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**BANCA MONTE DEI PASCHI DI SIENA S.P.A.**

SHAREHOLDERS' MEETING

11 April 2019 (single call)

EXPLANATORY REPORT OF THE BOARD OF DIRECTORS

ON POINT 7 ON THE AGENDA OF THE ORDINARY PART

drafted pursuant to article 125-ter del of Italian Legislative Decree no. 58 of 24 February 1998, as amended

**APPOINTMENT OF THE INDEPENDENT AUDITORS 2020-2028.**

REPORT OF THE BOARD OF DIRECTORS PURSUANT TO ARTICLE 125-TER OF ITALIAN LEGISLATIVE DECREE No. 58 OF 24 FEBRUARY 1998, AS AMENDED.

Dear Shareholders,

you have been summoned to the Shareholders' Meeting to resolve upon the following item, on the agenda of the ordinary session:

**APPOINTMENT OF THE INDEPENDENT AUDITORS 2020-2028.**

The statutory audit assignment conferred on the company Ernst & Young Spa by the Shareholders' Meeting on 29 April 2011, for the financial years from 2011 to 2019, expires at the date of approval of the financial statements as at 31 December 2019.

The Board of Directors submits for the approval of the Shareholders' Meeting the reasoned proposal from the Board of Statutory Auditors of Banca Monte dei Paschi di Siena S.p.A., in accordance with article 13, paragraph 1, and article 17, paragraph 1, of Italian Legislative Decree no. 39 of 27 January 2010, and article 16 of Regulation (EU) no. 537/2014 of 16 April 2014, concerning the conferral of the statutory audit assignment for the financial years from 2020 to 2028, as illustrated in the recommendation set forth below:

***“RECOMMENDATION FROM THE BOARD OF STATUTORY AUDITORS OF BANCA MONTE DEI PASCHI DI SIENA SPA IN ITS CAPACITY AS INTERNAL CONTROL AND AUDIT COMMITTEE: CONFERRAL OF THE STATUTORY AUDITING ASSIGNMENT FOR THE NINE-YEAR PERIOD FROM 2020 TO 2028***

**1. Introduction**

*The statutory auditing assignment for the nine-year period from 2011 to 2019, conferred on Ernst & Young Spa (EY) through the shareholders' resolution of 29 April 2011, will expire at the approval of the financial statements for the year 2019.*

*According to current legislation on statutory audits, as last amended by European Regulation no. 537/2014 (the “Regulation”) and Italian Legislative Decree no. 39/2010, supplemented by Italian Legislative Decree no. 135/2016 (the “Decree”):*

- i. the assignment may not be conferred again to EY until at least four financial years have elapsed from the expiry of the current assignment;*
- ii. the new statutory auditing assignment must be entrusted through a suitable selection procedure, to be conducted according to the criteria and procedures laid down in article 16 of the said European Regulation.*

*In order to enable an adequate handover between the outgoing auditor and the newly appointed auditing firm, as well as to ensure compliance with the time limits imposed to protect the independence of the auditor (‘cooling-in period’), the Board of Statutory Auditors, acting in its capacity as the Internal Control and Audit Committee pursuant to article 19 of the Decree, in cooperation with the competent company functions, deemed it appropriate to launch the selection procedure for the conferral of the statutory auditing assignment for the nine-year period from 2020 to 2028 one year earlier.*

*The Board of Statutory Auditors thus drafted this recommendation (the “Recommendation”) for the forthcoming Shareholders’ Meeting on 11/04/19 for the purposes provided for by the legislation in force. The proposal provides for two possible alternatives for the conferral of the assignment and indicates the duly reasoned preference for one of the two, resulting from the final score given at the end of the selection procedure subject to specific monitoring through the Internal Audit Function.*

*The Board of Statutory Auditors agreed, together with the competent company structures, on the identification of the auditing companies who would receive requests for bids according to transparent and non-discriminatory criteria, as required by the reference legislation, opening participation up to bidders with sufficient expertise and experience in the sector and adequate structures for the auditing of the Montepaschi Group (hereinafter, the “Group”).*

## **2. Regulatory Framework**

*The EU legislation on statutory audits was last modified by two distinct acts:*

- *Directive 2006/43/EC as amended by Directive 2014/56/EU (the “Directive”) on statutory audits of annual accounts and consolidated accounts, transposed by Italian Legislative Decree no. 39 of 27 January 2010, as last amended by Italian Legislative Decree no. 135 of 17 July 2016;*
- *European Regulation 537/2014 on the statutory audit of public-interest entities, in effect since 17 June 2016.*

*The purpose of the new legislation is to ensure further harmonisation of the rules originally introduced by Directive 2006/43/EC at European Union level to reinforce the independence, objectivity, transparency and reliability of auditors, as well as the quality of their work, also to increase the public’s faith in the annual and consolidated financial statements of public-interest entities and thus to contribute to the smooth functioning of the market.*

*In particular, the Regulation reinforced the role of the Internal Control and Audit Committee in choosing the new audit firm, making it responsible for submitting a reasoned ‘recommendation’ to enable the Shareholders’ Meeting to make a sufficiently informed decision.*

*The Recommendation was thus drafted following a suitable selection procedure conducted according to the provisions in article 16(3) of the Regulation.*

## **3. The Selection Procedure**

### **3.1 Preamble**

*In order to implement the selection procedure, the Board of Statutory Auditors drew on the operating support of the Bank’s internal structures with which it established an Internal Committee composed of the Manager in charge of the preparation of corporate accounting documents, the Head of the Procurement Function for contractual and technical/organisational aspects and the Head of the Internal Audit Function for assisting with supervision of selection procedure of the audit firms.*

### **3.2 Audit Firms**

*Firstly, an analysis was conducted to prepare for the identification of the audit firms to invite to the call for bids; to this end, the following aspects were taken into consideration, for the main international audit networks:*

- *'expertise', taking as a benchmark the financial clients audited in Italy;*
- *'knowledge of the Montepaschi Group', based on assignments conducted over the last few years;*
- *'international presence of the network' of the audit firm, with particular reference to countries where the Group operates;*
- *'revenue from audit services provided in Italy', in order to avoid potential independence risks.*

*At the end of the preliminary phase, three audit firms were selected: Deloitte & Touche Spa (or "D&T"), KPMG Spa (or "KPMG") and PricewaterhouseCoopers Spa (or "PwC") (hereinafter referred to jointly as the "Bidding Firms" or "Bidders").*

*Subsequently, on 12 November 2018, the Bank sent the three firms an invitation to participate in the procedure, providing access, through an appropriate computer platform, to the Request for Bids and other documents.*

*Since the statutory auditor of the Parent Company Bank is of particular significance as the Group's principal auditor, the invitation to submit a bid was also extended to other audit assignments of the Bank's Subsidiaries in order to optimise the auditor's work with respect to the entire Group.*

*The procedure carried out was prepared with an indication of:*

1. *the provision of audit services both for the Bank and for its subsidiaries for the period from 2020 to 2028;*
2. *the content of the Commercial Proposal composed of three distinct parts: Technical Proposal, Economic Proposal and Framework Agreement;*
3. *the technical procedures for participation in the call for bids;*
4. *the analysis of the bids and the assessment criteria adopted with the relevant maximum possible score;*
5. *the procedures for awarding the assignment.*

*Lastly, it should be noted that there was no attempt to exclude from the selection procedure firms which received, during the previous calendar year, less than 15% of their total considerations for the audit of public-interest entities in Italy, in accordance with the provisions of article 16(3)(a) of the Regulation.*

### **3.3 Selection Criteria**

*Before beginning the selection procedure, selection criteria were identified that would make it possible to ensure a procedure characterised by the transparency and traceability of the activities conducted and the decisions made.*

*In defining the selection criteria, particular focus was placed on:*

- A. *both qualitative elements, such as:*
  - *knowledge of the Montepaschi Group, the independence and reputational risks;*
  - *the organisation of the audit firm and its network;*
  - *the methodological approach proposed for auditing the Bank;*
  - *the audit team;*
  - *the total number of hours envisaged; in this context, the minimum optimal level for the partner responsible for the work and the managers/specialists was considered to be 10% and 35%, respectively, of the total work performed by the audit team;*
- B. *and quantitative elements, such as:*
  - *the overall consideration for the assignments covered by the bid, subdivided by the different companies and activities of the Bank and Group.*

*The macro-categories thus identified were also structured into specific criteria.*

### **3.4 Conducting of the Procedure**

*Following the request to participate in the call for bids to which the three invited firms responded, in-depth interviews were conducted with the individual Bidding Firms.*

*By 14 December 2018, the Bank had received bids from D&T, KPMG and PWC, accompanied by the information and documentation requested.*

*Based on this documentation and in consideration of the assessment criteria (as defined below), the bids were assessed in detail through the analysis, for each criterion, of the individual key and distinctive aspects of the Bidding Firms.*

### **3.5 Assessment Criteria**

*As indicated and consequently set forth in the Request for Bids, for the purposes of this Recommendation, the intention was to assess both qualitative and economic elements, which received an overall maximum score of 70 and 30 points, respectively, as shown below:*

- *Qualitative criteria, including:*
  - a. *Knowledge of the Group, independence and reputational risks (max. 15 points);*
  - b. *Assessment of the audit firm and its network (max. 10 points);*
  - c. *Assessment of the methodological approach proposed (max. 10 points);*
  - d. *Assessment of the audit team (max. 20 points);*
  - e. *Assessment of the total amount of hours envisaged (max. 15 points).*
- *Quantitative criteria:*
  - f. *Overall amount of consideration (max. 30 points).*

As regards the process for assessing the qualitative and quantitative aspects illustrated above, the Board of Statutory Auditors took the following considerations into account:

- *Qualitative aspects:*
  - (i) Knowledge of the Montepaschi Group, independence and reputational risks: the focus in this assessment area was on the knowledge of the Group accrued by the Bidding Firms, through the provision of non-audit services. Moreover, particular attention was paid to reputational aspects, taking into account the volume and content of any sanctions imposed against the Bidders by Supervisory Bodies over the last five years with reference to statutory audit services.
  - (ii) Assessment of the Audit Firm and its network: in this assessment area, the focus was on experience in auditing Italian listed companies operating in the financial sector and in large banking groups with organisational structures and complexities similar to those of the Montepaschi Group. In addition, there was also an analysis of ongoing assignments and those soon to expire, the presence of networks, local and otherwise, and IFRS centres of excellence and clients of the Bidders subject to the Single Supervisory Mechanism.
  - (iii) Assessment of the methodological approach proposed: within the context of the methodological approach, certain key profiles were assessed positively, such as the audit strategy and the method according to which significant risks and key audit matters are identified; the process of interacting with the company functions and control functions and the detail with which the process of communication to the Board of Statutory Auditors is prepared; the procedures and process for transition to the new auditor; the procedures for interaction with any third-party auditors and coordination of the information flow between the audit team of the Parent Company and the audit teams at the subsidiaries; the internal quality control and monitoring process of the independence requirement in accordance with the legislation in force.
  - (iv) Assessment of the Audit Team: the particular focus in this area was on the composition of the audit team and, in particular, the profile of the responsible partner and the teams dedicated to specialised fields, including the presence within the team of 'IAS/IFRS' technical members.
  - (v) Assessment of the total number of hours envisaged: the assessment of these qualitative aspects concerned the mix of hours and the composition of the professional structure, as well as the impact of the partners/managers/specialists on the total hours worked.
  
- *Quantitative aspects:*
  - (i) The assessment of the economic aspects regarding audit activities took the cost incurred for the outgoing auditor as a benchmark. For statutory audit services, fee discounts were assessed positively up to a certain threshold, in order to protect the quality of the audit activities and the interests of the stakeholders.

The Board of Statutory Auditors wished to adopt such an assessment procedure, conscious of the important role it plays in the appointment of the statutory auditor, in order to be able to analyse and assess each relevant aspect individually and, subsequently, trace them back and assess them, including within the general framework.

#### **4. Results of the Selection Procedure**

*The documentation collected, meetings held and analyses conducted all highlighted the high standing of the Bidding Firms and the audit teams proposes. In this regard, certain differences were noted which led to the following final scores (expressed in hundredths):*

<i>COMPANY</i>	<i>QUALITATIVE ASPECTS</i>	<i>QUANTITATIVE ASPECTS</i>	<i>TOTAL AFTER NEGOTIATION PHASE</i>
<i>D&amp;T</i>	<i>64.6</i>	<i>25.6</i>	<i>90.2</i>
<i>KPMG</i>	<i>52.2</i>	<i>19.6</i>	<i>71.8</i>
<i>PWC</i>	<i>58.0</i>	<i>29.2</i>	<i>87.2</i>

*The following classification thus emerged from the selection procedure:*

- 1. D&T;*
- 2. PwC;*
- 3. KPMG.*

*In particular, D&T received a higher score for the following reasons, all qualitative in nature, which constitute the grounds for this Recommendation:*

- lower number of sanctions imposed by the Supervisory Authorities with reference to statutory audit activities over the last 5 years;*
- importance of the audit assignments at Italian and foreign banking groups subject to the Single Supervisory Mechanism;*
- better qualitative/quantitative composition of the team;*
- number of hours envisaged for the audit activities, more suitable for the characteristics of the Group, with reference also to the hours declared by the outgoing audit firm at the seventh year of its assignment.*

*As regards the economic part, the highest score went to PwC, whose fees were closer to the set parameters.*

#### **5. Recommendation of the Board of Statutory Auditors**

*In view of the foregoing, the Board of Statutory Auditors of Banca Monte dei Paschi di Siena, in relation to the awarding, for the nine-year period from 2020 to 2028, of the statutory audit assignment indicated hereunder:*

- statutory audit of the annual financial statements;*
- statutory audit of the consolidated financial statements of the BMPS Group;*
- consolidated non-financial declaration;*
- periodic bookkeeping checks;*
- limited consolidated half-yearly audit and audit of the half-yearly financial statements of the Parent Company included in the consolidated accounts;*
- comfort letters of 30 June and 31 December for the inclusion of the result for the period in the calculation of the Common Equity Tier 1 Capital;*
- limited audit of financial statements for determining the interim profit as at 31 March and 30 September to enable the inclusion of the interim result in the calculation of the Common Equity Tier 1 Capital;*

- checks connected with the signature of tax returns;
  - checks connected with the calculation of the contribution to the Fondo Nazionale di Garanzia (National Guarantee Fund);
- based on the procedure conducted, the bids received, the assessments conducted and the results thereof, as well as the final assessment by the Internal Audit Function on the fairness of the selection procedure;
  - considering the fact that article 16(2) of the Regulation states that the reasoned recommendation of the Board of Statutory Auditors must contain at least two possible alternatives to enable ease of choice;

*CONSIDERING THE FACT THAT*

- the said article 16(2) requires the Board of Statutory Auditors to express a duly reasoned preference;
- in any event, both Deloitte & Touche Spa and PricewaterhouseCoopers Spa displayed technical fitness for taking on the assignment,

*RECOMMENDS*

*that the Shareholders' Meeting confer the assignment of the statutory audit of Banca Monte dei Paschi di Siena Spa for the financial years from 2020 to 2028 either on Deloitte & Touche Spa or on PricewaterhouseCoopers Spa in view of the contractual conditions shown in the relevant technical annex,*

*EXPRESSES*

*its preference for Deloitte & Touche Spa, whose bid obtained, for the reasons indicated in point 4 of this Recommendation, the highest score, according to the selection procedure conducted - subject to the supervision of the Internal Audit Function - by a suitable technical Committee established for the purpose, as indicated in point 3.*

**6. Declarations**

*The Board of Statutory Auditors, in accordance with article 16(2) of Regulation (EU) no. 537/2014, hereby declares that this Recommendation has not been influenced by third parties and that none of the clauses of the type shown in paragraph 6 of the aforementioned article 16 of the Regulation has been applied.*

*Sienna, 05 March 2019*

*BOARD OF STATUTORY AUDITORS*

*Elena Cenderelli  
Chair*

*Raffaella Fantini  
Standing auditor*

*Paolo Salvadori  
Standing auditor*

*Annex:*

*Contractual conditions of the Audit Firms subject to this Recommendation.*



## TECHNICAL ANNEX (CONTRACTUAL CONDITIONS)

### Identification of the Audit Firms

#### 1) Deloitte & Touche Spa

Registered Office in: Milan, Via Tortona no. 25 (Cap 20144)

Register of Audit Firms' Registration Number: Section A, no. 132587

VAT no.: 03049560166

- **Hours and fees proposed in the Offer**

**for Banca Monte dei Paschi di Siena - Parent Company:**

AUDIT SERVICES	Audit Hours and Fees	
	No. Hours	Fees
<b>Deloitte &amp; Touche Spa</b>		
Audit of annual financial statements (i)	12,580	805,145
Audit of consolidated financial statements (ii)	1,800	115,200
Periodic bookkeeping checks (iii)	260	16,640
Limited consolidated half-yearly audit and audit of the half-yearly financial statements of the Parent Company included in the consolidated accounts	2,100	134,400
Comfort Letters of 30 June and 31 December for the inclusion of the result for the period in the calculation of the Common Equity Tier 1 Capital	140	8,960
Limited audit of financial statements for determining the interim profit as at 31 March and 30 September to enable the inclusion of the interim result in the calculation of the Common Equity Tier 1 Capital	640	40,960
<b>Total</b>	<b>17,520</b>	<b>1,121,305</b>

**Notes:**

Pyramid of allocation of hours per professional figure: partner 20%, manager and specialist 40%, senior/assistant 40%.

(i) Figure includes the audit of foreign branches, declaration to the Fondo Nazionale di Garanzia.

(ii) Figure includes the Consolidated Non-Financial Declaration.

(iii) Figure includes the signature of tax returns.

The annual fees will be supplemented by out-of-pocket expenses (travel, accommodation, etc.), which will be charged as a final amount up to a maximum of 12%.

The supervisory contribution owed to Consob must also be added, pursuant to article 40 of Italian Law no. 724 of 23 December 1994, as subsequently amended and supplemented, where applicable, plus VAT.

Should the statutory audit assignment be conferred, not only by the Parent Company, but also by all companies which currently belong to the Montepaschi Group, the overall Fees would be €2,239,910 for a total of 34,999 hours.

- **Revision of the Fees**

*Deloitte & Touche envisages an annual adjustment equal to the percentage change in the ISTAT cost of living index (based on the month of June 2019) starting from the audit of the financial statements and the consolidated abridged half-yearly statements for the year 2021.*

*In addition, should there arise any exceptional circumstances which lengthen the times compared with the estimates in the proposal, such as:*

- *change to the structure and dimension of the Bank and its subsidiaries/branches;*
- *legislative changes which require the conducting of further significant activities by the auditor;*
- *the introduction of new accounting and/or auditing standards;*
- *the conducting of complex operations by the Bank or its subsidiaries/branches;*
- *the need to carry out further audit procedures, such as requests for information and documents by the Supervisory Bodies;*
- *any additional significant activities conducted in relation to the companies examined by other auditors,*

*the Firm shall estimate the greater number of hours only when this exceeds the threshold of 5% of the total hours considered in the proposal. Should this not be the case, D&T shall merely report the greater time spent and share it with the management, without requesting an increase to its fees. Conversely, should less time be required than that envisaged in the proposal, the considerations will be reduced proportionally, with no consideration of any percentage threshold.*

- **Other Contractual Conditions**

*Standard conditions for Deloitte & Touche Spa audit assignments.*

*The transition activities with respect to the outgoing auditor are the responsibility of Deloitte & Touche Spa.*

## 2) PricewaterhouseCoopers SpA

Registered Office in: Milan, Viale Monte Rosa no. 91 (Cap 20149)

Register of Audit Firms' Registration Number: Section A, no. 119466

VAT no.: 12979880155

- **Hours and fees proposed in the Offer**

**for Banca Monte dei Paschi di Siena - Parent Company:**

AUDITING SERVICES	Audit Hours and Fees	
	No. Hours	Fees
<b>PWC Spa</b>		
Audit of annual financial statements (i)	<b>11,240</b>	<b>759,848</b>
Audit of consolidated financial statements (ii)	<b>1,000</b>	<b>67,600</b>
Periodic bookkeeping checks (iii)	<b>900</b>	<b>60,840</b>
Limited consolidated half-yearly audit and audit of the half-yearly financial statements of the Parent Company included in the consolidated accounts	<b>1,500</b>	<b>101,400</b>
Comfort Letters of 30 June and 31 December for the inclusion of the result for the period in the calculation of the Common Equity Tier 1 Capital	<b>160</b>	<b>10,816</b>
Limited audit of financial statements for determining the interim profit as at 31 March and 30 September to enable the inclusion of the interim result in the calculation of the Common Equity Tier 1 Capital	<b>1,000</b>	<b>67,600</b>
<b>Total</b>	<b>15,800</b>	<b>1,068,104</b>

**Notes:**

Pyramid of allocation of hours per professional figure: partner 15%, manager and specialist 45%, senior/assistant 40%.

(i) Figure includes the audit of foreign branches, declaration to the Fondo Nazionale di Garanzia.

(ii) Figure includes the Consolidated Non-Financial Declaration.

(iii) Figure includes the signature of tax returns.

The annual fees will be supplemented by out-of-pocket expenses (travel, accommodation, etc.), which will be charged as a final amount up to a maximum of 5%.

The supervisory contribution owed to Consob must also be added, pursuant to article 40 of Italian Law no. 724 of 23 December 1994, as subsequently amended and supplemented, where applicable, plus VAT.

Should the statutory audit assignment be conferred, not only by the Parent Company, but also by all companies which currently belong to the Group, the overall Fees would be €2,149,149 for a total of 30,410 hours.

- **Revision of the Fees**

*PwC states that the final fees may vary, on the assumption of the following conditions, should exceptional circumstances arise or those that cannot be foreseen at the time of drafting of the proposal, which generate the need for a greater number of hours and/or different mix of professional figures compared with those envisaged. The greater times will be assessed by applying the same tariffs, per professional figure, indicated in the proposal, updated based on the changes which have occurred in the interim in the cost of living indices. The Group Audit Lead Partner will be responsible for bringing the specific circumstances and associated effects on the fees before the Manager in charge and/or Board of Statutory Auditors.*

*By way of example, the following cases may constitute cases of exceptional circumstances:*

- *significant changes to the structure and activities of the firms subject to the assignment;*
- *changes to the legislation, accounting and/or auditing standards and information systems that supervise the process for preparing financial information and the internal control systems, which entail a significant increase in the times necessary for carrying out the assignment;*
- *application of additional, different or amended accounting standards.*

*The method used to adjust the considerations also stipulates that:*

- *in the case of circumstances which require the non-recurring use of greater times than those envisaged, the communication indicated above will indicate the reasons for that change and the additional hours considered necessary, separately for each professional figure;*
- *in the case of circumstances which require the recurring use of greater times than those originally envisaged, the communication to the Manager in charge and/or Board of Statutory Auditors will indicate, in detail, the reasons for that change, the updated budget of the times needed for conducting the audit activities subdivided by each professional figure involved and the updated quote for the fees.*

*In the event of recurring variations, caused by the need to audit the financial statements of entities not currently within the scope indicated in the aforementioned communication, an indication shall be provided of the number of hours necessary for each professional figure, assessed using the same tariffs provided in the proposal. Equally, in the event of exceptional or unforeseeable circumstances which give rise to a reduction in the time necessary for conducting the audit, the fees will be reduced based on the same criteria.*

- **Other Contractual Conditions**

*Standard conditions for PricewaterhouseCoopers Spa audit assignments.*

*The transition activities with respect to the outgoing auditor are the responsibility of PricewaterhouseCoopers Spa.”*

Dear shareholders,

in consideration of the foregoing, with reference to the assignment of the statutory audit of the accounts of Banca Monte dei Paschi di Siena S.p.A. for the nine-year period between 2020 and 2028, you are invited:

*“to approve the proposal formulated, according to the terms and procedures indicated in the “Recommendation of the Board of Statutory Auditors of Banca Monte dei Paschi di Siena Spa in its capacity as Internal Control and Audit Committee: Conferral of the assignment of the statutory audit of the accounts 2020-2028” and in the relevant Annex which, based on the preference justified therein, provides for:*

- principally, to confer the assignment on the audit firm Deloitte & Touche Spa for an annual fee of Euro 1,121,305, corresponding to 17,520 hours for the statutory audit activities;*
- alternatively, should the aforementioned proposal fail to gain approval when put to the vote, to confer the assignment on the audit firm PricewaterhouseCoopers Spa for an annual fee of Euro 1,068,305, corresponding to 15,800 hours for the statutory audit activities;*
- to vest the Board of Directors with all necessary powers for the implementation of the shareholders’ resolution, including persons from outside appointed by it.”*

Milan, 11 March 2019

On behalf of the Board of directors

Stefania Bariatti

Chair of the Board of Directors