



BANCA D'ITALIA
EUROSISTEMA

Annual Accounts

Ordinary Meeting of Shareholders
Rome, 29 March 2018

124th FINANCIAL YEAR

2017

Financial Year

124th



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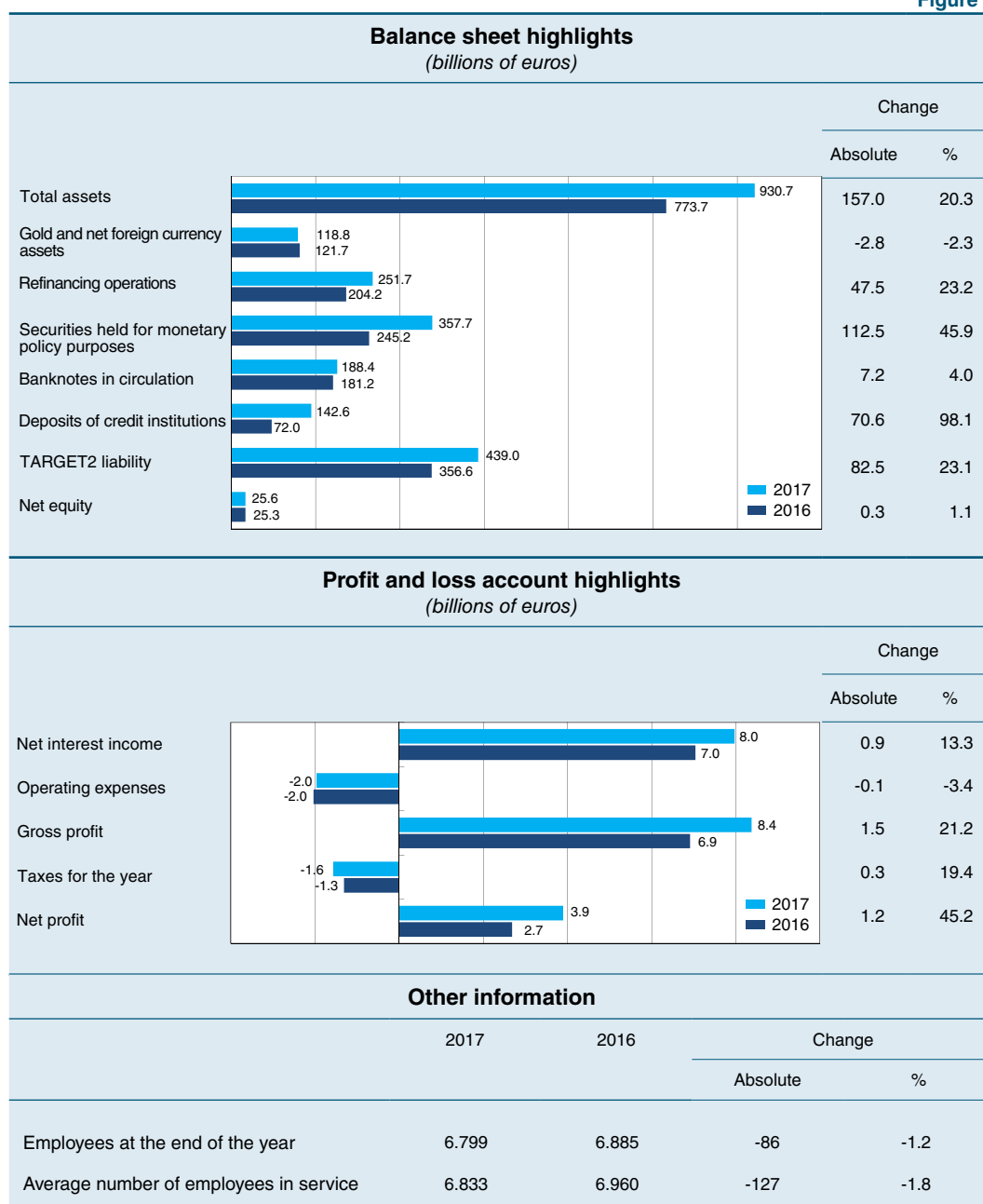
* Official Italian version.

MANAGEMENT REPORT AND ANNUAL ACCOUNTS

The Bank of Italy's annual accounts consist of the balance sheet, the profit and loss account and the notes to the accounts and are accompanied by the management report pursuant to Article 37 of the Bank's Statute. The draft annual accounts are transmitted to the Ministry of Economy and Finance in accordance with Article 117 of Royal Decree 204/1910 (Consolidated Law on the Bank of Issue).

Overview of the Bank of Italy's annual accounts

Figure 1



MANAGEMENT REPORT

The management report briefly describes the Bank of Italy's governance and contains information on assets, liabilities and profit and loss, which is designed to help readers better understand the activities of the Bank. It illustrates the main risks to which the Bank is exposed and the resources available.

The various items in the balance sheet underline some of the main tasks carried out by the Bank of Italy. The implementation of the monetary policy decisions taken at Eurosystem level is reflected in the securities purchased for monetary policy purposes, in lending to euro-area credit institutions and, on the liability side, in the latter's deposits with the Bank of Italy. Other securities are for investment purposes, including those held in relation to own funds. The management of Italy's official reserves, which includes gold, is reflected in claims and liabilities denominated in foreign currency. The item *Banknotes in circulation*, on the liability side, reflects the Bank of Italy's task of issuing currency, a role it shares with the other Eurosystem central banks. Liquidity is distributed across the euro area through the TARGET2 settlement platform developed and managed by the Bank of Italy together with other central banks; this generates intra-Eurosystem claims and liabilities in the Bank's balance sheet. The treasury services the Bank performs on behalf of the government are reflected in the general government deposits recorded on the liability side.

The income arising from these activities is entered into the profit and loss account together with the operating expenses connected to them and those incurred in relation to the other functions performed by the Bank, mainly in the domains of banking supervision and crisis resolution, economic research and statistical analysis, anti-money laundering, and customer protection in banking and finance.

Further information on the functions, the activities and the administration of the Bank can be found on its website (www.bancaditalia.it).

Governance

According to the Bank's Statute, the central decision-making bodies responsible for the annual accounts are the Meeting of Shareholders, the Board of Directors, the Governing Board and the Board of Auditors.

The Meeting of Shareholders appoints the members of the Board of Directors, approves the annual accounts and the distribution of the net profit, and appoints the internal auditing bodies and the independent auditing company.

The Board of Directors is chaired by the Governor and is responsible for the general administration, management oversight, and internal control of the Bank. Neither the members of the Board of Directors nor the shareholders may interfere in any matters or decisions relating to the exercise of the public functions assigned to the Governor and the Governing Board by law and by the Bank's Statute.

The Governing Board is a collegial body which adopts measures of external relevance concerning the exercise of the Bank's public functions, without prejudice to the Governor's powers and competencies as a member of the decision-making bodies of the European Central Bank (ECB). The Governing Board is made up of the Governor, the Senior Deputy Governor, and the three Deputy Governors.

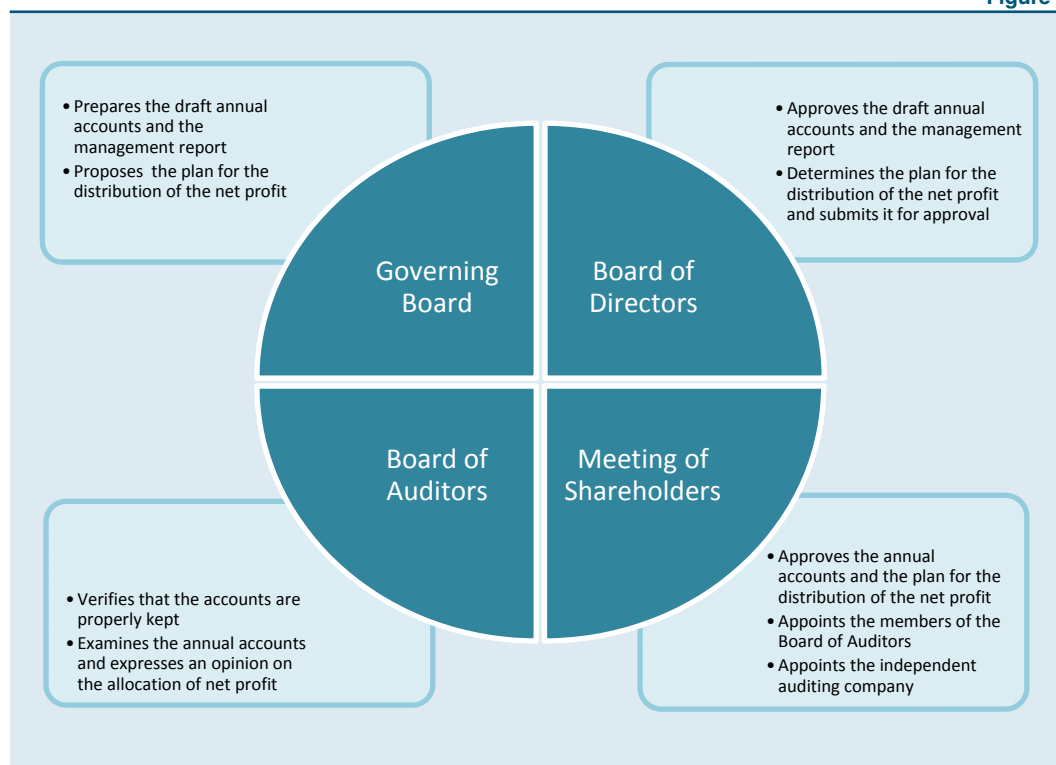
The Board of Auditors oversees the administration of the Bank to ensure compliance with the law, the Statute, and the General Regulation. It also verifies that the accounts are properly kept, examines the annual accounts, and expresses an opinion on the distribution of the net profit.

Annual accounts: the approval process

The draft annual accounts and the management report are approved by the Board of Directors, on a proposal of the Governing Board and having heard the Board of Auditors. They are then submitted to the Ordinary Meeting of Shareholders for approval, together with the Report of the Board of Auditors and that of the independent auditing company.

In accordance with Article 27 of the Statute of the European System of Central Banks (ESCB), the Bank's accounts are audited by an independent company, which issues a report on the annual accounts for the year (Article 42 of the Bank's Statute). The auditor appointed for the years 2016-2022 is BDO Italia. Figure 2 shows the tasks of the Bank's central decision-making bodies in relation to the annual accounts.

Figure 2



Internal control system and risk management

The Bank of Italy's organization is based on a functional approach in which each organizational unit is responsible not only for managing its own risks and the corresponding controls, but also for its own results in terms of effectiveness and efficiency. Specific types of risk (financial, accounting, operational, fiscal, IT, legal, and workplace health and safety) are also monitored by means of further targeted controls based on proportionality and on a comprehensive and transversal approach.

The internal audit function has the task of verifying the adequacy of the internal control system and of promoting continuous improvement to increase the effectiveness, efficiency and security of all operational processes. It works independently and is subject to external periodic review, in compliance with international standards. It also conducts reviews within the ESCB.

An advisory committee on internal auditing has been set up to strengthen the system of controls and the independence and objectivity of the internal audit function. It provides advice and support to the Board of Directors and the Governor on matters concerning the oversight of the internal audit system. It also issues opinions on internal audit policy and on the annual audit plan.

Financial risk

The Bank of Italy manages financial risk on an integrated basis, taking into account the links between the various risk factors.

Financial risk stems chiefly from the management of the foreign currency reserves and of the investment portfolio and from assets held for monetary policy purposes. The Statute of the ESCB provides that the risk attached to the latter assets may be shared with the other euro-area national central banks in proportion to their respective contributions to the capital of the ECB (see the box 'Rules on risk sharing in monetary policy operations').

The Bank of Italy measures financial risk using a methodology very similar to the one developed by the Eurosystem, with some adaptations to ensure it conforms more closely with the specific features of the Bank. The methodology proposes an analysis from two different perspectives: financial and accounting. The first approach assesses risk exposure without considering the accounting rules applied to the balance sheet items and evaluates its impact on the net equity of the Bank at current market values. The second approach, which is used for assessments relating to the size of the financial buffers when drawing up the annual accounts, instead estimates the impact of risk exposure on the profit and loss account and on net equity taking into consideration Eurosystem accounting rules. In both cases, it is a very conservative metric in that it provides an estimate of potential losses characterized by low probability and high impact (expected shortfalls). In addition to monitoring its risk position as a whole, the Bank performs controls and adopts mitigation measures for each type of risk (Table 1).

Table 1

| Financial risk map | | | |
|--------------------|---|---|---|
| Component | Type | Source of the risk | Measures for risk control and impact mitigation |
| Credit risk | <ul style="list-style-type: none"> ▪ Default risk ▪ Migration risk (1) ▪ Counterparty risk | <ul style="list-style-type: none"> ▪ Foreign exchange reserves ▪ Investment portfolio | <ul style="list-style-type: none"> ▪ A rigorous selection of investment instruments and counterparties ▪ Limits to individual and sectoral exposures, to be monitored daily |
| | | <ul style="list-style-type: none"> ▪ Monetary policy assets | <ul style="list-style-type: none"> ▪ Collateralization of monetary policy operations and stringent credit quality criteria for assets pledged as collateral and for issuers of monetary policy securities (2) ▪ Daily monitoring of collateral and use of risk control measures such as spreads, variation margins and limits ▪ For securities purchase programmes, specific limits applying to issues and issuers |
| Market risk | Risk of incurring losses owing to unfavourable changes in exchange rates and in the prices of gold and securities | <ul style="list-style-type: none"> ▪ Foreign exchange reserves ▪ Investment portfolio ▪ Monetary policy assets | <ul style="list-style-type: none"> ▪ Risk measurement and monitoring ▪ Revaluation accounts (3) ▪ Foreign exchange forward sales (for foreign currency assets held as investments of own funds, when deemed necessary) |
| Liquidity risk | Risk of incurring losses owing to the impossibility of selling assets at market value in a suitable time frame | <ul style="list-style-type: none"> ▪ Foreign currency reserves (4) | <ul style="list-style-type: none"> ▪ High-liquidity financial instruments ▪ Very prudent criteria for selecting instruments and counterparties ▪ Tight restrictions on maturity ▪ Restrictions on acquisitions of individual issues |

(1) Downgrade risk. – (2) Defined at Eurosystem level. The rules on assets eligible for use as collateral in Eurosystem refinancing operations have remained accommodative in 2017, allowing counterparties to tap a broad range of collateral. – (3) Revaluation accounts, which record the unrealized gains on assets valued at current exchange rates and prices, limit the impact on the year-end financial results of fluctuations in the prices and exchange rates of the assets to which the unrealized gains refer (see 'Legal basis, accounting policies and layout of the annual accounts'). Unrealized losses in excess of the corresponding revaluation accounts, instead, are recorded directly in the profit and loss account. – (4) Liquidity risk mainly affects foreign currency reserves, as these are traded more frequently compared with the investment portfolio.

Operational risk

Operational risk represents the risk that external events or inadequate procedures, information systems and human resources pose to the Bank's reputation, its operations and its capital. The Bank has in place a system for integrated operational risk management (ORM) in which each organizational unit assesses its own risk exposure in relation to the adequacy of existing safeguards. The Operational Risk Committee assists the Governing Board in promoting and coordinating measures and in monitoring their implementation and inclusion in the strategic planning process.

Operational risk is also quantified in terms of its potential financial impact using an internal advanced measurement approach (AMA) model similar to the ones that prudential regulations require banks to adopt. Starting last year, in line with international best practices, the Bank established a function for ethical compliance and the prevention of corruption; it also introduced more stringent rules on insider trading. In 2017 the Bank published its anti-corruption plan 2017-2019 (*Piano triennale di prevenzione della corruzione*, available only in Italian on the Bank of Italy's website).

Background to Eurosystem monetary policy

The movements in the balance sheet figures, the risks and the Bank's financial results are examined in relation to its institutional functions and especially to the decisions it takes within the context of Eurosystem monetary policy.

Decisions of the Eurosystem

In 2017, in a context of strengthening economic activity in the euro area but with inflation dynamics still not consistent with the monetary stability objective, the ECB Governing Council confirmed the expansionary monetary policy stance for the Eurosystem.

The interest rates on the main refinancing operations and on the marginal lending facility remained unchanged at 0.0 per cent and 0.25 per cent respectively; the interest rate on the deposit facility was kept at -0.40 per cent.¹ The Governing Council stated that it expects the official rates to remain at present levels for an extended period of time and well past the horizon of the asset purchases under the expanded asset purchase programme (APP).²

¹ The negative deposit facility interest rate also applies to bank deposits in excess of the minimum reserve requirement and to certain accounts held with Eurosystem national central banks (NCBs), including government deposits exceeding a certain threshold.

² The existing programmes encompass the third Covered Bond Purchase Programme (CBPP3), the Asset-Backed Securities Purchase Programme (ABSPP), the Corporate Sector Purchase Programme (CSPP), and the Public Sector Purchase Programme (PSPP). Under the PSPP, the ECB and the NCBs can buy, in the secondary market, euro-denominated securities issued by euro-area central governments with a residual life of 1 to 30 years and those issued by euro-area agencies and institutions. A decision published on 3 December 2015 extended the programme to include bonds issued by euro-area regional and local authorities.

The main refinancing operations and the three-month longer-term refinancing operations were conducted as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the last reserve maintenance period of 2019. In March 2017, the fourth and final allotment of the second series of the targeted longer-term refinancing operation (TLTRO II)³ took place, its aim being to further encourage lending to the real economy.

From April to December 2017 purchases under the APP amounted to a monthly €60 billion (€80 billion in the first three months of the year). At its October 2017 meeting the Governing Council decided to continue the asset purchases at a monthly pace of €30 billion until the end of September 2018, or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation consistent with its inflation aim. Moreover, the Eurosystem will reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of the programme, and in any case for as long as necessary.

RULES ON RISK SHARING IN MONETARY POLICY OPERATIONS

Generally, the risks associated with refinancing operations are shared. Under Article 32.4 of the ESCB Statute any losses associated with these operations can, by decision of the Governing Council of the ECB, be shared among the Eurosystem NCBs in proportion to capital key, i.e. their shares in the ECB's capital. The ESCB Statute states that all Eurosystem refinancing operations with bank counterparties must be based on adequate collateral in the form of the transfer of ownership or pledging of eligible financial assets. In accordance with the rules it established, the Governing Council waives the principle of risk sharing where certain types of collateral are accepted by the NCBs at their own discretion.

As the Governing Council has already established, the risks attached to securities purchased under the Securities Markets Programme (SMP), the third Covered Bond Purchase Programme (CBPP3), and the Corporate Sector Purchase Programme (CSPP) are shared among the NCBs according to their capital key. The risks associated with covered bonds purchased in the context of CBPP1 and CBPP2 are borne by the single NCBs. In the case of the PSPP, the risks relating to public securities are borne by the single NCBs, while those of securities issued by European institutions are shared according to the capital key. The risk sharing system also applies indirectly to all the securities purchased by the ECB for monetary policy purposes given that the NCBs hold its capital.¹

¹ ABSPP securities are reported solely in the ECB's accounts.

³ TLTRO II auctions have been held quarterly since June 2016; the interest rate applied to them varies within a range between the rate on the main refinancing operations and the rate on the deposit facility prevailing at the time of allotment, based on the increase in loans granted by each counterparty to firms and households (excluding loans for house purchase), as recorded over a given time period within the horizon of the operation.

Overview of Eurosystem monetary policy

In 2017 the Eurosystem's exposure to the counterparties participating in refinancing operations increased on the previous year, mainly owing to the latest TLTRO II allotment. The volume of refinancing operations outstanding at the end of the year rose from €595.9 billion to €764.3 billion; the portion represented by longer-term refinancing operations increased from 93.4 per cent to 99.5 per cent owing to the higher share of TLTRO II operations.

The portfolio of securities held for monetary policy purposes also increased, from €1,654 billion to €2,386 billion, mainly as a result of the considerable purchases of public sector securities made under the PSPP (Figure 3).

At 31 December 2017, the securities held by the NCBs through the programmes subject to risk sharing amounted to €639 billion (€472.5 billion at the end of 2016), while those for which the risk is borne by the individual NCBs totalled €1,518.7 billion. Securities held by the ECB amounted to €228.4 billion.

Key developments in the Bank's annual accounts

Assets

Compared with 2016, the Eurosystem's expansionary monetary policy has led to further, significant growth in the Bank of Italy's balance sheet (up by 20.3 per cent), which had already reached a very high level at the end of the previous year (Figure 4).⁴

Similar to what happened at Eurosystem level, the Bank of Italy continued its asset purchases for monetary policy purposes, especially under the PSPP (Figure 5); it also increased its lending to credit institutions as an effect of the liquidity granted through the last TLTRO II allotment.

The country's official reserves consist of gold and claims on non-euro-area residents denominated in foreign currency; they are held by the Bank of Italy under the Treaty on the Functioning of the European Union and the Statute of the ESCB.⁵ Compared with last year, the value of the gold reserves was virtually stable at €85.3 billion (€86.6 billion at end-2016). Net assets vis-à-vis euro-area residents and non-residents denominated in foreign currency – for which the

⁴ Assets are reclassified as follows: *Foreign currency assets* include securities and other assets denominated in foreign currency (Items 2 and 3); *Portfolio of financial assets* includes bonds, equity shares and other participating interests and other assets denominated in euro and foreign currency allocated to Items 4, 6, 7.2, 8 and 11.2 on the asset side as well as participating interest in the ECB (Item 9.1 on the asset side); and *Intra-Eurosystem claims* include those under Items 9.2, 9.3 and 9.4 on the asset side.

⁵ Management of the official reserves makes it possible to service the Italian Republic's foreign currency debt and meet its commitments to international organizations such as the International Monetary Fund (IMF). In addition, the official reserves are an integral part of the Eurosystem's reserves: their overall level and proper management help to safeguard its credibility. The foreign currency reserves are managed primarily with the aim of guaranteeing high levels of liquidity and security while also considering long-term expected yield. The Bank also manages a part of the reserves transferred to the ECB in accordance with the guidelines laid down by the Governing Council.

percentage composition is given in Figure 6 – totalled €33.6 billion at end-2017 (€35.1 billion at end-2016). The contraction recorded during the year was due to the depreciation of the main foreign currencies, especially the US dollar, against the euro.

Figure 3

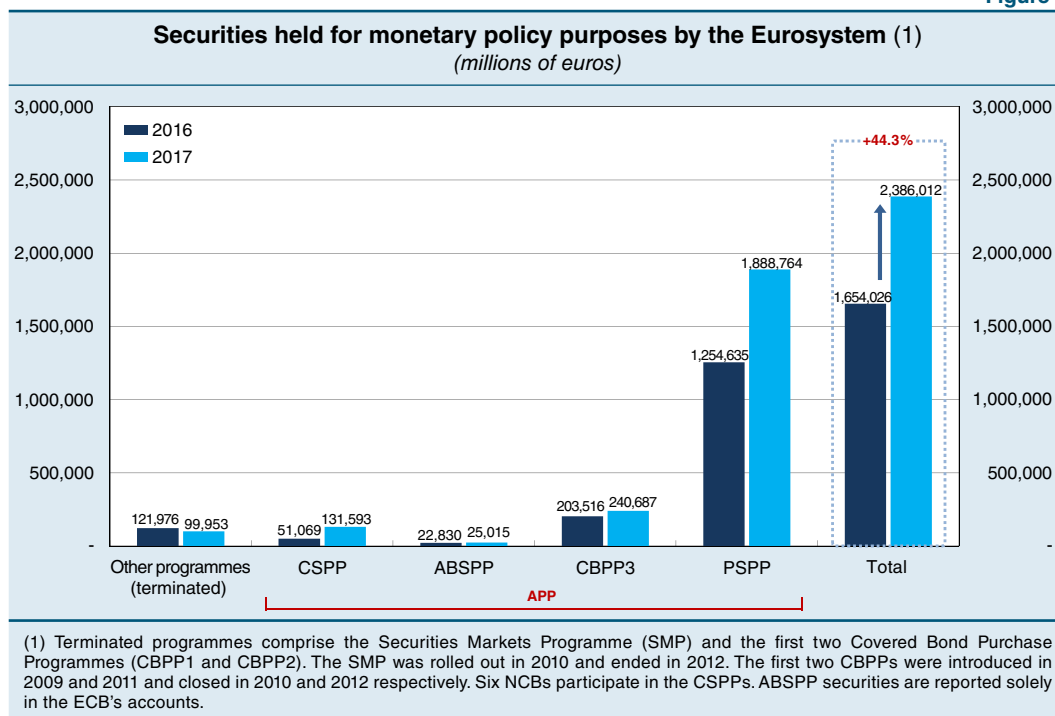


Figure 4

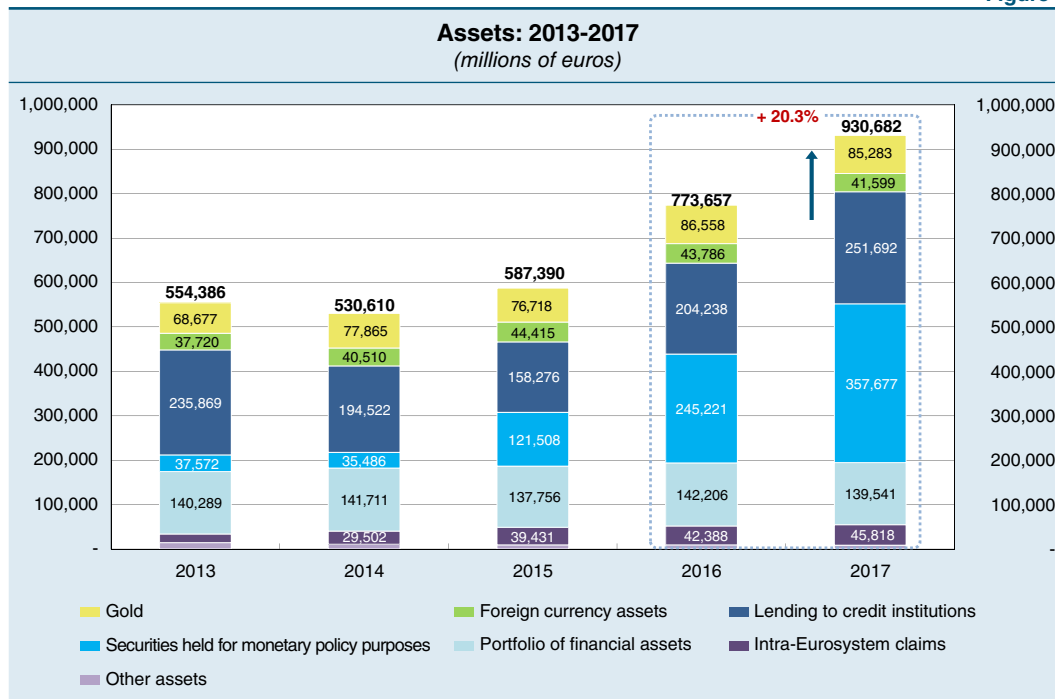


Figure 5

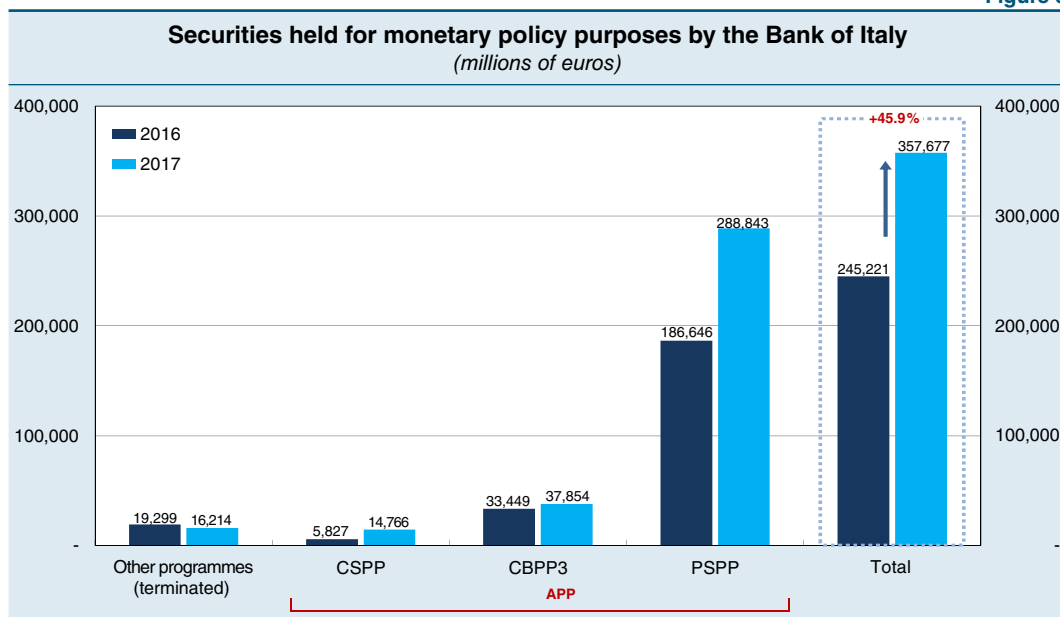


Figure 6

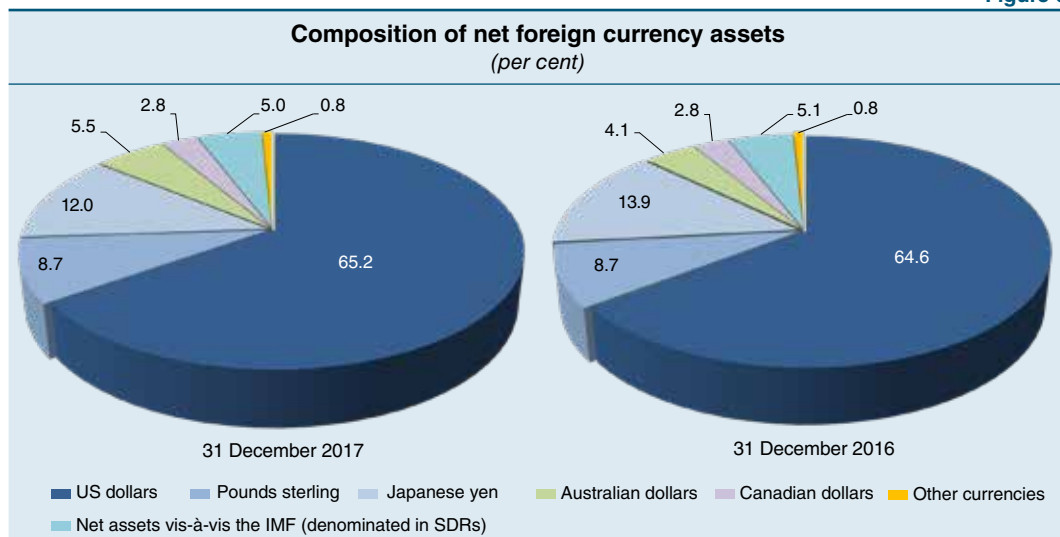


Table 2

Composition of the financial portfolio (1)
(millions of euros)

| | 31.12.2017 | 31.12.2016 | Change |
|---|----------------|----------------|---------------|
| Government securities | 124,500 | 127,971 | -3,471 |
| Other bonds | 3,003 | 3,034 | -31 |
| Equity shares and other participating interests | 9,227 | 7,155 | 2,072 |
| ETFs and shares/units of UCITS | 1,393 | 2,641 | -1,248 |
| Total | 138,123 | 140,801 | -2,678 |

(1) In compliance with the ban on the monetary financing of member states and euro-area public institutions, the securities of public-sector issuers are not acquired at issue. No investments are made in shares of banks and insurance companies. *Other bonds* are those issued by international organizations and by corporates.

The securities held for investment purposes amounted to €138.1 billion at the end of 2017 (€140.8 billion in 2016; Table 2).

The investment portfolio is mainly composed of bonds, especially Italian and other euro-area government securities; the part invested in equities consists primarily of listed shares. In 2017, the Bank has continued to restructure its share portfolio to bring it into line with the relevant benchmarks.

INVESTMENTS NOT RELATING TO MONETARY POLICY

At the end of 2017, the Bank's net investments not relating to monetary policy, which are governed by a specific agreement (Agreement on Net Financial Assets – ANFA), totalled €120.5 billion, compared with €124.1 billion at the end of 2016. ANFA is an agreement on net financial assets (NFAs) between the national central banks of the euro-area countries and the ECB. The agreement sets rules and limits that NCBs must follow to ensure that purchases of financial assets connected with their national functions do not interfere with the conduct of the single monetary policy. NFAs are calculated as the algebraic sum of the balance sheet financial assets that are not directly related to monetary policy, including gold, net foreign currency assets and securities denominated in euros, net of non-monetary-policy liabilities.

Further information on net financial assets can be found on the website of the ECB, which publishes a monthly financial statement and the annual average amount of NFAs for each NCB and for the ECB.

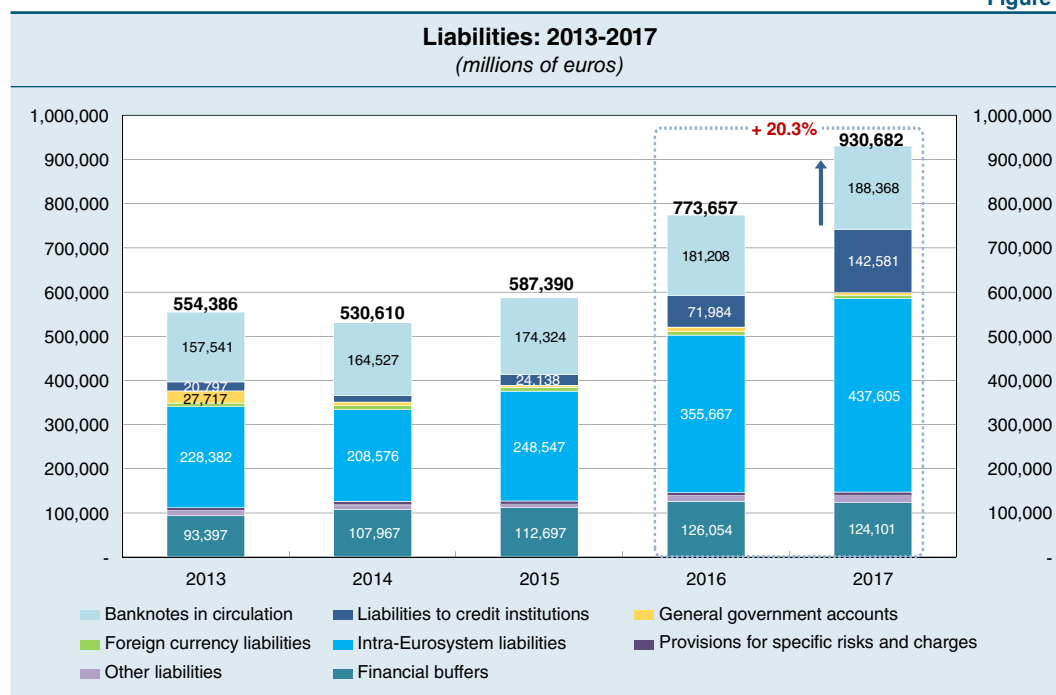
The Bank also manages the investments of the defined-contribution pension fund for staff hired starting on or after 28 April 1993. The fund constitutes a separate asset for administrative and accounting purposes pursuant to Article 2117 of the Civil Code. Its investments and earmarked funding contributions are included in the Bank's balance sheet, under *Other assets* and *Other liabilities* respectively. Investments are made observing benchmarks. At 31 December 2017 the fund's total assets and corresponding liabilities in the Bank's balance sheet amounted to €0.5 billion.

Liabilities

On the liability side (Figure 7),⁶ there was a significant increase in the Bank's liabilities towards credit institutions and intra-Eurosystem liabilities in connection with the TARGET2 payment system; the amount of banknotes in circulation continues to rise.

⁶ Liabilities are reclassified as follows: *Intra-Eurosystem liabilities* include items 9.1, 9.2 and 9.3 on the liability side; *Financial buffers* include capital and reserves, the provision for general risks, the damage insurance provision and the revaluation accounts; the net profit for the year and the provision for specific risks and expenses are included under *Other liabilities*.

Figure 7



Since March 2015, when the APP was launched, the Bank of Italy's debit balance with the TARGET2 payment system has widened, mainly as a result of the outflows connected to the purchases of foreign securities by Italian investors. Since last spring the TARGET2 balance has stabilized at around €427 billion on average. It stood at €439 billion at the end of the year. To this contributed the stronger demand for Italian securities and the current account surplus in the balance of payments. The creation of liquidity through monetary easing has started to affect credit institutions' deposits (Figure 8), which grew from €72 billion at end-2016 to €142.6 billion at end-2017.

The total value of euro banknotes in circulation⁷ is allocated within the Eurosystem according to the banknote allocation key.⁸ The total amount allocated to the Bank of Italy is shown under the liability item *Banknotes in circulation*. The difference between the value of the banknotes allocated to the Bank of Italy and that of the banknotes the Bank actually puts into circulation gives rise to remunerated intra-Eurosystem assets (liabilities) if positive (negative), which are recorded under *Net claims (liabilities) relating to the allocation of euro banknotes within the Eurosystem*. The total value of banknotes in circulation assigned to the Bank of Italy has been rising constantly in the last five years owing to the overall growth in banknote circulation at Eurosystem level. Conversely, the share of banknotes actually put into circulation by the Bank has diminished gradually. As a consequence, there has been

⁷ The amount of banknotes in circulation is equal to the difference between the notes issued and those withdrawn from circulation.

⁸ The ECB is allocated 8 per cent of the total value of euro banknotes in circulation while the remaining 92 per cent is allocated to the NCBs according to their weightings in the capital of the ECB (see 'Legal basis, accounting policies and layout of the annual accounts').

an increase in the Bank's remunerated intra-Eurosystem claims on the asset side (Figure 9; see 'Notes on the items of the balance sheet' – *Banknotes in circulation*).

Figure 8

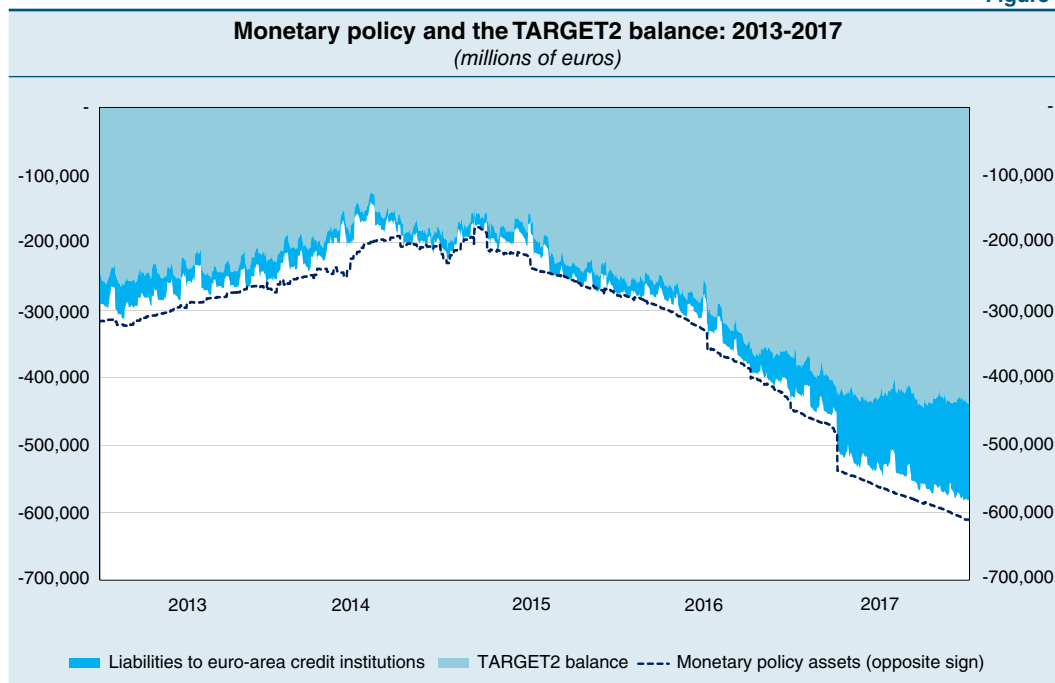
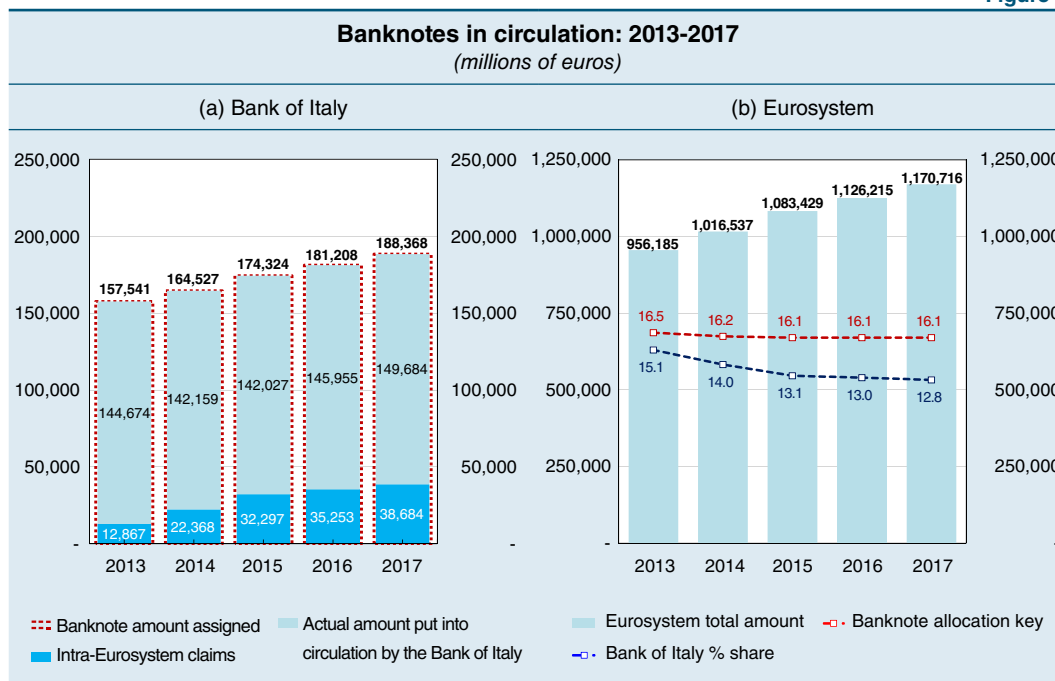


Figure 9



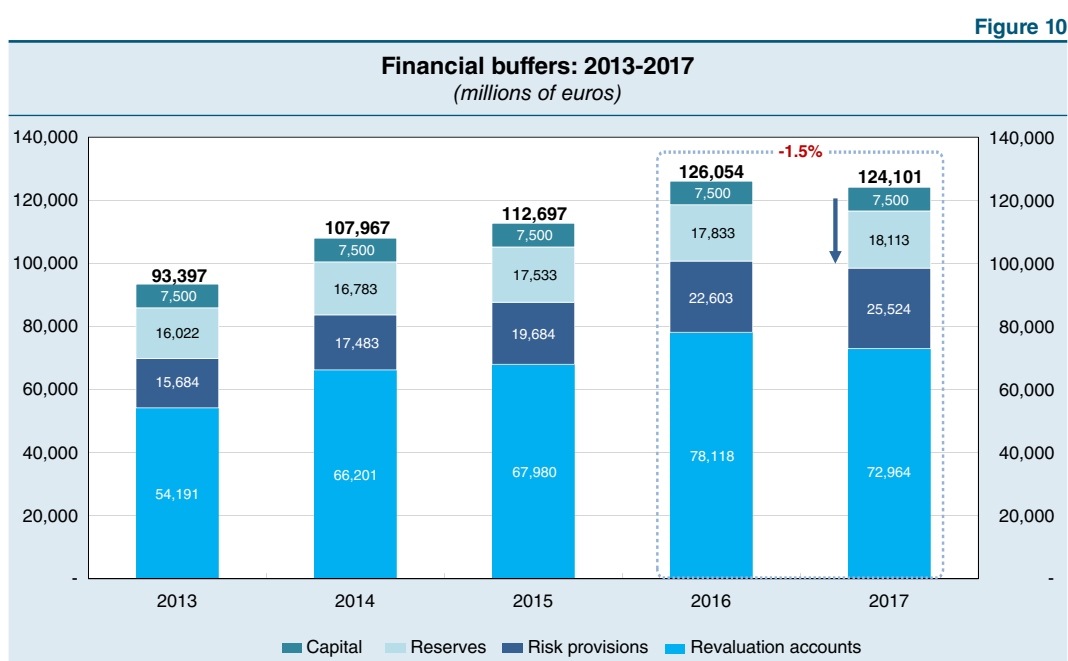
The average stock of banknotes put into circulation in 2017 amounted to €143,499 million, up from €139,895 million in 2016, an increase of 2.6 per cent compared with 4.3 per cent for the euro area.

Financial risk

At the end of 2017 the overall financial risks, measured according to the accounting perspective, remained high owing to the increase in the size of monetary policy assets, notwithstanding the improvement in the credit ratings of government securities issuers.

Financial buffers

Changes in the Bank's financial buffers in the period 2013-17 (Figure 10) mainly reflect movements in the revaluation accounts, which in turn are affected by the price of gold.⁹ Excluding this component, the other financial buffers have risen largely as a result of transfers to the provision for general risks to cover the risks assumed by the Bank following the expansion of monetary policy operations.



The Bank's capital

Law 5/2014 reformed the structure of the Bank's capital establishing, among other things, a threshold of 3 per cent on direct and indirect shareholdings. Shares held above this limit do not carry voting rights; the relative dividends are allocated by law to the Bank's statutory reserves. In the period between the introduction of

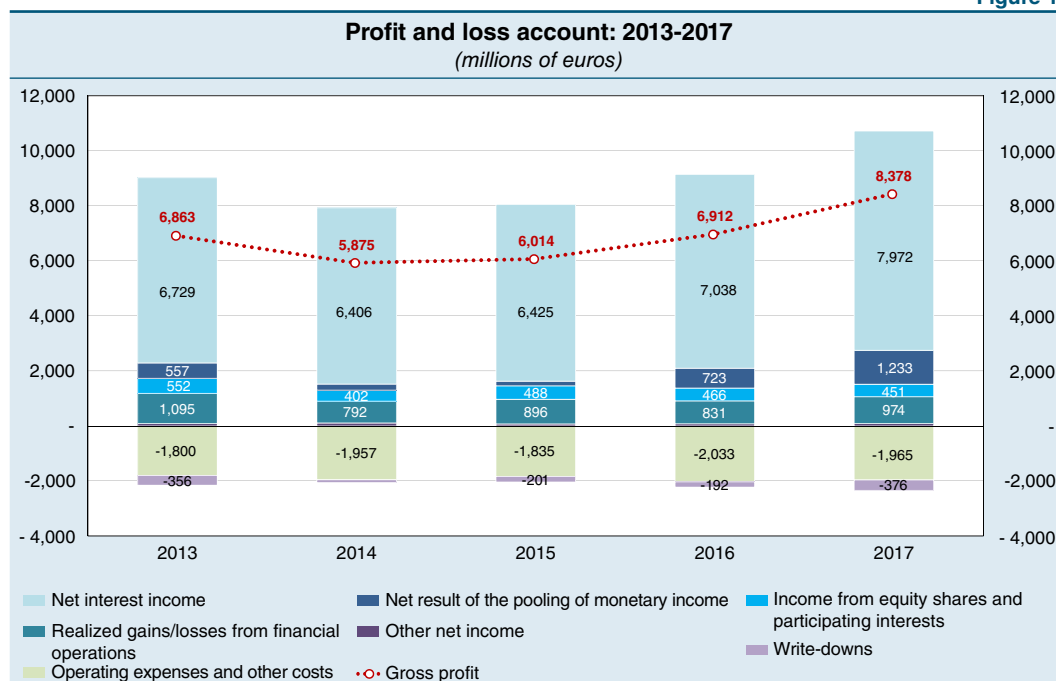
⁹ The Bank's financial buffers consist of capital, reserves, provisions, especially the provision for general risks, and the revaluation accounts. Allocations to reserves are made at the time of the distribution of net profit; allocations to provisions are transferred out of gross profits to offset the risks associated with the different sectors of operation on the basis of an overall evaluation of adequacy. The revaluation accounts include unrealized gains on gold, foreign currencies and securities not entered in the profit and loss account under income. These balances are used to offset the impact of possible unfavourable fluctuations in prices and/or exchange rates and therefore constitute a first capital buffer against the risks to which the Bank is exposed (see 'Legal basis, accounting policies and layout of the annual accounts').

the reform and 16 February 2018, the last date by which a shareholder could acquire shares with the right to dividends for 2017, 10 30.65 per cent of the capital was transferred. The three largest shareholders sold a combined 27.02 per cent of the capital. There are now 124 shareholders, of which 85 are new (6 insurance companies, 8 pension funds, 9 social security institutions, 20 banking foundations and 42 banks). At the above date, shareholdings that still exceeded the ceiling amounted to around €2,690,950,000 in nominal value.

The profit and loss account

Over the period 2013-17, the growth of the Bank's balance sheet, the changes in the composition of the assets and liabilities and the path of average interest rates were all reflected in the gross profit (Figure 11).¹¹ The decrease in net interest income recorded in 2014 is due to the reduction in the amount of monetary policy-related securities pertaining to programmes that are no longer active (SMP, CBPP1 and CBPP2). Over the last three years purchases under the APP, especially those relating to the PSPP, have supported net interest income despite a significant decline in average interest rates.

Figure 11



¹⁰ This only applies to shareholders that owned shares at the end of the fortieth day before the first notice convening the Meeting of Shareholders (Article 38 of the Statute).

¹¹ The profit and loss items are reclassified as follows. *Net interest income* includes interest income and interest expense under Items 1 and 6.1 of the profit and loss account. *Income from equity shares and participating interests* includes dividends and income from ETFs and shares/units of UCITS (Items 4, 6.2 and 6.5). *Gain/losses on financial operations* include income and expense under Items 2.1 and 6.3. *Write-downs* are entered under Items 2.2 and 6.4. *Other net income* includes the amounts under Items 3, 7, and 8. *Operating expense and other costs* include the amounts under Item 9.

In line with these developments, the year 2017 closed with a net profit of €3,895 million compared with €2,683 million in 2016. The gross profit before tax and transfers to the provision for general risks was equal to €8,378 million (€6,912 million in 2016).

Net interest income was up significantly with respect to the previous year (by €934 million). The increase was due mainly to interest income on PSPP securities, only partly offset by interest expense on TLTRO II operations (see ‘Notes on the items of the profit and loss account’ – *Net interest income*).

The net result arising from the redistribution of monetary income was once again positive and up by €510 million, reflecting the higher rate of growth in monetary income of other Eurosystem central banks and the consequent reallocation to the Bank of Italy.

Realized gains from financial operations grew by €143 million, mainly owing to the sale of UCITS, while income from equity shares and participating interests decreased by €15 million. Write-downs increased by €184 million on the previous year, mainly owing to the appreciation of the euro.

Operating expenses and other costs amounted to €1,965 million, down by 3.4 per cent compared with the previous year (see ‘Operating expenses and other costs’).

The provision for general risks, which, under the Statute, covers the Bank’s overall risk exposure, increased by €2,920 million (the same amount of 2016) to continue the gradual adjustment of financial buffers, taking into account the overall risk exposure and the expansion of the balance sheet due to the gradual implementation of monetary policy decisions regarding the purchases of private and public sector securities.

Taxes for the year amounted to €1,563 million (€1,309 million in 2016).

Out of the net profit of €3,895 million, €150 million were allocated to the ordinary reserve, shareholders were assigned a dividend of €340 million, €40 million were allocated to the special item for stabilizing dividends and €3,365 million were transferred to the State (see ‘Proposals of the Board of Directors’). The amount of €122 million, representing the dividends on shares exceeding the 3 per cent limit, was allocated to the ordinary reserve pursuant to Article 3.4 of the Statute (see ‘The Bank’s capital’).

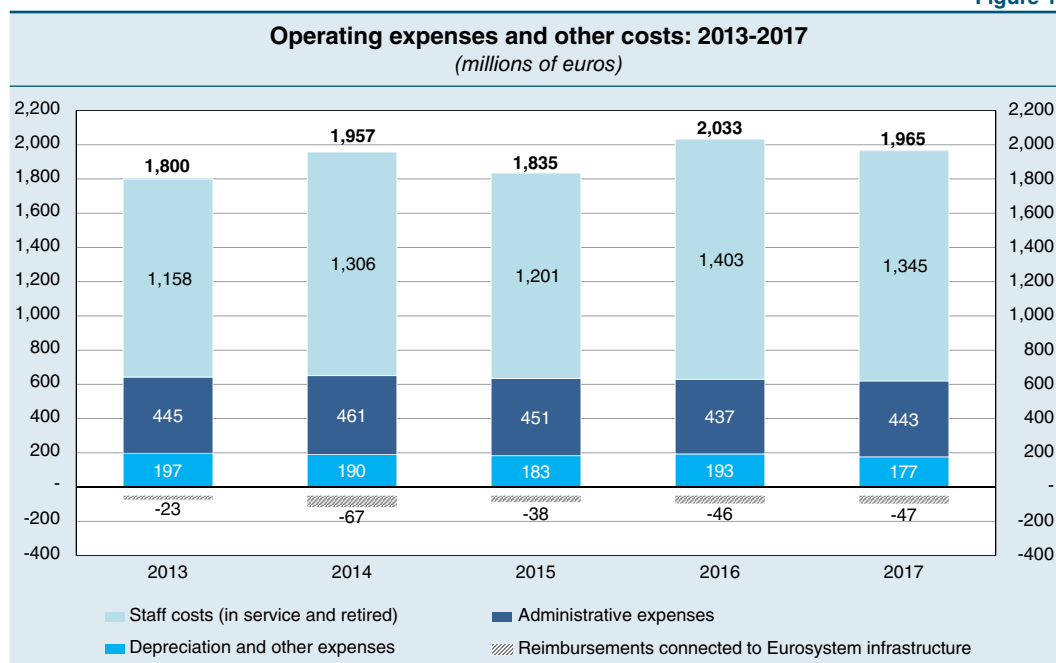
Operating expenses and other costs

In 2017 operating expenses and other costs were down from €2,033 million to €1,965 million. Their trend and composition are detailed in Figure 12.

The decrease was mainly due to a reduction in the item *Transfers from/to provisions for staff severance pay and pensions, contributions to the supplementary pension fund and other expenses* included under staff costs. No allocations to the staff pension and severance pay fund were necessary in 2017, compared with €123 million in

2016. Allocations totalling €77 million were instead made in relation to the early retirement plan (compared with €81 million in 2016; see ‘Other information’).

Figure 12



Administrative expenses,¹² which in 2017 represented 23 per cent of total costs, were up slightly compared with 2016 (from €437 million to €443 million) owing to higher costs for the purchase of raw materials for banknote production, security services and transport of valuables. This effect was partly offset by the reduction of 5 per cent in other expenses (see ‘Notes on the items of the profit and loss account’ – *Expenses and sundry charges*).

Hardware and software infrastructure costs accounted for about 24 per cent of the total. Among the various IT projects carried out in 2017 is the further development of the TARGET2 system. As regards the projects currently under way at Eurosystem level, the Bank of Italy is involved in the consolidation of the TARGET2-Securities and TARGET2 systems, including the TARGET instant payment settlement system (TIPS). At domestic level, the Bank is involved in several IT projects seeking to strengthen cooperation with other authorities and improve the quality of the services it provides to the public.

THE COSTS INCURRED FOR EUROSYSTEM INFRASTRUCTURE

Together with some of the other national central banks, the Bank of Italy provides specific technological infrastructures to the Eurosystem. The costs incurred by the Bank are included under administrative expenses and staff costs and are reimbursed in full by the Eurosystem. The reimbursements are recorded

¹² *Administrative expenses* incorporate a wide range of costs (such as raw materials and materials for banknote production, security services and transport of valuables, hardware and software infrastructure, and property maintenance).

under *Other income* and amounted to €47 million in 2017 (€46 million in 2016; see Figure 12).

As a participating central bank in the Eurosystem infrastructure, the Bank bears the corresponding costs in proportion to its share of the ECB's capital; such costs are under *Administrative expenses* and amounted to €24 million in 2017 (€21 million in 2016).

Expenditure on property management and maintenance decreased slightly compared with 2016. Several initiatives on security were launched in 2017, especially to revamp the security systems in place in the Bank's branches and head office and to extend video surveillance to the entire cash handling process. Property maintenance continues both at the head office and in the branches.

Depreciation and other expenses have generally decreased over the last five years.

The Bank's staff

At 31 December 2017 the Bank's employees numbered 6,799, of which 4,536 working at the head office and 2,263 at branch offices. The total number of staff decreased by 86 employees compared with the end of 2016. There were 207 new appointments, of which about 53 per cent hold a university degree. Terminations totalled 293 (down by 18.4 per cent compared with 2016), of which 250 were part of an early retirement scheme offered to staff affected by the reorganization of the branch network and by the new personnel classification system. As at end-2017, the managerial area accounted for 46.8 per cent of total staff, a share that is virtually unchanged compared with 2016 (45.4 per cent). The staff's average age is 48.9 years and 36.6 per cent of the Bank's employees are women.

Table 3

| Composition of the Bank's staff | | | | | | | | | | |
|---|--------------|--------------|--------------|--------------|--------------------|--------------|--------------|--------------|--------------|--------------------|
| AREAS (1) | 31.12.2017 | | | | | 31.12.2016 | | | | |
| | Men | Women | Total | At branches | At head office (2) | Men | Women | Total | At branches | At head office (2) |
| Managerial Area | 2,074 | 1,109 | 3,183 | 720 | 2,463 | 2,038 | 1,085 | 3,123 | 710 | 2,413 |
| <i>of which: Managing Directors and Principal Directors</i> | 77 | 11 | 88 | 13 | 75 | 73 | 12 | 85 | 14 | 71 |
| Operational Area | 2,220 | 1,358 | 3,578 | 1,543 | 2,035 | 2,331 | 1,393 | 3,724 | 1,607 | 2,117 |
| Contract workers | 15 | 23 | 38 | – | 38 | 15 | 23 | 38 | – | 38 |
| Total | 4,309 | 2,490 | 6,799 | 2,263 | 4,536 | 4,384 | 2,501 | 6,885 | 2,317 | 4,568 |

(1) With the reform of the personnel classification system, in effect as of 1 July 2016, Bank employees are separated into two areas: managerial and operational. – (2) Includes members of the staff assigned to the Financial Intelligence Unit (UIF) and to the representative offices abroad and those seconded to other organizations or on leave of absence.

During the year, 5,010 members of staff received training, accounting for 74 per cent of the total (82 per cent including on-the-job training) and equal to about 217,000 hours of training, or 43 hours per person.

Other information

Banknote production and circulation

In 2017, the Bank produced 907 million banknotes in denominations of €20 and €50 for the Europa series, and an additional 30 million as part of the pilot production of the new €100 and €200 notes. The total production volume of 937 million banknotes was in line with the quota assigned to the Bank of Italy. The quota was met despite both the reduction in staff numbers and the Bank's strong focus on research and development for the production of high-denomination notes in its capacity as the Eurosystem's R&D main test-print centre, which has become a priority following the ECB's decision to stop issuing €500 banknotes around the end of 2018. Production is expected to remain at high levels in 2018.

In December 2017 the Board of Directors approved the reorganization of the banknote production function. This was prompted by the developments under way at euro-area level,¹³ which are characterized by a strong push to cut costs and reduce production needs. The new configuration strengthens the role of the Bank's printing works within the in-house segment of the euro-area banknote production sector, both by revamping its banknote development and production activities and by enhancing productivity and efficiency. The reorganization is effective from March 2018 and is accompanied by a new work organization and early retirement incentives for Bank employees who meet certain age and contribution requirements. The regulatory and financial aspects of the reform were set out in a trade union agreement signed in December 2017 that adjusted entry-level wages and salaries for newly hired staff in the technical-operational stream in order to contain staff wages and salaries over time.

The Bank's branches play an important role in meeting the demand for banknotes and in ensuring that the quality of those in circulation remains high. During the year 2.6 billion banknotes were put into circulation, for a total value of €91 billion. The return flow to the Bank amounted to 2.4 billion banknotes, worth €87.2 billion. Some 2.4 billion notes were checked and 0.9 billion withdrawn from circulation.

The branch network

The Bank's branches continue to be involved in a number of areas, including the protection of banks' customers and financial education, prudential supervision of non-bank financial intermediaries, assessment of credit claims eligible for monetary policy operations, and monitoring of professional cash handlers. The year 2017 was the first in which the four new panels of the Banking and Financial Ombudsman and their relative technical secretariats were fully operational at the Bank's branches

¹³ Starting 1 January 2015 the Eurosystem's euro banknote production is organized according to the Eurosystem Production and Procurement System (EPPS) and is based on two pillars, the first one represented by NCBs using in-house printing works (public sector model) and the second one represented by NCBs relying on the market for the supply of banknotes (private sector model). As regards the public sector segment of banknote production, each NCB has committed itself to enhancing, over a multi-year horizon, the efficiency of the production process with a view to bringing unit costs in line with those of private sector providers.

in Bari, Bologna, Palermo and Turin. In December 2016, they joined those already operating in Milan, Naples and Rome.

By the end of 2018, the last ten temporary territorial service units (TSUs)¹⁴ will be closed. They were set up in 2015 in accordance with the plan approved that year by the Board of Directors to ease the transition period following the closure of 22 branches. Following the implementation of the plan, the branch network now consists of 39 branches throughout Italy, down from 97 in early 2008, before the reorganization began.

Environmental policy

The Environmental Policy Document sets out the Bank's environmental policy objectives: sustainable use of resources, optimal waste management, sustainable mobility, 'green' procurement, and the promotion of an environmentally friendly culture. The Environment Report describes the Bank's ecological footprint and the main measures it adopted. Both documents are available on the Bank's website.

Disclosure of relations with subsidiary and associate companies

The Bank of Italy is the sole shareholder in Società Italiana di Iniziative Edilizie e Fondiarie (SIDIEF), a real estate company whose main activity is the management and rental of its own properties. The Bank directs and coordinates the activities of the subsidiary, principally with regard to its corporate strategy, but it does not interfere in areas of operational autonomy.

A special agreement regulates relations between the Bank of Italy and SIDIEF, sets out the rental policies applying to employees and third parties, and lays down the financial terms and conditions by which the Bank may rent out property from SIDIEF for its own purposes. In 2017, total rentals to SIDIEF amounted to about €1 million.

In 2017 the Bank of Italy acquired a 0.50 per cent participating interest in Europafi, the Banque de France's paper manufacturing subsidiary. Based on shareholders' agreements, the Bank of Italy, together with other Eurosystem NCBs, exercises control over Europafi according to the rules on public contracts awarded to controlled legal persons set out in Directive 2014/24/EU ('in-house providing'). As a result, the Bank of Italy purchases from Europafi a portion of the watermarked paper it uses. This should lead to smoother procurement processes, lower costs and greater financial benefits, which translate into more favourable price conditions for the Bank of Italy compared with those obtained through open tenders. The direct award of contracts to Europafi is not sufficient to meet the Bank of Italy's demand for watermarked paper, unlike for other NCBs. However, the agreement improves the efficiency of the Bank of Italy's printing works, in line with a broader cost-containment strategy for in-house banknote printing and against a backdrop of greater emphasis on cost effectiveness.

¹⁴ The first 12 TSUs were closed in July 2016.

ANNUAL ACCOUNTS

BALANCE SHEET

| ASSETS | NOTE | Amounts in euros | |
|--|------|------------------------|------------------------|
| | | 31.12.2017 | 31.12.2016 |
| 1 GOLD AND GOLD RECEIVABLES | [1] | 85,283,376,219 | 86,557,643,700 |
| 2 CLAIMS ON NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY | [1] | 40,790,095,316 | 42,497,728,952 |
| 2.1 Claims on the IMF | | 9,480,776,424 | 10,163,468,189 |
| 2.2 Securities | | 27,240,812,570 | 28,519,589,578 |
| 2.3 Current accounts and deposits | | 4,012,440,242 | 3,315,721,507 |
| 2.4 Reverse operations | | 50,860,314 | 493,315,420 |
| 2.5 Other claims | | 5,205,766 | 5,634,258 |
| 3 CLAIMS ON EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY | [1] | 809,230,163 | 1,288,209,172 |
| 3.1 Financial counterparties | | 800,754,188 | 1,288,209,172 |
| 3.1.1 Securities | | 112,256,868 | 292,835,163 |
| 3.1.2 Reverse operations | | – | 47,433,830 |
| 3.1.3 Other claims | | 688,497,320 | 947,940,179 |
| 3.2 General government | | 6,794,335 | – |
| 3.3 Other counterparties | | 1,681,640 | – |
| 4 CLAIMS ON NON-EURO AREA RESIDENTS | | 1,560,024,080 | 1,554,356,308 |
| 4.1 Claims on EU central banks | | – | – |
| 4.2 Securities | [4] | 1,559,213,529 | 1,553,827,612 |
| 4.3 Other claims | | 810,551 | 528,696 |
| 5 LENDING TO EURO-AREA CREDIT INSTITUTIONS RELATING TO MONETARY POLICY OPERATIONS | [2] | 251,692,120,000 | 204,238,460,000 |
| 5.1 Main refinancing operations | | 942,400,000 | 16,050,000,000 |
| 5.2 Longer-term refinancing operations | | 250,749,720,000 | 188,188,460,000 |
| 5.3 Fine-tuning reverse operations | | – | – |
| 5.4 Structural reverse operations | | – | – |
| 5.5 Marginal lending facility | | – | – |
| 5.6 Credits relating to margin calls | | – | – |
| 6 OTHER CLAIMS ON EURO-AREA CREDIT INSTITUTIONS | [3] | 45,893,215 | 35,260,222 |
| 7 SECURITIES OF EURO-AREA RESIDENTS | | 431,800,797,198 | 327,388,058,761 |
| 7.1 Securities held for monetary policy purposes | [2] | 357,677,002,655 | 245,220,714,306 |
| 7.2 Other securities | [4] | 74,123,794,543 | 82,167,344,455 |
| 8 GENERAL GOVERNMENT DEBT | [4] | 13,947,423,314 | 14,080,834,910 |
| 9 INTRA-EUROSYSTEM CLAIMS | [5] | 47,151,049,469 | 43,720,535,794 |
| 9.1 Participating interest in the ECB | | 1,332,644,970 | 1,332,644,970 |
| 9.2 Claims arising from the transfer of foreign reserves to the ECB | | 7,134,236,999 | 7,134,236,999 |
| 9.3 Net claims relating to the allocation of euro banknotes within the Eurosystem | | 38,684,167,500 | 35,253,653,825 |
| 9.4 Other claims within the Eurosystem (net) | | – | – |
| 10 ITEMS IN COURSE OF SETTLEMENT | | 8,908,834 | 19,426,239 |
| 11 OTHER ASSETS | [6] | 57,593,286,876 | 52,276,673,389 |
| 11.1 Euro-area coins | | 93,533,260 | 128,668,789 |
| 11.2 Financial assets relating to the investment of reserves and provisions | [4] | 48,530,918,627 | 43,036,006,461 |
| 11.3 Intangible fixed assets | | 71,507,380 | 79,832,057 (1) |
| 11.4 Tangible fixed assets | | 2,093,274,366 | 2,179,613,002 |
| 11.5 Accruals and prepaid expenses | | 4,568,871,013 | 3,926,869,770 |
| 11.6 Deferred tax assets | | 1,480,878,752 | 2,116,419,642 (1) |
| 11.7 Sundry | | 754,303,478 | 809,263,668 |
| TOTAL | | 930,682,204,684 | 773,657,187,447 |

(1) The amounts are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*).

THE ACCOUNTANT GENERAL: ROBERTO RINALDI

THE GOVERNOR: IGNAZIO VISCO

Audited and found correct.

THE BOARD OF AUDITORS: GIULIANA BIRINDELLI, LORENZO DE ANGELIS, GIAN DOMENICO MOSCO, SANDRO SANDRI, DARIO VELO

BALANCE SHEET

| LIABILITIES | NOTE | Amounts in euros | |
|--|------|------------------------|------------------------|
| | | 31.12.2017 | 31.12.2016 |
| 1 BANKNOTES IN CIRCULATION | [7] | 188,368,204,400 | 181,208,154,400 |
| 2 LIABILITIES TO EURO-AREA CREDIT INSTITUTIONS RELATING TO MONETARY POLICY OPERATIONS | [2] | 142,581,388,513 | 71,983,519,691 |
| 2.1 Current accounts (covering the minimum reserve system) | | 109,645,746,513 | 69,956,519,691 |
| 2.2 Deposit facility | | 32,935,642,000 | 1,997,000,000 |
| 2.3 Fixed-term deposits | | – | – |
| 2.4 Fine-tuning reverse operations | | – | – |
| 2.5 Deposits relating to margin calls | | – | 30,000,000 |
| 3 OTHER LIABILITIES TO EURO-AREA CREDIT INSTITUTIONS | | – | – |
| 4 LIABILITIES TO OTHER EURO-AREA RESIDENTS | [8] | 12,793,141,654 | 15,649,429,988 |
| 4.1 General government | | 6,589,159,366 | 9,779,685,154 |
| 4.1.1 Treasury payment account | | 6,550,224,106 | 9,733,536,062 |
| 4.1.2 Other liabilities | | 38,935,260 | 46,149,092 |
| 4.2 Other counterparties | | 6,203,982,288 | 5,869,744,834 |
| 5 LIABILITIES TO NON-EURO-AREA RESIDENTS | [9] | 3,301,477,382 | 2,565,236,028 |
| 5.1 To EU central banks | | – | – |
| 5.2 Other liabilities | | 3,301,477,382 | 2,565,236,028 |
| 6 LIABILITIES TO EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY | [1] | 231,770,831 | 304,095,162 |
| 6.1 Financial counterparties | | – | – |
| 6.2 General government | | 231,770,831 | 304,095,162 |
| 6.3 Other counterparties | | – | – |
| 7 LIABILITIES TO NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY | [1] | 2,327,033 | 3,142,681 |
| 7.1 Current accounts and deposits | | 2,327,033 | 3,142,681 |
| 7.2 Other liabilities | | – | – |
| 8 COUNTERPART OF SDRs ALLOCATED BY THE IMF | [1] | 7,809,789,673 | 8,381,911,348 |
| 9 INTRA-EUROSYSTEM LIABILITIES | [5] | 437,604,548,808 | 355,667,482,471 |
| 9.1 Liabilities in respect of debt certificates issued by the ECB | | – | – |
| 9.2 Net liabilities relating to the allocation of euro banknotes within the Eurosystem | | – | – |
| 9.3 Other liabilities within the Eurosystem (net) | | 437,604,548,808 | 355,667,482,471 |
| 10 ITEMS IN COURSE OF SETTLEMENT | | 40,471,710 | 36,553,002 |
| 11 OTHER LIABILITIES | [10] | 2,861,921,603 | 2,094,559,470 |
| 11.1 Cashier's cheques | | 104,129,685 | 169,138,833 |
| 11.2 Accruals and income collected in advance | | 1,226,692,457 | 317,183,180 |
| 11.3 Sundry | | 1,531,099,461 | 1,608,237,457 |
| 12 PROVISIONS | [11] | 7,401,368,946 | 7,335,325,517 |
| 12.1 Provisions for specific risks | | 338,573,065 | 326,416,336 |
| 12.2 Staff-related provisions | | 7,062,795,881 | 7,008,909,181 |
| 13 REVALUATION ACCOUNTS | [12] | 72,963,996,604 | 78,118,157,673 |
| 14 PROVISION FOR GENERAL RISKS | [11] | 25,213,675,075 | 22,293,675,075 |
| 15 CAPITAL AND RESERVES | [13] | 25,612,771,806 | 25,332,658,206 |
| 15.1 Capital | | 7,500,000,000 | 7,500,000,000 |
| 15.2 Statutory reserves | | 10,373,260,885 | 10,093,147,285 (1) |
| 15.3 Other reserves | | 7,739,510,921 | 7,739,510,921 |
| 16 NET PROFIT FOR THE YEAR | | 3,895,350,646 | 2,683,286,735 |
| TOTAL | | 930,682,204,684 | 773,657,187,447 |

(1) The amounts are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*).

THE ACCOUNTANT GENERAL: ROBERTO RINALDI

THE GOVERNOR: IGNAZIO VISCO

Audited and found correct.

THE BOARD OF AUDITORS: GIULIANA BIRINDELLI, LORENZO DE ANGELIS, GIAN DOMENICO MOSCO, SANDRO SANDRI, DARIO VELO

PROFIT AND LOSS ACCOUNT

| | NOTE | Amounts in euros | |
|---|------|------------------------|----------------------------|
| | | 2017 | 2016 |
| 1.1 Interest income | | 7,904,193,630 | 6,384,047,763 |
| 1.2 Interest expense | | - 960,256,189 | - 288,725,078 |
| 1 NET INTEREST INCOME | [14] | 6,943,937,441 | 6,095,322,685 |
| 2.1 Realized gains/losses arising from financial operations | | 265,801,489 | 363,383,705 |
| 2.2 Write-downs on financial assets and positions | | - 168,807,995 | - 145,881,460 |
| 2.3 Transfers to/from the provisions for general risks for exchange rate, price and credit risks | | - 2,920,000,000 | - 2,920,000,000 |
| 2 NET RESULT OF FINANCIAL OPERATIONS, WRITE-DOWNS AND TRANSFERS TO/FROM RISK PROVISIONS | [15] | - 2,823,006,506 | - 2,702,497,755 |
| 3.1 Fee and commission income | | 34,269,861 | 25,548,983 |
| 3.2 Fee and commission expense | | - 16,051,397 | - 13,736,253 |
| 3 NET INCOME FROM FEES AND COMMISSIONS | [16] | 18,218,464 | 11,812,730 |
| 4 INCOME FROM PARTICIPATING INTERESTS | [17] | 212,422,647 | 216,145,484 |
| 5 NET RESULT OF THE POOLING OF MONETARY INCOME | [18] | 1,233,275,945 | 722,703,575 |
| 6.1 Interest income | | 1,027,737,943 | 943,166,644 |
| 6.2 Dividends from equity shares and participating interests | | 206,983,962 | 195,882,137 |
| 6.3 Realized gains/losses arising from financial operations | | 708,209,119 | 467,891,233 |
| 6.4 Write-downs on financial assets and positions | | - 207,013,507 | - 46,237,012 |
| 6.5 Other components | | 31,508,565 | 53,998,264 |
| 6 NET INCOME FROM FINANCIAL ASSETS RELATING TO THE INVESTMENT OF RESERVES AND PROVISIONS | [19] | 1,767,426,082 | 1,614,701,266 |
| 7 OTHER TRANSFERS FROM PROVISIONS | | - | - |
| 8 OTHER INCOME | [20] | 70,430,059 | 67,662,526 (1) |
| TOTAL NET INCOME | | 7,422,704,132 | 6,025,850,511 |
| 9.1 Staff wages and salaries | | - 651,772,404 | - 623,136,632 |
| 9.2 Social security and insurance | | - 165,920,192 | - 160,624,677 |
| 9.3 Other staff costs | | - 40,227,719 | - 45,069,537 |
| 9.4 Pensions and severance payments | | - 340,690,331 | - 304,031,716 |
| 9.5 Transfers from/to provisions for staff severance pay and pensions, contributions to the supplementary pension fund and other expenses | | - 145,836,783 | - 270,021,961 |
| 9.6 Emoluments paid to head office and branch collegial bodies | | - 2,988,283 | - 2,977,335 |
| 9.7 Administrative expenses | | - 443,522,127 | - 437,224,441 (1) |
| 9.8 Depreciation of tangible and intangible fixed assets | | - 130,665,744 | - 138,851,668 (1) |
| 9.9 Banknote production services | | - | - |
| 9.10 Other expenses | | - 43,013,174 | - 51,496,968 |
| 9 EXPENSES AND SUNDRY CHARGES | [21] | - 1,964,636,757 | - 2,033,434,935 |
| 10 OTHER TRANSFERS TO PROVISIONS | | - | - |
| PROFIT BEFORE TAX | | 5,458,067,375 | 3,992,415,576 |
| 11 TAXES ON INCOME FOR THE YEAR AND ON PRODUCTIVE ACTIVITIES | [22] | - 1,562,716,729 | - 1,309,128,841 (1) |
| NET PROFIT FOR THE YEAR | | 3,895,350,646 | 2,683,286,735 (1) |

(1) The amounts are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*).

THE ACCOUNTANT GENERAL: ROBERTO RINALDI

THE GOVERNOR: IGNAZIO VISCO

Audited and found correct.

THE BOARD OF AUDITORS: GIULIANA BIRINDELLI, LORENZO DE ANGELIS, GIAN DOMENICO MOSCO, SANDRO SANDRI, DARIO VELO

NOTES TO THE ACCOUNTS

Legal basis, accounting policies and layout of the annual accounts

Legal basis of the annual accounts. – The annual accounts of the Bank of Italy are drawn up in compliance with special statutory provisions. Where these do not provide any guidance, the Bank, where applicable, follows the rules in the Civil Code and refers to the generally accepted accounting principles. The figures in the financial statement are presented in euros, while those in the notes to the accounts are given in millions of euros, unless otherwise stated.

The main statutory provisions of reference are:

- Article 8.1 of Legislative Decree 43/1998 ('Adaptation of Italian law to the provisions of the Treaty establishing the European Community for matters concerning monetary policy and the European System of Central Banks'). The Decree states that 'in drawing up its annual accounts, the Bank of Italy may adapt, in derogation from the provisions in force, its accounting and reporting criteria to comply with the rules established by the ECB pursuant to Article 26.4 of the Statute of the ESCB and with the ECB recommendations issued in this regard. The annual accounts drawn up in accordance with this paragraph, particularly as concerns the methods used in their preparation, are also valid for tax purposes'. This validity is recognized by Article 114 of Presidential Decree 917/1986 (Consolidated Income Tax Law) as amended by Legislative Decree 247/2005.

The special rules adopted by the ECB are set out in Guideline No. 34 of 3 November 2016 (published in OJ L347 of 20 December 2016), which contains provisions mainly in relation to items of the annual accounts that refer to the institutional activities of the ESCB and non-binding recommendations for the other items of the annual accounts.

On the basis of the authority granted by Article 8 of Legislative Decree 43/1998, the Bank of Italy fully applies the accounting rules and recommendations issued by the ECB, including those on the layout of the profit and loss account and the layout of the balance sheet. The latter is the same as that used for the monthly financial statement approved by the Minister of Economy and Finance pursuant to Article 8.2 of Legislative Decree 43/1998.

- the Bank's Statute, approved by the Presidential Decree of 15 February 2016, which lays down the principles and rules for the allocation of the net profit for the year and the creation of reserves and provisions.

For matters relating to the preparation of the accounts not covered by the foregoing rules, the following provisions apply:

- Legislative Decree 127/1991, as amended;
- Article 65 (transactions involving government bonds) of Law 289/2002, as amended by Decree Law 203/2005, converted by Law 248/2005.

Accounting policies. – The accounting policies applied to the main balance sheet items in the annual accounts for 2017 are described below. Where provided for by law they were agreed with the Board of Auditors.

GOLD, FOREIGN CURRENCY ASSETS/LIABILITIES, SECURITIES AND PARTICIPATING INTERESTS

Gold and foreign currency assets/liabilities

- stocks, including those consisting of foreign currency securities, are valued by applying, for each currency and for gold, the method based on the daily average net cost determined in the manner established by the ECB, which requires account to be taken of operations carried out during the year but settled in the following year;
- gold and foreign currency assets/liabilities are valued on the basis of the year-end gold price and exchange rates communicated by the ECB. Unrealized gains are included in the corresponding revaluation account, while losses are covered first by earlier unrealized gains recognized on the same foreign currencies and any amount in excess is included in the profit and loss account.

Assets denominated in foreign currencies, stated in the balance sheet sub-item *Securities relating to the investment of reserves and provisions*, are not included in the net foreign exchange position but shown as a separate item.

Securities and participating interests

- each security (identified by its International Securities Identification Number – ISIN) is valued by applying the method of the daily average cost determined in the manner established by the ECB. In the case of bonds, account is taken of the amount of the premium/discount, which is recorded daily for those denominated in foreign currency;
- the year-end valuation is made:
 - 1) for securities held for monetary policy purposes at amortized cost subject to impairment (lasting reduction in recoverable value with respect to book value);
 - 2) for other securities:
 - a) held to maturity, at amortized cost subject to impairment;
 - b) not held to maturity:
 - i) for shares, exchange-traded funds (ETFs) and marketable bonds, at the market price available at the end of the year; shares/units of UCITS, at the value available at the end of the year published by the management company. Unrealized gains are included in the corresponding revaluation accounts; losses are covered first by earlier unrealized gains on the relative security and any amount in excess is taken to the profit and loss account;
 - ii) for non-marketable bonds, at amortized cost subject to impairment;
 - iii) for non-marketable shares and equity interests not represented by shares, at cost subject to impairment;

- 3) participating interests that constitute permanent investments are valued at cost subject to impairment. The participating interest in the capital of the ECB is valued at cost. The Bank's accounts are not consolidated with those of investee companies as the Bank is not among the entities listed in Article 25 of Legislative Decree 127/1991.

Dividends are recognized on a cash basis.

TANGIBLE FIXED ASSETS

Buildings

- are stated at cost, including improvement expenses, plus revaluations made pursuant to specific laws. The depreciation of the Bank's premises and the depreciation of investment property, unusable for other purposes without radical restructuring, are on a straight line basis using the annual rate of 4 per cent established by the ECB. Land is not depreciated.

Buildings for sale and those no longer in use or usable for the Bank's activities are not amortized and are valued at whichever is lowest of net book value and realizable value based on market prices.

Plant, furniture and equipment

- are stated at cost, including improvement expenses. They are depreciated on a straight line basis using the rates established by the ECB (plant, furniture, and equipment, 10 per cent; computers and related hardware and basic software and motor vehicles, 25 per cent).

Depreciation begins in the quarter subsequent to that of acquisition both for buildings and for plant and equipment.

INTANGIBLE FIXED ASSETS

The procedures developed as part of the Eurosystem IT projects are capitalized at purchase price and, once completed, are amortized on the basis of amortization rates deemed congruent with the remaining useful life of the assets.

The costs relating to internally developed application software are recorded in the profit and loss accounts in the years in which they are incurred, even if the software's useful life covers a multi-year period.

Software licences are stated at cost and amortized on a straight line basis over the life of the contract or, where no time limit is established, over the estimated useful life.

The costs of improvements to buildings owned by third parties and leased to the Bank are amortized on a straight line basis over the remaining life of the rental contract.

Expenses of less than €10,000 are not capitalized, with the exception of those incurred for software licences.

ACCRUALS AND PREPAID EXPENSES

Accrued income and expenses are recorded in the period in which they arise. Prepaid income and expenses represent costs or revenue that arise in future periods but that are paid or received in the current accounting period. Interest accrued on foreign exchange assets and liabilities is recorded on a daily basis and included in the net foreign exchange position.

BANKNOTES IN CIRCULATION

The ECB and the euro-area NCBs, which together form the Eurosystem, issue euro banknotes (ECB Decision No. 29 of 13 December 2010 on the issue of euro banknotes, OJ L35 of 9 February 2011, as amended).

The total value of euro banknotes in circulation is allocated within the Eurosystem on the last working day of each month on the basis of the criteria set out below.

The ECB is allocated 8 per cent of the total value of euro banknotes in circulation, while the remaining 92 per cent is allocated to the NCBs according to their shares in the capital of the ECB. The share of banknotes allocated to each NCB is disclosed under the balance sheet liability item *Banknotes in circulation*. On the basis of the banknote allocation key, the difference between the value of the banknotes allocated to each NCB and that of the banknotes it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. From the year of the cash changeover of each member state that has adopted the euro and for the five subsequent years the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in the NCBs' relative income positions with respect to previous years. The adjustments take into account the differences between the average value of banknotes in circulation of each NCB in the reference period established by law and the average value of banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments are reduced in annual steps for five years starting from the year of the cash changeover, after which income on banknotes is allocated fully in proportion to the NCBs' paid-up shares in the ECB's capital (ECB Decision No. 36 of 3 November 2016 on the allocation of monetary income of the national central banks of member states whose currency is the euro). The adjustments recorded in 2017 arise from the entry into the Eurosystem of the central banks of Latvia in 2014 and Lithuania in 2015; they will terminate at the end of 2019 and 2020 respectively.

The interest income and expense on intra-Eurosystem balances are cleared through the accounts of the ECB and disclosed in the profit and loss account under *Net interest income*.

The Governing Council of the ECB has ruled that the seigniorage income of the ECB arising from the 8 per cent share of banknotes allocated to the ECB and the income deriving from the securities held in connection with the SMP, the CBPP3, the ABSPP and the PSPP must be recognized to the euro-area NCBs in full with reference to the financial year in which they accrued and are distributed in January of the following year, or later, in the form of an interim distribution of profit

(ECB Decision No. 57 of 15 December 2014, OJ L53 of 25 February 2015, as amended). The seigniorage income and the income arising from the above securities purchase programmes are distributed unless they exceed the ECB's net profit for that year or the Council decides to transfer all or part to a provision for exchange rate, interest rate, credit and gold price risk. The interim distribution of ECB profit is recorded on an accrual basis in the year to which the income refers, in derogation from the cash basis applied in general to dividends.

The Governing Council of the ECB may also decide to reduce the seigniorage income for distribution by the amount of the expenses incurred in connection with the issue and handling of banknotes.

The amount distributed to the NCBs is entered in the profit and loss account under *Income from participating interests*.

INTRA-EUROSISTEM CLAIMS AND LIABILITIES

Intra-Eurosystem balances arise mainly from cross-border payments in euros within the EU that are settled in central bank money. Most of these transactions are ordered by private individuals and settled in TARGET2 – the Eurosystem's real-time gross settlement system – giving rise to bilateral balances in the TARGET2 accounts of the EU member states' central banks. These balances are netted out and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position with the ECB. The intra-Eurosystem balance with the ECB arising from TARGET2 and the other intra-Eurosystem balances denominated in euros, including the provisional distribution of the ECB's profit to the NCBs and the result of the pooling of monetary income, are entered in the accounts as a single net position, appearing on the asset side under *Other claims within the Eurosystem (net)* or on the liability side under *Other liabilities within the Eurosystem (net)*.

The net intra-Eurosystem balance arising from the allocation of euro banknotes is included among the net claims or liabilities relating to the allocation of banknotes within the Eurosystem.

The intra-Eurosystem claims arising from the subscription of the ECB's capital and the transfer of official reserves to the ECB are included under *Participating interest in the ECB* and *Claims arising from the transfer of foreign reserves to the ECB*.

PROVISIONS FOR RISKS

In determining the provisions for risks, the riskiness of each sector of the Bank's operations is taken into account in an overall evaluation of adequacy.

According to the Bank's Statute, the provision for general risks also covers risks connected with the Bank's overall activity that cannot be determined individually or allocated objectively.

The riskiness of the foreign exchange position and that of the securities portfolio are evaluated by the methods in use within the Eurosystem, with consideration also given to the size of the revaluation accounts.

TAX PROVISION

The provision for taxation includes deferred tax liabilities for IRES and IRAP and amounts arising from possible fiscal checks and disputes with the tax authorities.

STAFF-RELATED PROVISIONS

The recorded amounts are determined as follows:

- transfers to the provision for severance pay and pensions of staff hired before 28 April 1993 are included in the annual accounts under Article 3 of the relative Rules for an amount that comprises the severance pay accrued at the end of the year, the mathematical reserves for the disbursements to pensioners, and those corresponding to the situation of staff having entitlement;
- the provision for grants to Bank of Italy pensioners and their surviving dependants is funded, as a rule, by the income arising from investment of the corresponding amount, in accordance with Article 24 of the Rules governing staff severance pay and pensions;
- transfers to the provisions for measures connected with the reorganization of the Bank's branch network and with voluntary early retirement for staff at the head office and at the branches not scheduled to be closed are calculated on the basis of the expected costs;
- transfers to the provision for severance pay for staff who do not participate in pension funds or who pay only a part of the contributions for retirement benefits are determined in accordance with Law 297/1982,
- transfers arising from lump-sum disbursements to staff hired on or after 28 April 1993 who joined the defined-contribution supplementary pension fund to be settled upon their leaving service. These transfers are funded on the basis of measures agreed upon with the trade unions and partly tied to the achievement of certain productivity, quality, efficiency and effectiveness targets (see 'Other assets and liabilities');
- the provision for staff costs includes the costs accrued but not paid at year-end.

OTHER ASSETS AND LIABILITIES

Receivables are stated at their nominal value, except for diminutions in value regarding particular situations attributable to the counterparty.

Pursuant to Recommendation ECB/1999/NP7 of the ECB Governing Council, banknote production costs are not included in the valuation of stocks but are taken in full to the profit and loss account in the year in which they are incurred.

Deferred tax assets and liabilities are included in the financial statements on the basis of their presumable tax effect in future years. The recognition of deferred tax assets in the balance sheet is based on the reasonable expectation of recovering them in the future. The amount of deferred tax assets and liabilities is calculated using the tax rates

that are expected to be in force at the time in which the temporary differences that have generated them are reversed. Deferred tax assets include those deriving from the application of Article 65.2 of Law 289/2002, as amended by Decree Law 203/2005, converted by Law 248/2005.

The items *Other assets* and *Other liabilities* include the investments and separate assets of the defined-contribution supplementary pension fund created for staff hired on or after 28 April 1993. The fund invests in financial instruments, which are valued at year-end market prices. The resulting revaluation gains (losses) are treated as revenue (expense) and, like other operating revenue (expense), add to (subtract from) the fund's assets.

Other liabilities also includes the amount of IRES and IRAP tax payables, net of payments on account, due for the reference period, determined on the basis of a realistic estimate of the foreseeable costs under the tax rules in force. Any excess payments on account are recorded correspondingly under *Other assets*.

Other liabilities also includes the special item made up of allocations of the net profit in accordance with Article 38.2.b of the Statute, whose purpose is to stabilize over time the amount of net profit paid to the shareholders under the dividend policy in force.

Securities lending transactions are entered in the balance sheet only if collateral is in the form of a cash deposit in an account of the central bank.

The other components are stated at nominal value or at cost depending on their nature.

COMMITMENTS, COLLATERAL GRANTED AND OTHER OFF-BALANCE-SHEET ACCOUNTS

Commitments, collateral granted and other off-balance-sheet accounts are shown and explained in the notes to the accounts.

Commitments include the following types of operations:

Forward purchases and sales of foreign currency

- forward purchases and sales are recorded in off-balance-sheet accounts from the trade date to the settlement date at the spot exchange rate of the transaction. The difference between the values at the spot and forward exchange rates is recorded, on a pro rata temporis basis, under interest in the profit and loss account;
- forward sales of the currencies included in the special drawing rights (SDR) basket to cover the SDR position are valued in conjunction with the latter and therefore do not affect the net position in the single currencies.

Foreign currency swaps

- forward and spot purchases and sales are recorded in the off-balance-sheet accounts from the trade date to the settlement date at the spot exchange rate of the transaction. The difference between the values at the spot and forward exchange

rates is recorded, on a pro rata temporis basis, under interest in the profit and loss account.

At the time of the settlement of forward purchases and sales of foreign currency and foreign currency swaps, the entries in the off-balance-sheet accounts are transferred to the appropriate items of the balance sheet.

Futures contracts

- are recorded in the off-balance-sheet accounts at the trade date at their notional value and those denominated in foreign currency are translated at the end of the year at the exchange rate communicated by the ECB. Initial margins in cash are recorded in the balance sheet among claims, those in securities are recorded in the off-balance-sheet accounts. Positive and negative daily variation margins are communicated by the clearer and taken to the profit and loss account; those denominated in foreign currency are converted at the exchange rate of the day.

Forward foreign currency transactions and other financial instruments involving an exchange of one currency for another at a future date are included in the calculation, at the spot settlement date, of the outstanding net foreign currency positions for the purposes of applying the method of average cost determined daily and of determining the results of exchange rate valuation and foreign exchange trading.

Commitments in respect of foreign currency transactions are shown at the contractually agreed exchange rate.

Other off-balance-sheet accounts include:

- bonds of third parties denominated in euros held on deposit are stated at their nominal value; other securities are stated on a quantity basis, and other kinds are stated at face value or at conventional value;
- the total balance sheet assets of the National Resolution Fund, set up within the Bank of Italy under Article 78 of Legislative Decree 180/2015. The Fund has its own capital, which is independent and separate in all respects from that of the Bank but is managed by the Bank in its capacity as National Resolution Authority. The Fund issues an annual report, published in conjunction with the Bank's annual accounts.

Items denominated in foreign currency are converted at the year-end exchange rates communicated by the ECB.

Notes on the items of the balance sheet

The items *Gold, assets and liabilities denominated in foreign currency, Monetary policy operations* and *Securities portfolio* are aggregated according to their purpose or type of operation. Comments on the other items follow the layout of the balance sheet.

[1] Gold, assets and liabilities denominated in foreign currency

Table 4

| Gold, assets and liabilities denominated in foreign currency (1) (millions of euros) | | | |
|--|---------------|---------------|---------------|
| | 31.12.2017 | 31.12.2016 | Change |
| Gold (Item 1) | 85,283 | 86,558 | -1,275 |
| Net assets denominated in foreign currency | 33,555 | 35,097 | -1,542 |
| Assets denominated in foreign currency | 41,599 | 43,786 | -2,187 |
| Claims on the IMF (Sub-item 2.1) | 9,481 | 10,163 | -682 |
| Securities (Sub-items 2.2, 3.1.1, 3.2 and 3.3) | 27,361 | 28,812 | -1,451 |
| Current accounts and deposits (Sub-items 2.3 and 3.1.3) | 4,701 | 4,264 | 437 |
| Reverse operations (Sub-items 2.4 and 3.1.2) | 51 | 541 | -490 |
| Other assets (Sub-item 2.5) | 5 | 6 | -1 |
| Liabilities denominated in foreign currency | 8,044 | 8,689 | -645 |
| Counterpart of SDRs allocated by the IMF (Item 8) | 7,810 | 8,382 | -572 |
| Advances of general government departments (Sub-item 6.2) | 232 | 304 | -72 |
| Current accounts and deposits (Sub-item 7.1) | 2 | 3 | -1 |

(1) The figures do not include financial assets denominated in foreign currency relating to the overall amount of own funds, as they constitute a separate foreign currency position.

The value of gold amounted to €85,283 million at the end of 2017. The decrease of €1,275 million compared with the end of 2016, fully matched by the related revaluation account on the liability side, was entirely due to the reduction in the metal's price. The stock remained unchanged at 79 million ounces or 2,452 tons.¹⁵ The value of net assets denominated in foreign currency decreased from €35,097 million to €33,555 million as a result of the depreciation of all the major currencies against the euro, especially the US dollar,¹⁶ which more than offset the effect of the increase in the corresponding stocks.

Table 5

| Composition of net foreign currency assets (millions of euros) | | | |
|--|---------------|---------------|---------------|
| | 31.12.2017 | 31.12.2016 | Change |
| US dollars | 21,874 | 22,676 | -802 |
| Pound sterling | 2,918 | 3,065 | -147 |
| Japanese yen | 4,045 | 4,879 | -834 |
| Australian dollars | 1,849 | 1,427 | 422 |
| Canadian dollars | 931 | 989 | -58 |
| Chinese renminbi | 173 | 184 | -11 |
| South Korean won | 91 | 91 | - |
| Other currencies | 3 | 4 | -1 |
| Net assets vis-à-vis the IMF (denominated in SDRs) | 1,671 | 1,782 | -111 |
| Total | 33,555 | 35,097 | -1,542 |

¹⁵ Gold reserves are valued at the year-end market price in euros per fine ounce notified by the ECB. Compared with the end of 2016, gold depreciated by 1.47 per cent (from €1,098.046 to €1,081.881 per ounce).

¹⁶ Compared with the end of the previous year, all the main currencies have depreciated against the euro: the pound sterling from £0.85618 to £0.88723, the Chinese renminbi from ¥7.3202 to ¥7.8044, the US dollar from \$1.0541 to \$1.1993, the Japanese yen from ¥123.40 to ¥135.01, the Canadian dollar from C\$1.4188 to C\$1.5039, the Australian dollar from A\$1.4596 to A\$1.5346, the Korean won from ₩1,269.36 to ₩1,279.61, and SDRs from €1.2746 to €1.1876.

The depreciation of the main currencies against the euro gave rise to unrealized foreign exchange losses amounting to €5,375 million. These losses were covered by the corresponding revaluation accounts with the exception of the Australian dollar and the Chinese renminbi, which together generated an unrealized loss of €46 million in the profit and loss account (Table 6).

Table 6

| Unrealized foreign exchange gains and losses (millions of euros) | | | | | |
|--|--|--|-----------------------------|--------------------------------|--|
| | Revaluation accounts at 31 December 2016 | Gains reported in the revaluation accounts | Losses reported | | Revaluation accounts at 31 December 2017 |
| | | | in the revaluation accounts | in the profit and loss account | |
| Gold | 67,137 | – | -1,275 | – | 65,862 |
| US dollars | 5,252 | – | -3,194 | – | 2,058 |
| Pound sterling | 256 | – | -108 | – | 148 |
| Japanese yen | 1,034 | – | -376 | – | 658 |
| Australian dollars | 72 | – | -72 | -40 | – |
| Canadian dollars | 61 | – | -57 | – | 4 |
| Special Drawing Rights (SDRs) (1) | 379 | – | -242 | – | 137 |
| Chinese renminbi | 4 | – | -4 | -6 | – |
| South Korean won | 2 | – | -1 | – | 1 |
| Total | 74,197 | – | -5,329 | - 46 | 68,868 |

(1) Includes the valuation of the related hedging operations.

Claims on the IMF fell by €682 million (Table 7).

Table 7

| Accounts with the International Monetary Fund (millions of euros) | | | |
|---|--------------|---------------|--------------|
| | 31.12.2017 | 31.12.2016 | Change |
| Assets | | | |
| Claims on the IMF (Sub-item 2.1) | 9,481 | 10,163 | -682 |
| a) Reserve Tranche Position in the IMF | 1,270 | 1,274 | -4 |
| Quota in the IMF | 17,897 | 19,208 | -1,311 |
| IMF holdings | -16,627 | -17,934 | 1,307 |
| b) Participation in the PRGT | 943 | 1,130 | -187 |
| c) Participation in the NAB | 906 | 1,223 | -317 |
| d) Special Drawing Rights (SDRs) | 6,362 | 6,536 | -174 |
| Liabilities | | | |
| Counterpart of SDRs allocated by the IMF (Item 8) | 7,810 | 8,382 | - 572 |

The change was mainly due to the decrease in loans by the Bank of Italy on behalf of the Italian government to the IMF under the New Arrangements to Borrow (NAB) and the depreciation of SDRs against the euro (see the box ‘The IMF in the Bank of Italy’s balance sheet’).

THE IMF POSITION IN THE BANK OF ITALY'S BALANCE SHEET

Italy's position vis-à-vis the International Monetary Fund is recorded in the Bank of Italy's balance sheet according to arrangements drawn up with the Ministry of Economy and Finance. Specifically:

a) Italy's reserve tranche position, subscribed in gold, SDRs and national currency and amounting to €1,270 million at the end of 2017, represents the difference between Italy's quota in the Fund (€17,897 million, equal to SDR15,070 million) and the IMF's holdings deposited in its account with the Bank (€16,627 million, equal to SDR14,000 million) which are funded by the quota paid over time in national currency.

b) The contribution to the Poverty Reduction and Growth Trust (PRGT), amounting to €943 million (SDR794 million), is used to grant long-term loans to countries facing structural balance of payments difficulties.

c) Loans to the IMF by the Bank of Italy on behalf of the Italian government under the NAB, amounting to €906 million (SDR763 million), are used to strengthen the IMF's lending capacity to cope with the financial crisis.

d) Since 1969 the IMF has allocated SDRs to Italy in proportion to its quota. The last allocations made in 2009 brought Italy's total holdings to SDR6,576 million. Following a series of withdrawals, at the end of 2017 Italy's holdings amounted to SDR5,357 million, equal to €6,362 million.

The amount of SDR6,576 million is entered as a liability vis-à-vis the IMF under the item Counterpart of SDRs allocated by the IMF (Item 8), totalling €7,810 million at the end of the year.

The portfolio of securities denominated in foreign currency classified as not held to maturity (Table 8) mostly consists of bonds and certificates of deposit issued by foreign government bodies. Of the total portfolio, 73 per cent is denominated in US dollars, 10 per cent in Japanese yen, 8 per cent in pound sterling, 5 per cent in Australian dollars and 3 per cent in Canadian dollars.

The other foreign currency assets (Sub-items 2.3, 2.4, 2.5, 3.1.2 and 3.1.3), denominated primarily in US dollars, Japanese yen and pound sterling, consist of fixed-term deposits (€1,285 million), current accounts (€3,416 million), reverse operations¹⁷ (€51 million) and foreign banknotes (€5 million). Among the other liabilities denominated in foreign currency, mainly in US dollars, the most important are the liabilities to general government (€232 million, Sub-item 6.2) in respect of advances received for the management of foreign currency cross-border payments and collections.

¹⁷ Sub-item 3.1.2 (*Claims on euro-area residents denominated in foreign currency – reverse operations*), nil at the end of 2017, refers to reverse operations with Eurosystem counterparties connected with the short-term US dollar refinancing programme in the amount of €47 million at end-2016. Under the programme, the Federal Reserve provides dollars to the ECB using liquidity swap lines for their respective currencies in order to offer short-term dollar funding to Eurosystem counterparties. At the same time the ECB initiates back-to-back swaps with the euro-area NCBs that use US dollar funds to provide liquidity to euro area counterparties through reverse operations or foreign currency swaps. Back-to-back swaps with the ECB are settled through intra-Eurosystem accounts.

Table 8

| Movements in securities denominated in foreign currency (millions of euros) | | | | |
|---|----------------------------------|--------------------------|---------------------------------|-----------------|
| | Non-euro-area residents (Item 2) | | Euro-area residents (Item 3) | Total |
| | Bonds | Shares/units of UCITS | Bonds | |
| Opening balance | 28,034 | 485 | 293 | 28,812 |
| Increases | 32,399 | 5 | 132 | 32,536 |
| Purchases | 32,362 | 4 | 132 | 32,498 |
| Net gains | 37 | – | – | 37 |
| Net price revaluation gains (1) | – | 1 | – | 1 |
| Decreases | - 33,645 | - 38 | - 304 | - 33,987 |
| Sales and redemptions | - 30,115 | - | - 254 | - 30,369 |
| Net price revaluation losses (1) | - 50 | - | – | - 50 |
| Net exchange rate revaluation losses (1) | - 3,267 | - 32 | - 47 | - 3,346 |
| Premiums and discounts | - 75 | – | - 2 | - 77 |
| Write-downs due to price changes (2) | - 106 | – | - 1 | - 107 |
| Write-downs due to exchange rate changes (2) | - 32 | - 6 | – | - 38 |
| Closing balance | 26,788 | 452 | 121 | 27,361 |

(1) Increase/decrease in revaluation accounts. – (2) Recognized in the profit and loss account.

[2] Monetary policy operations

The amounts outstanding at 31 December 2017 and the average for the year of operations carried out by the Bank of Italy within the framework of the single monetary policy of the Eurosystem are shown in Table 9.

Refinancing operations (Item 5) rose from €204.2 billion at the end of 2016 to €251.7 billion at the end of 2017.¹⁸ The average values for the year increased more sharply, rising from €165.7 billion in 2016 to €241.7 billion in 2017. In both cases the increase was in large part due to the amounts gradually allocated through TLTRO II operations (which were up by €67 billion in 2017), which more than offset the reduction in main refinancing operations and the early repayment of the TLTROs allocated in previous years.

At 31 December 2017 lending to credit institutions consisted almost exclusively of longer-term refinancing operations, of which ordinary operations with a 3-month maturity amounted to only €7 billion. Main refinancing operations were also down markedly.

¹⁸ At the end of 2017, Italian counterparties held 32.9 per cent of all euro-area refinancing operations, a slight decrease on the 34 per cent registered at the beginning of the year.

Table 9

| Monetary policy operations (millions of euros) | | | | | | |
|--|----------------|----------------|----------------|----------------|----------------|----------------|
| | Balances | | | Averages | | |
| | 31.12.2017 | 31.12.2016 | Change | 2017 | 2016 | Change |
| Lending to euro-area credit institutions (Item 5) (1) | | | | | | |
| 5.1 Main refinancing operations | 942 | 16,050 | - 15,108 | 5,055 | 13,905 | - 8,850 |
| 5.2 Longer-term refinancing operations | 250,750 | 188,188 | 62,562 | 236,649 | 151,762 | 84,887 |
| 5.3 Fine-tuning reverse operations | - | - | - | - | - | - |
| 5.4 Structural reverse operations | - | - | - | - | - | - |
| 5.5 Marginal lending facility | - | - | - | 3 | 2 | 1 |
| 5.6 Credits relating to margin calls | - | - | - | - | - | - |
| Total | 251,692 | 204,238 | 47,454 | 241,707 | 165,669 | 76,038 |
| Securities held for monetary policy purposes (Sub-item 7.1) | | | | | | |
| | 357,677 | 245,221 | 112,456 | 306,144 | 182,583 | 123,561 |
| Liabilities to euro-area credit institutions (Item 2) | | | | | | |
| 2.1 Current accounts (covering the minimum reserve system) | 109,646 | 69,957 | 39,689 | 81,016 | 26,203 | 54,813 |
| 2.2 Deposit facility | 32,935 | 1,997 | 30,938 | 18,863 | 1,874 | 16,989 |
| 2.3 Fixed-term deposits | - | - | - | - | - | - |
| 2.4 Fine-tuning reverse operations | - | - | - | - | - | - |
| 2.5 Deposits relating to margin calls | - | 30 | - 30 | 15 | - | 15 |
| Total | 142,581 | 71,984 | 70,597 | 99,894 | 28,077 | 71,817 |

(1) At 31 December 2017 the collateral for lending to euro-area credit institutions, deposited with the Bank, amounted to €321 billion.

Securities held for monetary policy purposes (Sub-item 7.1) rose from €245.2 billion to €357.7 billion following the purchases made as part of the APP, especially under the PSPP.

In 2017 the Bank sold securities included in the CSPP portfolio for an amount equal to €26 million. The sale was carried out jointly with other NCBs and was necessary to comply with the limits set by the programme, which had been exceeded owing to a buyback of securities by their issuer.

Table 10

| Movements in securities held for monetary policy purposes (Sub-item 7.1) (millions of euros) | | | | | | | |
|--|-----------------|--------------|----------------|----------------|----------------|---------------|----------------|
| | Total bonds (1) | | | | | | Total |
| | CBPP1 | CBPP2 | CBPP3 | SMP | PSPP | CSPP | |
| Opening balance | 1,997 | 897 | 33,449 | 16,405 | 186,646 | 5,827 | 245,221 |
| Increases | - | 1 | 6,583 | 139 | 106,563 | 9,165 | 122,451 |
| Purchases | - | - | 6,583 | - | 106,563 | 9,165 | 122,311 |
| Net premiums and discounts | - | 1 | - | 139 | - | - | 140 |
| Decreases | - 1,248 | - 137 | - 2,178 | - 1,840 | - 4,366 | - 226 | - 9,995 |
| Sales and redemptions | - 1,247 | - 137 | - 1,723 | - 1,840 | - 1,460 | - 69 | - 6,476 |
| Net premiums and discounts | - 1 | - | - 455 | - | - 2,906 | - 157 | - 3,519 |
| Closing balance | 749 | 761 | 37,854 | 14,704 | 288,843 | 14,766 | 357,677 |

(1) The first two CBPPs were introduced in 2009 and 2011 and closed in 2010 and 2012 respectively. The SMP was rolled out in 2010 and ended in 2012.

At the end of the year, the market value of the securities held for monetary policy purposes amounted to €359.8 billion, slightly higher than the balance sheet value.

Table 11

| Comparison with market price of securities held for monetary policy purposes (Sub-item 7.1) <i>(millions of euros)</i> | | | | | | |
|--|----------------|----------------|----------------|----------------|----------------|----------------|
| | 31.12.2017 | | 31.12.2016 | | Change | |
| | Amortized cost | Market price | Amortized cost | Market price | Amortized cost | Market price |
| CBPP1 | 749 | 829 | 1,997 | 2,119 | - 1,248 | - 1,290 |
| CBPP2 | 761 | 828 | 897 | 992 | - 136 | - 164 |
| CBPP3 | 37,854 | 38,483 | 33,449 | 33,675 | 4,405 | 4,808 |
| SMP | 14,704 | 16,433 | 16,405 | 18,607 | - 1,701 | - 2,174 |
| PSPP | 288,843 | 288,260 | 186,646 | 185,811 | 102,197 | 102,449 |
| CSPP | 14,766 | 14,919 | 5,827 | 5,756 | 8,939 | 9,163 |
| Total | 357,677 | 359,752 | 245,221 | 246,960 | 112,456 | 112,792 |

Generally, the risks associated with monetary policy operations are shared among the NCBs as decided by the ECB Governing Council (see the box ‘Rules on risk sharing in monetary policy operations’).

In accordance with the Governing Council’s decisions, all securities acquired through the existing monetary policy programmes are valued at amortized cost subject to impairment based on Eurosystem criteria.

The annual impairment tests conducted at Eurosystem level on the portfolios held for monetary policy purposes showed impairment losses amounting to €69 million relating to one security purchased under the CSPP for which the risks are shared among the NCBs. In accordance with the prudence principle, therefore, the Governing Council of the ECB has deemed it appropriate to establish a provision for the same amount in the NCBs’ balance sheets in proportion to their shares in the ECB’s capital. The security was sold in full in January 2018 (see ‘Provision for general risks and other provisions’).

[3] Other claims on euro-area credit institutions

Item 6 on the asset side, amounting to €46 million (€35 million in 2016), includes current accounts in connection with the management of cross-border euro payments and collections for government bodies (€19 million) and other current accounts denominated in euros (€27 million).

[4] Securities portfolio

Table 12

| Securities portfolio (millions of euros) | | | |
|--|----------------|----------------|----------------|
| | 31.12.2017 | 31.12.2016 | Change |
| A. SECURITIES DENOMINATED IN EUROS (Sub-items 4.2 and 7.2 and Item 8) | | | |
| 1. Securities held to maturity | 81,112 | 87,535 | - 6,423 |
| a) Government securities (Sub-item 7.2) | 65,497 | 71,748 | - 6,251 |
| b) Other bonds (Sub-items 4.2 and 7.2) | 1,668 | 1,706 | - 38 |
| c) Government securities assigned to Bank of Italy (Item 8) | 13,947 | 14,081 | - 134 |
| 2. Securities other than those held to maturity | 8,518 | 10,267 | - 1,749 |
| a) Government securities (Sub-item 7.2) | 7,615 | 9,373 | - 1,758 |
| b) Other bonds (Sub-items 4.2 and 7.2) | 903 | 894 | 9 |
| Total A | 89,630 | 97,802 | - 8,172 |
| B. SECURITIES RELATING TO THE INVESTMENT OF RESERVES AND PROVISIONS (Sub-item 11.2) | | | |
| 1. Securities held to maturity and other permanent investments | 38,200 | 33,503 | 4,697 |
| a) Government securities | 37,183 | 32,484 | 4,699 |
| - of which: denominated in foreign currency | 2,453 | 2,779 | - 326 |
| b) Other bonds | 432 | 435 | - 3 |
| c) Shares and participating interests | 585 | 584 | 1 |
| - in subsidiary companies and entities | 527 | 527 | - |
| - in other companies and entities | 3 | 2 | 1 |
| - in other companies and entities denominated in foreign currency | 55 | 55 | - |
| 2. Securities other than those held to maturity and other permanent investments | 10,293 | 9,496 | 797 |
| a) Government securities | 258 | 284 | - 26 |
| - of which: denominated in foreign currency | 242 | 268 | - 26 |
| b) Shares and participating interests | 8,642 | 6,571 | 2,071 |
| - of which: companies and entities | 8,642 | 6,571 | 2,071 |
| c) ETFs and shares/units of UCITS | 1,393 | 2,641 | - 1,248 |
| - of which: denominated in foreign currency | 1,393 | 1,410 | - 17 |
| Total B | 48,493 | 42,999 | 5,494 |
| Total (A+B) | 138,123 | 140,801 | - 2,678 |

Securities denominated in euros (Total A) consist exclusively of bonds and are detailed in:

- Sub-item 4.2 (*Claims on non-euro-area residents – securities*), which consists mostly of bonds issued by international organizations;
- Sub-item 7.2 (*Securities of euro-area residents – other securities*), which consists mainly of bonds issued by the Italian government and by other euro-area governments;
- Item 8 (*General government debt*), which contains the Italian government securities assigned to the Bank following the bond conversion under Law 289/2002 and those arising from the termination of the management of mandatory stockpiling.

Table 13

| A. Movements in securities denominated in euros | | | | | | |
|--|------------------|----------------|-----------------------------------|----------------|----------------|---------------|
| <i>(millions of euros)</i> | | | | | | |
| | Bonds | | | | | Total |
| | held to maturity | | other than those held to maturity | | | |
| | (Sub-item 4.2) | (Sub-item 7.2) | (Item 8) | (Sub-item 4.2) | (Sub-item 7.2) | |
| Opening balance | 1,109 | 72,345 | 14,081 | 445 | 9,822 | 97,802 |
| Increases | – | 833 | – | 240 | 610 | 1,683 |
| Purchases | – | 833 | – | 236 | 532 | 1,601 |
| Transfers | – | – | – | – | 73 | 73 |
| Net gains | – | – | – | 4 | 5 | 9 |
| Decreases | -33 | -7,089 | -134 | -202 | -2,397 | -9,855 |
| Sales and redemptions | -20 | -6,455 | -50 | -189 | -2,139 | -8,853 |
| Transfers | – | -70 | – | -3 | – | -73 |
| Net revaluations (1) | – | – | – | -6 | -137 | -143 |
| Net premiums and discounts | -13 | -564 | -84 | -4 | -105 | -770 |
| Write-downs (2) | – | – | – | – | -16 | -16 |
| Closing balance | 1,076 | 66,089 | 13,947 | 483 | 8,035 | 89,630 |

(1) Increase/decrease in revaluation accounts. – (2) Recognized in the profit and loss account.

Securities relating to investments of reserves and provisions (Total B) are denominated in euros and in foreign currency (mainly US dollars and Japanese yen).¹⁹

At year-end, 78 per cent of the portfolio consisted of bonds, mostly government securities, and 22 per cent of shares, participating interests, ETFs and shares/units of UCITS. Almost all of the investments in shares were listed securities. The majority of issuers were from euro-area countries, and in particular from Italy.

The bulk of the bond portfolio (93 per cent) comprises securities held to maturity and is therefore valued at amortized cost subject to impairment based on Eurosystem criteria. The annual impairment tests conducted on these securities do not show evidence of any losses.

The portfolio contains securities whose book value (€16,376 million) is higher than the market value at year-end (€15,767 million). If all listed financial instruments were valued at end-of-year market prices, the portfolio would be worth €150,303 million.

The Bank of Italy is the sole shareholder²⁰ of SIDIEF SpA and holds a participating interest in Europafi sas (Table 15). Based on shareholders' agreements, the Bank of Italy, together with other Eurosystem NCBs, exercises control according to the rules on

¹⁹ The Bank also makes foreign currency investments relating to reserves and provisions. These assets constitute a separate position with respect to the foreign currency assets and liabilities described under the heading *Gold, assets and liabilities denominated in foreign currency*.

²⁰ The Bank's accounts are not consolidated with those of investee companies as the Bank is not among the entities listed in Article 25 of Legislative Decree 127/1991. Moreover, consolidation would be immaterial for the purpose of providing a true and fair view of the Bank's balance sheet, financial position and profit and loss account.

public contracts awarded to controlled legal persons set out in Directive 2014/24/EU ('in-house providing').

Table 14

| B. Movements in securities relating to the investment of reserves and provisions | | | | | | |
|---|------------------|-----------------------------------|--|-----------------------|--------------------------------|---------------|
| (Sub-item 11.2) | | | | | | |
| <i>(millions of euros)</i> | | | | | | |
| | Bonds | | Shares and other participating interests | | ETFs and shares/units of UCITS | Total |
| | held to maturity | other than those held to maturity | Permanent investments | Temporary investments | | |
| Opening balance | 32,919 | 284 | 584 | 6,571 | 2,641 | 42,999 |
| Increases | 8,712 | 10 | 1 | 2,722 | 505 | 11,950 |
| Purchases (1) | 8,712 | 9 | 1 | 1,936 | 1 | 10,659 |
| Net gains | – | – | – | 212 | 504 | 716 |
| Net price revaluation gains (2) | – | – | – | 574 | – | 574 |
| Net premiums and discounts | – | 1 | – | – | – | 1 |
| Decreases | -4,016 | -36 | – | -651 | -1,753 | -6,456 |
| Sales and redemptions (1) | -3,590 | -16 | – | -610 | -1,501 | -5,717 |
| Net price revaluation losses (2) | – | – | – | – | -224 | -224 |
| Net premiums and discounts | -247 | – | – | – | – | -247 |
| Write-downs due to price changes (3) | – | -2 | – | -41 | – | -43 |
| Exchange rate adjustments (4) | -179 | -18 | – | – | -28 | -225 |
| Closing balance | 37,615 | 258 | 585 | 8,642 | 1,393 | 48,493 |

(1) Include the adjustments to the average cost of currency. – (2) Increase/decrease in revaluation accounts. – (3) Recognized in the profit and loss account. – (4) Gains and losses that are reported, net of the valuation of the relative hedges of exchange rate risk, in the revaluation accounts or among write-downs in the profit and loss account.

Table 15

| Participating interests in subsidiary and associated companies | | | | | | |
|---|-----------------------|-------------------|--------------------------------|--|--------|-----------------------|
| | At the end of 2017 | | | Subsidiary or associated company data for 2016 (millions of euros) | | |
| | Number of shares held | % of capital held | Book value (millions of euros) | Net equity | Profit | Dividends distributed |
| Società Italiana di Iniziative Edilizie e Fondiarie SpA - Rome, Italy (Capital of €507,000,000 represented by 507,000 shares with a par value of €1,000 each) | 507,000 | 100 | 527 | 556 | 3 | – |
| EuropaFi SAS - Longues, Vic-le-Comte, France (Capital of €133,000,000 represented by 1,330,000 shares with a par value of €100 each) | 6,650 | 0.5 | 0.7 | 140 | 6 | – |

The other participating interests held as permanent investments include shares in the Bank for International Settlements, which are denominated in SDRs, valued at

cost and translated at historic exchange rates. The Bank's stake is equal to 9.4 per cent of the BIS's capital.

[5] Intra-Eurosystem claims and liabilities

Table 16

| Positions with the ECB and the other euro-area NCBs (millions of euros) | | | |
|---|----------------|----------------|---------------|
| | 31.12.2017 | 31.12.2016 | Change |
| Assets | | | |
| 9.1 Participating interest in the ECB | 1,333 | 1,333 | – |
| 9.2 Claims arising from the transfer of foreign reserves to the ECB | 7,134 | 7,134 | – |
| 9.3 Net claims relating to the allocation of euro banknotes within the Eurosystem | 38,684 | 35,254 | 3,430 |
| 9.4 Other claims within the Eurosystem (net) | – | – | – |
| Total | 47,151 | 43,721 | 3,430 |
| Liabilities | | | |
| 9.3 Other liabilities within the Eurosystem (net) | 437,605 | 355,667 | 81,938 |
| Total | 437,605 | 355,667 | 81,938 |

On the asset side:

- the *Participating interest in the ECB*²¹ remained unchanged at €1,333 million. Claims arising from the transfer of foreign reserves to the ECB,²² which are computed according to the Bank's subscription, also remained stable at €7,134 million.
- *Net claims relating to the allocation of euro banknotes within the Eurosystem* amounted to €38,684 million (see 'Banknotes in circulation').

On the liability side:

- *Other liabilities within the Eurosystem (net)* amounted to €437,605 million (compared with €355,667 million in 2016) and represent the Bank's net position vis-à-vis the Eurosystem, mainly deriving from the operation of the TARGET2

²¹ Pursuant to Article 28 of the Statute of the ESCB, the NCBs are the sole subscribers and holders of the capital of the ECB. Subscriptions are determined on the basis of the key established in Article 29 of the Statute and adjusted every five years or when a new country joins the EU. At the end of 2017 the Bank of Italy's share of the ECB's subscribed capital amounted to 12.3108 per cent. Considering only the NCBs belonging to the Eurosystem, it amounted to 17.4890 per cent.

²² *Claims arising from the transfer of foreign reserves to the ECB* represent the interest-earning claim denominated in euros recorded at the start of the third stage of the EMU following the transfer of gold, foreign securities and foreign currencies to the ECB in proportion to the Bank's share of the ECB's capital, as in the case of the other Eurosystem NCBs. This item is adjusted when the participating interest in the ECB's subscribed capital is revised.

system. The latter gave rise to an overall debit position of €439,023 million at the end of 2017 (compared with €356,559 million in 2016).²³

[6] Other assets

This item consists mainly of investments in securities of reserves and provisions (see 'Securities portfolio').

Table 17

| Other assets (Item 11) (millions of euros) | | | |
|---|---------------|----------------|--------------|
| | 31.12.2017 | 31.12.2016 (1) | Change |
| 11.1 Euro-area coins | 93 | 129 | -36 |
| 11.2 Securities relating to the investment of reserves and provisions (2) | 48,531 | 43,036 | 5,495 |
| 11.3 Intangible fixed assets | 72 | 80 | -8 |
| 11.4 Tangible fixed assets | 2,093 | 2,180 | -87 |
| 11.5 Accruals and prepaid expenses | 4,569 | 3,927 | 642 |
| 11.6 Deferred tax assets | 1,481 | 2,116 | -635 |
| 11.7 Sundry | 754 | 809 | -55 |
| Other investments for staff severance pay and pensions | 100 | 109 | -9 |
| Supplementary pension fund | 520 | 446 | 74 |
| Other components | 134 | 254 | -120 |
| Total | 57,593 | 52,277 | 5,316 |

(1) For intangible fixed assets and deferred tax assets, the balances at 31 December 2016 are adjusted for ease of comparison. –
(2) The balance at 31 December 2017 is composed of securities amounting to €48,493 million and reverse operations totalling €38 million.

The composition of *Intangible fixed assets* (Sub-item 11.3) and movements during the year are shown in Table 18.

Starting in 2017, the costs relating to internally developed software are recorded in the profit and loss accounts in the years in which they are incurred, and no longer under intangible fixed assets, even if the software's useful life covers a multi-year period. The change was implemented retrospectively with the adjustment of the opening balance of net equity for the year 2017. The data for 2016 are restated for comparison purposes. The opening balance of net equity for the year 2017 was adjusted downwards by €16 million. This amount arises from the derecognition of the residual software's value at 1 January 2017, equal to €24 million, and the simultaneous recognition of €8 million in relation to deferred tax assets. The €16 million adjustment is shown in the comparative figures for 2016 as a reduction of €14 million in extraordinary reserves and of €2 million in profit for the previous year. The €2 million change is the effect of the algebraic sum of the €16 million derecognition of the corresponding amortization, the €12 million in capitalization

²³ At the end of the year the overall position was reduced by (a) a claim of €173 million (€169 million in 2016) for the ECB interim profit distribution pertaining to 2017 and (b) a claim of €1,245 million (€723 million in 2016) deriving from the net result of the pooling of monetary income for the year.

recognized in other income, the €7 million increase in previously capitalized administrative expenses, and the €1 million positive tax effect.

Table 18

| Movements in intangible fixed assets (Sub-item 11.3) (millions of euros) | | | | |
|--|----------------|----------------------------------|---|------------|
| | Procedures (1) | Multi-year software licence fees | Assets under development and related advances (1) | Total |
| Opening balance (2) | 67 | 10 | 3 | 80 |
| Increases | 6 | 7 | 4 | 17 |
| Purchases and improvement costs | – | 7 | 4 | 11 |
| Transfers | 6 | – | – | 6 |
| Decreases | -11 | -8 | -6 | -25 |
| Amortization | -11 | -8 | – | -19 |
| Transfers | – | – | -6 | -6 |
| Closing balance | 62 | 9 | 1 | 72 |

(1) Relating to procedures developed as part of the Eurosystem's IT projects. – (2) The opening balance is adjusted for ease of comparison.

The composition of *Tangible fixed assets* (Sub-item 11.4) and movements during the year are shown in Tables 19 and 20. The year-end market value of the buildings owned by the Bank is estimated to be €3,553 million (€3,631 million in 2016).

Table 19

| Movements in tangible assets (property) (millions of euros) | | | | | | | |
|---|--------------|------------|--|-----------|--------------------|-----------|--------------|
| | Premises | | Investment property for allocations to severance and pension provision (1) | | Other property (1) | | Total |
| | Buildings | Land (2) | Buildings | Land | Buildings | Land | |
| Opening balance (gross) | 2,792 | 914 | 9 | 2 | 529 | 90 | 4,336 |
| Accumulated depreciation | -1,922 | – | -4 | – | -353 | – | -2,279 |
| Opening balance (net) | 870 | 914 | 5 | 2 | 176 | 90 | 2,057 |
| Increases | 3 | – | – | – | 1 | – | 4 |
| Transfers (cost) | 3 | – | – | – | – | – | 3 |
| Other changes (cost) | – | – | – | – | 1 | – | 1 |
| Decreases | -82 | – | -1 | -1 | -8 | -3 | -95 |
| Sales and/or disposals (cost) | – | – | -3 | -1 | -11 | -2 | -17 |
| Sales and/or disposals (accum. depreciation) | – | – | 2 | – | 6 | 1 | 9 |
| Depreciation | -82 | – | – | – | – | – | -82 |
| Other changes (cost) | – | – | – | – | -4 | -1 | -5 |
| Closing balance (gross) | 2,795 | 914 | 6 | 1 | 516 | 86 | 4,318 |
| Accumulated depreciation | -2,004 | – | -2 | – | -347 | 1 | -2,352 |
| Closing balance (net) | 791 | 914 | 4 | 1 | 169 | 87 | 1,966 |

(1) Buildings/land for sale and/or no longer in use or usable for the Bank's activities. – (2) Land, including that on which buildings stand, is not depreciated.

Accruals and prepaid expenses (Sub-item 11.5) are detailed in Table 21.

Deferred tax assets (Sub-item 11.6) show a net decrease of €635 million, being the combined effect of:

- a decrease of €649 million as a result of offsetting the remaining tax loss for 2002 against taxable income for 2017;
- a net increase of €14 million in deferred tax assets associated with other items of the profit and loss account.

Table 20

| Movements in tangible fixed assets (other) | | | | | |
|---|------------------------------------|------------|-----------------------|---|------------|
| <i>(millions of euros)</i> | | | | | |
| | Equipment, furniture & furnishings | Plant | Coins and collections | Assets under development and related advances | Total |
| Opening balance (gross) | 207 | 548 | 2 | 17 | 774 |
| Accumulated depreciation | -165 | -486 | – | – | -651 |
| Opening balance (net) | 42 | 62 | 2 | 17 | 123 |
| Increases | 3 | 31 | – | – | 34 |
| Purchases and improvement costs | 3 | 14 | – | 20 | 37 |
| Transfers (cost) | - | 17 | – | -20 | -3 |
| Decreases | -11 | -19 | – | – | -30 |
| Sales and/or disposals (cost) | -7 | -20 | – | – | -27 |
| Sales and/or disposals (accumulated depreciation) | 7 | 20 | – | – | 27 |
| Depreciation | -11 | -19 | – | – | -30 |
| Closing balance (gross) | 203 | 559 | 2 | 17 | 781 |
| Accumulated depreciation | -169 | -485 | – | – | -654 |
| Closing balance (net) | 34 | 74 | 2 | 17 | 127 |

Table 21

| Accruals and prepaid expenses (Sub-item 11.5) | | | |
|--|--------------|--------------|------------|
| <i>(millions of euros)</i> | | | |
| | 31.12.2017 | 31.12.2016 | Change |
| Accrued income | 4,554 | 3,913 | 641 |
| Interest accrued on securities denominated in euros | 4,428 | 3,773 | 655 |
| Interest accrued on monetary policy deposits | 9 | 3 | 6 |
| Interest accrued on securities denominated in foreign currencies | 104 | 130 | -26 |
| Interest accrued on other foreign currency assets | 12 | 6 | 6 |
| Other | 1 | 1 | – |
| Prepaid expenses | 15 | 14 | 1 |
| Administrative expenses | 15 | 14 | 1 |
| Total | 4,569 | 3,927 | 642 |

The bulk of the deferred tax assets included in the balance sheet derive from the carry-forward of the residual tax losses from the bond conversion under Law 289/2002.²⁴ The reasonable expectation of their recovery takes account of the Bank's expected profit and the applicable tax rules.

²⁴ The rules governing the carry-forward of losses from bond conversion under Law 289/2002 are set out in Article 65 of that law as amended by Law 248/2005. They state that the losses may be utilized with no time restriction to offset up to 50 per cent of corporate taxable income (IRES) each year.

Movements in deferred tax assets and liabilities during the year are shown in Tables 43 and 44 of 'Notes on the items of the profit and loss account'.

Sundry (Sub-item 11.7 on the asset side) includes the balance sheet total (€520 million) of the defined-contribution supplementary pension fund for staff hired on or after 28 April 1993, which is matched on the liability side by an equal amount entered in Sub-item 11.3 of *Other liabilities*. The fund constitutes a separate asset for administrative and accounting purposes pursuant to Article 2117 of the Civil Code. The Bank manages its investments observing benchmarks.

Table 22

| Deferred tax assets (millions of euros) | | | | | | | | |
|--|-----------------------|--------------|-----------|--------------|-----------------------|--------------|-----------|--------------|
| | 31.12.2017 | | | | 31.12.2016 (1) | | | |
| | Temporary differences | IRES | IRAP | Total | Temporary differences | IRES | IRAP | Total |
| Tax loss for 2002 | 4,835 | 1,329 | – | 1,329 | 7,193 | 1,978 | – | 1,978 |
| Staff costs accrued but not paid | 272 | 75 | 15 | 90 | 224 | 62 | 12 | 74 |
| Civil law depreciation - not yet tax deducted (Revaluation reserve under Law 266/2005) | 142 | 39 | 8 | 47 | 143 | 39 | 8 | 47 |
| Other | 44 | 12 | 3 | 15 | 52 | 14 | 3 | 17 |
| Total | 5,293 | 1,455 | 26 | 1,481 | 7,612 | 2,093 | 23 | 2,116 |
| Deferred tax liabilities (millions of euros) | | | | | | | | |
| | 31.12.2017 | | | | 31.12.2016 | | | |
| | Temporary differences | IRES | IRAP | Total | Temporary differences | IRES | IRAP | Total |
| Realized gains on securities, property and other assets | 5 | 1 | – | 1 | 4 | 1 | – | 1 |
| Depreciation on differences generated by separating land and buildings (2) | 35 | 10 | 2 | 12 | 36 | 10 | 2 | 12 |
| Other | 13 | 4 | – | 4 | 13 | 4 | – | 4 |
| Total | 53 | 15 | 2 | 17 | 53 | 15 | 2 | 17 |

(1) The balances at 31 December 2016 are adjusted for ease of comparison (see 'Other assets'). – (2) Depreciation on the increased tax values generated by separating land from buildings for sale and/or no longer in use or usable for the Bank's activities.

[7] Banknotes in circulation

The total value of banknotes in circulation issued by the Eurosystem is distributed among the ECB (8 per cent) and the NCBs in proportion to their shares in the ECB's capital (see 'Legal basis, accounting policies and layout of the annual accounts'). The item, which represents the Bank of Italy's share (16.1 per cent),²⁵ increased by €7,160

²⁵ This is equal to 92 per cent of the Bank's share in the capital of the ECB (17.4890 per cent) considering only the Eurosystem NCBs.

million (from €181,208 million to €188,368 million). To a lesser extent, the value of banknotes actually put into circulation by the Bank was also up (from €145,955 million to €149,684 million). The amount of banknotes issued by the Bank was lower than the notional amount assigned to it and the difference of €38,684 million is shown as a claim on the Eurosystem in Item 9.3 on the asset side, as *Net claims relating to the allocation of euro banknotes within the Eurosystem*.

[8] Liabilities to general government and other counterparties

Item 4 on the liability side, which amounted to €12,793 million at the end of 2017 compared with €15,649 million in 2016, refers mainly to the deposits held by the Treasury with the Bank of Italy (€6,550 million) and euro-denominated deposits of counterparties other than credit institutions (€6,204 million).

Table 23

| Liabilities to other euro-area residents (Item 4) | | | |
|---|---------------|---------------|---------------|
| (millions of euros) | | | |
| | 31.12.2017 | 31.12.2016 | Change |
| 4.1 General government | 6,589 | 9,779 | -3,190 |
| 4.1.1 Treasury payment account | 6,550 | 9,733 | -3,183 |
| 4.1.2 Other liabilities | 39 | 46 | -7 |
| 4.2 Other counterparties | 6,204 | 5,870 | 334 |
| Total | 12,793 | 15,649 | -2,856 |

The year-end balance on the Treasury deposits with the Bank of Italy fell with respect to 2016, but the annual average balance rose from €14,867 million to €17,963 million.

GOVERNMENT DEPOSITS

Government deposits held with the Eurosystem are regulated by Decision ECB/2014/8 and Guideline ECB/2014/9 of 20 February 2014, amended by Guideline ECB/2014/22 and Decision ECB/2014/23 of 5 June 2014. Accordingly, (a) as of 1 December 2014, overnight and fixed-term government deposits are remunerated with an interest rate no higher than the Eonia and the Eurepo respectively and (b) as of June 2014, the total amount of government deposits that can be remunerated is the higher of either the sum of €200 million or 0.04 per cent of GDP, and any amount in excess is remunerated with an interest rate of zero per cent or with the interest rate on the deposit facility, if negative.

At 31 December 2017 *Other liabilities* amounted to €39 million (compared with €46 million in 2016) and consisted exclusively of debt positions with general government in respect of advances received for the management of cross-border euro payments and collections. *Liabilities to other counterparties* (Sub-item 4.2) amounted to €6,204 million, up from €5,870 million in 2016. Other deposits making up the item include the holdings of the National Resolution Fund set up by the Bank of Italy as National Resolution Authority.

[9] Liabilities to non-euro-area residents denominated in euros

Sub-item 5.2 (*Other liabilities*) amounted to €3,301 million (€2,565 million in 2016) and included accounts held by customers using the Eurosystem Reserve Management Services (ERMS)²⁶ in the amount of €1,553 million and other deposits by non-residents totalling €1,748 million, including the Single Resolution Board (SRB).²⁷

[10] Other liabilities

As detailed below:

Table 24

| Other liabilities (Item 11) (millions of euros) | | | |
|---|--------------|--------------|------------|
| | 31.12.2017 | 31.12.2016 | Change |
| 11.1 Cashier's cheques | 104 | 169 | -65 |
| 11.2 Accruals and income collected in advance | 1,227 | 317 | 910 |
| 11.3 Sundry | 1,531 | 1,609 | -78 |
| Supplementary pension fund | 520 | 446 | 74 |
| Special item for stabilizing dividends | 40 | - | 40 |
| Other components | 971 | 1,163 | -192 |
| Total | 2,862 | 2,095 | 767 |

Accruals and income collected in advance (Sub-item 11.2) are detailed below:

Table 25

| Accruals and income collected in advance (Sub-item 11.2) (millions of euros) | | | |
|--|--------------|------------|------------|
| | 31.12.2017 | 31.12.2016 | Change |
| Accrued expenses | 1,227 | 317 | 910 |
| Interest accrued on refinancing operations | 1,214 | 300 | 914 |
| Interest accrued on liabilities denominated in foreign currency | 13 | 17 | -4 |
| Income collected in advance | - | - | - |
| Total | 1,227 | 317 | 910 |

The interest accrued on refinancing operations refers to longer-term operations (see 'Notes on the items of profit and loss account' - *Net interest income*).

Other liabilities includes the special item for stabilizing dividends, which amounted to €40 million. The establishment of the special item was decided by the Meeting of Shareholders on 31 March 2017 in order to smooth the implementation of the dividend policy.²⁸ *Other liabilities* includes the amount of IRES and IRAP tax payables, net of payments on account, due for the reference period.

²⁶ The Eurosystem NCBs can offer ERMS to central banks and government bodies of non-euro countries and to international organizations within a framework of harmonized terms and conditions.

²⁷ Contributions paid by Italian credit institutions and collected by the Bank, in its role as National Resolution Authority and on behalf of the Single Resolution Board, pass through its accounts.

²⁸ In 2015 the Board of Directors indicated that, in subsequent years, they plan to keep the annual dividend within a range from €340 million to €380 million, provided that the net profit and the Bank's capital adequacy are sufficient.

[11] Provision for general risks and other provisions

The balances and movements of *Provisions* are shown in Tables 26 and 27.

Table 26

| Movements in provisions for specific risks (Sub-item 12.1) | | | | |
|---|----------------------------|-------------------|---|------------|
| <i>(millions of euros)</i> | | | | |
| | Damage insurance provision | Tax provision (1) | Provision for Eurosystem monetary policy operations | Total |
| Opening balance | 310 | 17 | – | 327 |
| Increases | – | 1 | 12 | 13 |
| Allocations | – | – | 12 | 12 |
| Other increases | – | 1 | – | 1 |
| Decreases | – | -1 | – | -1 |
| Other decreases | – | -1 | – | -1 |
| Closing balance | 310 | 17 | 12 | 339 |

(1) The tax provision includes liabilities for deferred IRES and IRAP taxes. *Other increases* and *Other decreases* include the change in deferred tax liabilities.

The increase in *Provisions for specific risks* (Sub-items 12.1) was due to the provision for risks relating to monetary policy operations established to cover impairment loss at Eurosystem level on one security in the CSPP programme (see '*Monetary policy operations*'). The size of the provision, equal to €69 million, was calculated by taking account of the information available on the sale of the security, which took place in early January 2018. As provided for by Article 32.4 of the Statute of the ESCB, the provision was established by all euro-area NCBs in proportion to their shares in the ECB's capital in 2017. Therefore, the amount assigned to the Bank of Italy was equal to €12 million.

Movements in the tax provision, which only refers to deferred tax liabilities for IRES and IRAP, are shown in Table 45.

Table 27

| Movements in staff-related provisions (Sub-item 12.2) | | | | | |
|--|--------------------------------------|-----------------|-----------------------|---|--------------|
| <i>(millions of euros)</i> | | | | | |
| | For staff severance pay and pensions | For staff costs | For severance pay (1) | For grants to BI pensioners and their survivors | Total |
| Opening balance | 6,734 | 269 | 3 | 3 | 7,009 |
| Increases | – | 175 | 1 | – | 176 |
| Allocations | – | 166 | – | – | 166 |
| Other increases (2) | – | 9 | 1 | – | 10 |
| Decreases | -8 | -112 | -2 | – | -122 |
| Withdrawals | – | -112 | -2 | – | -114 |
| Other decreases (2) | -8 | – | – | – | -8 |
| Closing balance | 6,726 | 332 | 2 | 3 | 7,063 |

(1) Includes severance pay accrued by contract staff and ordinary staff prior to joining the supplementary pension fund. – (2) Include transfers between funds.

Staff-related provisions (Sub-item 12.2) amounted to €7,063 million. In 2017:

- in relation to transfers to other provisions totalling €8 million, the severance pay provision decreased to €6,726 million, with a small surplus of about €12 million over total commitments for pensions and severance pay at 31 December 2017 that was prudentially left in the provision;

- the provision for staff costs increased by €63 million to €332 million at the end of the year. The increase was due to the higher provisions (€77 million) for the estimated costs of the early retirement measures approved in 2017 for staff affected by the reorganization of the banknote production function and the updated estimate of the costs of the early retirement measures approved in previous years²⁹ (see ‘Other information’). This provision includes transfers equal to €13 million for lump-sum disbursements to staff hired on or after 28 April 1993 who joined the defined-contribution supplementary pension fund to be settled upon their leaving service.

In 2017 the Bank continued to gradually adjust its financial buffers to reflect its overall risk exposure and the increased size of its balance sheet. In order to progressively increase the resources available to address the risks involved in implementing the public and private sector asset purchase programmes in even the most adverse scenarios, the provision for general risks was increased by €2,920 million (the same amount as in 2016) to €25,214 million.

Table 28

| Movements in the provision for general risks (Item 14) (millions of euros) | | |
|--|---------------|---------------|
| | 31.12.2017 | 31.12.2016 |
| Opening balance | 22,294 | 19,374 |
| Increases | 2,920 | 2,920 |
| Allocations | 2,920 | 2,920 |
| Decreases | – | – |
| Withdrawals | – | – |
| Closing balance | 25,214 | 22,294 |

[12] Revaluation accounts

These include unrealized gains from the valuation at market prices of gold, foreign currency, securities and forward operations (see *Gold, assets and liabilities denominated in foreign currency* and *Securities portfolio*).

Table 29

| Revaluation accounts (Item 13) (millions of euros) | | | |
|--|-----------------|------------------|-----------------|
| | Opening balance | Net revaluations | Closing balance |
| Exchange rate revaluations | 74,199 | -5,312 | 68,887 |
| <i>of which:</i> gold | 67,137 | -1,275 | 65,862 |
| net foreign currency assets (1) | 7,060 | -4,054 | 3,006 |
| financial assets relating to the investment of reserves and provisions (1) | 2 | 17 | 19 |
| Price revaluations | 3,919 | 158 | 4,077 |
| <i>of which:</i> foreign currency securities | 131 | -49 | 82 |
| securities denominated in euros | 583 | -143 | 440 |
| financial assets relating to the investment of reserves and provisions | 3,205 | 350 | 3,555 |
| Total | 78,118 | -5,154 | 72,964 |

(1) Includes net revaluations relating to operations to hedge exchange rate risks on the Bank's SDR position and foreign currency investments relating to reserves and provisions.

²⁹ The allocation is computed on the basis of the best estimate of the number of staff likely to take advantage of the incentive plan.

[13] Capital and reserves

The composition of this item is detailed below:

Table 30

| Capital and reserves (Item 15) (millions of euros) | | | |
|--|---------------|---------------|------------|
| | 31.12.2017 | 31.12.2016 | Change |
| 15.1 Capital | 7,500 | 7,500 | – |
| 15.2 Statutory reserves | 10,373 | 10,093 | 280 |
| Ordinary | 5,778 | 5,496 | 282 |
| Extraordinary (1) | 4,595 | 4,597 | -2 |
| 15.3 Other reserves | 7,740 | 7,740 | – |
| Monetary revaluation reserves (2) | 3,813 | 3,813 | – |
| Special Fund for the renewal of tangible fixed assets | 1,805 | 1,805 | – |
| Surplus from the merger of UIC (Legislative Decree 231/2007) | 2,122 | 2,122 | – |
| Total | 25,613 | 25,333 | 280 |

(1) The balance at 31 December 2016 of the extraordinary statutory reserve and retained earnings have been adjusted owing to changes in the accounting standard on the capitalization of internally developed domestic IT procedures (see *Other assets*). – (2) Under Laws 72/1983, 408/1990, 413/1991, 342/2000, and 266/2005.

Article 4 of Law 5/2014 (which reformed the Bank of Italy's ownership structure) and the ensuing changes to the Statute provide that shareholders' ownership rights be limited exclusively to the value of the capital and dividends; the latter cannot exceed 6 per cent of capital in a given year. Therefore, the equity reserves, regardless of their origin, may only be used to cover possible losses.

The movements in the ordinary and extraordinary reserves are detailed below:

Table 31

| Movements in ordinary and extraordinary reserves (Sub-item 15.2) (millions of euros) | | | | |
|--|-----------------------|---------------------------------|-------------------------------|-----------------------|
| | Balance at 31.12.2016 | Change in retained earnings (1) | Allocation of 2016 profit (2) | Balance at 31.12.2017 |
| Ordinary | 5,496 | – | 282 | 5,778 |
| Extraordinary (1) | 4,597 | -2 | – | 4,595 |
| Total | 10,093 | – | 282 | 10,373 |

(1) The balance at 31 December 2016 of the extraordinary statutory reserve and the retained earnings have been adjusted owing to the change in the accounting standard concerning the capitalization of internally developed domestic IT procedures (see *Other assets*). – (2) In accordance with the Statute.

The distribution of the shareholdings in the Bank of Italy's capital at 31 December 2017 is detailed in Table 32.

The transactions carried out in 2017 in relation to Bank of Italy shareholdings led to the transfer of about 9.7 per cent of capital. At 31 December 2017 there were 121 shareholders (102 at end-2016), of whom 27 were new (1 social security institution, 8 pension funds, 9 banking foundations, 5 insurance companies and 4 banks). The 8 entities no longer shareholders were all banks.

Table 32

| Shareholders in the Bank of Italy | | | | |
|-----------------------------------|--------------------|----------------|--------------------|----------------|
| | At the end of 2017 | | At the end of 2016 | |
| | Number | Shares | Number | Shares |
| Banks | 76 | 195,360 | 80 | 217,471 |
| Social security institutions | 11 | 58,760 | 10 | 58,360 |
| Pension funds | 8 | 9,880 | – | – |
| Insurance companies | 10 | 23,234 | 5 | 21,813 |
| Banking foundations | 16 | 12,766 | 7 | 2,356 |
| Total | 121 | 300,000 | 102 | 300,000 |

As a result of these developments, at year-end 65.12 per cent of the shareholdings were held by banks, 7.74 per cent by insurance companies, 19.59 per cent by social security institutions, 3.29 per cent by pension funds, and 4.26 per cent by banking foundations. Four shareholders still hold, at individual and consolidated level, shares exceeding the 3 per cent threshold set by the law.

Commitments, collateral granted and other off-balance-sheet accounts

Commitments and collateral granted by the Bank are reported in Table 33, which also shows the total third-party securities and valuables on deposit with the Bank and the balance sheet total of the National Resolution Fund set up within the Bank of Italy pursuant to Article 78 of Legislative Decree 180/2015.

Table 33

| Commitments and collateral granted (millions of euros) | | | |
|--|----------------|----------------|---------------|
| | 31.12.2017 | 31.12.2016 | Change |
| Orders in progress | 185 | 15 | 170 |
| Purchases | 181 | 9 | 172 |
| Sales | 4 | 6 | -2 |
| Forward operations | 2,678 | 6,421 | -3,743 |
| Forward sales of foreign currencies | 1,879 | 5,283 | -3,404 |
| Forward purchases of foreign currencies | 75 | 561 | -486 |
| Futures contracts purchased | 711 | 427 | 284 |
| Futures contracts sold | 13 | 150 | -137 |
| Commitments | 34,161 | 9,649 | 24,512 |
| To the IMF for loans granted | 34,160 | 9,649 | 24,511 |
| Other | 1 | – | 1 |
| Collateral granted | 12 | 13 | -1 |
| Third-party securities and valuables on deposit with the Bank | 94,536 | 100,670 | -6,134 |
| Total balance sheet of the National Resolution Fund | 463 | 1,797 | -1,334 |
| Commitments of the supplementary pension fund | 99 | 85 | 14 |
| Total | 132,134 | 118,650 | 13,484 |

THE NATIONAL RESOLUTION FUND

Legislative Decree 180/2015 transposing Directive 2014/59/EU (Bank Recovery and Resolution Directive) provides that one or more Italian resolution fund be set up to finance the resolution of credit institutions and investment firms in financial difficulty. These funds are financed mainly by ordinary and extraordinary contributions from credit institutions and investment firms and provide the National Resolution Authority with the necessary financial resources to carry out resolutions. The Bank of Italy has been designated as national resolution authority. The Bank has accordingly established a Resolution and Crisis Management Unit that reports directly to the Governing Board. Its function is to draft and implement resolutions. On 18 November 2015 the Bank issued a measure creating the National Resolution Fund. The Fund has its own capital that is in all respects independent and separate from that of the Bank and from any other capital the Bank manages, as well as from the capital of each of the contributors to its resources. To ensure the necessary transparency vis-à-vis the public, the Fund issues an annual report, audited by the same independent auditing company that audits the Bank's annual accounts and published at the same time. Its operating and administrative costs figure among those of the Bank, as do the indirect costs for resolution activity. The Fund has separate fiscal personality for IRES and IRAP taxation purposes.

Forward sales of foreign currency include exchange-rate risk-hedging operations on the Bank's SDR position and foreign currency investments relating to reserves and provisions (see *Securities portfolio*).

Commitments to the IMF for granting loans relate to measures by the IMF for financing to be disbursed on behalf of the Italian government. In May 2017 a bilateral borrowing agreement worth €23,480 million was signed.

The Bank participates in the automatic securities lending programmes managed by specialized intermediaries, involving foreign currency securities and all portfolios of securities held for monetary policy purposes. The market value of securities lent by the Bank under these programmes amounted to €1,265 million for foreign currency securities, €564 million for covered bonds, and €11,541 million for PSPP, CSPP and SMP securities.

Notes on the items of the profit and loss account

[14] Net interest income

Net interest income (Item 1) represents the balance of interest income and interest expense for the year, excluding interest on financial assets relating to the investment of reserves and provisions, which is given under Item 6. In 2017, this item rose by €849 million, from €6,095 million to €6,944 million. The change was mainly due to the rise in interest income on securities purchased under the APP, which was partly offset by the increase in negative interest on TLTRO II operations recognized under interest expense.

Total interest income amounted to €7,904 million (Table 34), up by €1,520 million on 2016.

Table 34

| Interest income (Sub-item 1.1) (1) (millions of euros) | | | |
|--|--------------|--------------|--------------|
| | 2017 | 2016 | Change |
| Securities denominated in euros | 7,113 | 5,993 | 1,120 |
| <i>of which:</i> CBPP1, CBPP2, CBPP3 | 323 | 372 | -49 |
| SMP | 856 | 995 | -139 |
| PSPP | 2,845 | 1,427 | 1,418 |
| CSPP | 100 | 10 | 90 |
| Government bond conversion under Law 289/2002 | 710 | 710 | – |
| Other bonds | 2,279 | 2,479 | -200 |
| Main refinancing operations | – | 2 | -2 |
| Intra-ESCB balances | – | 4 | -4 |
| Current accounts (covering the minimum reserve system) | 267 | 43 | 224 |
| Treasury payments account | 6 | – | 6 |
| Other in euros | 114 | 25 | 89 |
| Securities denominated in foreign currency | 310 | 284 | 26 |
| Claims on the IMF | 50 | 9 | 41 |
| Other in foreign currency | 44 | 24 | 20 |
| Total | 7,904 | 6,384 | 1,520 |

(1) Interest earned on *financial assets relating to the investment of reserves and provisions* is shown as a separate income item (see *Net income from financial assets relating to the investment of reserves and provisions*).

Total interest income on securities denominated in euros amounted to €7,113 million. The increase of €1,120 million on 2016, despite lower average interest rates, was due to a further, substantial rise in the volume of securities held for monetary policy purposes, specifically those relating to purchases under the PSPP.

The ECB Governing Council kept the interest rate on refinancing operations at 0.0 per cent throughout 2017. As an effect, interest income was nil on the main refinancing operations (down from €2 million in 2016) and on the intra-ESCB balances (down from €4 million in 2016) under *Net claims relating to the allocation of euro banknotes within the Eurosystem* (€3 million in 2016) and under *Claims arising from the transfer of foreign reserves to the ECB* (€1 million in 2016); see ‘Notes on the items of the balance sheet’ – *Intra-Eurosystem claims and liabilities*.³⁰

The interest on longer-term refinancing operations continued to display a negative net balance in 2017, and is classified as an interest expense.

As in the previous year, there was a positive balance of €267 million for interest on current accounts covering the minimum reserve requirement (€43 million in 2016).

³⁰ Balances from the allocation of euro banknotes within the Eurosystem are remunerated at the marginal rate of interest on MROs. The remuneration on claims arising from the transfer of reserves to the ECB is also based on the marginal interest rate on MROs, less 15 per cent to take account of the part of reserves consisting of gold, which does not generate interest.

This was entirely due to interest on reserves held in excess of the minimum reserve requirement, as interest on the minimum requirement was nil.³¹

The net interest expense on the Treasury payments account was positive by €6 million (compared with a negative €7 million in 2016). Of this, the interest accrued from applying negative deposit facility rates to balances exceeding the part eligible for remuneration³² was positive by €72 million (€57 million in 2016), while additional interest due to the Treasury constituted an interest expense of €66 million (€64 million in 2016).³³

Other interest denominated in euros, amounting to €114 million in 2017 (€25 million in 2016), was mainly in the form of interest income on the deposit facility and on deposits of non-bank intermediaries, owing to negative interest rates.

There was an increase in interest income on assets denominated in foreign currency, particularly vis-à-vis the IMF, owing to the higher interest rates recorded during the year.

Interest expense amounted to €960 million (Table 35), representing an overall increase of €671 million with respect to 2016.

Table 35

| Interest expense (Sub-item 1.2) <i>(millions of euros)</i> | | | |
|--|------------|------------|------------|
| | 2017 | 2016 | Change |
| Longer-term refinancing operations | 908 | 243 | 665 |
| Treasury payments account | – | 7 | -7 |
| Intra-ESCB balances | – | 27 | -27 |
| Counterpart of SDRs allocated by the IMF | 42 | 7 | 35 |
| Other in foreign currency | 10 | 5 | 5 |
| Total | 960 | 289 | 671 |

Interest on longer-term refinancing operations registered a negative net balance of €908 million (€243 million in 2016). The balance was the result of an interest expense of €910 million (€306 million in 2016) in connection with TLTRO II operations and interest income of €2 million on other operations (€63 million in 2016). The increase in interest expense on TLTRO II operations was exclusively due to the significant rise in the corresponding average stocks. The interest yield, unchanged from 2016, was equal to the negative deposit facility interest rate (-0.40 per cent). The contraction in interest on other longer-term refinancing operations was due to the reduction in the corresponding stocks which was driven mainly by the early repayments of the TLTROs conducted in previous years.

³¹ The accounts for the minimum reserve requirement are remunerated at the average of the marginal interest rates on Eurosystem MROs during the reserve maintenance period. Reserves in excess of the requirement are remunerated at the interest rate on the deposit facility, which was negative (-0.40 per cent) throughout 2017.

³² See 'Notes on the items of the balance sheet' – *Liabilities to general government and other counterparties* and the box 'Government deposits'.

³³ Supplementary interest is paid to the Treasury under Presidential Decree 398/2003 (Consolidated law containing provisions and rules on the public debt). It is computed on the basis of the daily interest-bearing balance of the Treasury payments account at a rate equal to the difference, if positive, between the interest rate on the securities originally purchased by the Bank to set up the related holdings (and not yet matured) and the reference rate used to compute the interest on the account.

TLTRO II REMUNERATION

The second series of TLTRO II, featuring a maturity of four years, is remunerated on the basis of the interest rate on the main refinancing operations prevailing at the time of allotment and this remuneration can be reduced up to the deposit facility rate depending on the increase observed in loans to households and firms by participating banks (see 'Background to Eurosystem monetary policy'). Therefore, since the rate used to calculate the interest recognized in the profit and loss account was not known at the end of 2017 and could not be reliably estimated, under the prudence principle it has been agreed at Eurosystem level to use the negative deposit facility rate prevailing at the time of allotment.

Interest expense on negative TARGET2 balances was nil (€27 million in 2016) on account of the rate of remuneration falling to zero on 10 March 2016³⁴ and remaining at that level throughout 2017.

As a result of the rise in interest rates, the interest on SDR allocations by the IMF has increased.

[15] Net result of financial operations, write-downs and transfers to/from risk provisions

The result for 2017 (Table 36) includes: (a) net profit from foreign exchange trading for €217 million, referring almost entirely to trading in US dollars; (b) net profit from trading in securities mostly denominated in US dollars and pound sterling, for €46 million, and (c) write-downs for €169 million, mainly due to price changes for securities denominated in US dollars and to exchange rate changes for those denominated in Australian dollars. Transfers to the provision for general risks amounted to €2,920 million, as in 2016.

Table 36

| Net result of financial operations, write-downs and transfers to/from risk provisions (Item 2) | | | |
|--|---------------|---------------|-------------|
| <i>(millions of euros)</i> | | | |
| | 2017 | 2016 | Change |
| Profits (+) and losses (-) on financial operations | 266 | 364 | -98 |
| Foreign exchange trading | 217 | 251 | -34 |
| Trading in securities denominated in euros | 9 | 23 | -14 |
| Trading in securities denominated in foreign currency | 37 | 84 | -47 |
| Derivatives contracts | -9 | 2 | -11 |
| Other transactions | 12 | 4 | 8 |
| Write-downs (-) of financial assets and positions | -169 | -146 | -23 |
| Due to exchange rate changes | -46 | - | -46 |
| Due to price changes | | | |
| – securities denominated in euros | -16 | -35 | 19 |
| – securities denominated in foreign currency | -107 | -111 | 4 |
| Transfers to (-) the provision for general risks for exchange rate, price and credit risks | -2,920 | -2,920 | - |
| Total | -2,823 | -2,702 | -121 |

³⁴ The TARGET2 balance is remunerated at the marginal rate of interest on MROs.

[16] Net income from fees and commissions

Net income from fees and commissions (Item 3) amounted to €18 million (€12 million in 2016), with the increase mainly related to the higher fees due from participants in TARGET2 and TARGET2 Securities (up by €8 million).

Table 37

| Net income from fees and commissions (Item 3) (millions of euros) | | | |
|---|-----------|-----------|----------|
| | 2017 | 2016 | Change |
| Fee and commission income | 34 | 26 | 8 |
| TARGET2 and TARGET2-Securities | 15 | 7 | 8 |
| Financial services to the public sector | 4 | 4 | – |
| Management of securities backing monetary policy operations | 5 | 4 | 1 |
| Clearing system | 3 | 3 | – |
| Substitute protest declarations | 2 | 2 | – |
| Other | 5 | 6 | -1 |
| Fee and commission expense | 16 | 14 | 2 |
| Centralized securities management | 12 | 10 | 2 |
| Other | 4 | 4 | – |
| Total | 18 | 12 | 6 |

[17] Income from participating interests

Income from participating interests (Item 4) amounted to €212 million, down by €4 million on the previous year. The result for 2017 included:

- €40 million representing the Bank's share of the ECB's profit earned in 2016 and distributed in 2017 (€47 million in the previous year);
- €173 million representing the ECB's interim profit distribution for 2017 (€169 million in the previous year).³⁵

[18] Net result of the pooling of monetary income

The result for 2017 (Item 5), was positive by €1,233 million, and included:

- the net result of the allocation of monetary income in 2017, equal to €1,246 million (€723 million in 2016). This was the difference between the monetary income pooled by the Bank, amounting to €641 million, and that distributed to the Bank, totalling €1,887 million;
- the effects of the recalculation of amounts for previous years were negative by €1 million;
- €12 million was set aside out of the Bank of Italy's share in the provision against losses on monetary policy operations conducted by the Eurosystem (see 'Notes on the items of the balance sheet' – *Monetary policy operations* and *Provisions and provision for general risks*).

³⁵ The balance of €50 million was received in February 2018.

MONETARY INCOME

The monetary income to be pooled by each NCB is equal to its annual income derived from the earmarkable assets held against its liability base. An NCB's liability base consists primarily of (a) banknotes in circulation; (b) liabilities to euro-area credit institutions relating to monetary policy operations denominated in euros; (c) net intra-Eurosystem liabilities resulting from TARGET2 transactions; and (d) net intra-Eurosystem liabilities relating to the allocation of euro banknotes within the Eurosystem. The interest paid on the liabilities included in the liability base is deducted from the monetary income to be pooled. An NCB's earmarkable assets comprise mainly (a) lending to euro-area credit institutions relating to monetary policy operations; (b) securities held for monetary policy purposes; (c) intra-Eurosystem claims arising from the transfer of reserves to the ECB; (d) net intra-Eurosystem claims resulting from TARGET2 transactions; (e) net intra-Eurosystem claims relating to the allocation of euro banknotes within the Eurosystem; and (f) a limited amount of gold holdings and gold receivables in proportion to each NCB's subscribed capital key. Gold is not considered to generate interest. Securities purchased under the first two covered bond purchase programmes (Decision ECB/2009/16 and Decision ECB/2011/17 of the Governing Council) and public sector securities purchased under the PSPP (Decision ECB/2015/10) are considered to bear interest at the marginal rate used by the Eurosystem for MROs. Where the value of an NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference is offset by applying the marginal rate used by the Eurosystem for MROs.

The total monetary income pooled by the NCBs of the Eurosystem is redistributed to each NCB according to its capital key. The difference between the monetary income pooled by each NCB and the amount, which may be larger or smaller, redistributed to it depends on two elements. The first relates to possible differences between NCBs regarding the interest income from specific earmarkable assets and the interest expense for some components of the liability base. The second element arises from the fact that the amounts of the above assets and liabilities in the NCBs' balance sheets do not generally coincide with their share in the capital of the ECB.

[19] Net income from financial assets relating to the investment of reserves and provisions

Item 6 of the profit and loss account amounted to €1,767 million, up €152 million on 2016 (Table 38).

The increase was due to higher interest income and net profit from trading, which more than offset the increase in write-downs. Net profit from trading mainly arose from the sale of UCITS shares. The growth in interest income was due to the greater average stock of bond holdings, which more than offset the reduction in average interest rates. Write-downs were mainly due to changes in the US dollar exchange rate.

Table 38

| Net income from financial assets relating to the investment of reserves and provisions (Item 6) (millions of euros) | | | |
|---|--------------|--------------|------------|
| | 2017 | 2016 | Change |
| Interest | 1,028 | 943 | 85 |
| Dividends from equity shares and participating interests | 207 | 196 | 11 |
| Profits/losses from trading | 708 | 468 | 240 |
| Write-downs | -207 | -46 | -161 |
| Other components | 31 | 54 | -23 |
| Total | 1,767 | 1,615 | 152 |

[20] Other income

Other income (Item 8) amounted to €70 million (€68 million in 2016).

Table 39

| Other income (Item 8) (millions of euros) | | | |
|---|-----------|-----------|----------|
| | 2017 | 2016 (1) | Change |
| Rental income | 5 | 5 | – |
| Other | 65 | 63 | 2 |
| Total | 70 | 68 | 2 |

(1) The 2016 balance for *Other* is adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*).

The item includes reimbursement from other Eurosystem NCBs for the development of platforms, applications and IT infrastructure by the Bank of Italy in cooperation with the other central bank providers. The reimbursements amounted to €47 million in 2017 (€46 million in 2016) and were for the most part connected to the TARGET2 and TARGET2-Securities platforms.

[21] Expenses and sundry charges

Expenses and sundry charges (Item 9) amounted to €1,965 million, against €2,033 million in 2016.

The overall reduction in operating expenses was mainly due to the decrease in the expenses included under the sub-item *Transfers to/from provisions for staff severance pay and pensions, contributions to supplementary pension fund and other expenses*. No allocations to the staff pension and severance pay fund were necessary in 2017, compared with €123 million in 2016. Conversely, the provisions for costs associated with early retirement measures amounted to €77 million (€81 million in 2016); see 'Notes on the items of the balance sheet' – *Provision for general risks and Other provisions*.

Gross employee compensation (including contract workers), comprising wages and salaries, overtime and accrued expenses not yet paid, rose from €623.1 million to €651.8 million. Taking into account the deferral to 2017 of the payment of some non-structural wage elements attributable to the previous year and amounting to

€8.6 million, the increase was equal to 1.8 per cent and reflects the adjustments to take account of the inflation rate and the full-year effects of the new personnel classification system that had already had an impact on the second half of 2016.

Table 40

| Expenses and sundry charges (Item 9) (millions of euros) | | | |
|---|--------------|--------------|-------------|
| | 2017 | 2016 (1) | Change |
| Staff wages and salaries | 652 | 623 | 29 |
| Social security and insurance | 166 | 161 | 5 |
| Other staff costs | 40 | 45 | - 5 |
| Pensions and severance payments | 341 | 304 | 37 |
| Transfers to/from provisions for staff severance pay and pensions, contributions to the supplementary pension fund and other expenses | 146 | 270 | - 124 |
| Emoluments paid to head office and branch collegial bodies | 3 | 3 | - |
| Administrative expenses | 443 | 437 | 6 |
| Depreciation of tangible and intangible fixed assets | 131 | 139 | - 8 |
| Banknote production services (2) | - | - | - |
| Other expenses | 43 | 51 | - 8 |
| Total | 1,965 | 2,033 | - 68 |

(1) For the items *Administrative expenses* and *Depreciation of tangible and intangible fixed assets*, the balances are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*). – (2) Costs for external banknote production services and for purchases of banknotes.

Considering the average number of full-time equivalent employees³⁶ (7,101) and the above-mentioned deferral, the average gross wage rose from €87,000 to €90,600, marking an increase of 4.1 per cent (compared with 3.4 per cent last year). In the two years concerned by the new personnel classification system, per capita wage growth has outpaced that of overall wages. This reflects the reduction in staff numbers and changes in its composition: the rise in specialized tasks has led to a reduction in the share of staff in charge of operational activities. According to balance sheet data for 2017, the average salary is €91,800 (compared with €85,800 in 2016). Other staff costs decreased from €45 million to €40 million.

Table 41

| The Bank's staff | | | | |
|-------------------------------------|--|--------------|------------------------|--------------|
| Composition of the Bank's staff (1) | Average number of employees in service | | Percentage composition | |
| | 2017 | 2016 | 2017 | 2016 |
| Managerial Area | 3,142 | 3,076 | 46.2 | 44.4 |
| Operational Area | 3,653 | 3,845 | 53.8 | 55.6 |
| Total | 6,795 | 6,921 | 100.0 | 100.0 |
| Contract workers | 38 | 39 | | |

(1) With the reform of the personnel classification system, in effect as of 1 July 2016, Bank employees are separated into two areas: managerial and operational. Therefore, the average data for 2016 are adjusted for ease of comparison.

Total staff costs, i.e. gross wages and salaries plus related costs (pension and social security contributions) and other staff expenses (including per diem expenses

³⁶ The number of full-time equivalent employees is calculated by taking into account overtime, part-time and unpaid absences.

for missions and transfers), amounted to €858 million in 2017, against €829 million in 2016.

Emoluments paid to head and branch office collegial bodies comprise the overall emoluments paid to members of the Board of Directors (€412,230), the Board of Auditors (€137,430) and the Governing Board. Since 2014, the emoluments for members of the Governing Board have been set at €450,000 for the Governor, €400,000 for the Senior Deputy Governor and €315,000 for each of the three Deputy Governors. The members of the Governing Board also sit in the Joint Directorate of IVASS, which sets its guidelines and strategic targets and adopts insurance supervision measures. No additional emoluments arise from this activity.

Administrative expenses amounted to €443 million (€437 million in 2016). The increase was due to higher costs for the purchase of raw materials for banknote production, security services and transport of valuables. This effect was largely offset by a 5 per cent reduction in the other components of the item *Expenses and sundry charges*.

Table 42

| Administrative expenses (millions of euros) | | | |
|---|------------|------------|-------------|
| | 2017 | 2016 (1) | Change |
| Services | 362 | 373 | - 11 |
| Hardware and software (2) | 107 | 111 | - 4 |
| Security services, banknote escort and guards | 64 | 61 | 3 |
| Building and equipment maintenance | 69 | 71 | - 2 |
| Utilities | 21 | 23 | - 2 |
| Equipment rental | 13 | 13 | - |
| Canteen and cleaning services | 22 | 23 | - 1 |
| Other | 66 | 71 | - 5 |
| Costs of materials and consumables | 81 | 64 | 17 |
| Banknote production | 65 | 46 | 19 |
| Subscriptions to publications and information providers | 12 | 12 | - |
| Office supplies | 2 | 3 | - 1 |
| Other | 2 | 3 | - 1 |
| Total | 443 | 437 | 6 |

(1) The 2016 balances are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*) – (2) Includes the costs of using Eurosystem technological infrastructures, which amount to €23 million in 2017 (€21 million in 2016).

Other expenses, amounting to €43 million, included €32 million for local and indirect taxes, of which €26 million for IMU (municipal property tax) and TASI (municipal services tax).

[22] Taxes on income for the year and on productive activities

Taxes for the year (Item 11) amounted to €1,563 million and comprised the current taxes due, taxes for prior years and the change in deferred tax assets and liabilities (see *Deferred tax assets* in 'Notes on the items of the balance sheet' – *Other assets*).

Table 43

| Composition of taxes on income for the year (Item 12) | | | | | | |
|--|----------------|--------------|----------------|----------------|--------------|----------------|
| <i>(millions of euros)</i> | | | | | | |
| | 2017 | | | 2016 (1) | | |
| | IRES | IRAP | Total | IRES | IRAP | Total |
| Current taxes (-) | - 563 | - 355 | - 918 | - 418 | - 285 | - 703 |
| Taxes for prior years (+/-) | - 9 | - | - 9 | 2 | - | 2 |
| Change in deferred tax assets (+/-) | - 638 | 2 | - 636 | - 609 | 4 | - 605 |
| Change in deferred tax liabilities (+/-) | - | - | - | - 2 | - 1 | - 3 |
| Taxes for the year (-) | - 1,210 | - 353 | - 1,563 | - 1,027 | - 282 | - 1,309 |

(1) The 2016 balances are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*).

IRES amounted to €1,201 million in 2017 (€1,025 million in 2016), of which €563 million for current taxes and €638 million for the net change in deferred tax assets and liabilities. The latter was due almost exclusively to the reduction in deferred tax assets from offsetting past tax losses (€649 million). The total charge for IRAP was €353 million (€282 million in 2016). Current taxes amounted to €355 million and the net change in deferred tax assets and liabilities was positive by €2 million.

Table 44

| Movements in deferred tax assets | | | |
|---|--------------|------------|--------------|
| <i>(millions of euros)</i> | | | |
| | IRES | IRAP | Total |
| Initial amount (1) | 2,093 | 23 | 2,116 |
| Increases | 48 | 10 | 58 |
| Deferred tax assets recognized during the year | 48 | 10 | 58 |
| Decreases | - 686 | - 7 | - 693 |
| Deferred tax assets cancelled during the year | - 686 | - 7 | - 693 |
| <i>of which: relating to tax losses carried forward</i> | - 649 | - | - 649 |
| Final amount | 1,455 | 26 | 1,481 |

(1) The initial amounts are adjusted for ease of comparison (see 'Notes on the items of the balance sheet' – *Other assets*).

Table 45

| Movements in deferred tax liabilities | | | |
|---|------------|----------|------------|
| <i>(millions of euros)</i> | | | |
| | IRES | IRAP | Total |
| Initial amount | 15 | 2 | 17 |
| Increases | 1 | - | 1 |
| Deferred tax liabilities recognized during the year | 1 | - | 1 |
| Decreases | - 1 | - | - 1 |
| Deferred tax liabilities cancelled during the year | - 1 | - | - 1 |
| Final amount | 15 | 2 | 17 |

Post-balance-sheet events

At the end of February 2018 the euro/US dollar exchange rate was \$1.2214, representing a depreciation in the value of the dollar since the end of 2017, when the exchange rate was \$1.1993. The Canadian dollar and the Australian dollar also depreciated, going from C\$1.5039 to C\$1.5608 and from A\$1.5346 to A\$1.5637 respectively. The pound sterling appreciated from £0.88723 to £0.88415, the Japanese yen from ¥135.01 to ¥130.72 and the Chinese renminbi from ¥7.8044 to ¥7.7285.

PROPOSALS OF THE BOARD OF DIRECTORS

The Board of Directors, having considered that:

- the Ordinary Meeting of Shareholders of 31 March 2017, following a proposal by the Board of Directors and having received the approval of the Board of Auditors, decided to create a special item in the balance sheet to be used to stabilize over the long term the amount of net profit paid to the shareholders under the dividend policy in force;
- the item will be credited annually with an amount equal to the difference between the upper bound of the range indicated in the dividend policy in force at the time and the dividend actually distributed;
- in accordance with Article 3.4 of the Statute, no dividend will be paid on the portions of shareholdings exceeding the 3 per cent threshold and the sum will instead be allocated to the Bank's statutory reserves;

acting on the proposal of the Governing Board and after hearing the opinion of the Board of Auditors, proposes the following allocation of the net profit for 2017 for approval by the Meeting of Shareholders:

| | euro |
|--|-----------------------------|
| – to the ordinary reserve | 150,000,000 |
| – as a dividend to the shareholders | 340,000,000 |
| <i>of which:</i> to the extraordinary reserve (pursuant to Art. 3.4 of the Statute) | 121,989,733 |
| – to the special item for stabilizing dividends | 40,000,000 |
| – to the State, the remaining amount of | <u>3,365,350,646</u> |
| Total | <u>3,895,350,646</u> |

There were 107,638 shares that exceeded the threshold on the date indicated in Article 38.2.b of the Statute; the corresponding dividend – equal to €121,989,733 – has been allocated to the ordinary reserve.

THE GOVERNOR
Ignazio Visco

**DOCUMENTS ATTACHED
TO THE ANNUAL ACCOUNTS**

REPORT OF THE BOARD OF AUDITORS

ON THE 124TH FINANCIAL YEAR OF THE BANK OF ITALY
AND THE ACCOUNTS FOR THE YEAR ENDING 31 DECEMBER 2017

To the shareholders,

We have examined the Annual Accounts of the Bank of Italy for the year ending 31 December 2017, drawn up in accordance with the accounting standards and valuation methods decided by the Board of Directors and agreed by us, which are described in detail in the Notes to the Accounts.

We have conducted our examination of the Annual Accounts in accordance with the rules and principles of conduct for the Board of Auditors issued by the Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili. We have also taken the same principles into account in performing the checks required by Article 20 of the Bank of Italy's Statute.

In our opinion the Annual Accounts of the Bank of Italy for the year ending 31 December 2017 have been prepared in accordance with the accounting standards and valuation methods indicated in the Notes to the Accounts. They comply with the laws in force and with the harmonized accounting rules laid down by the Governing Council of the ECB and transposed by Article 8 of Legislative Decree 43/1998.

We call particular attention to the following matters, which are treated at length in the Notes to the Accounts and the Management Report:

- a) The inclusion in the balance sheet of deferred tax assets, deriving chiefly from the carry-forward of the residual tax loss from the bond conversion under Law 289/2002, is based on the reasonable expectation of offsetting their full amount, considering the outlook for the Bank's income. Regarding the result for the year, deferred tax assets diminished by €635 million (from €2,116 million to €1,481 million).
- b) The Board of Directors approved the transfer of €2,920 million to the provision for general risks expressly provided for in Article 39 of the Statute.

We attest that in our opinion the total amount of the Bank's general and specific risk provisions is prudent. Specifically, the provision for staff severance pay and pensions had a small surplus of €12 million over total commitments for pensions and severance pay at 31 December 2017. The surplus remains prudentially allocated to that provision.

We have examined the Management Report required by Article 37 of the Bank's Statute and which accompanies the Annual Accounts and we consider it to be consistent with said accounts.

During the financial year ending 31 December 2017 we monitored compliance with the law, with the Bank's Statute and General Regulations, and with the principles of proper management.

We have attended all the meetings of the Board of Directors and have performed the checks and controls within the scope of our authority, including those regarding the amount of cash and valuables belonging to the Bank and to third parties. We have monitored the activity of the Bank's peripheral units, in accordance with Articles 20 and 21 of the Statute, with the assistance of the examiners at the main and local branches, whom we warmly thank.

We have examined the adequacy of the organizational arrangements governing the administrative and accounting aspects of the Bank to ensure their smooth operation and have ascertained that the system in place is suitable to ensure a full and accurate accounting record of events. The accounts are kept in conformity with the standards and rules laid down by the laws in force. The individual items of the Annual Accounts, which have also been audited by an independent auditing company, have been compared by us with the accounting records and have been found to conform with them.

No material issues requiring specific comment emerged in the course of the performance of our duties or in exchanges with the independent auditing company or with the managers in charge of the various functions.

The accounts submitted for your approval show the following results:

| | | |
|------------------------------|---|-----------------|
| Assets | € | 930,682,204,684 |
| Liabilities | € | 901,174,082,232 |
| Capital and reserves | € | 25,612,771,806 |
| Net profit for the year..... | € | 3,895,350,646 |

Pursuant to Article 38 of the Statute, the Board of Directors proposes the following allocation of the net profit:

| | | |
|---|---|----------------------|
| – to the ordinary reserve | € | 150,000,000 |
| – a dividend to the shareholders | € | 340,000,000 |
| <i>of which:</i> to the ordinary reserve (pursuant to Art. 3.4 of the Statute) | € | 121,989,733 |
| – to the special item for stabilizing dividends | € | 40,000,000 |
| – the remaining amount to the State | € | <u>3,365,350,646</u> |
| Total | € | <u>3,895,350,646</u> |

We note that on the date indicated in Article 38.2.b of the Statute there were 107,638 shares exceeding the limit indicated in Article 3.4 of the Statute. Therefore, the corresponding dividend – equal to €121,989,733 – will be allocated to the ordinary reserve.

Bearing in mind the provisions of Article 37.2 of the Statute, we recommend that you approve the Annual Accounts for 2017 that have been submitted to you (the Balance Sheet, the Profit and Loss Account, the Notes to the Accounts and the Management Report) and the proposed allocation of the net profit for the year pursuant to Article 38 of the Statute.

Rome, 13 March 2018

THE BOARD OF AUDITORS

Dario Velo (Chairman)

Giuliana Birindelli

Lorenzo De Angelis

Gian Domenico Mosco

Sandro Sandri

BALANCE SHEET FIGURES OF SUBSIDIARY COMPANIES

SIDIEF spa – SOCIETÀ ITALIANA DI INIZIATIVE EDILIZIE E FONDIARIE – ROMA

STATO PATRIMONIALE AL 31 DICEMBRE 2016

| ATTIVO | (importi in euro) | |
|--|--------------------|--------------------|
| | 31.12.2016 | 31.12.2015 |
| A) Crediti verso soci per versamenti ancora dovuti | – | – |
| B) Immobilizzazioni | | |
| I <i>Immateriali</i> | | |
| 4) concessioni, licenze, marchi e diritti simili | 51.321 | 79.194 |
| 7) altre | 107.258 | 150.681 |
| Totale | 158.579 | 229.875 |
| II <i>Materiali</i> | | |
| 1) terreni e fabbricati | 529.171.731 | 525.207.806 |
| 2) impianti e macchinari | 16.263 | 10.261 |
| 3) attrezzature industriali e commerciali | 59.510 | 216.015 |
| 4) altri beni | 443.434 | 263.554 |
| Totale | 529.690.938 | 525.697.636 |
| III <i>Finanziarie</i> | | |
| 2) crediti | | |
| d) verso altri | 200.981 | 106.043 |
| Totale immobilizzazioni finanziarie | 200.981 | 106.043 |
| Totale attivo immobilizzato | 530.050.498 | 526.033.554 |
| C) Attivo circolante | | |
| I <i>Rimanenze</i> | | |
| 4) prodotti finiti e merci | 211.164 | – |
| Totale | – | – |
| II <i>Crediti</i> | | |
| 1) verso clienti | | |
| – entro 12 mesi | 9.139.323 | 8.772.792 |
| 5bis) crediti tributari | | |
| – entro 12 mesi | 77.288 | 819.949 |
| 5ter) imposte anticipate | | |
| – entro 12 mesi | 3.216.211 | 3.266.312 |
| 5quater) verso altri | | |
| – entro 12 mesi | 300.405 | 40.054 |
| Totale crediti | 12.733.227 | 12.899.107 |
| III <i>Attività finanziarie che non costituiscono immobilizzazioni</i> | | |
| 6) altri titoli | – | 6.062.940 |
| Totale | – | 6.062.940 |
| IV <i>Disponibilità liquide</i> | | |
| 1) depositi bancari e postali | 30.368.780 | 32.273.327 |
| 2) assegni | – | 82.200 |
| 3) danaro e valori in cassa | 325 | 1.702 |
| Totale | 30.369.105 | 32.357.229 |
| Totale attivo circolante | 43.313.496 | 51.319.276 |
| D) Ratei e risconti attivi | 163.589 | 238.801 |
| Totale attivo | 573.527.583 | 577.591.631 |

STATO PATRIMONIALE AL 31 DICEMBRE 2016

| PASSIVO | (importi in euro) | |
|--|--------------------|--------------------|
| | 31.12.2016 | 31.12.2015 |
| A) Patrimonio netto | | |
| I Capitale Sociale | 507.000.000 | 507.000.000 |
| II Riserva da sovrapprezzo delle azioni | 21.222.851 | 21.222.851 |
| III Riserve di rivalutazione | 16.668.304 | 16.668.304 |
| IV Riserva legale | 4.050.431 | 3.950.073 |
| VI Altre riserve | | |
| – Riserva straordinaria facoltativa | 4.060.997 | 2.154.198 |
| Totale | | |
| IX Utile (perdita) d'esercizio | 3.272.177 | 2.007.157 |
| Totale patrimonio netto | 556.274.760 | 553.002.583 |
| B) Fondi per rischi e oneri | | |
| 2) per imposte, anche differite | 944.577 | 698.341 |
| 3) altri | 2.657.049 | 9.229.311 |
| Totale fondi per rischi e oneri | 3.601.626 | 9.927.652 |
| C) Trattamento fine rapporto di lavoro subordinato | 2.008.120 | 1.951.578 |
| D) Debiti | | |
| 6) acconti | | |
| – entro 12 mesi | 45.205 | 15.209 |
| 7) debiti verso fornitori | | |
| – entro 12 mesi | 6.168.455 | 7.552.905 |
| 12) debiti tributari | | |
| – entro 12 mesi | 272.026 | 189.547 |
| 13) debiti verso istituti di previdenza e di sicurezza sociale | | |
| – entro 12 mesi | 303.738 | 221.746 |
| 14) altri debiti | | |
| – entro 12 mesi | 4.454.388 | 4.463.641 |
| Totale debiti | 11.243.812 | 12.443.048 |
| E) Ratei e risconti passivi | 399.265 | 266.770 |
| Totale passivo | 573.527.583 | 577.591.631 |

CONTO ECONOMICO AL 31 DICEMBRE 2016

| | (importi in euro) | |
|---|-------------------|-------------------|
| | 2016 | 2015 |
| A) Valore della produzione | | |
| 1) ricavi delle vendite e delle prestazioni | 30.405.446 | 30.204.102 |
| 5) altri ricavi e proventi (vari) | 15.147.796 | 12.869.894 |
| Totale valore della produzione | 45.553.242 | 43.073.996 |
| B) Costi della produzione | | |
| 6) per materie prime, sussidiarie, di consumo e di merci | 83.345 | 117.396 |
| 7) per servizi | 10.000.756 | 10.356.479 |
| 8) per godimento di beni di terzi | 167.058 | 135.794 |
| 9) per il personale | | |
| a) salari e stipendi | 4.246.281 | 4.099.693 |
| b) oneri sociali | 1.216.108 | 1.190.650 |
| c) trattamento di fine rapporto | 339.571 | 309.993 |
| d) trattamento di quiescenza e simili | 38.878 | 39.439 |
| e) altri costi | 22.225 | 168.756 |
| <i>Totale</i> | <i>5.863.063</i> | <i>5.808.531</i> |
| 10) ammortamenti e svalutazioni | | |
| a) ammortamenti delle immobilizzazioni immateriali | 223.759 | 190.431 |
| b) ammortamenti delle immobilizzazioni materiali | 6.218.710 | 6.035.036 |
| d) svalutazioni dei crediti compresi nell'attivo circolante e delle disponibilità liquide | 1.528.146 | 424.209 |
| <i>Totale</i> | <i>7.970.615</i> | <i>6.649.676</i> |
| 12) accantonamenti per rischi | 114.787 | 77.477 |
| 14) oneri diversi di gestione | 12.561.562 | 12.408.585 |
| Totale costi della produzione | 36.761.186 | 35.553.938 |
| Differenza tra valore e costi di produzione (A-B) | 8.792.056 | 7.520.058 |
| C) Proventi e oneri finanziari | | |
| 16) Altri proventi finanziari | | |
| c) da titoli iscritti nell'attivo circolante | 85.959 | 619.982 |
| d) proventi diversi dai precedenti (altri) | 297.787 | 297.821 |
| <i>Totale</i> | <i>383.746</i> | <i>917.803</i> |
| 17) Interessi e altri oneri finanziari (altri) | 71.382 | 471.682 |
| Totale proventi e oneri finanziari | 312.364 | 446.121 |
| D) Rettifiche di valore di attività finanziarie | | |
| 19) svalutazioni | | |
| c) di titoli iscritti nell'attivo circolante | - | - |
| Totale rettifiche di valore di attività finanziarie | - | - |
| Risultato prima delle imposte (A-B±C±D±E) | 9.104.421 | 7.966.179 |
| 22) imposte su reddito dell'esercizio, correnti, differite e anticipate | | |
| a) imposte correnti | 5.610.228 | 5.779.983 |
| b) imposte differite | 246.236 | 173.622 |
| c) imposte anticipate | 50.101 | 310.253 |
| d) imposte esercizi precedenti | -74.321 | -304.837 |
| <i>Totale</i> | <i>5.832.244</i> | <i>5.959.021</i> |
| 23) UTILE (PERDITA) DELL'ESERCIZIO | 3.272.177 | 2.007.157 |

**REPORT OF THE
INDEPENDENT AUDITING COMPANY**

Relazione della società di revisione indipendente ai sensi dell'art.37 dello Statuto della Banca d'Italia

Ai Partecipanti al capitale della
Banca d'Italia

Relazione sulla revisione contabile del bilancio d'esercizio

Giudizio

Abbiamo svolto la revisione contabile dell'allegato bilancio d'esercizio della Banca d'Italia (di seguito, anche, l'"Istituto") costituito dallo stato patrimoniale al 31 dicembre 2017, dal conto economico per l'esercizio chiuso a tale data e dalla nota integrativa.

A nostro giudizio, il bilancio d'esercizio fornisce una rappresentazione veritiera e corretta della situazione patrimoniale e finanziaria della Banca d'Italia al 31 dicembre 2017 e del risultato economico per l'esercizio chiuso a tale data, in conformità ai principi e criteri contabili dettati dalle norme speciali descritte nella nota integrativa.

Elementi alla base del giudizio

Abbiamo svolto la revisione contabile in conformità ai principi di revisione internazionali (ISA Italia). Le nostre responsabilità ai sensi di tali principi sono ulteriormente descritte nella sezione *Responsabilità della società di revisione per la revisione contabile del bilancio d'esercizio* della presente relazione.

Siamo indipendenti rispetto all'Istituto in conformità alle norme e ai principi in materia di etica e di indipendenza applicabili nell'ordinamento italiano alla revisione contabile del bilancio. Riteniamo di aver acquisito elementi probativi sufficienti ed appropriati su cui basare il nostro giudizio.

Responsabilità degli Organi direttivi dell'Istituto e del Collegio sindacale per il bilancio d'esercizio

Gli Organi direttivi sono responsabili per la redazione del bilancio d'esercizio che fornisca una rappresentazione veritiera e corretta in conformità ai principi e criteri contabili dettati dalle norme speciali descritte nella nota integrativa e per quella parte del controllo interno dagli stessi ritenuta necessaria per consentire la redazione di un bilancio che non contenga errori significativi dovuti a frodi o a comportamenti o eventi non intenzionali.

Gli Organi direttivi sono responsabili per la valutazione della capacità dell'Istituto di continuare ad operare come un'entità in funzionamento e, nella redazione del bilancio d'esercizio, per l'appropriatezza dell'utilizzo del presupposto della continuità aziendale, a meno che non abbiano alternative realistiche a tale scelta.

Il Collegio sindacale, nei termini previsti dallo Statuto, svolge funzioni di controllo sull'amministrazione della Banca per l'osservanza della legge, dello statuto, del regolamento generale; verifica nel corso dell'esercizio la regolare tenuta della contabilità e la corretta rilevazione dei fatti di gestione nelle scritture contabili, esamina il bilancio ed esprime il proprio parere sulla destinazione dell'utile netto.

Responsabilità della società di revisione per la revisione contabile del bilancio d'esercizio


I nostri obiettivi sono l'acquisizione di una ragionevole sicurezza che il bilancio d'esercizio nel suo complesso non contenga errori significativi, dovuti a frodi o a comportamenti o eventi non intenzionali, e l'emissione di una relazione di revisione che includa il nostro giudizio. Per ragionevole sicurezza si intende un livello elevato di sicurezza che, tuttavia, non fornisce la garanzia che una revisione contabile svolta in conformità ai principi di revisione internazionali (ISA Italia) individui sempre un errore significativo, qualora esistente. Gli errori possono derivare da frodi o da comportamenti o eventi non intenzionali e sono considerati significativi qualora ci si possa ragionevolmente attendere che essi, singolarmente o nel loro insieme, siano in grado di influenzare le decisioni economiche prese dagli utilizzatori sulla base del bilancio d'esercizio.

Nell'ambito della revisione contabile svolta in conformità ai principi di revisione internazionali (ISA Italia) abbiamo esercitato il giudizio professionale e abbiamo mantenuto lo scetticismo professionale per tutta la durata della revisione contabile. Inoltre:

- abbiamo identificato e valutato i rischi di errori significativi nel bilancio d'esercizio, dovuti a frodi o a comportamenti o eventi non intenzionali; abbiamo definito e svolto procedure di revisione in risposta a tali rischi; abbiamo acquisito elementi probativi sufficienti ed appropriati su cui basare il nostro giudizio. Il rischio di non individuare un errore significativo dovuto a frodi è più elevato rispetto al rischio di non individuare un errore significativo derivante da comportamenti o eventi non intenzionali, poiché la frode può implicare l'esistenza di collusioni, falsificazioni, omissioni intenzionali, rappresentazioni fuorvianti o forzature del controllo interno;
- abbiamo acquisito una comprensione del controllo interno rilevante ai fini della revisione contabile allo scopo di definire procedure di revisione appropriate nelle circostanze e non per esprimere un giudizio sull'efficacia del controllo interno dell'Istituto;
- abbiamo valutato l'appropriatezza dei principi contabili utilizzati nonché la ragionevolezza delle stime contabili effettuate dagli Organi direttivi, inclusa la relativa informativa;
- siamo giunti ad una conclusione sull'appropriatezza dell'utilizzo da parte degli Organi direttivi del presupposto della continuità aziendale e, in base agli elementi probativi acquisiti, sull'eventuale esistenza di una incertezza significativa riguardo a eventi o circostanze che possono far sorgere dubbi significativi sulla capacità dell'Istituto di continuare ad operare come un'entità in funzionamento. In presenza di un'incertezza significativa, siamo tenuti a richiamare l'attenzione nella relazione di revisione sulla relativa informativa di bilancio, ovvero, qualora tale informativa sia inadeguata, a riflettere tale circostanza nella formulazione del nostro giudizio. Le nostre conclusioni sono basate sugli elementi probativi acquisiti fino alla data della presente relazione.
- abbiamo valutato la presentazione, la struttura e il contenuto del bilancio d'esercizio nel suo complesso, inclusa l'informativa, e se il bilancio d'esercizio rappresenti le operazioni e gli eventi sottostanti in modo da fornire una corretta rappresentazione.

Abbiamo comunicato ai responsabili delle attività di governance, identificati ad un livello appropriato come richiesto dagli ISA Italia, tra gli altri aspetti, la portata e la tempistica pianificate per la revisione contabile e i risultati significativi emersi, incluse le eventuali carenze significative nel controllo interno identificate nel corso della revisione contabile.

Roma, 13 marzo 2018

BDO Italia S.p.A.

Rosanna Vicari
Socio

ADMINISTRATION OF THE BANK OF ITALY

AT 31 DECEMBER 2017

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Anna Lucia MUSERRA

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|------------------|---|
| Claudio CLEMENTE | - DIRECTOR OF THE FINANCIAL INTELLIGENCE UNIT FOR ITALY |
| Daniele FRANCO | - STATE ACCOUNTANT GENERAL |

