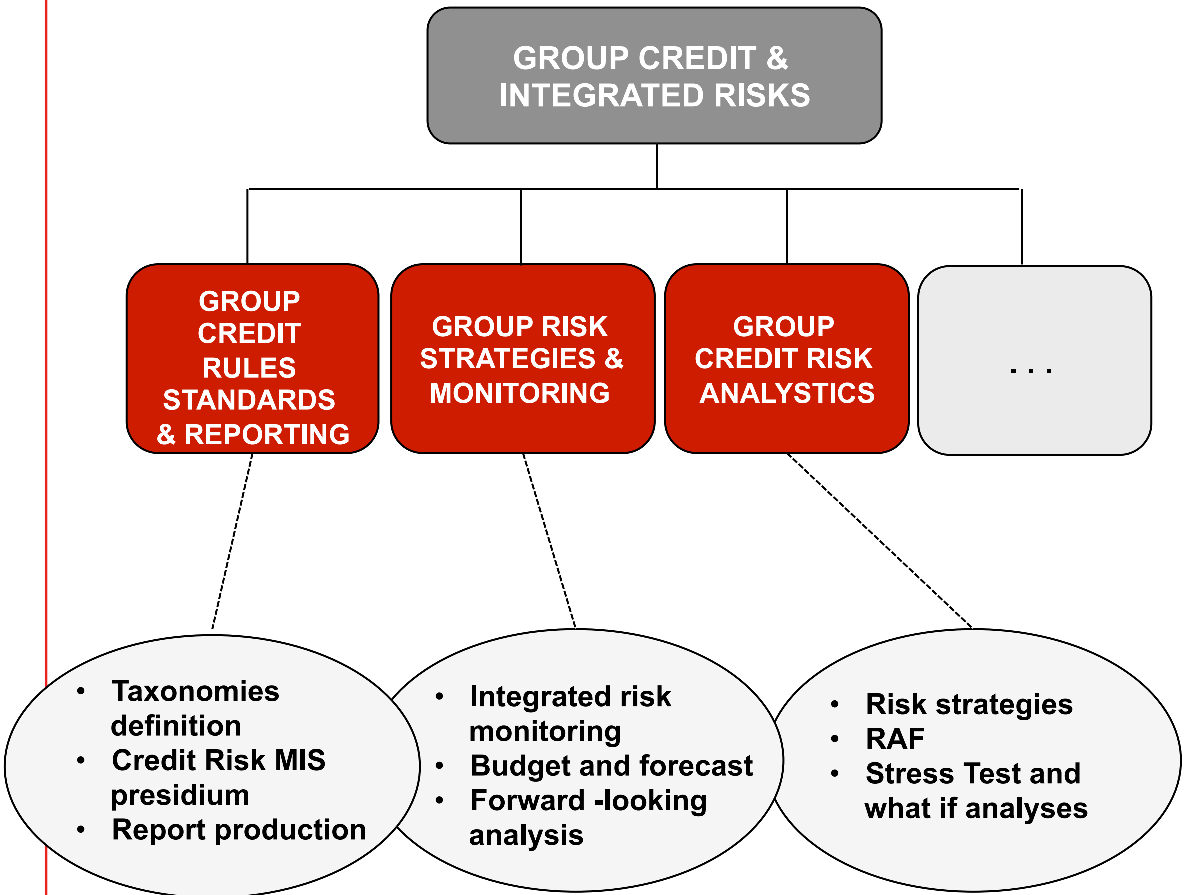
Already before the AQR kicked-off, UCG had changed the Credit & Integrated Risks organizational model in the direction of a higher specialization splitting reporting from monitoring and analytics



Strong focus on strengthening risk data aggregation and reporting capabilities at Group level:

- single entry point for integrated risks
- clear specialization of the structures:
  - risk rules&reporting
  - risk monitoring&forecasts
  - risk strategies&forward looking analyses
- splitting of reporting/production and monitoring in order to enhance their effectiveness
- reinforcement on reporting rules/ taxonomies definitions across the Group

The AQR exercise was held concurrently with the BCBS 239 project. The two challenges proved to be very much interlinked

Main gaps identified in AQR

- Improve the **accuracy and reliability of existing data** across geographies and LEs
- Ensure **reconciliation/consistency** among different report produced by the Bank (e.g. COREP / FINREP)
- **Increase** data aggregation speed
- Complete the **breadth of risk data** in group wide risk data base
- **Extend the coverage of Legal Entities** in group wide risk data base
- **Integrate credit risk data** with other risks (where relevant), financial figures and managerial information
- Extend **ability to represent data by debtor country of origin** in addition to LEs

The gaps identified by AQR and BCBS requirements were strongly interlinked

The AQR allowed the Group to achieve a better awareness of the implications of BCBS principles and to define a clearer path to meet the BCBS requirements

BCBS principles in a nutshell

- RISK REPORTING GOVERNANCE
- TAXONOMY
- CERTIFICATION & QUALITY CONTROLS
- FLEXIBILITY
- COMPLETENESS
- RECONCILIATION
- TIMELINESS
- RISK INTEGRATION

As a result of these challenges the Group by the end of 2015 will be much better equipped to meet internal and external reporting requirements

Key PERDAR Principles		Key deliverables
Governance	▪ Re-enforce Risk **data aggregation** framework	✓ Dedicated **Global Policy/Rules** on Risk data aggregation & reporting ✓ Set up of **Internal Validation Framework** for Reporting processes ✓ Risk reporting rationalizations
Taxonomy	▪ Definition of Group risk data **taxonomies** and definitions	✓ Set-up of **Risk data dictionaries** ✓ **Golden data sources** definition and Critical Data Elements mapping
Quality Controls	▪ **End-to-end** risk data **certification** process	✓ Review of the processes in plase (end-to-end view) ✓ Improved standards for **data quality certification**
Flexibility	▪ Flexibly aggregate and customize data **ad hoc requests**	✓ Improvement of existing **Group-wide risk platforms** ✓ **Granular data base** per risk type to allow flexible data aggregation
Completeness	▪ Capability to capture and aggregate all **material risk** data across the group	✓ **Increase of the geographical, attributes and risk types coverage** within the group wide vertical platforms
Reconciliation	▪ **Reconciliation** of risk data with other official sources,	✓ **Reconciliation** between credit risk data and regulatory reporting ✓ Diagnostic on **FINREP vs. COREP** reconciliation
Timeliness	▪ Definition and documentation of **timeliness requirements**	✓ Definition of **timeliness targets** for main KPIs (in normal and stress conditions)
Risk Integration	▪ **Integrated overview** of the risks to be monitored	✓ **Integrate credit risk data with other risks** (where relevant), financial figures and managerial information

BCBS 239 – PERDAR project will nevertheless not end by 2015. As the internal and external reporting requirements will be evolving on a continuing basis, so will data completeness, flexibility and timeliness remain moving targets

SSM Data Collections

Recurring:
- Short Term Exercise for SREP (previously SSM Pilot Exercise)
- JST reports (eg. FX Exposures / Credit Risk Internal Models)
- EBA Benchmarking exercises (SSM coordination role expected) …
- …

Ad hoc :
- Russian / Greek exposures
- CHF Retail Exposures
- Heta Asset Resolution (Hypo Alpe Adria bad bank) exposures
- …

Main features

- Recurrent (quarterly basis)
- **Templates and requirements had already changed** over the past submissions (not fully standardized), eg.
  - *Fx Exposures report:* split by LE (previously by Region)
  - *Internal Model report:* Net of IC (previously Gross of IC)

- Triggered by specific **exogenous events**
- **Rules and contents provided together with the data request**
- To be produced in a very **short time**
- Combination of **metrics/dimensions from different data sources** (profitability, regulatory, managerial ..)

Reporting content required by SSM is complementary to the information already included in the existing Regulatory reports (eg. COREP, FINREP)

In this landscape Anacredit will represent an additional challenge. Its development will require strong coordination with, and it will give additional inputs to, risk data aggregation and risk reporting

- AnaCredit (Analytical Credit Dataset) requires the set up a **centralized granular** (loan-by-loan) **credit risk data set** aimed at strengthening the supervisory activities
- Its **content largely overlaps with AQR loan tape even though it is broader,** as it comprises **more than 100 credit risk and accounting attributes** and it includes additional client, credit lines and counterparty credit risk information
- For a multinational Group the data flow will happen both from each legal entity to the ECB via its NCA, as well as directly from the Holding Company to the ECB for aggregated data

> ECB will be able to tap an extensive risk database and to perform **risk analyses and drill-downs** for each bank according to individual and consolidated views

> AnaCredit reinforces the mandatory set up of group-wide homogeneous **taxonomies** and **data sources, fully reconciled** with other Regulatory reports (eg. COREP, FINREP) and enhances the strong interconnection with BCBS #239 principles

To sum it up: it will be a much more challenging environment but it will also come with tangible positive effects

- Supervision much more **fact-based**, effective and analysis-driven
- Significant **IT investment growth** will imply the need for a clear **prioritization** and focus on IT **projects** (also involving multiple LEs in case of cross-border banking groups)
- **Data management / data quality governance** is a **must** and will require a clearer separation of the Data Management function from the Analytics, Monitoring and Reporting functions
- Banks will likely be allowed to perform more effective **benchmarking** and **competitive positioning** analyses across country and segment, supporting better risk management **decision making processes**