

# The Internal Audit Department's report on the correct application of the 2020 Remuneration Policies

(courtesy translation)

## To the attention of the Shareholders' Meeting of Banca Sistema S.p.A.

This report details the results of the audits conducted by the Internal Audit Department<sup>1</sup> (the “**Department**”) on the remuneration practices adopted by the Banca Sistema Group (or “**Bank**”) to assess their compliance with the “2020 Remuneration Policies Document” (the “**2020 Policies**”) and the applicable provisions of law.

The audits were conducted under a standardised control framework<sup>2</sup> deemed appropriate to provide the required assurance to shareholders and compliance with supervisory requirements.

The process of preparing the 2020 Policies was coordinated by the Bank's Human Capital Department, to ensure compliance with the relevant provisions and to align them with the main competitors.

The Bank's Risk Department assisted in determining the metrics for calculating corporate performance, validating the results and their consistency with the Risk Appetite Framework, also by establishing risk indicators to be used for (ex-ante and ex-post) adjustment mechanisms; it also expresses its opinion on the correct use of these mechanisms.

The Compliance and Anti-Money Laundering Department has verified ex ante the compliance of the 2020 Policy with the applicable legal framework, the Articles of Association and the Bank's Code of Ethics to consider the inherent legal and reputational aspects, especially in relations with customers. The 2020 Policies have been previously shared by the Bank's Remuneration Committee and the Board of Directors, before being formally approved by the Shareholders' Meeting on 23 April 2020, in compliance with the Articles of Association (art. 9.2) and Bank of Italy Circular no. 285/2013<sup>3</sup>, as confirmed on that occasion by the Bank's Compliance and Anti-Money Laundering Department<sup>4</sup>.

The audits carried out by this Department concerning the application of the 2020 Policies reveal the following:

- The Remuneration Committee, in its meeting of 9 March 2021, and the Board of Directors, in its meeting of 11 March 2021, each for their respective areas of responsibility, assessed the allocation of the 2020 incentives, verifying that the following "gates" to the 2020 Policies incentive system had been reached:
  - i) Condition for distribution: achieving a positive gross profit: €36,301,694 (target: €42,098,000).
  - ii) Condition for access: achieving the first-level thresholds of the key risk indicators (KRI) indicated in the RAF: Common Equity Tier 1 ratio (CET 1) equal to 12.60% (threshold level I = 9.00%) and Liquidity Coverage Ratio (LCR) equal to 390.00% (threshold level I 112.50%).

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<sup>1</sup> The provisions governing remuneration and incentive policies and practices, as per Part I, Title IV, Chapter 2, Section II, Paragraph 3 of Bank of Italy Circular No. 285 of 17 December 2013, provide that: “The internal audit department also assesses, at least yearly, the remuneration practices compliance with the approved policies and with these provisions”.

<sup>2</sup> Position Paper of the Associazione Italiana Internal Audit (AIIA) on “Provisions adopted by the Bank of Italy in relation to remuneration and incentives policies and practices in banks and banking groups”.

<sup>3</sup> With the 7th update to Circular 285 dated 18 November 2014, the principles of Directive 2013/36/EU (“CRD IV”) were transposed along with the guidelines and criteria agreed at international level, including those issued by the European Banking Authority (EBA) and the Financial Stability Board (FSB).

<sup>4</sup> Please refer to the Opinion of the Compliance and Anti-Money Laundering Department on the remuneration policies of the Banca Sistema Group for the year 2020 presented at the shareholders' meeting of 23 April 2020.

Regarding point ii) the first level thresholds provided for by the RAF were exceeded for both indicators and, consequently, the variable component was distributed. Also, given the reported RORAC figure of 24.80%, which is above the target threshold of 18.00%, the 150% multiplier specified in the 2020 Policies was applied to the bonus pool amount provided for in the 2020 budget, increasing it from €2 million to €3 million.

- The Director of Human Capital attended the meetings of the Bank's Remuneration Committee and Board of Directors which were held between February and March 2021, to illustrate in detail how the 2020 Policies were applied, highlighting the actual achievement of the indicators for establishing the amount of the bonus pool distributable for the year (e.g. estimates of the access criteria, adjustment factors, etc.) and the objectives of the Chief Executive Officer/General Manager.
- The amount of the variable remuneration component for the 2020 financial year for all beneficiaries was established with a ratio of 1:1, except for that of the Chief Executive Officer/General Manager, which was equal to 102.58% of the annual remuneration for the two offices held, a level that is nevertheless allowed by the 2020 Policies. The criteria for deferment and payment in financial instruments envisaged by the 2020 Policies were also applied for amounts exceeding € 30 thousand. The variable component paid to the heads of the internal control functions, the Human Capital Department, and the Manager in charge of Financial Reporting did not exceed the limit of 1/3 of their respective fixed remuneration.
- The deferred portions of the bonuses linked to the incentive scheme for the years up to and including 2016 have been fully paid, while for subsequent years there are portions yet to be paid to the beneficiaries, both in cash and in shares, which are based on achieving the performance objectives set out in the remuneration policies for the respective years. At present, the Bank's "stock" of shares intended for the beneficiaries is sufficient to cover only the deferred portion still due to the Chief Executive Officer for 2017 and equal to 28,939 shares, which completes the allocations relating to that year. Therefore, a proposal to purchase an amount of treasury shares corresponding to the variable, up-front and deferred portions of remuneration to be paid in shares for the three-year period 2018-2020 is recommended to be submitted to the Shareholders.
- The variable up-front component for 2020 will be paid upon approval of the 2020 financial statements by the Shareholders' Meeting to be held on 30 April 2021. As a result, this Department was unable to verify the payment<sup>5</sup> of the approved bonuses prior to issuing this report.
- The fees due to the Chairman of the Board of Directors and to the Directors for their activities comply with the decisions of the Shareholders' Meeting of 23 April 2018 and no incentive mechanism, apart from the Chief Executive Officer who, as already mentioned, also serves as General Manager. Likewise, the remuneration of the Board of Statutory Auditors refers exclusively to that resolved following its appointment by the Shareholders' Meeting of 23 April 2020.

The checks carried out also revealed the following aspects, which are brought to the attention of the Shareholders:

- 1) Starting in the 2015 financial year, Banca Sistema has signed non-compete agreements with managers and other employees that hold key positions, pursuant to and for the purposes of Article 2125 of the Italian Civil Code. The amounts were determined in proportion to the fixed remuneration of the beneficiaries and advances were paid over the three-year period 2015-2017. In March 2017, the aforementioned agreement was revised and formalised in a "protected" venue in order to bring it into line with the most recent legal guidelines on the subject which, among others, do not envisage the payment of

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<sup>5</sup>The cash portion of the 2020 variable component will be paid in May 2021.

advances. The Bank has therefore aligned itself with this interpretation and, since 2018, has paid no other advances during the employment relationship. The allowances for the non-compete agreement are recorded in a specific provision and are determined based on an actuarial valuation as required by IAS 19. The accrual for the 2020 financial year was determined to be €228,421, bringing the amount of the relevant provision to €2,918,313 as of 31 December 2020.

- 2) The audits conducted by this Department were based on the draft minutes of the Remuneration Committee and the Board of Directors for the meetings held between February and March 2021 which have not yet been formally approved and transcribed in the respective company books.
- 3) The possibility of raising the 1:1 ratio between the variable and fixed components of remuneration to a maximum of 2:1 is again confirmed for the 2020 financial year only for the Chief Executive Officer/General Manager.

Milan, 19 April 2021

The Head of Internal Audit  
of Banca Sistema S.p.A.  
(Signature)