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UniCredit Group reply to the BCBS Consultation Paper: Core Principles for Effective Banking Supervision

UniCredit is a major international financial institution with strong roots in 22 European countries, active in approximately 50 markets, with about 9.500 branches and more than 160.000 employees. UniCredit is among the top market players in Italy, Austria, Poland and Germany. In the CEE region, UniCredit operates the largest international banking network with around 4.000 branches and outlets. UniCredit Group is a market leader in the CEE region. Furthermore UniCredit was recently recognized as Global Systemically Important Bank.

Executive summary

We appreciate the effort to revise the Core Principles in order to provide a comprehensive standard for establishing a sound foundation for the regulation, supervision, governance and internal controls of the banking sector.

UniCredit is of the view that the Basel Committee on Banking Supervision (BCBS) has identified most of the important preconditions leading to effective supervision. However the preconditions to cope with **effective supervision of G-SIBs and cross-border banking groups** are not always – in our view - devoted sufficient and proper attention. We would like to mention the following selected and relevant concerns:

6. Transfer of significant ownership: It is necessary a level playing field by means of similar authorization processes across the various Jurisdictions and global cross-border homogeneous conditions for the transfer of significant ownership or controlling interests.

8. Supervisory approach: it is of the utmost relevance to specify what could be the duties of all the competent supervisors, e.g. anti money-laundering, and what is under other authorities competence, e.g. antitrust.

7: Major acquisitions: in case of acquisition of a bank by a foreign one, the host authority should cooperate with the home one, based on a pre-defined coordination framework, which includes the conditions for an intervention of consolidated supervision at supranational level, with new responsibilities allocated to global institutions such as the FSB, the Basel Committee on Banking Supervision or the IMF, or regional such as the European banking Authority.

11. Corrective and sanctioning powers of supervisors: it should be clearly stated that providing interim or special managers is an intrusive action allowed once the resolution plan is formally activated. Moreover, ring-fencing a bank from the actions of the parent company is totally inconsistent with an effective group management, since it could lead first of all to suboptimal choices and possibly a disorderly resolution of a Group.

13: Home-host relationships: it is suggested to investigate the opportunity and feasibility for the BCBS to define a template for a "Memorandum for a Cooperation framework at international level". This should include a clear allocation of responsibilities and a timeframe for a predefined list of areas (e.g. in crisis management and resolution) where joint decisions are needed. The

costs and systemic risks because of lack of coordination to reach joint decisions within a pre-defined timeframe may be potentially high, also for the financial system at large. There should be some form of third-party mediation at supranational level (e.g. FSB, BCBS, IMF) in those cases where competent authorities fail to comply with the Memorandum when pursuing a joint decisions.

14: Corporate Governance: the supervisors' powers to intervene – under certain conditions - in the composition of the Board are excessively discretionary.

16. Capital Adequacy: Capital Adequacy principle will be implemented at a global level with the highest degree of homogeneity, not only on the "quantity" of capital but also on the timeline of implementation. Moreover, the new regulation requirements (BASEL III) on bank capital, introducing multiple and cumulative capital buffers, might be disproportionately high on low risk asset classes such as credit to SMEs, which depend to a large extent on bank financing.

19. Concentration risk and large exposure limits: The Principle is fully supported. However its implementation requires a proper data and information flow within a Group (between the Legal Entities and the Holding Company) based on a legal framework for cooperation - of all entities pertaining to a Group - that can overrule local regulation in terms of data protection and banking secrecy. Otherwise the principle would never find the proper intended application.

26. Internal control and audit: we agree with this principle, however it is not sufficiently clear (please see below in the dedicated section).

27. Financial reporting and external audit. It is paramount that banking supervision over financial reporting reflects the scope and peculiarities of the supervision already put in place by the financial market supervisors. Coordination of supervisors involved for a multinational Group is essential, in order to avoid a double level of supervision on the very same topics and the subsequent burdens / costs.

Unicredit Answers

Chapter III Preconditions

UniCredit is of the view that the Basel Committee on Banking Supervision (BCBS) has identified most of the important preconditions.

However we still have a major concern since there is not an explicit reference to the preconditions to cope with **effective supervision of G-SIBs and cross-border banking groups**. In this regard, we would assume that the work which is being undertaken by the FSB on the SIFIs resolution is properly considered also with regards to this consultation .

We note that there are some references to a framework dealing with systemic risk and to the need of agreements among relevant authorities both on their individual and especially on their joint responsibilities for crisis management and resolution, and about how they will cope with these responsibilities in a coordinated manner.

However, we are very much concerned, as the recent crisis has shown, that this is not at all sufficient to allow an **effective supervision of G-SIBs and cross-border banking groups.** In this contest, supervisors cannot effectively perform their tasks – with unintended consequences on the financial stability of the system - when:

a) there is not a clear and efficiently **enforceable legislative frameworks for recovery and resolution** across national borders;

b) there is no reference to those resolution aspects that imply the existence of **forms of**

burden sharing agreement across borders;

c) there are no pre-defined intra-group financial support **agreements actually** ensuring the removal of unnecessary obstacles in order to allow an efficient and smooth flow of resources within a cross border bank, **not only in situations of shortage of liquidity but also in the normal course of business**;

d) there is no legal clarity about the terms for use of instruments such as bail-in; in our view they should **be used by the competent authorities in a gone concern phase and in a effective and internationally coordinated manner**. Only in the resolution phase authorities should have the power to impose a debt write-down.

On the positive side, UniCredit notes that the European Commission is considering to propose a comprehensive **EU legislative framework for recovery and resolution** that will try to address most of the above mentioned concerns. Albeit Unicredit has some reservations on some of the proposals, it may be a source of inspiration at a global level when:
a) granting a supranational authority with the necessary power and responsibility to resolve the disputes irrespective of the national assignments of the resolution functions in Member States.
b) granting a supranational authority with a strong role in drafting recommendations and technical standards, as well as and in the assessment of group recovery and resolution plans;
c) finding a mechanism to address the cross border financing arrangements and the burden sharing.

At a global level, in accordance with the view UniCredit expressed to the FSB during its 2011 consultation on SIFIs' resolution, the costs of a fragmented legislative framework and ineffective international supervisory cooperation in the resolution phase cannot and should not be borne by cross-border institutions already before entering the resolution phase. **Global and regional SIFIs require a global and regional governance for a proper and credible cross-border resolution regime.** If there are no substantial changes to the current various and different national regimes, a cross-border orderly resolution remains practically unfeasible and hardly of any help when really needed, especially for large and complex cross-country Groups. For instance, on orderly resolution requires as precondition a **jointly agreed declaration that refers to a Group consolidated level**. A mechanism to ensure rapid consultation among relevant competent authorities as well as concerned communication and necessary actions are seen as crucial elements for success.

Individual Assessment of Principles

Principle 1: Responsibilities, objectives and powers
An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorise banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.

UniCredit would deem as appropriate to specify that this principle is meant to deal only with specific supervision on banks, while other watchdogs, such as antitrust authorities are out of scope.

With this regard we deem of the utmost relevance that the target of the supervision should be specified, for instance in term the protection of depositors, the system stability, continuity of essential financial services, such as payment systems. This clarity would enhance the market players.

With this regard we would welcome any harmonisation of the targets, as it is a precondition for ensuring the consistency of supervisory practices across countries.

There is room for fine-tuning the definition of the banking group regarding the joint ventures that should be included only if the bank has the controlling rights, as well SPV that should be included as well,

because they could pose significant risk,.

Essential Criterion (EC) 1: attention should be paid to avoid any gaps but also to overlapping amongst authorities.

EC2: supervisors should also take into account not only banks but also other intermediaries that carry banking activities such as lending.

EC3: it is suggested to specify that in case of home supervisor, such provisions are meant both at consolidated level as well for the parent company.

EC5(c): it is suggested to specify whether incorporations should be related only to subsidiaries or also branches. The assumption is that the regime of free service providing, as foreseen within European Union, is out of scope.

EC6 (a): it could also be investigated the addition of the public declaration triggering the Resolution Plan or measures hereby included.

Principle 2: Independence, accountability, resourcing and legal protection for supervisors

The supervisor possesses operational independence, transparent processes, sound governance and adequate resources, and is accountable for the discharge of its duties. The legal framework for banking supervision includes legal protection for the supervisor.

UniCredit would deem as appropriate for the BCBS to specify under which legal terms a supervisor is accountable to avoid any potential threat or impediment to their full independence.

EC4: in view of the continued interactions between the supervised entity and the competent authorities (both individually with the relevant competent authorities and at group level with the various "constellations"), we consider of the utmost relevance the inclusion of a principle of "responsiveness" to underline that market participants in most cases need replies from Supervisors in a timely manner to avoid undesirable impact or unintended consequences. Therefore we would appreciate the setting of a pre-defined timeframe for supervisors act according to set deadlines in the fastest way as possible, especially for cross-border banking groups where inefficient coordination may be excessively time consuming.

To this purpose, a time frame for each kind of decision is welcomed as benchmark, even if in most cases a more timely reply is appropriate. To this end any enhancement to the capability of the competent authorities to cooperate across borders is very important.

EC6(d): it could also be recalled that also training in managerial skills could be useful to improve planning and optimization approaches.

Principle 3: Cooperation and collaboration

Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information.

UniCredit: The cooperation amongst supervisors (in the EU, the term "cooperation" should be replaced by "integration") is the key factor in ensuring the resilience of the global and regional financial systems.

EC2: the arrangements should be published to make market participants aware in making their business decisions and thus providing authorities with an incentive to cooperate. We fully support also the performance of "Peer reviews" among the competent authorities.

EC4: it would be appropriate that information classified as secret/restricted/confidential (depending on the target) by other supervisors is protected in a adequate and stricter way, e.g. the supervisors that receives such information cannot be shared with a third party without agreement with the providing authority.

Principle 4: Permissible activities

The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled.

UniCredit: it would be appropriate supervisors to focus not just on banks but also on financial intermediaries providing banking services. The aim is enhancing systemic financial stability and avoiding an undesirable development of the shadow banking sector as recommended by FSB. That could mean, inter alia, in note 26 related to EC4, non-banking financial institutions should be subject not only to equivalent banking regulation, but also supervision, including a comparable reporting regime.

This scope extension would also improve the level playing field across jurisdictions, as there are different market shape regarding banking services.

On the other hand, barring banks from some financial activities is likely to lead to suboptimal financial group structures.

Principle 5: Licensing criteria

The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management27) of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition (including capital base). Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home supervisor is obtained.

UniCredit: it would be appreciated to understand if such principle applies only to subsidiaries or also to branches. We would suggest to apply a similar regime also for branches, even if in a lighter way, otherwise this principle could not be neutral related to different group structure and consequent on the levelling playing field.

The licensing process should be clearly defined in term of documents required, timelines to allow banks to efficiently manage it and avoid potential inefficiencies and discretionary choices (QUALI ?).

EC7: it seems appropriate to state clearly that Board evaluation is performed at overall level, that means the Board as a whole has to have the required skills.

EC10: it is of the utmost relevance that the criteria underlying host evaluation of home supervisory practices are clearly set in advance, with a strong preference for a pre-definition at supranational level along the same lines as those released by European Union to assess the equivalence of supervisory practices with other authorities. This could serve the purpose of avoiding inconsistencies and promoting an effective cross-border cooperation.

It is suggested to transform the additional criteria into an essential one, through report submission or as a part of the on-going supervision.

Principle 6: Transfer of significant ownership

The supervisor has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.

UniCredit:

UniCredit would deem as appropriate a clear definition of the meaning of "*significant ownership or controlling interests*" in order to allow market participants to have a more aware decision making process. Should such definition rely on a supervisory decision, the underlying criteria should be specified as well.

We would like to point out a strong need to build a level playing field, by means of:

1. similar authorization processes across the various Jurisdictions. This allows to progressively align regimes/frameworks and significantly foster international supervisory cooperation;
2. global cross-border homogeneous conditions for the transfer of significant ownership or controlling interests, with the aim to progressively reduce (and ultimately remove) relevant differences. In this respect, we would like to suggest the need to:
    a. allow a waiver for intra-group transfers. In case acquisitions or investments are carried out within the same banking group (where all involved parties and the target company are part of the same banking group), no notification or silent consent mechanism proceedings should be applicable, ();
    b. define a materiality clause for a transfer of significant ownership or controlling interests;
    c. make a specific reference on a material transfer when it affects the ownership structure and the governance arrangements.

Moreover, it is regarded as necessary specifying those cases when a prior notification or approval are requested by the competent authority. It would be useful if the applicable laws and regulations also envisage the qualified/specific conditions pursuant to which the individual proposals are judged. UniCredit is of the view that the approval should be required only in case of transferring the control of the bank.

In case a bank is set to be purchased by a foreign one, the supervisory authority should coordinate with the relevant one(s) of the purchasing bank, based on a pre-defined coordination framework.

A clear procedure for litigation among supervisory authorities could be foreseen, such as going to court or any other conciliation mechanism, for instance in term of documentation and timelines.

EC2: In reference to cross-border transactions particularly, the selling party, on its request, should be granted the possibility to be heard by the bank's supervisor on a confidential basis in order to discuss the feasibility of the envisaged transaction from the supervisor's perspective.

EC3: The criterion for the supervisor being able to reject, modify or reverse the change in significant ownership should be amended from the supervisor "determining that" to the supervisor "ascertaining that". In any case, we deem that the term "information "should be replaced with "key information fundamental for reasonably assessing the transaction",.

EC4: it would be appropriate to better specify the meaning and threshold of significant shareholder to avoid inconsistent and potentially discretionary interpretations.

EC5: This criteria should also contemplate that the banks are granted with the right to demonstrate their appropriate behaviour/compliance with applicable law and regulations (i.e., right of defence) and subsequently be able to request an appropriate remedy.

EC6: since banks often are listed companies, it would be useful to clarify the meaning of term "major shareholders". For instance it could be defined as those that nominate/indicate a member of the board.

Principle 7: Major acquisitions

The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

UniCredit:
EC1: In reference to cross-border transactions particularly, either party, on their request, should be granted the possibility to be heard by the supervisor on a confidential basis in order to discuss the feasibility of the envisaged transaction from the supervisor's perspective.

EC1 (b): In case acquisitions or investments are carried out within the same banking group (where all involved parties and the target make part of the same banking group), a simplified proceedings

for approval should be applicable (notification or silent consent mechanism).

EC2: laws and legislation should also envisage the process, including the timelines, to judge individual proposals.

EC3: it is acknowledged that it is not straightforward to provide clear guidelines for all the potential transactions, nevertheless a smooth market functioning requires criteria to be stated clearly and therefore "undue risks" should be clarified. In this regard, should the major acquisition be performed by a banking subsidiary of a banking group, the group assessment should be performed by the home, or consolidating, supervisor, with the support of the other competent authorities.

Additional Criterion: as a preliminary remark, as stated above, "undue risks" should be clarified. Furthermore it is not clear whether the additional criterion (a) only applies to non-banking entities of a banking group and/or (b) applies to banking entities that are subject to a supervisor that is different from the one reviewing the major acquisitions or investment (i.e., of another country; in such an event the cooperation between the relevant supervisors is not clear). The term "bank" should be followed by "that is subject to its supervision". Finally, the phrase "other entities in the banking group" should be amended to read "the bank's subsidiaries in the banking group".

In order to promote the level playing field, a general assessment of laws/regulation/practices in a country prohibiting information/data flows deemed as necessary for the adequate consolidated supervision should be performed at supranational level, namely new responsibilities should allocated to Global institutions such as the FSB, the Basel Committee on Banking Supervision, or the IMF.[1]

In case there were unfavourable changes in the local laws, the behaviour of the home supervisor should be defined/known in advance not to unduly hamper the smooth execution of the transaction.

As overall remark, it is of the utmost **relevance that in case of acquisition of a bank by a foreign one, the host authority should fully cooperate with the home one, based on a pre-defined coordination framework, set-up by a supranational authority.**

Principle 8: Supervisory approach

An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.

UniCredit:

EC1: supervisors should also take in risk mitigation tools in place and above all the governance, including Board members involvement and oversight of banks decisions and operations. In analysing the group structure, there should be a focus on mechanism to steer and control the subsidiaries.

EC3: it is deemed of the utmost relevance specify what could be the other local regulations to clarify what could be the duties of the supervisors, e.g. risk assessment or anti money-laundering, and what is under other authorities competence, e.g. antitrust.

EC4: macroeconomic analysis is fundamental to prevent systemic risk, provided it is seen on a medium/long term perspective besides the short term fluctuations.

EC5: It is recommended that supervisors strengthen the oversight and regulation of the "shadow banking system", paying particular attention to possible source of systemic risk and of contagion effects to and from other financial institutions.

EC6: in the event a systemic bank in a jurisdiction is the subsidiary of a G-SIB Group, the resolvability analysis and the related remedial actions should be assessed at consolidated level by the home supervisor with the support of host competent authorities.

[1] For individual cases, the review could be performed by regional authorities such as the EBA for transactions originated by and involving banks in EU member states.

Before requiring corrective actions that could impact the bank management, insofar as to reshaping the business model, there should be a peer review across the other SIBs.

EC7: it is deemed appropriate to reword "framework or process" to "framework and process" as the terms are complementary

Principle 9: Supervisory techniques and tools

The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.

UniCredit: As overarching remark, UniCredit would like to recall its understanding that supervisors should raise deficiencies in the bank management while banks are in charge of defining the remedial actions that they deem as appropriate. Supervisors should be in charge to evaluate such plans, timely approve them when and as needed, monitor them and trigger escalation when the actions are lagging behind schedule or no clear commitment (from the Bank) is given. It does not seem appropriate that supervisors require specific actions or set the interim deadlines, rather it should be requested only for the final plan (see also Principle 11, Essential Criterion 4).

EC1: supervisors should take into consideration the risk profile together with the effectiveness of risk mitigation tools in place.

EC2: symmetrically to the provisions for bank management, the proper involvement of the supervisors' senior management should be ensured.

EC4(e): supervisors should also pay attention to the effectiveness and robustness of internal processes, for instance credit underwriting, as business functions make a first level of risk management.

EC5: in case the exercises are run at international level, they should be run by the parent company which properly involve the relevant subsidiaries.

EC6: it is recommended to expand this principle to acknowledge that supervisors could also rely on internal audit to perform a follow up on supervisory actions, e.g. on-site audits.

EC7: according to the jurisdictions, it is deemed appropriate that supervisors maintains contacts with any relevant control body/function in the bank, for instance the Board of Statutory Auditors or the external auditors.

EC10: banks should notify the mentioned items also in a forward looking perspective. Supervisors should hold Board and senior management responsible for any missing or delayed communication.

EC11: in case third-party information is used, that should be disclosed to the bank, or at least its the source.

Principle 10: Supervisory reporting

The supervisor collects, reviews and analyses prudential reports and statistical returns from banks on both a solo and a consolidated basis, and independently verifies these reports, through either on-site examinations or use of external experts.

UniCredit: it should not be ruled out that external experts (necessarily and undoubtedly independent and without any business ties with any of the relevant involved banks) are involved under the necessary confidentiality regime, and provided that their role is clearly stated and overseen also by the competent supervisor. Furthermore it should be known and transparent who pays for their services.

EC1: to ensure the levelling playing field and the effective management of banks, we deem of the utmost relevance that supervisors should pursue a harmonisation of the supervisory reporting, also regarding the involved items. With this regard it would be beneficial highlighting the list of items quoted in this criterion could not be held as exhaustive

EC2: it is supported the harmonisation of reporting. However should be clear that in some cases non-accounting data are requested which therefore are not supposed to meet a high level of standardisation.

EC3: it is deemed as appropriate for supervisors when dealing with the methodologies not only to focus on the valuations, but also taking in consideration the related components of processes, data flows and data quality.

EC5: a meaningful comparison could be achieved only if there are data that are comparable across the different banking groups, which means further harmonisation amongst jurisdictions.

EC6: it is necessary to underline that this principle holds only for home supervisors, while for the host ones it applies only to the subsidiaries under their jurisdictions.

Principle 11: Corrective and sanctioning powers of supervisors [42]

The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.

UniCredit:

EC3: in UniCredit's view, supervisors should look after not only depositors' interests, but also after those of the other bank's customers, e.g. clients for the non-lending activities, such as payment services, asset management, brokerage or insurance in case of , besides the other debt holders.

EC4: it is recalled UniCredit's understanding of the different roles between supervisors and banks. The former should raise deficiencies while the latter are in charge of defining the remedial actions that they deem as appropriate. Supervisors should be in charge to evaluate such plans, approve them when needed, monitor them and trigger escalation when the actions are lagging behind schedule or no clear commitment is given. It does not seem appropriate that supervisors require specific actions or set the interim deadlines, rather it should be requested only for the final plan (see also principle 9).

Regarding the list of measures, in case of a subsidiary, suspending payments to shareholders should be agreed by both the host and home authorities. Furthermore, in case of restricting the power of managers, it should be ensured there is no vacuum in the governance and decision-making processes. **It should be clearly stated that providing interim or special managers is always an intrusive action allowed only once the resolution plan is formally a activated.**

EC7: **ring-fencing a bank from the actions of the parent company is totally inconsistent with an effective group management that could lead first of all to suboptimal choices and possibly a disorderly resolution of a Group.** Any measure involving, directly or not directly, the parent company, should be agreed with the home supervisors.

Principle 12: Consolidated supervision

An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.

UniCredit: It is fully supported the principle that consolidated supervision better matches the market evolution/developments as well as the banking group structure.

EC2: it is recommended to mention risk profile and not only liquidity, that is a part of the former.

EC3: It should be clarified what consequences the home supervisor deem noteworthy as there is hindrance in host countries to have access to all the material information from their foreign branches and subsidiaries. As mentioned at the beginning, there should be a dispute settlement mechanism amongst authorities also to remove any impediments to free flow of information..

EC5: it is deemed as highly beneficial to specify the scope of the actions by the home supervisors: the

parent company, the whole group or also specific subsidiaries, also abroad.

EC7: it is deemed as necessary to remind that in case of subsidiaries of a group, the host authority should refrain from assessing the single bank, but actually evaluate it in the consolidated perspective.

Principle 13: Home-host relationships

Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.

UniCredit: This is the key issue for effective supervision nowadays as the most relevant banks operate on a cross-border basis. Furthermore UniCredit is of the considered opinion that there is ample room for improvement, also because in the unfolding of the recent crisis lower cross-border coordination and cooperation efforts have actually been observed.

It is suggested to investigate the opportunity and feasibility for the Basel Committee to define as early as possible a template for a "Memorandum for a cooperation framework at international level". This should include a clear allocation of responsibilities and a timeframe for a predefined list of areas where joint decisions are needed. The costs and systemic risks for lack of coordination to reach joint decisions within a pre-defined timeframe are potentially high/very high, also for the financial system as a whole. There should be some form of third-party effective and efficient mediation at supranational level (e.g. BCBS, IMF or FSB) in those cases where competent authorities fail to comply with the Memorandum when pursuing a joint decisions.

If set-up, the Memorandum should include a clear, effective and efficient mechanism to settle disputes that, amongst the other requires to identify a supranational conciliatory entity. In the absence of a joint decision within a predefined timeframe, e.g. three months, the consolidating supervisor may make its own decision, applicable for the Group. If any national banking supervisors disagrees, it may revert to such supranational conciliatory entity. The matter may not be reverted to such supranational conciliatory entity after the end of the predefined timeframe or after a joint decision has been reached. If referred to, the supranational conciliatory entity shall take its decision within a predefined timeframe e.g. one month. The subsequent decision of the consolidating supervisors shall comply with the decision of the supranational conciliatory entity.

EC1: other variable structures could be set up relate to specific initiatives such as validating internal models or a cross-border transaction (see Principle 7).

EC6: it would be better to reword the principle to specify that it is the banks that undertakes the recovery measures, while supervisors deal with ones related to resolution.

EC10: see the initial remark on the Memorandum.

Prudential regulations and requirements

Principle 14: Corporate governance

The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organisational structure, control environment, responsibilities of the banks' Boards and senior management, and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.

UniCredit: UniCredit agrees with the principle that supervisors issue rules and guidelines to enhance the corporate governance of banks and that the relevant policies and processes set up by the banks must be commensurate with the risk profile and systemic importance of the same.
Since 2008, Bank of Italy has established several provisions concerning specifically the corporate governance of the Italian banks which obviously have been applied by UniCredit.

Notwithstanding the general approval for the Basel Committee initiative concerning banks' corporate governance, it is worth pointing out that among the "essential criteria" connected to the above principle, UniCredit disagrees with criterion no. 9 which provides that "*The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria*".

Such provision gives the supervisor a very broad discretionary power to intervene in the composition of the Board, even requiring the substitution of the members, when in its view the appointed members do not satisfy the "*essential criteria*" on corporate governance. Such power seems to be overly extensive because such criteria do not contain unequivocal requirements which can or cannot be objectively met but general provisions such as, for example: "*Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty"*". The possibility of discretionary interpretation of the provisions by the domestic supervisors might even cause a competitiveness gap among the banks of the different countries.

In this regard, the a-priori set-up of unequivocal requirements that the Board members must meet and the supervisors' power to verify the satisfaction of such requirements may be considered as a better solution since it could give better guarantees with regard to the homogeneous application of the corporate governance rules among the European banks.

Principle 15: Risk management process

The supervisor determines that banks have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate[54] all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of robust and credible recovery plans, which take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.

UniCredit agrees with the principle that a comprehensive risk management process shall be in place and that it should be linked to the decision making process. The link between risk appetite, planning processes and risk strategies is set and implemented in UniCredit. Regular reporting and escalation processes have been set in Unicredit to inform and duly involve the competent bodies. Link with the recovery plan has also been defined. An international level playing field on the different topics affected / related to the risk measurement and management is needed to avoid inconsistency among geographies, the same stands for the constraints related to information flow.

Principle 16: Capital adequacy

The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses.

UniCredit: Given that one of the objectives of the new regulation is the harmonization of different regulatory frameworks and the establishment of a "level playing field" among financial institutions, it will be crucial that the **Capital Adequacy principle will be implemented at a global level with the highest degree of homogeneity. This concerns not just the level of capital requirements (i.e. the "quantity" of capital) but also the timeline of implementation.** Indeed, minimization of negative impacts on the real economy stemming from the new regulatory framework (i.e. credit restrictions) hinge on the critical hypothesis that the new rules will be applied following the "correct" regulatory timeline.

If not properly addressed, the burden of the **new regulation requirements on bank capital, introducing multiple and cumulative capital buffers, might be disproportionately high on low risk asset classes as credit to SMEs**, which depend to a large extent on bank financing. Therefore, in order to ensure the banks' capability to lend adequate amount of credit to crucial sectors of the economy, such as SMEs, a discussion is being held about the introduction of

a proper correction (a "de-multiplier") in the RWA calculation for low risk loans, so as to balance out the quantity increase in minimum capital requirements.

Principle 17: Credit risk[63]

The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk[64] *(including counterparty credit risk) on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.*

UniCredit: The Principle is fully supported as it is the basic principle on which the whole framework of the UniCredit Policies and Processes in Credit Risk assumption, management and control are built.

Principle 18: Problem assets, provisions and reserves

The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.

UniCredit: As a general consideration we support most of the proposed criteria included in Principle 18. Nevertheless with reference to banks with cross border legal entities it is not clear if those criteria shall be defined by each local supervisory authority for the single relevant legal entity or by the holding company responsible supervisory authority for the whole group. Moreover the following aspects require closer examination in order to provide a clear stance on the relevant provisions. With specific reference to:

- 18.1 From an operational perspective the regular review at portfolio level of "problematic" assets, asset classification, provisioning and write-offs depends not only from the type of assessment (individual vs. portfolio level) but also from banks' organizational structures, data/information. Therefore we highlight the need to balance the mentioned criteria referring specifically to different banks' implementation capacities.

- 18.5 We definitely agree with the criteria that banks should have appropriate policies and processes and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets and for collecting on past due obligations. However an additional clarification of the expressions "loans with uniform characteristics" (e.g. consumer lending) and "loan are classified" (e.g. "performing/impaired" or "regular/deteriorating") would be helpful. Moreover we believe that some exceptions should be defined / provided. We are referring for instance to emergency lending programs initiated by governments and central banks, with the involvement of local banking system aiming at supporting the local community in the event of financial crisis or natural disasters. In those cases and with reference to their classification when payments are contractually in arrears, the different treatment of the assets is not intended to circumvent the classification and provisioning standards but it could be part of the lending program itself.

- 18.8. With reference to the regular value assessing process of risk mitigants we already provided our considerations at point 18.1. Referring specifically to the "net realisable value", its calculation as well as its update depends on internal and external information availability and data quality in each single country. Furthermore we believe that the rules in order to calculate the "net realizable value" should be further and properly clarified.

- 18.9. - We definitely agree with the criterion 18.9. However we highlight the inconsistency between the example provided, with specific reference to the impaired status, and the definition included within the IAS 39 standard. The example states that loans are identified as impaired when there is a reason to believe that all the amounts due will not be collected in accordance with the contractual terms. In compliance with IAS 39 the financial asset or group of assets is impaired, and impairment losses are recognized, only if there is an objective evidence as a result

of one or more events that occurred after the initial recognition of the asset. The objective evidence is normally given by the joint presence of a breach of contract (such as a default or delinquency in interest or principal payments) and the significant financial difficulty of the debtor. Therefore the recognition of the impairment is not only due to the banks' reason to believe but also to the objective evidence that the impairment has incurred. Given the above further proper clarification is deemed necessary.

Principle 19: Concentration risk and large exposure limits

The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely

basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.

UniCredit: The Principle is fully supported. The implementation of the principle at consolidated level does require a coordinated information flow within the Group (between the Legal Entities and the Holding Company). **Specific measures or rules to easily implement a legal framework for cooperation of entities pertaining to a group that could overrule local regulation in terms of data protection and banking secrecy would be strongly needed.**

Principle 20: Transactions with related parties

In order to prevent abuses arising in transactions with related parties[73] and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.

UniCredit agrees with the substance of this Principle. We only suggest the insertion of the words "**as a general rule**" in the sentence "*the supervisor requires banks to enter into transactions with related parties on an arm's length basis*" considering that the convenience and substantial correctness of the transactions with related parties (also when they aren't closed on an arm's length basis) could be effectively ensured requiring that the resolutions adopted by the competent decisional bodies provide adequate reasons for (i) the interest of the Bank in the completion of the transactions and (ii) any difference of the economic and contractual conditions of the transactions vis-à-vis the standard or market conditions.

Principle 21: Country and transfer risks

The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk[76] and transfer risk[77] in their international lending and investment activities on a timely basis.

UniCredit consider Principle 21 applicable only to cross border businesses (where borrower is located elsewhere with respect to the legal entity granting credit lines).
We recognize that different approaches to measure and account for country risk and transfer risk could be adopted by different banks. It will be essential to provide a framework allowing banks to choose without jeopardizing accuracy of treatment as well as avoiding double-counting of same risk at various measurement levels (single transaction, counterparty, portfolio aggregation).
Treatment of intra-group exposures in general country risk reporting has to be considered appropriately to provide a true picture of risk profile.
As far as the list of Essential Criteria is concerned, we would like to highlight importance of option "c" in coherence with the Italian regulator approach and the advanced IRB approach adopted by UniCredit.

Principle 22: Market risk

The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.

UniCredit:
UniCredit agrees with the opinion that an adequate risk management process should take into account risk appetite and risk profile, together with market and macroeconomic conditions, and that this should be achieved through the bank's strategies, policies and processes.
The Group internal regulation largely reflects most of the essential criteria listed in the consultation paper. In order to ease a comprehensive group-wide view of market risk exposure and guarantee the ability to steer, to coordinate and to control aggregated risks, a reorganization of Risk Management functions through dedicated responsibility centers (Portfolio Risk Managers), completely focused and specialized on "Portfolio Risks", under a Group and interdivisional perspective has been implemented. The internal guidelines establish, inter alia, that target architecture aims at ensuring the most accurate and prompt identification, aggregation, monitoring and reporting of market risk exposure; Limits, Warning Level and Stress Test Warning Level are also defined in order to ensure a proper steering of risks, with an escalation process in case Warning Levels/Limits are breached.
At the same time, internal pricing models are validated by functions that are independent of the relevant risk-taking business units.

Principle 23: Interest rate risk in the banking book

The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate[78] risk in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.

UniCredit agrees and is compliant with the IRRBB (CHECK ACRONIMO) Principle. It works, together with the other relevant functions of the Group, in order to measure, monitor, control and mitigate Interest Rate Risk in the Banking Book. New approved UniCredit IRRBB Policy is also in accordance with this Principle.

Principle 24: Liquidity risk

The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons.

UniCredit: the principles seems appropriate and logical. However Basel 3 liquidity risk framework is not risk-driven but is based on a "one-size-fits all" approach. When banks are using a risk-driven approach, the resulting indicators may be not necessarily aligned with the minimum Basel 3 indicators.

Principle 25: Operational risk

The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk on a timely basis.

UniCredit agrees with the Principle.

The Group is already progressing in line with the mentioned criteria according to the *Principles for the Sound Management of Operational Risk* (June 2011). However we would like to remark that is difficult to link market and macroeconomic conditions to direct correlations and concrete elements within the Operational Risk framework, therefore more specific indications on the topic would be appreciated.

Principle 26: Internal control and audit

The supervisor determines that banks have adequate internal controls to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

UniCredit agrees with this principle. At the same time, we would like to make a few suggestions in order to further clarify some issues:

a) We suggest that reference should be to an "internal control framework" or "internal control system", instead of "internal controls", in order to provide both a wider focus on all the components and an alignment with other Basel Committee and EBA documents. This consultation is a good opportunity to reach a precise definition of the "internal control framework" and its objectives (some of the sources, though not exhaustive references, are in the EBA "Guidelines on Internal Governance", September 2011 edition, sect. D., par. 24 and the BCBS "Framework for Internal Control System in Banking Organisation", 1998).

We would also suggest considering the concept of "three lines of defense", as described in principle 13 of the BCBS consultative document "The internal audit function in banks ", December 2011):

1st line: operational management
2nd line: risk management function, compliance function and other monitoring functions;
3rd line: internal audit function.

Furthermore, including risk management (ie. the risk control function) among the specific independent internal control functions is consistent with the EBA "Guidelines on Internal Governance" issued in September 2011 (sect. D par. 24).

b) First essential criteria: we suggest adding the following elements as control targets, such as: i) compliance with legislation and internal and external regulations, supervisory requirements and ii) the reliability of financial and non-financial statements.

c) Second essential criteria: we suggest, in particular, clarifying whether the mentioned "internal control functions" are those responsible for first-line controls. If so, it could be appropriate to refer to the "operational management" definition as set out in the BCBS consultative document "The internal audit function in banks " (principle 13 "*operational management has ownership, responsibility and accountability for identifying, assessing, controlling, mitigating and reporting on risks encountered in the course of a bank's business activities*").

d) Third essential criteria: considering that further functions other than Compliance (e.g. "Human Resources", "Legal", "Tax"), may be in charge to assist the Bank in managing specific compliance risks, due to the particularity and technicalities of those risks, we suggested to duly consider this aspect in the criteria.

e) Fourth essential criteria: we suggest aligning the provisions relating to the duties of the internal audit function with those described in the above mentioned BCBS consultative document "The internal audit function in banks" (principle 6) or, as an alternative, specifying that those set out in the fourth criteria are the "minimal" ones.

Principle 27: Financial reporting and external audit

The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.

UniCredit: the enforcement of sound accounting practices together with a rigorous external audit verification over financial statements are essential for promoting stability and efficiency of financial markets.

However, for listed companies (and listed banks), financial reporting is already disciplined by financial market regulators, which set, among other topics, accounting principles to be applied and terms of the external audit activities.

Therefore, **it is paramount that banking supervision over financial reporting reflects the scope and peculiarities of the supervision already put in place by the financial market supervisors. Coordination is essential, in order to avoid a double level of supervision on the same topics and subsequent burden and costs.**

For example, we don't see the value added by an independent verification and validation of valuation practices, considering the assessment already done on accounting valuations by the external auditors of financial statements.

Coordination and respect of different scope and peculiarities of the two different authorities (market supervisor and banking supervisor) is essential, considering that the two authorities have different key purposes. Ultimate duty of the market supervision is to promote the highest level of disclosure to the market, in order to help market efficiency so that market prices can promptly inform market participants about changes in value due to sensitive disclosure. On the contrary, the banking supervision shall pursue financial stability, prevent value disruption and ultimately protect the intermediated public saving. These two key purposes may be in several circumstances conflicting between them.

We do not agree in particular with the proposal to report the differences between valuation used for regulatory reporting ad valuation used for financial reporting. In fact, financial statements reflect accounting principles whose ultimate purpose (i.e. fairly represent the financial position and performance) are not necessarily consistent with regulatory measurement, which are often inspired by the exercise of a prudent judgment. For example, while the approach to the accounting valuation (such as fair value under IFRSs) is based on a point-in-time measurement (i.e. to reflect the current conditions at the reporting date), measurement for regulatory purposes are often counter-cyclical or through-the-cycle (i.e. promote the accrual of provisions in good times that will be reversed in the worse phases of an economic cycle).

Principle 28: Disclosure and transparency

The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.

UniCredit: Italian regulatory requirements for Market Disclosure (Pillar III) already encompass many of the principles outlined in the consultative document.

Nonetheless, it appears useful – according to our point of view – to limit the matters to be reported for Market Disclosure in coherence with the original aim of the Pillar III document, mainly concerning

capital adequacy, risk exposure and the general characteristics of the systems established to identify, measure and manage such risks.

While – otherwise – some of the topics mentioned under point 28.2 seems redundant for Pillar III purposes as they:

(I) are already disclosed within financial reporting under dedicated sections and
(II) do not appear closely related to risk matters in its aforementioned meaning; by way of example, we are referring to: financial condition and performance; exposure to related parties; transactions with related parties; accounting policies.

Moreover, it is also worth mentioning that:

- "*timeliness*" (please ref. section 28.1 of the consultative document) surely represents a value-added topic, but it should be proportionated with the amount of required information and requirement of "certification" of data;
- regarding the frequency of issuing, Market Disclosure information should be coherent with changes in underlying data (e.g. it does not make sense to recurrently issue information on relatively stable data); on this side, Italian regulation requires[2] the issuing – on quarterly basis – of "Supervisory capital structure" and "Capital adequacy" tables only.

Regarding the Section 28.5 of the consultative document, we deem relevant to highlight the fact that possible comparable disclosures are effectively only in presence of a really "common level playing field", otherwise Market reaction could result altered as data are not suitably perceived; in short, it appears necessary to us – as far as we believe – that the primary value to be pursued is financial stability, evaluating accurately the diffusion of further data other than those currently issued if not really needed.

Principle 29: Abuse of financial services

The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.

UniCredit: We do agree with the essential criteria declared by this principle. In addition we believe that is particularly important for the supervisor to determine that banks have sufficient controls and system to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.

[2] For "*banks authorized to adopt internal systems to calculate capital requirements for credit and operational risks*" (Bank of Italy Circular n. 263/2006).

CONTACT PEOPLE (name.surname@unicredit.eu)
Please find below the list of the key people involved in this work, whose contribution made possible to coordinate and provide UniCredit answers to this Consultation. Some other experts have been involved alongside the UniCredit Group, but are not listed below.

Regulatory Affairs (Public Affairs) – Coordination and Contributor Team
Lugaresi Sergio – Head of Regulatory Affairs - Public Affairs
Lagana Marco – Regulatory Affairs
Mantovani Andrea – Regulatory Affairs

KEY CONTRIBUTORS

Banking Supervisory Relations
Moscon Guido – Head of Banking Supervisory Relations
Cremonino Andrea – Head of Banking Supervision College and EU

Group Risk Management
Arnaboldi Fadio – Head of Group Risks Control (GRM dept Coordinator (*))
De Mori Valeria – Head of Risk Integration & Capital Adequacy (GRM dept Coordinator (*))
(*) Several GRM areas have participated to the Consultation replies

Other CONTRIBUTORS
Audit
Balit Patrizia – Head of Advisory & ICRC Secretariat
Di Stefano Giovanna – Advisory & ICRC Secretariat

CFO dept
De Martino Pasquale – Head of Shareholding
Milani Mara – Head of Group Finance and Treasury Business Management (Coordinator – Group Finance)
Di Francescantonio Bonifacio - Consolidated Financial Statement (Accounting)
Nuzzo Manlio – Corporate Law Advice (CL)
Barchietto Alessandro – Head of Capital Planning and Allocation (CM)

Global Regulatory Counsel
Bertulessi Enrico – Head of Global Regulatory Counsel
La Rocca Antonio – Head of Global Regulatory Counsel
Lattuada Paola – Head of Global Banking Services Counsel
D' Imperio Gianluca– Global Banking Services Counsel

Group Organization Development
Francescucci Paola – Head of Group Organization Development
Veneziani Ettore – Head of Organization Development - Structures & Rules

Legal
Di Cosimo Maria Cristina – Head of GST
Karolczak Paulina – GST
Donati Paolo – Corporate Transactions Legal Support

Bank Austria
Klepp Stella – Compliance Dept (Coordinator)

Bank Pekao – Poland
Szmilewska Agnieszka – Compliance Dept (Coordinator)

Unicredit Bank AG – Germany

Oelgarth Achim – Institutional Affairs (Coordinator)