



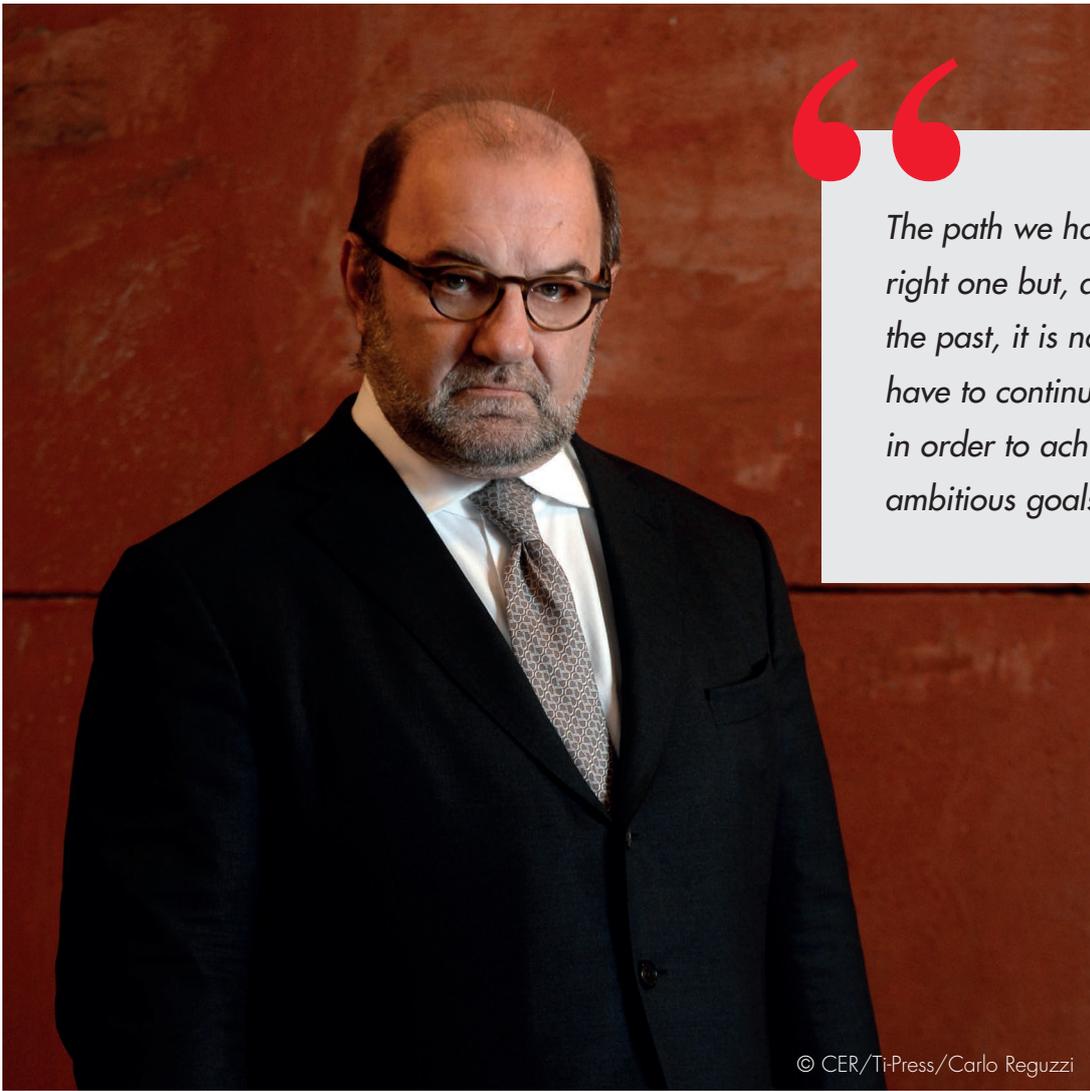
# Annual Report 2018



Pictures: Teatro Sociale, Bellinzona

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*The path we have taken is the right one but, as I have said in the past, it is not enough: we will have to continue to work very hard in order to achieve even more ambitious goals.*

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**Bernardino Bulla**

Chairman of the Board of Directors

# Message from the Chairman of the Board of Directors

Dear Madam,  
Dear Sir,

The months go by quickly, and it is once again time for me, in my role as Chairman of the Board of Directors, to write the introduction to BancaStato's Annual Report.

My aim is twofold: to focus on a number of facts that you will find elsewhere in this Annual Report and provide you with some additional supporting information.

Let us begin with the Bank's operating result, the difference between costs incurred and profit achieved, that amounts to a highly gratifying CHF 73 million. Among expense items accounted for in this figure there are hundreds of contributions from BancaStato that cannot be inferred from the accounting tables. These are donations in support of collective bodies, associations and societies which are active in Ticino. In this regard, BancaStato's commitment is both diversified and substantial, consisting of a few major sponsorships, such as CHF 350,000 to the Orchestra of Italian-speaking Switzerland (OSI) to help maintain this important entity and CHF 100,000 to TicinoTicket. In addition, there is a large number of contributions to various sports, cultural and charitable events, totalling CHF 2 million, of which over CHF 330,000 has been allocated to youth sports.

At BancaStato, we do not consider these outlays as "expenses", but rather "investments", as they are another way for us to continue to fulfil our public mandate. BancaStato supplements this Annual Report with an annual Social and Environmental Report which I invite you to peruse as it explains and details the full scope of the Bank's commitment to the community in canton Ticino.

A similar comment can be made with regard to net profit, which exceeded a record CHF 50 million in 2018, and which would have been even greater without the CHF 26 million allocation to the reserves for general banking risks. This allocation, which matches those of previous years, was established with an eye to the future. Our task is not only to work hard in order to be able to present the best possible results, but also to ensure that

the Bank continues to maintain a solid financial foundation necessary to face the coming years with relative tranquillity. Along with this allocation, the Bank paid out to the Canton, and therefore to all Ticinese people, an ever-increasing amount which exceeded CHF 38 million this past year, therefore providing an important source of funds to the cantonal coffers.

The reporting year was also positive for Axion SWISS Bank SA, a subsidiary of the BancaStato Group. This is in spite of the fact that it was operating under challenging conditions for asset management and in turbulent financial markets. In recent years, BancaStato and Axion have made extensive efforts refining and consolidating their synergies, and the Group has expressed satisfaction with the results.

In conclusion, I invite you to consult the following pages for all the financial details regarding BancaStato. In this document you will find, as in past years, an analysis of both the national and cantonal economies provided by the Economic Research Institute of the University of Lugano.

As for me, I am satisfied with the work undertaken by the staff at BancaStato to whom I give thanks for their commitment. In the past years, the Institute has invested heavily in efforts to improve its operations. The path we have taken is the right one but, as I have said in the past, it is not enough: we will have to continue to work very hard in order to achieve even more ambitious goals. We must ensure the success of our efforts without losing sight of the many challenges awaiting us in the financial sector. One such challenge is digitalization, which is already revolutionising the use of banking instruments around the world and here at home. I am certain that BancaStato will be well-prepared for these challenges and will continue to adapt its tools by ensuring they match the requirements and banking habits of the Ticinese people, continuing a legacy that reflects its more than 100 years of history.

I thank you all for your continued trust in BancaStato.

**Bernardino Bulla**  
Chairman of the Board of Directors

# Corporate Governance

Corporate Governance is defined as a set of rules and relationships which dictate how an enterprise is managed: it is therefore intended to provide those essential elements to better understand how Banca dello Stato del Cantone Ticino is administered, as well as who is in charge of specific executive functions, and the basic principles which govern its operations.

## Introduction

Banca dello Stato del Cantone Ticino (BancaStato), in full respect of minimal disclosure requirements laid down in Circular 2016/1 "Disclosure – banks" of the Swiss Financial Market Supervisory Authority (FINMA)<sup>1</sup> voluntarily publishes information on its corporate governance and draws reference from the outline proposed by the Directive on Information Relating to Corporate Governance issued by SIX Swiss Exchange on 20 March 2018<sup>2</sup>.

For information on risk management and monitoring measures implemented by the Group, refer to Section 5.4 of the Annex to the Consolidated Financial Statements.

All data herein are at 31 December 2018 or refer to the entire 2018 financial year, unless otherwise indicated.

## Corporate Name, Legal Status, Duration and Head Office

Banca dello Stato del Cantone Ticino, founded in 1915, is an autonomous institution operating under public law. The Republic and Canton of Ticino owns 100% of the Bank's equity. The Institution's statute is that of a cantonal bank, in accordance with the Swiss Federal Law on Banks and Savings Banks<sup>3</sup>.

The activities of the Bank are regulated by the Law on Banca dello Stato del Cantone Ticino dated 25 October 1988.

The Bank is established with no time limit. Its head office is in Bellinzona<sup>4</sup>.

## Purpose and Activities

The purpose of BancaStato, as indicated in Art. 3 of the Law on Banca dello Stato del Cantone Ticino, is to promote the economic development of the Canton and to provide the public with opportunities for secure and remunerative investment of their

savings.

As stated in the above Law, the activities of the Bank extend to all operations of a full-service bank.

As illustrated in its Operating Rules and Regulations, the Bank's activities comprise:

1. acceptance of deposits in all forms allowed by the banking legislation;
2. granting of collateralised and non-collateralised loans and credits;
3. processing transactions with letters of credit and standby letters of credit, in particular in Commodity Trade Finance;
4. issuing guarantees, sureties and guarantee commitments;
5. securities trading for third parties and on own account;
6. trading in derivative financial instruments both for third parties and on own account;
7. issuing and participating in the issuance of shares, bonds and other securities, for both Swiss and foreign debtors;
8. spot or forward trading of currency and securities in foreign currency, precious metals and monetary market papers, both for third parties and on own account;
9. trading with professional banknote dealers as per Art. 2e of the FINMA Anti-Money Laundering Ordinance (ORD-FINMA; RS 955.033.0);
10. setup and distribution of investment funds in Switzerland and abroad, and the acceptance of mandates as a

<sup>1</sup> <https://www.finma.ch/fr/~media/finma/dokumente/dokumentencenter/myfinma/rundschreiben/finma-rs-2016-01-20190101.pdf?la=fr>

<sup>2</sup> Any amendment or addition to this Circular in 2019 will be communicated on [www.bancastato.ch](http://www.bancastato.ch), under "Media" [https://www.six-exchange-regulation.com/dam/downloads/regulation/admission-manual/directives/O6\\_16-DCG\\_en.pdf](https://www.six-exchange-regulation.com/dam/downloads/regulation/admission-manual/directives/O6_16-DCG_en.pdf)

<sup>3</sup> [http://www.admin.ch/ch/i/rs/c952\\_0.html](http://www.admin.ch/ch/i/rs/c952_0.html)

<sup>4</sup> <https://m3.ti.ch/CAN/Rleggi/public/index.php/raccoltaleggi/legge/id/1014/evidenzia/false/esplodi/false>

custodian and/or underwriter;

11. advisory, intermediation and asset management, as well as custody and administration of securities and valuables;
12. payment transaction processing in Switzerland and abroad;
13. carrying out the functions of an asset administrator;
14. providing treasury services;
15. providing custody and securities administration services, as well as safe deposit box rentals;
16. carrying out fiduciary transactions, in its own name, but on account and at the risk of customers;
17. issuing and placing of bonds, shares and other financial instruments, and participating in issues or financial operations of public or private corporations.

## Supervision

The Bank is subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA) pursuant to the provisions of the banking legislation<sup>5</sup>.

## 1. BANK STRUCTURE AND OWNERSHIP

### 1.1 Operational structure

#### 1.1.1 Group operational structure

BancaStato is a Group. As at 31 December 2018 the Bank held 100% of the share capital of the Lugano-based Axion SWISS Bank SA (nominal capital CHF 43 million)<sup>6</sup>.

With this structure, BancaStato remains legally autonomous. As a Group, BancaStato has adopted special Group Regulations which lay down its overall organisational rules.

#### 1.1.2 Bank operational structure

The Heads of each Division, along with the President, form the Executive Board. The following business units report to the President of the Executive Board: Human Resources and Strategic Planning & Communications. The other business units are: Credit Management and Support, Markets and Private

Banking, Retail and Corporate, and Financial and Operational Services.

### 1.2 Ownership

Banca dello Stato del Cantone Ticino is an autonomous institution with legal status under public law. The Republic and Canton of Ticino owns 100% of the Bank's equity.

### 1.3 Cross-shareholdings

The Bank does not have any cross-shareholdings.

## 2. CAPITAL STRUCTURE

### 2.1 Capital

By law, the State assigns the Bank an endowment capital and the Bank is authorised to issue participation certificates<sup>7</sup>. To this date, the Bank has not made use of the latter source of capital, and its capital solely consists of the endowment capital provided by the State, that is CHF 430 million. The interest paid out on endowment capital is fixed by the Bank's Board of Directors and by the State Council. A 5% interest was paid out on endowment capital in 2018.

### 2.2 Specifications concerning capital

Pursuant to Art. 6 of the Law on Banca dello Stato del Cantone Ticino, any increase in endowment capital must be authorised by the Grand Council (Cantonal Parliament). On 19 June 2017, the Grand Council approved a request for an increase of the endowment capital from CHF 240 million to CHF 500 million. This increase was granted in order to guarantee, in advance, adequate coverage in terms of capital adequacy in view of the Bank's growing business as well as in the event of more restrictive federal laws and regulations.

This increase was authorised through the transformation into endowment capital of perpetual subordinated loans for a total amount of CHF 140 million and through the authorisation to increase capital by a further CHF 120 million<sup>8</sup>.

<sup>5</sup> <https://www.finma.ch/it/finma-public/istituti-persone-e-prodotti-autorizzati/>

<sup>6</sup> In 2018 BancaStato announced that it would review its strategic cooperation with Soave Asset Management Ltd, Lugano and Londinium Dac, Dublin, in agreement with these two companies. At the end of 2018 BancaStato's minority participations returned to their original shareholders.  
<https://www.bancastato.ch/dms/site-bancastato/documenti/Comunicati-stampa/SoaveAssetManagement.pdf>

<sup>7</sup> <https://m3.ti.ch/CAN/Rleggi/public/index.php/raccolta-leggi/legge/num/622/index17/960.100/evidenzia/false/esplodi/false>

<sup>8</sup> [https://www4.ti.ch/user\\_librerie/php/GC/allegato.php?allid=115514](https://www4.ti.ch/user_librerie/php/GC/allegato.php?allid=115514)

## 2.3 Changes in capital

In consideration of the authorisation granted by the Grand Council (refer to Section 2.2), the State Council (Cantonal Government) increased the endowment capital to CHF 430 million (from CHF 300 million), following Government Resolution 3739 and 3740 of August 2018. This increase took effect on 31 December 2018.

Below is a brief summary of capital increases effected in recent years:

- 2012: from CHF 100 million to CHF 110 million,
- 2013: from CHF 110 million to CHF 200 million,
- 2014: from CHF 200 million to CHF 240 million,
- 2017: from CHF 240 million to CHF 300 million,
- 2018: from CHF 300 million to CHF 430 million.

## 2.4 Shares and participation certificates

The Bank's endowment capital is not divided up into shares. According to Art. 6 of the Law on Banca dello Stato del Cantone Ticino, the Institution is authorised to increase its participation capital by issuing participation certificates not exceeding 50% of its endowment capital. As at 31 December 2013, just as at the end of 2017, there was no participation capital.

## 2.5 Bonus certificates

The Law on Banca dello Stato del Cantone Ticino does not contemplate the issuing of bonus certificates.

## 2.6 Limitations on transferability and nominee registrations

As the capital of Banca dello Stato del Cantone Ticino is not divided into shares, there is no relevant information to provide under this heading.

## 2.7 Convertible bonds and options

BancaStato has not issued any convertible bonds, and there are no options on the Bank's equity. By way of supplementary information, it is hereby stated that, in 2011, the Bank issued a

subordinate bond of CHF 175 million due to mature in 2021. This bond qualifies as Tier 2 Capital in conformity with the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders (CAO). It must also be mentioned that the CHF 80 million (Additional Tier 1) loan with PONV clause granted by Canton Ticino at the end of 2015, was reimbursed at year-end. At the same time as this reimbursement, and in conformity with the authorisation of the Grand Council of Canton Ticino dated 19 June 2017, the Bank's endowment capital was increased by CHF 130 million.

## 3. BOARD OF DIRECTORS

### 3.1 Members of the Board of Directors and activities

The Board of Directors exercises the ultimate responsibility for the management of the Bank and the supervision and control of the state of business. The Board is composed of seven members who must be Swiss citizens of which at least six must be domiciled in the Canton (Art. 19 of the Law on Banca dello Stato del Cantone Ticino).

Based on the provisions of Art. 20 of the Law on Banca dello Stato del Cantone Ticino, members of the State Council (Cantonal Government), government officials, magistrates of any type (except for justices of peace), directors, administrators and employees of other credit institutions (with the exception of members of the Swiss National Bank governing bodies), cannot be appointed to the Board of Directors. Relatives and next of kin, spouses, registered partners or cohabiting partners, siblings or siblings-in-law, business partners and employees of the same company may not be members of the Board of Directors simultaneously.

The members of the Board of Directors fulfil the independence criteria described in FINMA Circular 2017/01<sup>9</sup> except for the Chairman who was, until 30 June 2017, President of the Executive Board. Given the above and, in agreement with the surveillance authority and the Statutory Auditors, the appointment of the Chairman was preceded by an internal reorganisation and a revision of the duties entrusted to the Bank's supervisory organs.

The members of the Board of Directors do not carry out operational functions and have not been members of the Statutory Auditors (previous or present).

<sup>9</sup> [https://www.finma.ch/it/~/\\_/media/finma/dokumente/dokumentcenter/myfinma/rundschreiben/finma-rs-2017-01.pdf?la=it](https://www.finma.ch/it/~/_/media/finma/dokumente/dokumentcenter/myfinma/rundschreiben/finma-rs-2017-01.pdf?la=it)

Hereunder is a brief presentation of the members of the Board in office as at 31 December 2018, their function, education, professional background and principal activities.

## **BERNARDINO BULLA**

### **Function**

Appointed Chairman of the Board of Directors on 15 March 2017, in charge since 1 July 2017. Born on 7 February 1957, Swiss. Chair of the Chairman's office.

### **Education and professional background**

Degree in Economics and Social Sciences from the University of Geneva in 1983. He started work for the Credit Department of BSI SA in Lugano in 1984. In 1997, he joined the Swiss Bank Society as Head of Private and Corporate Clients, then transferred to UBS SA as Head of International Clients and Trading within the Corporate Clients Division. At the end of 1998 he was responsible for corporate customers in Ticino at Credit Suisse, Lugano. He joined BancaStato on 1 October 2000 as a Member of the Executive Board and Head of the Corporate Clients Division. From 16 April 2007 to 31 December 2011, he was Head of the Risk Control Division. From January 2012 to June 2017 he was President of the Executive Board.

### **Other principal activities**

- » Chairman of the Board of Directors of Axion SWISS Bank SA, Lugano;
- » Chairman of the Foundation council of Fondazione del Centenario BancaStato, Lugano;
- » Member of the Board of Directors of Pizzarotti SA, Lugano.

## **CARLO DANZI**

### **Function**

Member of the Board of Directors, born on 24 February 1963, Swiss. On the Board of Directors since 10 July 2007, Secretary of the Board of Director from 1 October 2009 to 28 August 2017, when he took over the function of Deputy Chairman. Deputy Chairman of the Chairman's office and Member of the Projects Committee.

## **Education and professional background**

After the Lyceum and various language courses abroad, he worked for a pharmaceutical company in 1983, later becoming its owner in 1994. Since 1997 he has been the owner of a real estate management company based in Locarno.

### **Other principal activities**

- » Governing director of Fonte SA, Locarno;
- » Governing director of Laude SA, Locarno;
- » Sole member of the Carlo Danzi Foundation, Prato Leventina;
- » Sole member of the Rì di Foch Foundation, Prato Leventina.

## **MARCO FANTONI**

### **Function**

Member of the Board of Directors, born on 27 October 1957, Swiss. On the Board of Directors since 10 March 2009, Chairman of the Projects Committee.

## **Education and professional background**

He graduated in Commercial Sciences from the Cantonal Business School in Bellinzona and worked for Fidinam Fiduciaria SA, Lugano from 1977 to 1985. In 1987 he became the owner of Comafim SA, Lugano, a company active in the area of real estate promotion, administration of revenue buildings and condominiums and intermediation in houses, villas and apartments.

### **Other principal activities**

- » Member of the Board of Directors of the Carla and Bruno Fabbroni Foundation, Lugano.

## **GIOVANNI JELMINI**

### **Function**

Member of the Board of Directors since 1 December 2011, born on 10 July 1962, Swiss. Member of the Audit and Risk Committee.

## **Education and professional background**

Degree in Law from the University of Fribourg, lawyer and

public notary. Owner of the law and notary firm Jelmini from 1996 to 2009. Since 2010 co-owner of the law and notary firm Respini, Jelmini, Beretta Piccoli. Grand Council Deputy from 1995 to 2011, he was a member of the Management Commission, Chairman of the Legislation Commission, Taxation Commission, Constitution and Political Rights Commission as well as of the Grand Council Public Mandate Control Commission of Banca dello Stato del Cantone Ticino. He was Cantonal President of Ticino's Popular Democratic Party from 2007 to 2015.

#### **Other principal activities**

- » Deputy Chairman of the Board of Directors of Axion SWISS Bank SA, Lugano and member of its Audit Committee;
- » Member of the Fondazione Cardiocentro Ticino;
- » President of the Civic Philharmonic of Mendrisio.

### **MICHELE MORISOLI**

#### **Function**

Member of the Board of Directors, born on 30 November 1966, Swiss. On the Board of Directors since 2 December 2008, member of the Audit and Risk Committee.

#### **Education and professional background**

Master of Science (MSc) in Business Economics from the University of Lausanne in 1988. Worked for a leading banking institution in both Zurich and Ticino from 1988 to 1997. From 1997 to 2002, he was Administrative Director at the University of Lugano (USI). Until 31 December 2011 he was Director of the Regional Hospital of Bellinzona and Valleys, Director of the Oncology Institute of Southern Switzerland in Bellinzona and member of the General Management of the Cantonal Hospital Organisation (EOC – Ente Ospedaliero Cantonale). Since 1 January 2012 he has been the managing general agent of the insurance company Helvetia. Vice-president of the Liberal-Radical Party of Ticino since 2012.

#### **Other principal activities**

- » President of the Casa dell'Accademia Foundation, Mendrisio;
- » Vice-president of the Associazione l'Ancora, a centre for drug addiction recovery, Lugano.

### **RAOUL PAGLIA**

#### **Function**

Member of the Board of Directors, born on 22 April 1967, Swiss. On the Board of Directors since 10 July 2012. Secretary of the Board of Directors since 28 August 2017 and Member of the Chairman's office. Member of the Audit and Risk Committee.

#### **Education and professional background**

Master's degree from the "École des Hautes Études Commerciales" of the University of Lausanne in 1993 and Certified EFFAS Financial Analyst and Portfolio Manager – AZEK in 1999. From 2003 to 2006, he was an expert examiner in financial operations for the Swiss Federal examinations in banking (Eidgenössische Bankfachprüfung). In February 2013, he obtained a Master's Degree in Advanced Studies in Tax Law from SUPSI. In 1993, he was employed by Banca del Gottardo in Lugano as a financial analyst. He started at BSI SA in 1996, and worked in the investment funds, institutional clients and stock markets departments. In 2011 he was responsible for stock markets for the Family Office Division (which later became Patrimony 1873) until June 2012, when he left the Institution. He is at present Managing Director and Member of the Board of Directors at AMCO Fiduciaria SA.

#### **Other principal activities**

- » Member of the Board of Directors of Axion SWISS Bank SA, Lugano;
- » Member of the Board of Directors of Lugano Airport SA, Lugano;
- » Deputy Chairman of the Foundation Council of Perspectiva Joint Foundation, Basel;
- » Chairman of the Board of Directors of Swiss Investments SA, Lugano;
- » Member of the Board of Directors of SOAVE Asset Management Ltd., Lugano<sup>10</sup>;
- » Chairman of the Board of Directors of Swissmemotec SA, Lugano.

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<sup>10</sup> In January 2019 Raoul Paglia stepped down when BancaStato relinquished its share in the company. Refer to Point 1.1.1.

## LUCA SONCINI

### Function

Member of the Board of Directors, born on 18 May 1957, Swiss. On the Board of Directors since 11 October 2017. Member of the Projects Committee.

### Education and professional background

Degree in Economics from the University of Fribourg in 1981, subsequently researcher for the Economic Research Office of Canton Ticino. In 1982, he joined the daily newspaper *Corriere del Ticino* as chief editor for economic and financial news.

During the 1980s, he also worked for the Italian Language Swiss Television in financial journalism. In 1987, he was employed by Banca del Gottardo and, in 1998, was appointed member of the Executive Board, Head of Private Banking. In 2007 he entered the PKB Privatbank group as a member of the Executive Board responsible for Finances and Risks. He was a member of the National Committee of the Swiss Bank Employers Association, the Executive Committee of the Ticino Bank Association, the Foundation Council of the Swiss Institute in Rome, the Board of Directors of Banca del Gottardo Italia SpA, Bergamo, the Board of Directors of Gestivalor-Gestione fondi SA, Lugano, the Board of Directors of Compagnia Finanziaria Mobiliare SIM SpA, Milan, and the Board of Directors of Banca Intermobiliare SpA, Turin.

### Other principal activities

- » Professor at the University of Lugano where he currently teaches a course titled "Banking Strategies" to students of the Master's programme in Finance, Lugano;
- » Member of the Foundation Council of the Swiss Finance Institute;
- » Independent financial consultant.

### 3.2 Other activities and vested interests of the members of the Board of Directors

This information is included in Section 3.1.

### 3.3 Elections and terms of office

The members of the Board of Directors are appointed by the State Council. Their education, competence and professional history are decisive criteria for their appointment. They remain in office for 3 years, until 30 June. Retiring members may be

re-elected. On an annual basis, the State Council renews two or two and three mandates respectively. The maximum term of office is 12 years (Articles 21 and 22 of the Law on Banca dello Stato del Cantone Ticino).

The dates of election and terms of office for the present members of the Board of Directors are as follows:

- » Bernardino Bulla, Chairman: 1 July 2017/30 June 2020,
- » Carlo Danzi, Deputy Chairman: 10 July 2007/30 June 2019,
- » Marco Fantoni: 10 March 2009/9 March 2021,
- » Giovanni Jelmini: 1 December 2011/30 June 2019,
- » Michele Morisoli: 2 December 2008/30 June 2020,
- » Raoul Paglia: 10 July 2012/30 June 2021,
- » Luca Soncini: 16 October 2017/30 June 2020.

### 3.4 Internal organisational structure

The Board of Directors elects among its members the Chairman, the Deputy Chairman and the Secretary, who together form the Chairman's Office.

The Board of Directors reaches a quorum when at least five of its members are present. Decisions are determined by a simple majority of those present, and abstention is not permitted.

In principle, the President of the Executive Board attends the meetings in an advisory capacity. With prior agreement from the Chairman of the Board of Directors, he may invite members of the Executive Board to the meetings for the presentation of specific points on the agenda. Every member of the Board of Directors must inform the other members of possible conflicts of interest and/or conflicts in personal business or that of relatives, and may not in those circumstances attend or take part in deliberations or vote on the subject matter. Minutes are taken at each meeting.

The Board of Directors has defined its own committees, which are described below. The organisation, functioning and competences of the committees are illustrated and set out in specific rules and regulations.

Every member of the Board of Directors is entitled to obtain, under absolute observance of professional secrecy (Art. 11 of the Law on Banca dello Stato del Cantone Ticino), information and details on all Bank business. The members

of the committees of the Board of Directors have, within the framework of their mandate, an unlimited right to information on and consultation of Bank documents. The Executive Board and the Internal Auditors must provide the committees of the Board of Directors with all information they require.

In 2018, the Board of Directors convened 14 times. The meetings of the Board of Directors and its committees lasted between two and a half and four and a half hours.

### 3.5 Areas of responsibility

The Board of Directors exercises the ultimate responsibility for the management of the Bank, as well as the supervision and control over the state of business. Pursuant to applicable law, regulatory, organisational, strategic and financial responsibilities, as well as supervision and control, lie with the Board of Directors.

Some of its tasks, as defined by Art. 24 of the Law on Banca dello Stato del Cantone Ticino and Art. 11 of the Operating Rules and Regulations are listed by category hereunder:

#### *Regulatory duties*

- establishing the Bank's regulatory provisions;
- laying down and updating, on a regular basis, the operating rules and the Organisation and Risk Management Regulations, and other regulations;
- drawing up a formal document on the public mandate in view of defining the general and specific objectives which are to be met in the medium term by the Bank in favour of the development of the cantonal economy, specifying the instruments to be used to this end and priorities;
- issuing Staff Rules and Regulations upon prior consultation with personnel.

#### *Organisational duties*

- establishment of the Bank's organisational structure;
- definition of the Bank's organisational chart;
- allocation of appropriate resources within the Bank in terms of personnel, infrastructure and IT;

- appointment, suspension, revoking of functions or rank, or dismissal of the President of the Executive Board, members of the Executive Board, members of Management, Chief Internal Auditor, Deputy Chief Internal Auditor and his substitute as well as their periodic assessment, and planning their succession accordingly;
- compensation and adoption of disciplinary measures as regards the Executive Board, the Chief Auditor and the Deputy Chief Auditor;
- organisation of accounting, controlling and financial planning;
- establishment and closing of branches and agencies;
- appointment and dismissal of External Auditors;
- granting or revoking power to sign as laid down in Art. 22 and 23 of the Operating Rules and Regulations;
- authorisation to assume mandates as corporate or foundation bodies on the part of all Bank staff;
- authorisation to operate in new sectors;
- approval of tasks and objectives of each division;
- decision to appear in court and initiate legal proceedings, with power to delegate;
- appointment of the Chairs and members of the Committees of the Board of Directors.

#### *Strategic and financial duties*

- approval of the Bank's financial plans and strategic guidelines laid down in the strategic planning document;
- review and approval of budgets, accounts, semi-annual and annual financial reports;
- approval of capital planning and liquidity planning;
- definition of the staff and remuneration policies;
- review and approval of the Annual Social and Environmental Report and of the section on Corporate Governance of the Annual Report;
- decision on the issuance of participation certificates as

per special regulations and the annual setting of the base dividend on participation capital;

- decision-making, upon notice from the Executive Board, on requests for loans, credits or advances and on operations which engage Bank funds or its pecuniary responsibility and which are not part of delegated responsibilities as laid down in the Operating Rules and Regulations;
- approval of loans to the members of the Executive Board and the Chief Internal Auditor;
- ratification of loans granted to members of the Board of Directors by the Executive Board or by its subordinate offices within the framework of their delegated responsibilities;
- decision-making on the acquisition and disposal of participations exceeding CHF 2 million, or 15% of the subsidiary's capital, within the limits set by Art. 14 of the Law on Banca dello Stato del Cantone Ticino;
- fixation, in agreement with the State Council, of the interest rate on the endowment capital;
- providing the State Council by 31 March of each year with the annual report, financial statements, proposal for appropriation of available earnings and Statutory Auditors' report;
- providing the Grand Council by 31 March of each year with the Auditors' report in compliance with Art. 37a of the Law on Banca dello Stato del Cantone Ticino;
- establishment of reference rates and oversight to ensure that the individual rates set by the Executive Board comply with Art. 3 of the Law on Banca dello Stato del Cantone Ticino;
- reporting to the FINMA in the event that capital or liquidity requirements are not met, or maximum limits on major risks have been exceeded;
- current operating expenses and investments in infrastructure which are not specifically delegated to the Executive Board.

### *Supervision and control duties*

- determining the control procedures to undertake in line with current applicable external regulatory provisions;
- oversight on compliance with banking regulatory provisions with respect to risks, in particular the control of major risks as per Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders (CAO, RS 952.03) and the requirements of the Ordinance on Liquidity (OLiq, RS 952.06),
- supervision of the work of the Executive Board, including assessment of the Executive Board in terms of meeting its objectives and its work procedures;
- supervision of the work performed by the Internal Auditors;
- annual appraisal and assessment of the Bank's framework strategy for risk management, implementing any necessary adjustments, as well as undertaking its own risk analysis;
- review of the reports of the External Auditors and the Internal Auditors;
- analysis of the summary prepared by the Head of Credit Management and Support of the results of various reports on activities and risk evaluation.

Moreover, the Board of Directors makes decisions, in accordance with Art. 24 of the Law on Banca dello Stato del Cantone Ticino, on any other matter that the said Law or the Bank's Rules and Regulations do not explicitly assign to another Bank body or authority.

With respect to consolidated supervision, the Board of Directors exercises its competences on the basis of the Group Rules and Regulations which is drawn upon the principles mentioned above (Art. 24 of the Law on Banca dello Stato del Cantone Ticino and Art. 11 of the Operating Rules and Regulations).

In compliance with Art. 25 of the Law on Banca dello Stato del Cantone Ticino, the Board of Directors may delegate part of its duties, to the exclusion of those inalienable on the analogy of Art. 716a of the Swiss Code of Obligations<sup>11</sup>, to permanent or ad hoc committees composed of members of the Board of Directors or to the Executive Board.

<sup>11</sup> <https://www.admin.ch/opc/it/classified-compilation/19110009/index.html>

As a rule, the Committees do not have any decision-making authority; they draw up notices to the Board of Directors on matters relating to their own charter. Specific decisional authority may be attributed by the Board of Directors.

Minutes are taken at every meeting of the Committees.

With respect to the delegation of duties to the Executive Board, refer to the corresponding paragraph under Executive Board.

The functions and organisation of the Chairman's Office and the Board of Directors' Committees as at the end of 2018 are described hereunder.

As laid down in internal regulatory provisions, at Group level, the activities of the Committees of the Board of Directors also comprise all issues entrusted for the Group to BancaStato's Board of Directors.

### Chairman's Office

The Chairman's Office represents the Bank vis-à-vis its owner as well as political institutions and public opinion.

The Chairman's Office is composed of the Chairman, Bernardino Bulla, the Deputy Chairman, Carlo Danzi, and the Secretary, Raoul Paglia.

### Audit and Risk Committee<sup>12</sup>

The Audit and Risk Committee of the Board of Directors deals with issues relating to financial matters, internal control systems, compliance and risk management, as well as external and internal audits.

With respect to financial matters, the Committee examines the issues and draws up recommendations for the Board of Directors regarding the following:

- decision on accounting principles to be adopted for the preparation of accounts;
- approval of annual and semi-annual financial statements,
- approval of the budget;
- approval of capital and liquidity planning;
- approval of expenses and overrun expenditures for matters which fall within the authority of the Board of

Directors;

- organisation of accounting, reporting and financial planning;
- discussion with the member of the Executive Board responsible for Finances and Accounting, as well as with the Statutory Auditors and the Internal Auditors on financial reporting and integrity of financial closures;
- definition of the policy in matters of staff and remuneration.

As regards the internal control system and risk management, it examines and submits notices to the Board of Directors on the following:

- functioning, efficiency and results of the internal control system;
- strategic decisions relative to risk management and, at least once a year, an evaluation of the framework strategy;
- functioning, methodologies, efficiency and results of the risk management system;
- procedures to ensure that all risks incurred by the Bank are duly identified, assessed, monitored and controlled;
- compliance with current or upcoming banking rules and regulations within the banking business;
- system for monitoring irregularities or recommendations issued by the audit authorities;
- adequacy of the internal control and risk management system with regard to the Bank's strategic decision-making;
- reports of the Executive Board on risk management;
- matters within the competence of the Board of Directors listed in the appropriate Organisation and Risk Management Regulations;
- reports on the risk-assessment activities of the Legal and Compliance, and the Human Resources departments, as well as the Competence Centre and the organisational

<sup>12</sup> Although this is outside the reporting period, it should be stated that, in 2017, the Audit and Risk Committee incorporated the competences of the Strategy Committee.

units for Risk Management, Group Internal Control and Security. The Head of Credit Management and Support summarises the results of the various reports and ensures this information is conveyed;

- rules and regulations which fall within the competence of the Board of Directors and are relevant to the tasks of the Committee.

The Audit and Risk Committee examines and submits notices to the Board of Directors also as regards the following:

- supervision of specific regulatory and organisational competences which are entrusted to the Board of Directors;
- management and control of risks in connection with the acquisition and divestment of participations which fall within the responsibility of the Board of Directors;
- management and control of risks in connection with proposals for expanding the Bank's business scope.

As for internal and external audits, the Committee draws up further recommendations on specific matters, and brings them to the attention of the Board of Directors. The Audit and Risk Committee of the Board of Directors is composed of the Chairman, Michele Morisoli, and Giovanni Jelmini and Raoul Paglia, members. In 2018 the Committee convened nine times.

### **Projects Committee**

The Projects Committee examines and draws up notices to the Board of Directors on:

- planning, implementation, management and control methods, budgets and observance thereof, work progress, reasons pertaining to planning variations, future impacts and other possible aspects of current projects;
- planning, budgets, implementation, management and control methods, future impact and other possible aspects relating to projects which the Bank may consider;
- investments which fall within the authority of the Board of Directors.

The Projects Committee is composed of the Chairman, Marco Fantoni and Carlo Danzi and Luca Soncini, members. In 2018 the Committee met five times.

### **3.6 Information and control instruments vis-à-vis the Executive Board**

In line with the Operating Rules and Regulations, the President of the Executive Board reports to the Board of Directors:

*On a monthly basis*

- the balance sheet and income statements;
- information on the Bank's liquidity, equity, and major risks;
- the situation as regards risks and information on the functioning, effectiveness and results of the internal control system.

*On a semi-annual basis*

- the consolidated balance sheet and consolidated income statement;
- information on measures to be implemented in order to close loopholes and on the progress of the implementation of recommendations resulting from the internal and external audits.

*On an annual basis*

- strategic planning;
- budgets, financial statements and annual reports;
- information regarding the general state of business with respect to objectives and strategies set by the Board of Directors and the general situation at the Bank;
- the Social and Environmental Report as well as the chapter of the Annual Report on Corporate Governance;
- assessments of amendments to regulations within the competences of the Board of Directors;
- confirmation of adequate allocation of resources both in terms of personnel and equipment;

- a report on the activities and risk evaluation of the Legal and Compliance Department, the Human Resources Department, the Competence Centre, and the organisational units of Risk Management, Internal Group Controls and Security;
- summary of the results of various reports mentioned in the above paragraph.

As deemed necessary, other documents or data may be requested.

The fundamental principles of information flows have been set also for the Group. The Bank has External Auditors, in conformity with current banking legislation as well as Internal Auditors (refer to Section 8.1). The Internal Auditors' Office is independent of the Executive Board and was composed at the end of 2018 of five staff, including the Head of Internal Auditors (Mr. Gabriele Guglielmini, Chartered Accountant – Federal Accounting Diploma). The Chairman of the Audit and Risk Committee of the Board of Directors acts as the Head of Internal Auditor's direct superior and oversees his activity.

The audit is planned in agreement with the Board of Directors. The latter may assign specific checks, investigations or controls to the Internal Auditors. Details pertaining to the organisation, functions and duties of the Internal Auditors are laid down by the Board of Directors in special regulations. The internal audit provides important bases for decision-making to evaluate and verify whether the Institute can rely on an appropriate and efficient internal control system. It conducts at least annually a comprehensive risk assessment and plans its activities for the following audit period. The personnel involved in internal auditing may not take part in Bank operational processes.

The members of the Board of Directors receive all reports relating to ordinary audits. These documents comprise also the stance of the Executive Board on the recommendations formulated by the Internal Auditors. The Internal Audit reports are discussed by the Internal Auditors with the Audit and Risk Committee of the Board of Directors and, when needed, also with the Board of Directors.

Internal audits are conducted in compliance with the quality requirements of the Institute of Internal Auditing, Switzerland.

#### 4. EXECUTIVE BOARD

The Board of Directors may delegate part of its functions relating to business management, to the exclusion of those inalienable on the analogy of Art. 716a of the Swiss Code of Obligations, to the Executive Board.

The functions of the Executive Board are listed in detail in Art. 15 of the Operating Rules and Regulations, and are the following:

##### *Regulatory duties*

- implementing the regulatory provisions and recommendations of the supervisory authority and surveillance bodies, internal and professional guidelines, and oversight on compliance of the same;
- issuing specific regulations, guidelines and appropriate orders as required for the performance of banking activities;
- implementing the provisions as laid down in the public mandate document;
- implementing the measures set out in the Staff Rules and Regulations;
- issuing a code of conduct and laying down the sanctions in case of non-compliance.

##### *Management and organisational duties*

- implementation of the Bank's organisation;
- implementation of the Bank's detailed organisational chart;
- development of the Bank's strategic planning and implementation of the measures envisaged in the same based on decisions of the Board of Directors;
- organisation of financial management controls;
- recruitment, compensation, appointment of rank and position, carrying out of disciplinary action, dismissals, as well as direction and supervision of Bank staff falling outside the authority of the Board of Directors;

- preparation of the documents pertaining to matters to be submitted to the Board of Directors;
- membership in trade associations;
- decision to appear in court and initiate legal proceedings, as delegated;
- apprising the Board of Directors on the Bank's business development and on its economic and financial state;
- definition of the duties and targets in each division;
- provision of an adequate technological infrastructure.

#### *Financial duties*

- preparation of budgets, semi-annual and annual financial statements;
- drawing up of the Social and Environmental Reports and of the section of the Annual Report on Corporate Governance;
- approval of monthly accounts to be submitted to the Board of Directors;
- implementation of the decisions taken by the Board of Directors with regard to loan requests, credits and advances on operations which engage Bank funds or pecuniary responsibility, and which are not included in delegated responsibilities as outlined in the Operating Rules and Regulations;
- decision on risk-incurring and on investments and expenditure, within the limits of the relevant Organisation and Risk Management Regulations;
- decision on the issuance of bonds or other third-party asset gathering;
- determination of individual interest rates, in accordance with the provisions of Art. 3 of the Law on Banca dello Stato del Cantone Ticino;
- preparation of capital planning and liquidity planning;
- reporting to the Board of Directors in the event capital

requirements are not met or of major risks or liquidity;

- decision-making on the acquisition and disposal of participations not exceeding 15% of the subsidiary's capital or CHF 2 million.

#### *Supervision and control duties*

- implementation of the control procedures based on applicable external regulatory provisions;
- implementation of the provisions envisaged in the Organisation and Risk Management Regulations and the proposals for update to be submitted to the Board of Directors;
- supervision on risks incurred and adequacy of allocated capital;
- preparation of the records for the Public Mandate Control Commission of the Cantonal Parliament;
- establishing an evaluation with respect to its own work procedures and the meeting of its objectives.

#### *Credit duties*

- decisions related to credit business on the basis of delegated competencies defined by the Board of Directors.

With respect to the Group's operational management, it is important to note that the Executive Board exercises its own competences based on the Group Regulations.

The activities of the Executive Board are supported by specific business units as well as by committees of the Executive Board, whose principal responsibilities are summarised below.

These committees carry out their own functions also for specific issues pertaining to the Group.

## **Risk Committee**

The Risk Committee is responsible for ensuring adequate supervision of overall risk and, in particular, operational risks. The duties assigned to this Committee are to develop risk profiles within the framework of thresholds set by the Board of Directors, to ratify the individual operational losses up to the threshold described in the Committee's regulations, and the provision of infrastructure and adequate resources for the control and supervision of risks (including aspects related to personnel and outsourced activities).

The Risk Committee is chaired by the President of the Executive Board. Its Deputy Chairman is the Head of Financial and Operational Services.

## **Credit Risk Committee**

The Credit Risk Committee is responsible for managing the credit risk with the aim of optimising its administration. Within the framework of the competencies assigned to it, the Credit Risk Committee decides on loan applications (loan granting, extension, renewal, increase). It also proceeds to a preliminary examination of and submits prior notice on all matters which are brought to the attention of the Board of Directors for information or debate.

The Chairman of the Credit Risk Committee is the Head of Credit Management and Support. The Deputy Chairman is the Head of the Retail and Corporate Clients Division.

## **ALCO (Assets & Liabilities Committee)**

Within the framework of assignments entrusted to it, the ALCO is responsible for the market risk, including liquidity risk, on all Bank portfolios in view of optimising the management of this risk based on the Bank's strategy and budget. More specifically, this Committee manages rate and currency risk exposure on the balance sheet (as regards both benefits and economic value), overall liquidity, positions in the financial investment portfolio, and exposure to market risk derived from trading activities.

This Committee is chaired by the Head of Markets and Private Banking. The Deputy Chairman is the President of the Executive Board.

## **4.1 Members of the Executive Board**

The Executive Board comprises the President of the Executive Board and members who are all Heads of Divisions. The members' term is indefinite, and they retire three years earlier than the standard age of retirement, provided that their nomination occurred at least 10 years before the standard

retirement age. No member of the Executive Board was ever a member of the Bank's Board of Directors or worked for the Internal Auditors (past or present).

Following is a short introduction to the five members in office as at 31 December 2018 along with their functions on the Executive Board, their educational background, their professional record of accomplishments and their other activities.

### **FABRIZIO CIESLAKIEWICZ**

#### **Function**

Appointed President of the Executive Board on 15 March 2017, effective on 1 July 2017. Member of the Executive Board since 1 August 2008; born on 4 September 1970, Swiss.

#### **Education and professional background**

Degree in Political Economics from the University of Lausanne in 1993. In 1994 he was employed by UBS SA as a member of a post-graduate team for corporate clients in the Ticino area. In the following year, he became a business consultant for corporate clients and member of the managerial staff. From the end of 1997 to the beginning of 2000 he was Head of the General Secretariat for the Liberal Radical Party of Ticino. He began his employment at BancaStato on 19 June 2000 as Deputy Manager of the Biasca Agency. On 31 December 2001, he was appointed Member of the Management and assumed the position of Regional Head and Head of the Corporate Clients Division for the Bellinzona Area. On 1 August 2008 he was appointed Member of the Executive Board and took over the position of Head of Retail and Corporate Clients. On 1 July 2017 he assumed the role of President of the Executive Board.

#### **Other activities**

- » Deputy Chairman of the Foundation Council of the Fondazione di Previdenza Risparmio 3 of Banca dello Stato del Cantone Ticino;
- » Member of the Board of Directors of the Association of Swiss Cantonal Banks, Basel;
- » Member of the Executive Committee of the Ticino Bankers' Association;
- » Member of the Foundation Council of the Center for Banking Studies;
- » Member of the Board of the Carlo and Albina Cavargna Foundation;
- » Member of the Board of Governors of the Ticino Cancer League,



From left to right:

**Gabriele Zanzi** Head of the Retail and Corporate Clients Division;

**Patrick Lafranchi** Head of the Credit Management and Support Division;

**Fabrizio Cieslakiewicz** President of the Executive Board;

**Claudio Genasci** Head of the Markets and Private Banking Division;

**Daniele Albisetti** Head of the Financial and Operational Services Division.

» Member of the Foundation Council of the Oncological Research Institute (IOR).

## **DANIELE ALBISETTI**

### **Function**

Member of the Executive Board since 1 April 2014, born on 28 October 1962, Swiss.

### **Education and professional background**

Degree in Economics with a major in Corporate Management from the University of Lausanne in 1985. He began his professional career in the internal audit division of Banca del Gottardo where he was team leader and was promoted to Bank Officer in 1988 and then to Assistant Vice-President in 1989. In 1990, he was entrusted with several projects pertaining to organisation, and risk management control within the Financial and Risk Management Department. In 1996,

he was promoted to Member of the Management and in 1999 became Head of Controlling at Group level. He joined BancaStato on 1 February 2003 as Head of the Financial and Risk Management Department, taking on de facto the position of Chief Financial Officer. On 1 April 2014, he became a member of the Executive Board and Head of Financial Services and Operations Division which is responsible for financial management and risk supervision, as well as for providing organisational, IT and operational support to various Bank processes.

### **Other activities**

- » Member of the Board of Directors of Tele Ticino SA, Melide;
- » Member of the Executive Committee and treasurer of the Swiss Walking Federation.

## **CLAUDIO GENASCI**

### **Function**

Member of the Executive Board since 1 January 2003; born on 26 February 1959, Swiss.

### **Education and professional background**

Degree in Economics and Social Sciences from the University of Fribourg in 1985. Hired at UBS SA as an all-rounder and later as an asset manager in their Finance Department in Lugano. Starting in 1990 he was Head of Asset Management at UBS SA in Locarno. He moved to Cornè Banca SA, Lugano Offices, in 1996 as Head of Investment Strategies. He joined BancaStato on 1 August 2001 as Head of the Markets and Finances Division. In 2003, the Board of Directors appointed him Member of the Executive Board for the Market and Finances Division. Since 16 April 2007 he has been Head of the Markets and Private Banking Division.

### **Other activities**

- » Member of the Board of Directors of Axion SWISS Bank SA, Lugano;
- » Chairman of the Foundation Council of the Fondazione di Previdenza Risparmio 3 of Banca dello Stato del Cantone Ticino, Bellinzona;
- » Member of the Investment Committee of the Real Estate Fund Residentia, as an expert in real estate financing;
- » Member of the Board of Directors of SOAVE Asset Management Ltd., Lugano<sup>13</sup>.

## **PATRICK LAFRANCHI**

### **Function**

Member of the Executive Board since 1 July 2017.  
Born on 22 October 1969, Swiss.

### **Education and professional background**

After graduating from the University of Zurich in 1996, and obtaining his lawyer's license, he joined BancaStato in 1998 as Head of Legal Affairs. In 2005, he was promoted to Member of Management and became Head of Credit Recovery. In 2012, he became Head of the Management and Credit Control Department. On 15 March 2017, he was appointed by the Board of Directors as a member of the Executive Board and Head of the Credit Management and Support Division.

## **GABRIELE ZANZI**

### **Function**

Member of the Executive Board as of 1 December 2017.  
Born on 22 August 1963, Swiss.

### **Education and professional background**

Degree in Economics from the University of Zurich in 1989. The next year he began his professional career at the Ticino Chamber of Commerce. In 1995 he joined UBS Ticino, assuming various positions with responsibility for Corporate clients. In 1998 he was employed by Credit Suisse, undertaking increasingly important functions. He was appointed Head of Corporate Clients in 2012 and Regional Head for Ticino in 2016. Since 1 December 2017, he has been the Head of Retail and Corporate Clients Division at BancaStato.

### **Other activities**

- » Member of the Executive Committee of "Associazione Industrie Ticinesi AITI", Lugano;
- » Member of the Board of Directors of Hockey Club Lugano SA, Lugano;
- » Member of the Committee of "Fondo per il perfezionamento commerciale", Lugano.

## **5. COMPENSATION, PARTICIPATIONS AND LOANS**

### **5.1 Content and method of determining the compensation and the participation programs**

The fixed and variable compensation of the Executive Board, as well as that of the Chief Internal Auditor and his Deputy fall within the responsibility of the Board of Directors. Present compensations of the Members of the Board of Directors are established on the basis of a Resolution of the State Council dated 7 December 2016, effective 1 January 2017.

The Board of Directors approves the Staff Rules and Regulations and the Management Rules and Regulations. On an annual basis and acting on proposals from the Executive Board, the Board of Directors makes decisions with regard to the review of annual salaries and the variable component within the framework of MbO (Management by Objectives).

The social security coverage of the members of the Executive Board is calculated using the same parameters as used

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<sup>13</sup> In January 2019, Claudio Genasci stepped down from this function when BancaStato relinquished its shareholding in the company. Refer to Point 1.1.1.

for calculating the compensation to all Members of the Management.

Guaranteed coverage exceeds minimum legal requirements. Moreover, they benefit from the family allowances granted to all staff.

The following figures include fixed retribution, variable retribution and a lump sum figure for entertainment expenses. In 2018, total compensation for members of the Bank's bodies was as follows: CHF 525,863 for the Board of Directors and CHF 3,603,284 for the five members of the Executive Board. The highest compensation within the Board of Directors was CHF 112'340 and the highest compensation within the Executive Board was CHF 888,605<sup>14</sup>.

Among the Bank's providers there are entities connected to the members of the Board of Directors and the Executive Board.

The members of the Board of Directors and the members of the Executive Board benefit from mortgage loans and other banking services under the same conditions as the Bank staff. At the end of 2018, loans to Bank governing bodies totalled CHF 111 million and amounts due CHF 7.7 million (see also the corresponding table of the Annex to the Financial Statements).

## **5.2 Transparency of the compensations, shareholdings and loans pertaining to issuers domiciled abroad**

As the Bank has no registered offices abroad, there is no relevant information under this point.

## **6. SHAREHOLDERS' PARTICIPATION RIGHTS Relations with Ownership**

The information to be disclosed as per paragraphs 6.1 to 6.5 of the Annex to the Directive on Information Relating to Corporate Governance issued by SIX Swiss Exchange does not apply to Banca dello Stato del Cantone Ticino. However, it was deemed useful to sum up the main features of the Bank's relation with its ownership. The members of the Board of Directors are appointed by the State Council. As laid down in Art. 33 of the Law on Banca dello Stato del Cantone Ticino, the Grand Council and the State Council ensure that the Law

is adhered to and that the general policy of the Bank is in line with the objectives laid down in the Law.

Within the authority of the Grand Council and the State Council lie, in particular, the overview and approval of the Bank's income statement and balance sheet.

In accordance with Art. 39 of the Law on Banca dello Stato del Cantone Ticino, the Board of Directors must submit its report on the state of business at the Bank, the income statement and the balance sheet, the proposal for appropriation of available earnings and the report of the External Auditors to the State Council by 31 March of every year.

By 30 April, the State Council transmits the documentation to the Grand Council for approval of the annual accounts, the proposed appropriation of available earnings and the sign off of the Bank's governing bodies. In conformity with Art. 34 of the Law on Banca dello Stato del Cantone Ticino, the Grand Council exercises a supervisory duty as regards the fulfilment of the public mandate by way of the Public Mandate Control Commission. This Commission is made up of one member per parliamentary group each of whom is appointed by the Grand Council for a period corresponding to one legislative session. In compliance with the provisions of Art. 35 of the Law on Banca dello Stato del Cantone Ticino, the Public Mandate Control Commission verifies the correct fulfilment of the public mandate and draws up a special report to the attention of the Management and Finance Commission on the achievement of the public mandate.

The report prepared by the Commission must include its opinion on the degree of fulfilment of the general and specific objectives laid down in the strategic document on the public mandate as drawn up by the Board of Directors and based in particular on its analysis of the Annual Social and Environmental Report.

The Commission, which details the parliamentary debate on the aforementioned documents with its report, is entitled to view all the documentation and to hear the Bank representatives insofar as this is compatible with banking secrecy.

As of 31 December 2018, the Commission included: Maurizio Agustoni (Chairman as of September 2018), Gabriele Pinoja (Deputy Chairman as of September 2018), Omar Balli, Nicola Brivio, Claudia Crivelli Barella and Pelin Kandemir Bordoli.

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<sup>14</sup> The Corporate Governance guidelines (which BancaStato implements on a voluntary basis) introduce more specific recommendations for the presentation of compensations within the Board of Directors and the Executive Board. We believe that the description contained in this Annual Report reflects the requirements for exhaustiveness and transparency.

## 7. CONTROL AND DEFENCE MEASURES

The information to be disclosed as per paragraphs 7.1 and 7.2 of the Annex to the Directive on Information Relating to Corporate Governance issued by SIX Swiss Exchange is not applicable to Banca dello Stato del Cantone Ticino.

## 8. AUDITORS

### 8.1 Duration of the mandate and term of office of the Lead Auditor

The appointment of the Auditors falls under the authority of the Board of Directors (Art. 37 of the Law on Banca dello Stato del Cantone Ticino). In 2005, the Board of Directors entrusted the External Auditor mandate to PricewaterhouseCoopers SA in accordance with the Banking Law. In 2018, Ms. Glenda Brändli, partner at PricewaterhouseCoopers SA, assumed the function of Lead Auditor for the second time. This mandate is annual.

PricewaterhouseCoopers SA also audits Axion SWISS Bank SA.

### 8.2 Auditing honorarium

For the year 2018, the auditing honorarium of PricewaterhouseCoopers SA for the ordinary audit of BancaStato and other audits please refer to Table 5.12.26 of the Annex to the Group Financial Statements as well as to Table 5.8.18 of the Annex to the Individual Financial Statements.

### 8.3 Additional honorariums

For information pertaining to this point, please refer Table 5.12.26 of the Annex to the Group Financial Statements as well as to Table 5.8.18 of the Annex to the Individual Financial Statements.

### 8.4 Supervisory and control instruments vis-à-vis the auditors

As stated in the Section on the Board of Directors, the Audit and Risk Committee of the Board of Directors exercises various activities connected to the External Auditors.

The reports of the External Auditors are brought to the attention of the Board of Directors.

The Board of Directors meets at least once a year with the External Auditors. The full report of the External Auditors (including Group audits) on the financial statements as well as the report on the basic audit are presented by the External Auditors to the Board of Directors. Representatives of the External Auditors take part in the meetings of the Audit and Risk Committee of the Board of Directors.

## 9. INFORMATION POLICY

BancaStato's information and communication policy is based upon principles of consistency, clarity, continuity, up-to-datedness, transparency and verifiability. It specifically aims to strengthen corporate culture and promote its image in observance of its corporate identity both within and without.

The responsibility for the management of the Bank's communication policy is entrusted to the Strategic Planning and Communications Department. The Bank has an Intranet site in which it informs all staff on corporate strategy, the products and services of the various divisions, financial results, press releases, as well as on communications from the Executive Board and the Board of Directors. This intranet website is an essential source of corporate information, truly a valuable resource comprising all documentation and data to facilitate the ongoing pursuit of banking activities.

Financial results are published twice a year and communicated to the Ticinese media (radio, television and newspapers as well as on the internet), to press agencies, as well as to the press offices of all Cantonal Banks and the Association of Swiss Cantonal Banks. As a rule, the annual financial report is presented during the first quarter at a press conference held at BancaStato's Head Office. The annual report is sent to the FINMA, the State Council, the Grand Council, the Public Mandate Control Commission, the Swiss National Bank, all Cantonal Banks, the Association of Swiss Cantonal Banks, as well as to correspondent banks, and Swiss and foreign clients upon request. Annual reports, in Italian and in English, can be accessed via the BancaStato website at [www.bancastato.ch](http://www.bancastato.ch)<sup>15</sup> and are available at any BancaStato counter.

For the 2018 financial year, the Bank published once again its Social and Environmental Report<sup>16</sup>. BancaStato can be accessed by the public via their website [www.bancastato.ch](http://www.bancastato.ch) which facilitate

<sup>15</sup> <http://www.bancastato.ch/bancastato/Area-media/Pubblicazioni/Rapporti-di-esercizio.html>

<sup>16</sup> <http://www.bancastato.ch/bancastato/Area-media/Pubblicazioni/Rapporti-di-esercizio.html>

access to information on products, services and news from the Bank. The Bank is present in various daily newspapers, broadcasts and publications which deal with financial issues with interviews, presentations and financial articles<sup>17</sup>. These articles also appear on the website and, whenever possible, on the Bank's other communication channels in order to provide information on the diversified world of the Institution. BancaStato also posts its institutional news on Twitter. Moreover, representatives from BancaStato participate regularly in conferences and other public events and respond to queries from the media with regard to the Bank's stance on topical issues.

The Executive Board receives journalists on a regular basis for the presentation of the financial reports and in order to introduce various issues relating to the Bank's activities, thus promoting dialogue and reciprocal knowledge.

All principal documents published by BancaStato are available at its branches and agencies as well as on its website. For further information, contact:

**Dr. rer. pol. Curzio De Gottardi**

Member of the Management

Head of Strategic Planning and Communications

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<sup>17</sup> <http://www.bancastato.ch/bancastato/Area-media/Novita/Rassegna-stampa.html>

# Ticino's Economy in 2018 and Outlook for 2019

Davide Arioldi, Head of the PanelCODE ([www.panelcode.ch](http://www.panelcode.ch))

Economic Research Institute, University of Lugano

## The international overview

In 2018, the growth in global economies reached a peak with the world GDP increasing by 3.7%. This development was however more diversified with respect to 2017, both in terms of countries and the various economic sectors. The labour market continued to consolidate and grow, with an unemployment rate in OECD countries sitting at its lowest point since the 1980s. Some problems nevertheless emerged towards the end of the year. Investments and growth in international trade turned out to be much weaker than expected with stricter financial conditions in some countries along with worsening consumer and business confidence indexes. Recent economic data which signalled a period of fairly robust growth in the United States, indicated a clear slowdown for the economies of China, Europe and Japan. The Purchasing Managers Index (PMI), new orders, industrial production and retail sales, have weakened considerably compared as compared to the first part of the year. The introduction of commercial duties, which have led to growing tensions between the United States and China, as well as, more generally, between the U.S. and the rest of the world, continue to produce high levels of uncertainty in terms of future prospects for world growth. Anticipatory business indexes, such as export orders, maritime container traffic, and the evolution of maritime shipping costs, indicate clearly weakened prospects for future international exchanges. Moreover, there is the risk that further tariffs and trade limitations will be introduced in 2019 over and above those already imposed in 2018 which have fuelled inflationary pressure on consumer prices and caused disruptions of the value production chain in all branches affected by these new taxes. Combined with the lack of clarity in the regulatory framework which is expected to remain for years to come, these new taxes have compelled businesses to review and restrict their future investment plans. In this context, the rise in oil prices along with a more restrictive financial environment, have contributed to a further depression of the financial situation. Monetary policies were more restrictive in 2018, particularly in the United States, where financing rates over the short and long terms were substantially increased. This resulted in the rebalancing of the principal portfolio components which in turn increased volatility in financial and

foreign exchange markets. Manifest risks of a general economic slowdown increased risk premiums, with greater negative effects on high-debt countries and economic sectors. Higher oil prices have also impacted negatively on the economic situation, increasing inflationary pressure. Compared to 2017, WTI prices rose by an average of 28%, production in the US and Russia reached historical highs while potential output in Venezuela and Iran remained uncertain due to their unresolved political situations. As a result of these tensions, global growth estimates have been revised. According to the OECD, growth is expected to dwindle from a rate of 3.7% in 2018 to 3.5% in both 2019 and 2020, with potential further reductions in the event of an increase in negative risks or political uncertainty. As a result, the European area will show major slowdown with a GDP growth that is not expected to exceed 1.5% in 2020, along with growing political risks resulting from a no-deal Brexit as well as increased social tensions in France (yellow vests) and Italy (political unrest).

## The national overview

Switzerland also experienced peak economic growth in 2018. In the second quarter, Swiss GDP grew by +3.5% on an annual basis, falling to +2.4% during the third quarter due to a major slowdown in world economies which directly affected Europe. This was felt mostly in Germany and Italy, two of Switzerland's major commercial partners. In Germany, the downturn in the automotive sector has reduced demand in the Asian markets, leading to a decline in production that was subsequently felt by supplier countries. In the third quarter of 2018, the commercial balance was negative: Swiss goods exports fell by -3.3% on an annual basis (+7.4% in the preceding quarter) while imports increased by +4% (+7.8% in the second quarter). Investments in machinery and equipment also decreased from an annual growth rate of +4.8% in the second quarter of 2018 to +1.1% annually in the third quarter of the same year. The Swiss economy continues to reflect the international situation which was characterised by declining commerce and investments due to major levels of uncertainty regarding future prospects. The year is therefore expected to close, according to SECO estimates,

with a growth in GDP of +2.6% thanks in large part to the positive results achieved during the first two quarters. In 2018, contributions are expected to remain on the positive side for all balance sheet items: State and household consumption (+1.1% and +0.9%, on a yearly basis), investments in equipment and construction (+3.2% and +1.4%) and commercial balance, with exports and imports up by +2.9% and +2.4% respectively. In this context, occupation in terms of full-time equivalents (FTE) is believed to have increased in 2018 by +1.8% on an annual basis, with diversified trends across the main regions. North-Western Switzerland and the Lemman region saw an annual FTE occupation rate above +2.8% during the third quarter while in the Mittelland, Zurich and Eastern and Central Switzerland the increase ranged between +1.2% and +1.6%. As for Ticino, there was a clearly lower rate of growth sitting at +0.24%. The SECO national unemployment rate was 2.6%, a clear drop from 2017 when it stood at 3.2%. The ILO unemployment rate was also below that of the preceding year. In the third quarter of 2018, ILO-measured unemployment in Switzerland was 4.4%, below the 5% rate in the same quarter of 2017.

As the rest of Europe, Switzerland is expected to experience slower economic growth. In 2019, SECO anticipates a GDP growth of only +1.5% with a slightly negative contribution of the commercial balance (+3.1% for exports and +3.2% for imports) and a modest increase in consumer and State consumption (+1.1% and +0.7% respectively). Inflation will remain in the lower positive range (approximately +0.5%) with a still expanding job market (+0.8% increase in FTE employment) and a further declining SECO unemployment rate of 2.4%.

As regards popular votes, in 2018, the right of the Swiss Confederation to collect direct federal taxes and value added tax was extended until 2035. The following initiatives were however rejected: the initiative for the abolition of the radio and television license fee (the so-called Billag fee), the "sovereign money initiative" which was aimed at impeding the "creation" of money on the part of private commercial banks, and the "self-determination initiative" which sought to enshrine the superiority of the Federal Constitution over international law.

### **The overview for Canton Ticino**

According to BAK Basel, and based on their data, Canton Ticino's real GDP grew by +1.9% in 2018, matching the level recorded by BAK Basel in 2017. An analysis of data from the "employment side" labour market as well as the demographic evolution of companies, shows that, in 2018, economic growth in Ticino was below that of other cantons and major Swiss regions. Employment, measured in full-time equivalents, was only slightly positive (+0.24% in Ticino in the third quarter of 2018 compared to +1.8% at the national level). The number of new businesses in Ticino increased marginally in the third quarter of 2018 through the addition of 29 new companies. A geographical breakdown shows that, in the second and third quarters of 2018, the total number of businesses in the district of Lugano decreased while the Bellinzona district exhibited a more positive trend. An analysis in terms of bankruptcies reveals that, in the first three quarters of 2018, the rate of liquidations was below that of the preceding year. The present minor growth may therefore not be seen as stemming from a critical economic situation, but rather from a slowdown in the creation of new businesses and new jobs, at least at an aggregate level. However, according to a review of trends in the various sectors, 2018 saw further growth in turnover in the banking, logistics and transport sectors and, to a lesser degree, in the construction and manufacturing branches. Sales for companies in the tourism and accommodation industry either remained stable or decreased compared to the preceding year. Business in the commerce sector has further contracted as a result of structural changes due to progressing online purchases. Unemployment, as measured by ILO standards, stood at 7% in the third quarter of 2018, above its 5.4% level in the same quarter of the preceding year, while average SECO unemployment stood at 3% throughout 2018, a -0.4% decrease from the previous year.

For 2019, BAK Basel forecasts indicate a potential real GDP growth of +1.7%, indicating a slowdown if compared to the current rates.

# Report of the Board of Directors of Banca dello Stato del Cantone Ticino

## **Banca dello Stato del Cantone Ticino and the Economy of Switzerland and Ticino in 2018**

The reporting year was once again characterised by negative interest rates on the Swiss franc, starting with banks' deposits with the Swiss National Bank (SNB). These rates, which were introduced in January 2015 to counterbalance the strong Swiss franc, continued to impact negatively on commercial margins of credit institutions' intermediation business. In spite of the fact that the Swiss franc gradually weakened relative to the euro over the past two years, therefore alleviating the negative pressure on Swiss exports, the SNB maintained its expansive monetary policy aiming at supporting the economy.

In 2018, the Swiss gross domestic product (GDP) experienced solid growth, principally during the first semester, while in the last six months of the year the weaker economic situation became tangible. The reporting year was also characterised by turbulent stock markets which impacted on client asset volumes and financial transactions.

In Ticino, the real estate sector, which has been monitored by economic operators for several years, has continued to grow, but at a slower pace than previously, while at the same time showing signs of a saturated market, exemplified in a substantial increase in the percentage of empty housing.

Looking more specifically at BancaStato's performance, 2018 resulted, once again, in major satisfaction in terms of growing business volumes and results achieved in a market which may still objectively be termed difficult and characterised primarily, as already mentioned, by negative rates on short- and medium-term maturities. In the reporting year, the Bank successfully introduced its new corporate strategy, 2020@GruppoBancaStato which is to be implemented over a three-year period. The aim of this strategy is to increase efficiency, profitability and productivity through specific projects such as digital transformation and the

optimization of synergies within the Group, all supported by continuous training, and in keeping with BancaStato's vision and values.

The financial results achieved by BancaStato in the reporting year are consistent with those produced in 2017. On the one hand, this has permitted an increase in the allocation to the Bank's owner from CHF 36.1 million to CHF 38.4 million and, on the other, it has bolstered the Bank's financial base through a substantial increase in its capital.

Client business volumes have continued to increase in both lending (+6% to CHF 11 billion) and funding (+4.3% to CHF 8.3 billion), which again confirms the significance of BancaStato's role in the economy of Ticino as well as its impact on its people.

The Bank's operating result increased from CHF 72 million to CHF 73 million, up by CHF 1 million (+1.3%). Net revenues showed a gratifying progression, totalling CHF 190.7 million, up by 5.1% compared to 2017. This growth refers to results from interest operations, which has traditionally been a primary source of income for the Bank and stood at CHF 144.8 million, an increase of CHF 15.7 million or 12.2%. The Bank's other sources of revenues were affected by the prevailing situation on the stock markets. Net of non-recurring elements, operating costs remained at the same levels as in the preceding year, and there was no significant change in depreciation of fixed assets. Considering these excellent results, BancaStato made another allocation of CHF 26 million to reserves for general banking risks which, together with an additional CHF 11.7 million to the statutory retained earnings reserve, will further bolster the Institute's capital base. In spite of these substantial allocations, profit increased by CHF 1.9 million (+4%), exceeding for the first time the CHF 50 million threshold.

### **Comment on the Evolution of Major Balance Sheet and Off-balance Sheet Items<sup>18</sup>**

Although BancaStato provides the full range of services typically offered by a universal bank, it continued to maintain its focus on mortgage lending in 2018. Mortgage loans increased by 6.1%, or CHF 536.3 million, and stood at CHF 9.37 billion. As interest rates remain at a historic low, the loan portfolio continues to be primarily structured along the lines of fixed rate mortgages. In this regard, it must be stated that BancaStato maintains a lending policy that reflects a cautious approach. As a result, the quality of its lending portfolio has steadily improved. An analysis of the stratification of mortgage loans shows that 94.1% of them are first mortgages and over 74% are for housing. The average mortgage granted for a single housing unit has slightly increased, but still remains below CHF 550,000, confirming that Bank continues to be a valuable resource for those Ticinese people wishing to buy their own home.

Amounts due from customers continue their progression (+CHF 84.6 million or 5.3%) just shy of CHF 1.7 billion. Loans to public corporations have increased, totalling CHF 706 million, a threshold guaranteeing BancaStato's ability to maintain its dominant position in Ticino within this market segment. Loans to private individuals and companies also exhibited a positive trend (+CHF 66 million) and reached CHF 974 million. These items are tangible signs of BancaStato's significant contribution to the development of the economy in the Canton.

As regards funding, payables resulting from client deposits once again showed a renewed and clear progression, up by CHF 344 million, exceeding CHF 8.3 billion. This 4.3% growth confirms the positive trend which has been in progress

for several years. Within this item, clients have turned primarily to savings accounts, which progressed by CHF 286 million and, in a smaller way, towards transactional accounts, which were up by CHF 58 million. Negative market rates have once again caused a further major regression in all fixed term deposit items on the balance sheet (fixed savings and cash bonds).

In order to satisfy its requirements for medium to long-term funding, as well as to ensure sound management of exposure to interest rate risk, the Bank operated on the capital market<sup>19</sup> to finance increased lending with a CHF 250 million mortgage bond at 0.375% maturing in February 2028. Moreover, as it had done in previous years, the Bank turned to bond issues of the Central Mortgage Bond Issuing Body of the Swiss Cantonal Banks to substitute matured funding. This source provided additional medium- to long-term capital at particularly low costs. Funding obtained on the capital market totalled CHF 2.8 billion at the end of 2018, representing a 7.2% increase.

The Bank's balance sheet total grew from close to CHF 12.6 billion at the end of 2017 to over CHF 13.4 billion as at 31.12.2018, exhibiting a further 6.3% progression. In the ten-year period from 2008 to 2018, business volumes increased by over 77%.

With respect to off-balance sheet operations, contingent liabilities regressed by CHF 21 million, down to CHF 112.5 million. In this context it is to be noted that guarantees provided by the Bank increased slightly to CHF 100.1 million from approximately CHF 97 million in the preceding year. However, commitments arising from documentary letters of credit partly connected to Commodity & Trade Finance, saw a CHF 24.4 million regression, down to CHF 12.4 million. Irrevocable commitments increased by CHF 77.3 million for new confirmed loans for mortgages and participations in syndicated loans.

<sup>18</sup> The data refer to BancaStato's Individual financial statements. A distinction is made between Individual and Group statements only in the case of significant variances.

<sup>19</sup> The 0.375% bond issue of Banca dello Stato del Cantone Ticino 2018-2028 was floated with the support of Credit Suisse.



### Evolution of Assets under Management

Assets under management at the BancaStato Group exhibited a further progression during 2018, up from CHF 15.6 billion at the end of 2017 to CHF 15.7 billion at 31.12.2018.

The volume of assets under management at BancaStato increased by CHF 302 million (+ 2.7%), levelling off at close to CHF 11.55 billion. In 2018, inflow in net new money, CHF 715 million, was once again particularly gratifying. However, the evolution of asset values was affected by stock and forex market trends resulting in a negative performance of CHF 414 million. By the end of 2018, assets under custody totalled CHF 503 million, down from CHF 614 at the end of 2017.

Assets under management by Axion SWISS Bank SA were also clearly influenced by prevailing financial market trends, with a negative performance of CHF 341 million. This was offset by a CHF 94 million inflow of net new money.

These elements reduced total assets under management by CHF 247 million to just over CHF 4.1 billion at the end of 2018 (-5.6%) at end 2018.

### Comment on the Evolution of the Main Items of the Income Statement

In 2018 BancaStato was once again able to consolidate the ongoing growth achieved in the preceding years, thus reconfirming its position as a valuable source of income for the Canton's treasury. The operating result for 2018, CHF 73 million, exceeded by CHF 1 million the result achieved by the Bank in the previous year. BancaStato once again seized this opportunity to bolster its capital with an allocation of CHF 26 million to reserves for general banking risks (CHF 22 million in 2015, CHF 24 million in 2016 and CHF 26.1 million in 2017).

In spite of this major allocation, net income progressed by 4% from CHF 48.1 million in 2017 to CHF 50 million in 2018. Consequently, the payment to the Canton increased by 6.3% from CHF 36.1 million for 2017 to CHF 38.4 million for 2018.

Net revenues for 2018 totalled CHF 190.7 million, up by 5.1% or CHF 9.2 million.



The gross results from interest activities, traditionally the principal revenue item for BancaStato, continued its progressive trend from previous years, and grew by over CHF 7.5 million (+5.5%). This evolution was supported on the one hand by an increase in mortgage volumes in recent years as well as by commercial margins and, on the other, by opportunities being offered in the current market environment for lower cost financing. As a result of continuing negative market rates on short and medium-term operations, the trend towards shrinking margins on client deposits continues. In this context, BancaStato has achieved gratifying results by maintaining its cautious policy with respect to the management of its balance sheet structure, as well as by turning to own issues and issues of the Cantonal Banks' mortgage refinancing institute in order to adequately refinance existing outstanding loans. Net result from interest operations (CHF 144.8 million or +12.2%) benefited from a reduced need for provisions for lending activities with respect to loans granted and need for provisions in the preceding year.

The results from commission business and services stood at CHF 28.7 million, just below the outstanding results achieved

in the previous year (-1.3%). This regression was due primarily to decreased net income from securities trading and investment activities (-CHF 0.4 million) resulting from the uncertainty prevailing on stock markets. Other components of result from commission business (lending operations and service fee activities) only saw minor changes.

The result from trading business was also affected by market trends which led to a reduction in revenues on securities portfolios held by the Bank as well as on customer foreign currency transactions. This item therefore regressed by 16.5% from CHF 14.7 million in 2017 to CHF 12.3 million in 2018.

Other results from ordinary activities were down from CHF 8.7 million in 2017 to CHF 5 million in 2018 (-42.7%). In this case as well, the regression was attributable to the particular stock market trends affecting the securities held in the Bank's financial investments portfolio. This was offset, albeit in a minor way, by increased revenues from permanent participations and real estate.

Operating expenses were up by 7.6%, from CHF 101.9 million in 2017 to CHF 109.6 million in 2018. Disregarding non recurrent elements, this item would stand at the same level as in the preceding year. Personnel expenses increased by CHF 5.3 million (+7.7%) and reached CHF 73.8 million as a result of the Bank's decision to fully and immediately pay out a staff pre-pension plan which is to be implemented by 2020. Other operating expenses showed a similar progression (+7.5%) due to the adoption of new versions of banking IT programmes and the provision of technical and financial information for their functioning.

Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets increased by CHF 0.4 million (+5.3%), and stood at CHF 8 million.

The item "Changes to provisions and other value adjustments, and losses"<sup>20</sup> recorded a net requirement of CHF 45,000 in 2018 against a release of CHF 80,000 in the preceding year.

Operating results for 2018 nevertheless recorded a satisfactory increase of CHF 1 million (+1.3%) at CHF 73 million, exceeding the record set last year.

The item "Extraordinary income" saw a positive evolution (+CHF 1.1 million or 44.5%). This was principally the result of the increase in the last payment of the variable component in the sales price of the Swisscanto Holding AG participation (assigned to Zurich Cantonal Bank in 2015).

In consideration of the excellent ordinary and extraordinary income achieved, the Board of Directors has decided to further bolster the Bank's capital and financial base by allocating CHF 26 million to the Reserve for general banking risks, in line with the preceding year's allocation.

This major allocation had no effect on the growth in net income which progressed by 4%, up from CHF 48.1 million in 2017 to over CHF 50 million in 2018. As has already been mentioned, this increase is to the advantage of the Bank's owner as the payment to the Canton was augmented from CHF 36.1 in 2017 to CHF 38.4 in 2018 (+6.3%).

This payment is a valuable source of income for the public body. An analysis of the evolution of this item over the last decade shows that the payment to the Canton has increased substantially from CHF 26.3 million in 2008 to CHF 38.4

million in 2018 (+45.6%). In the same decade, BancaStato paid out over CHF 327.5 million to its owner. Considering that the endowment capital was increased from CHF 300 million to CHF 430 million as at 31.12.2018, it can be said that the Institute repaid over 100% of the Canton's initial investment in the last decade.

As for the results of Axion SWISS Bank SA<sup>21</sup>, both net revenues and operating expenses increased substantially in all component items. Net income rose from CHF 31.1 million in 2017 to CHF 34.9 million in 2018 (+12%), while operating costs increased from CHF 22.7 million to CHF 25.2 million (+11%).

Among revenue items, results from interest operations grew by CHF 3.7 million and stood at CHF 12.3 million in 2018 (+42.8%) thanks to careful management of the balance sheet structure, especially with regards to balances in foreign currency on client current accounts even though these were adversely affected by negative market rates applied to short- and to medium-term for both CHF and EUR. The result from commission business and services, the principal source of revenue for a private-banking-oriented bank, saw further growth, up from CHF 18.9 million in 2017 to CHF 19.7 million in 2018 (+4.2%). This stemmed primarily from the management of client assets. However, income from trading activities, CHF 2.8 million, regressed by CHF 0.8 million (-21.5%) compared to the previous year.

The increase in operating expenses, which includes both personnel (+11.5%) and general and administrative expenses (+9.9%), was correlated to the growth in business volumes. As in the preceding year, the item Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets results from the depreciation of goodwill following the acquisition of a portion of client assets of Société Générale Private Banking SA (Lugano) in 2016.

The operating results and net income evolved in a highly gratifying manner, progressing by 68.8% to CHF 5 million (+2 million) and 72.9% to CHF 3.9 million (+CHF 1.7 million) respectively. This allowed a major distribution to the Parent Bank.

From a consolidated viewpoint, the Group's profit stood at CHF 49.3 million, a 10% increase (+CHF 4.5 million), compared to the previous year.

<sup>20</sup> Since 2015, in accordance with FINMA Circular 2015/01 "Accounting – banks", this item shows only operating losses.

<sup>21</sup> For further information on the results of Axion SWISS Bank SA, refer to its Annual Report.

## Profitability, Efficiency and Financial Strength

BancaStato's profitability in terms of Return on Equity (ROE)<sup>22</sup> stood at 7.6%, slightly below the remarkable levels of the previous year (8.3%), thus fulfilling the expectations of its owner. In this regard, it should be mentioned that in 2010 this indicator stood at 5.5%. Return on Risk Adjusted Capital (RORAC) also regressed from 14.9% in 2017 to 14.2% in 2018, primarily as a result of major capital requirements.

As regards efficiency indicators, a ratio of operating expenses (whether or not they include depreciation and provisions for other operating risks) to income (Cost / Income I and II), the Bank further consolidated the progressive positive trend it has demonstrated since 2010. Net of non-recurrent expenses assumed in 2018 in connection with the pre-pension plan to be effected by 2020, Cost / Income I (which does not consider depreciation and provisions for other business risks incurred during the year) evolved from 56.1% in 2017 to 54.6% in 2018 (against a 67.3% indicator in 2010), while Cost /

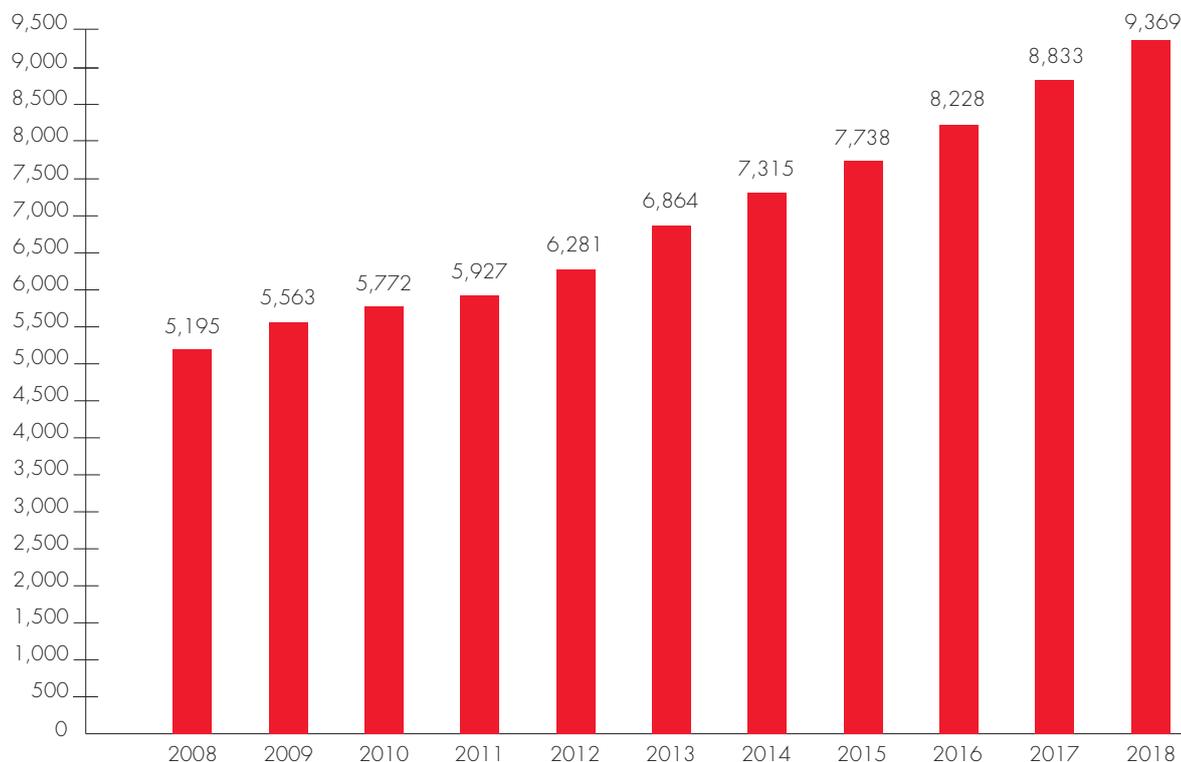
Income II (which considers all costs, depreciation and provisions during the year) further improved from 60.3% in 2017 to 58.8% in 2018 (76.4% in 2010). The strategic measures implemented by the Bank in the past decade bolstered its profitability. The Institute's operating result more than doubled over the past 9 years (from CHF 35.2 million in 2010 to CHF 73 million in 2018).

As at 31 December 2018, the Institute had 419 staff (380.95 FTEs with trainees calculated at 50%) compared to 427 at the end of 2017 (388.05 FTEs).

From the close of 2011 to the present, the Bank's capital adequacy, as determined by the ratio of required capital to available funds<sup>23</sup>, showed changes resulting from stricter requirements on the part of the surveillance authority, set against increases in endowment capital granted by the Canton and allocations to reserves decided by the Institute in the light of the increasingly excellent financial results achieved. Therefore, on the back of the coverage ratio of required capital with

## EVOLUTION OF MORTGAGE LENDING

(CHF millions)

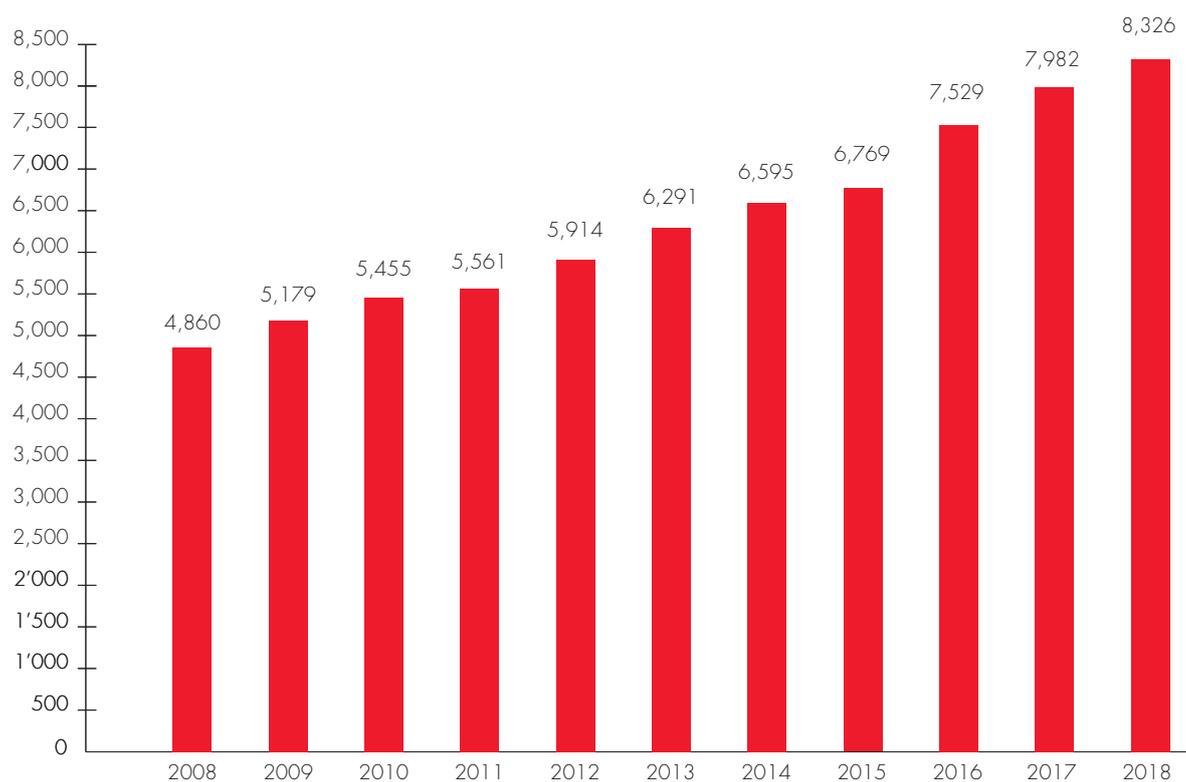


<sup>22</sup> The reference used to calculate ROE is net revenues before allocation to the reserve for general banking risks, while the reference capital comprises average core capital of the reporting year (net of any increase in endowment capital at year-end and of the year's allocation to reserves for general banking risks).

<sup>23</sup> Calculated on the basis of Basel III rules set by the Bank for International Settlements.

## EVOLUTION OF TOTAL AMOUNTS DUE TO CUSTOMERS

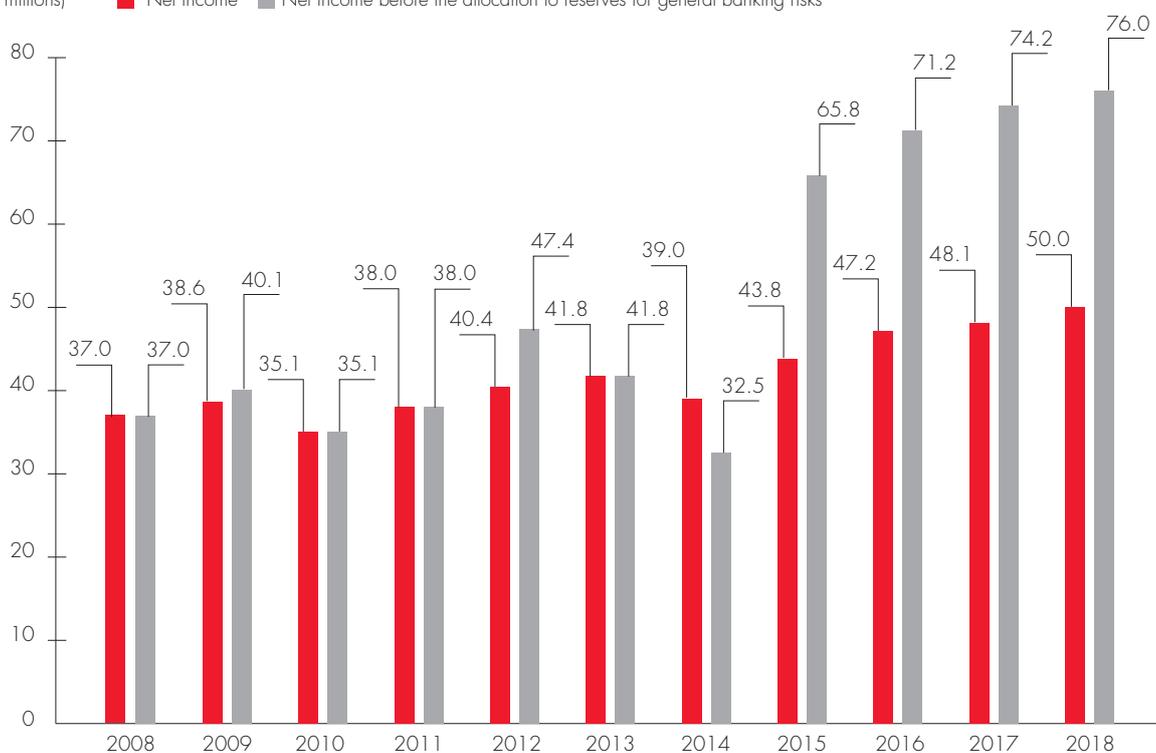
(CHF millions)



## EVOLUTION OF NET INCOME

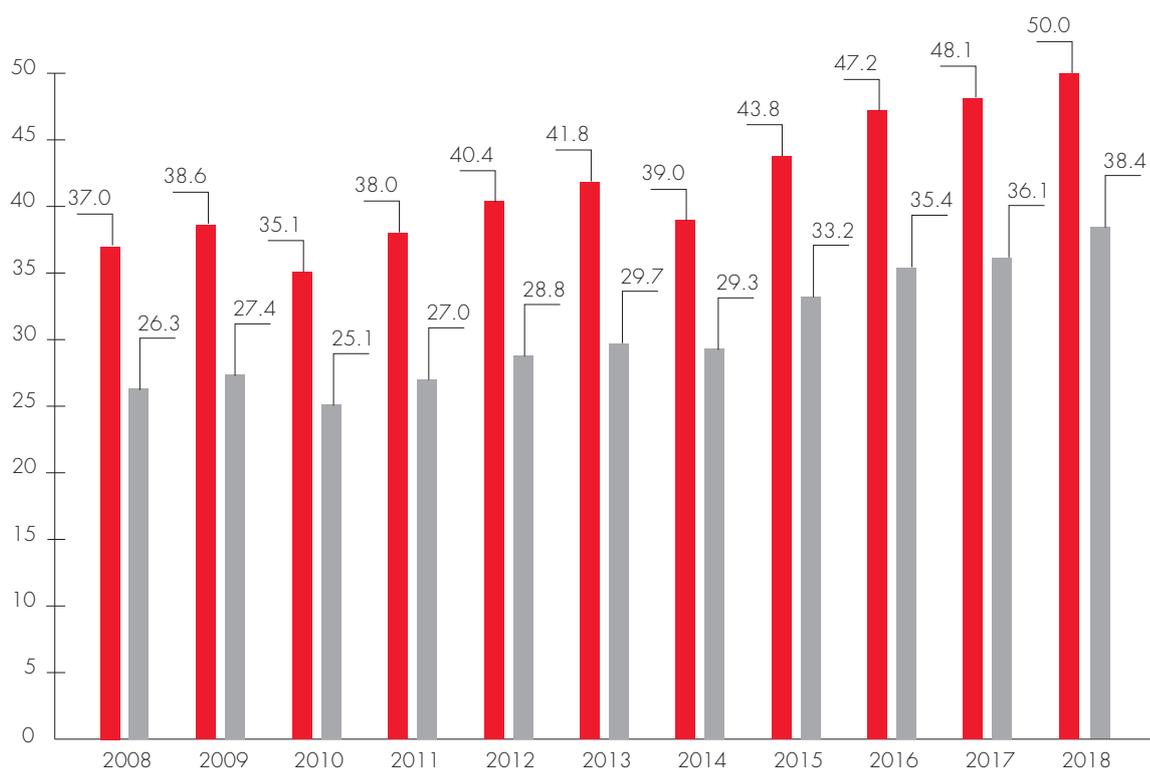
(CHF millions)

■ Net income ■ Net income before the allocation to reserves for general banking risks



## EVOLUTION OF THE PAYMENT TO THE CANTON

(CHF millions) ■ Net income ■ Payment to the Canton



available capital (including the countercyclical buffer introduced by the Federal Council in 2013 and doubled in the following year) the Bank's capital adequacy stood at 196% at the close of 2011, after fluctuating from a minimum of 178.1% (31.12.2013) to a maximum of 211.9% (31.12.2015). It further improved from 196.5% at the end of 2017 and stood at 198.2% on 31.12.2018. This translates into a 16.7% solvency ratio (16.5% at the end of 2017) against a minimum FINMA

requirement of 15.9%, including the countercyclical buffer (15.7% at the end of 2017). The reader should be reminded that for BancaStato (which for its size and profile is included in the Category IV of medium-sized banks), the minimum regulatory requirement is 140% (equivalent to a solvency ratio of 11.2% and to a minimum FINMA requirement of 12%).

The evolution of the Bank's principal adequacy indicators on an individual level may be summarised as follows:

BIS adequacy indicators	Without countercyclical buffer		With countercyclical buffer	
	2018	2017	2018	2017
Core Tier 1 (CET1) <sup>24</sup>	15,6%	13,9%	14,8%	13,1%
Tier 1 (T1) <sup>25</sup>	15,6%	15,2%	14,8%	14,4%
Total regulatory capital <sup>26</sup>	16,7%	16,5%	15,9%	15,7%

<sup>24</sup> Common Equity Tier 1 – CET1

<sup>25</sup> Additional Tier 1 – T1

<sup>26</sup> Capital adequacy indicators



Capital adequacy at the consolidated level is marginally better compared to the individual financial statements. Taking into account the countercyclical capital buffer introduced by the Federal Council in order to restrain an overheated real estate market, the Bank's coverage ratio increased from 199.3% at the end of 2014 to a maximum of 219.2% at the end of 2015,

decreasing to 216.4% at the end of 2016, and to 204.4% at the end of 2017. It rose again, reaching 207.8% by the end of 2018. The Group's indicators as set by the Bank for International Settlements evolved in a much similar manner as those of the Individual accounts, namely:

<b>BIS adequacy indicators</b>	<b>Without countercyclical buffer</b>		<b>With countercyclical buffer</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Core Tier 1 (CET1)	16,4%	14,6%	15,6%	13,6%
Tier 1 (T1)	16,4%	15,8%	15,6%	14,9%
Total regulatory capital	17,4%	17,1%	16,6%	16,4%

# Group Financial Statements

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# 1. Consolidated Balance Sheet

(CHF thousands)	Annex	31.12.2018	31.12.2017	Change
<b>Assets</b>				
Liquid assets		2,022,904	2,036,626	-13,722
Amounts due from banks		277,984	262,761	15,223
Amounts due from customers	5.10.2	1,962,296	1,875,231	87,065
Mortgage loans	5.10.2	9,369,105	8,832,812	536,293
Trading portfolio assets	5.10.3	27,620	40,833	-13,213
Positive replacement values of derivative financial instruments	5.10.4	9,892	51,607	-41,715
Financial investments	5.10.5	356,037	295,413	60,624
Accrued income and prepaid expenses		12,994	12,002	992
Non-consolidated participations	5.10.6 and 5.10.7	6,313	6,529	-216
Tangible fixed assets	5.10.8	78,120	80,111	-1,991
Intangible assets	5.10.9	7,011	14,302	-7,291
Other assets	5.10.10	191,570	17,774	173,796
<b>Total assets</b>		<b>14,321,846</b>	<b>13,526,001</b>	<b>795,845</b>
Total subordinated claims		10,208	20,419	-10,211
<i>of which subject to mandatory conversion and/or debt waiver</i>		10,208	20,419	-10,211
<b>Liabilities</b>				
Amounts due to banks		639,647	517,529	122,118
Liabilities from securities financing transactions	5.10.1	171,290	70,000	101,290
Amounts due in respect of customer deposits		9,417,141	9,102,551	314,590
Negative replacement values of derivative financial instruments	5.10.4	37,334	28,663	8,671
Cash bonds		736	1,105	-369
Bond issues and central mortgage institution loans	5.10.11 and 5.10.13	2,806,000	2,617,000	189,000
Accrued expenses and deferred income		41,273	42,012	-739
Other liabilities	5.10.10	10,902	125,935	-115,033
Provisions	5.10.14	10,677	3,600	7,077
Reserves for general banking risks	4 and 5.10.14	464,000	438,000	26,000
Endowment capital	4	430,000	300,000	130,000
Statutory retained earnings reserve	4	243,514	234,772	8,742
Group profit	4	49,332	44,834	4,498
<b>Total liabilities</b>		<b>14,321,846</b>	<b>13,526,001</b>	<b>795,845</b>
Total subordinated liabilities		175,273	255,273	-80,000
<i>of which subject to mandatory conversion and/or debt waiver</i>		-	80,000	-80,000
<b>Off-balance sheet transactions</b>				
Contingent liabilities	5.10.2 and 5.11.21	114,958	140,081	-25,123
Irrevocable commitments	5.10.2	307,267	232,535	74,732
Obligations to pay up and make further contributions	5.10.2	14,180	14,180	-

## 2. Consolidated Income Statement

(CHF thousands)	Annex	2018	2017	Change
<b>Income and expenses arising from ordinary banking operations</b>				
<b>Result from interest operations</b>				
Interest and discount income		193,603	187,970	5,633
Interest and dividend income from trading portfolios		-	-	-
Interest and dividend income from financial investments		3,104	2,790	314
Interest expense		-40,573	-45,798	5,225
<b>Gross result from interest operations</b>		<b>156,134</b>	<b>144,962</b>	<b>11,172</b>
Changes in value adjustments for default risks and losses from interest operations		939	-7,300	8,239
<b>Net result from interest operations</b>		<b>157,073</b>	<b>137,662</b>	<b>19,411</b>
<b>Result from commission business and services</b>		<b>49,281</b>	<b>48,906</b>	<b>375</b>
Commission income from securities trading and investment activities		47,265	47,331	-66
Commission income from lending activities		3,736	3,783	-47
Commission income from other services		10,145	10,358	-213
Commission expenses		-11,865	-12,566	701
<b>Result from trading activities and fair value option</b>	5.12.23	<b>15,096</b>	<b>18,291</b>	<b>-3,195</b>
<b>Other results from ordinary activities</b>		<b>300</b>	<b>3,715</b>	<b>-3,415</b>
Result from the disposal of financial investments		-299	1,289	-1,588
Income from participations		934	710	224
<i>of which from participations valued using the equity method</i>		6	40	-34
<i>of which non-consolidated participations</i>		928	670	258
Result from real estate		304	144	160
Other ordinary income		1,856	1,740	116
Other ordinary expenses		-2,495	-168	-2,327
<b>Net revenues</b>		<b>221,750</b>	<b>208,574</b>	<b>13,176</b>
<b>Operating expenses</b>		<b>-133,142</b>	<b>-122,705</b>	<b>-10,437</b>
Personnel expenses	5.12.25	-91,052	-83,934	-7,118
General and administrative expenses	5.12.26	-42,090	-38,771	-3,319
<b>Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets</b>	5.10.6, 5.10.8 and 5.10.9	<b>-16,071</b>	<b>-16,381</b>	<b>310</b>
<b>Changes to provisions and other value adjustments, and losses</b>		<b>-86</b>	<b>-50</b>	<b>-36</b>
<b>Operating result</b>		<b>72,451</b>	<b>69,438</b>	<b>3,013</b>
<b>Extraordinary income</b>	5.12.27.02	<b>4,606</b>	<b>2,553</b>	<b>2,053</b>
<b>Extraordinary expenses</b>	5.12.27.02	<b>-320</b>	<b>-16</b>	<b>-304</b>
<b>Changes in reserves for general banking risks</b>	5.12.27.04	<b>-26,000</b>	<b>-26,114</b>	<b>114</b>
<b>Taxes</b>	5.12.28	<b>-1,405</b>	<b>-1,027</b>	<b>-378</b>
<b>Group profit</b>		<b>49,332</b>	<b>44,834</b>	<b>4,498</b>

### 3. Cash Flow Statement

(CHF thousands)	2018		2017	
	Cash inflow	Cash outflow	Cash inflow	Cash outflow
<b>Cash flow from operating activities (internal financing)</b>	-	<b>228,172</b>	<b>426,694</b>	-
Group result	49,332	-	44,834	-
Change in reserves for general banking risks	26,000	-	26,114	-
Valuation adjustments on participations and depreciation of fixed assets and intangible assets	16,071	-	16,381	-
Provisions	7,077	-	-	625
Accrued income and prepaid expenses	-	992	1,448	-
Accrued expenses and deferred income	-	739	-	1,066
Other assets and liabilities	-	288,829	351,608	-
Interest on the endowment capital of the previous year	-	12,000	-	12,000
Prior year dividend	-	24,092	-	-
<b>Cash flow from endowment capital transactions</b>	<b>130,000</b>	-	<b>59,825</b>	-
Endowment capital	130,000	-	60,000	-
Change in consolidation perimeter	-	-	-	175
<b>Cash flow from transactions in respect of participations, fixed assets and intangible assets</b>	-	<b>6,573</b>	-	<b>7,170</b>
Non-consolidated participations	323	123	-	140
Real estate	-	1,216	-	2,139
Other tangible fixed assets	-	6,853	-	4,891
Intangible assets	1,296	-	-	-
<b>Cash flow from banking operations</b>	<b>91,023</b>	-	-	<b>647,490</b>
<b>Medium and long-term business (&gt;1 year)</b>	-	<b>557,961</b>	-	<b>622,586</b>
Amounts due to banks	-	4,000	-	-
Amounts due in respect of customer deposits	-	91,119	-	82,109
Cash bonds	-	369	-	2,082
Bond issues and central mortgage institution loans	185,000	246,000	294,000	220,000
Bond issues	250,000	-	-	-
Amounts due from customers	-	54,556	-	7,458
Mortgage loans	-	536,293	-	605,022
Financial investments	-	60,624	85	-
<b>Short-term business</b>	<b>648,984</b>	-	-	<b>24,904</b>
Amounts due to banks	126,118	-	-	338,755
Liabilities from securities financing transactions	101,290	-	-	55,000
Negative replacement values of derivative financial instruments	8,671	-	-	23,627
Amounts due in respect of customer deposits	405,709	-	422,436	-
Trading portfolio assets	13,213	-	-	13,040
Positive replacement values of derivative financial instruments	41,715	-	-	27,538
Amounts due from banks	-	15,223	32,975	-
Amounts due from customers	-	32,509	-	22,355
<b>Liquidity</b>	<b>13,722</b>	-	<b>168,141</b>	-
Liquid assets	13,722	-	168,141	-
	<b>234,745</b>	<b>234,745</b>	<b>654,660</b>	<b>654,660</b>

## 4. Statement of Changes in Equity

(CHF thousands)	Paid out endowment capital	Statutory retained earnings reserve	Reserves for general banking risks	Result of the period	<b>Total</b>
<b>Equity at 1.1.2018</b>	300,000	234,772	438,000	44,834	1,017,606
<b>Appropriation of retained earnings 2017</b>					
<i>Assignment to statutory retained earnings reserve</i>	-	+8,742	-	-8,742	-
<i>5% interest on the endowment capital</i>	-	-	-	-12,000	-12,000
<i>Additional payment to the Canton</i>	-	-	-	-24,092	-24,092
Endowment capital increase	+130,000	-	-	-	130,000
Changes in the reserves for general banking risks	-	-	+26,000	-	26,000
Group profit	-	-	-	+49,332	49,332
<b>Total equity at 31.12.2018</b>	<b>430,000</b>	<b>243,514</b>	<b>464,000</b>	<b>49,332</b>	<b>1,186,846</b>

## 5. Annex

### 5.1 ACTIVITIES OF THE GROUP AND STAFF

#### 5.1.1 Group Activities

Banca dello Stato del Cantone Ticino, BancaStato, based in Bellinzona, is an autonomous banking institution under public law whose primary aim is to favour the development of the economy in Ticino.

Its operations have evolved over 100 years and comprise the complete range of services provided by full service banks.

In 2010 and 2013, as part of a move to diversify its sources of revenue, BancaStato acquired the entire capital of AHSA Holding SA, Lugano, in order to gain indirect control over Axion SWISS Bank SA, Lugano (Axion). At end-2016, BancaStato acquired the entire capital of Axion from AHSA Holding SA. During 2017, the capital of AHSA Holding SA was entirely reimbursed, and the company was cancelled from the Commerce Registry of Canton Ticino in 2018.

Axion's core business is asset management for private as well as institutional clients, and it is active in the principal directly related services, such as securities and currency intermediation on the main international markets, investment advisory and lending. Operations in the lending business are prevalently limited to Lombard loans, i.e. in advances on deposited assets.

During the first quarter of 2016, in the framework of a strategy aimed at strengthening its asset administration business, Axion acquired a portion of the infrastructure and client assets of Société Générale Private Banking (Lugano-Svizzera) SA.

Effective at end 2018, BancaStato ceded its minority share (30%) in Soave Asset Management Ltd., a company active in asset management, as well as its share in Londinium Dac, Dublin, a company authorised to operate as an investment enterprise in accordance with the MiFID.

##### 5.1.1.1 Balance sheet transactions

Interest-earning transactions are largely executed with customers and they represent the Group's primary source of revenue. Loans to customers are generally secured by mortgages, and most lending is used to finance housing properties. "Lombard" loans are secured against deposited assets while commercial loans are granted against collateral or are unsecured.

Interbank operations almost entirely consist of short-term transactions. In consideration of the current crisis in the financial sector, interbank exposure has been reduced by giving preference to deposits at the Swiss National Bank. For medium and long-term funding, BancaStato turned to the capital market. In addition, it is a member of the Central Mortgage

Bond Issuing Body of the Swiss Cantonal Banks and therefore regularly utilises bond issues floated by this institution.

The Banks of the Group hold a strategic security portfolio in medium to long-term investments, booked under financial investments.

#### 5.1.1.2 Trading activities

The Group performs, on behalf of its customers, the full array of foreign exchange trading services offered by banks. Moreover, it trades on its own account in foreign exchange as well as, to a limited extent, in debt securities (bonds), equity securities (shares and participation certificates), investment funds and metals.

Currency trading operations on foreign currencies on the Bank's own account are limited to a small number of currencies for which a liquid market exists.

#### 5.1.1.3 Commission business and services

Asset management and administration, payment transactions, as well as trading in securities and financial instruments on behalf of customers and loan related business, constitute the bulk of the Bank's commission activities and other services.

#### 5.1.2 Group personnel

As at 31 December 2018, the Group had a total of 483 employees on payroll, i.e. 444.15 full-time equivalents (FTEs) with apprentices calculated at 50%, compared to 486 employees at the end of 2017 (446.15 FTEs).

#### 5.1.3 Outsourcing

The Group outsources a number of its business services as defined by the FINMA Circular 2018/3 "Outsourcing – Banks and insurers". This includes payment transaction services, securities administration, the printing and sending out of banking documents and the management of IT systems (central informatics and work stations) which are performed by the service provider Avaloq Sourcing (Switzerland & Liechtenstein) SA, Bioggio.

The expenses related to payment transactions, securities administration and back office stock exchange/currency/treasury, are posted under the item "Commission expenses". In 2018 this item totalled CHF 3,010,000 (CHF 2,911,000 in 2017).

In addition to the activities listed in the FINMA Circular, the Group contracts out activities pertaining to building management and maintenance as well as supplies.

Within the Group, Axion outsources a number of services to BancaStato.

## 5.2 ACCOUNTING AND VALUATION PRINCIPLES

### 5.2.1 General principles

The accounting and valuation principles referred to by the Group and its various entities comply with the provisions of the Swiss Code of Obligations (CO), the Swiss Federal Law on Banks and Savings Banks (Banking Act), the Ordinance on Banks and Savings Banks (Banking Ordinance) and the guidelines issued by the Swiss Financial Market Supervisory Authority (FINMA), in particular the FINMA Circular 2015/1 "Accounting - banks".

The Group's financial statements are prepared on the basis of regular reporting and comply with the true and fair view principle.

All transactions are recorded at the time they are concluded. The balance sheet is presented on a transaction date basis.

### 5.2.2 General valuation principles

The financial statements are prepared on the going-concern assumption. The accounting is therefore based on going-concern values.

Balance sheet items and off-balance sheet items are valued individually. The Group does not apply the transitional provision of Art. 69.2 of the Banking Ordinance which allows the individual valuation of tangible fixed assets and intangible assets by 1 January 2020 at the latest.

In principle, neither assets and liabilities nor expenses and income are allowed to be offset.

Receivables and payables are offset only in the following cases:

- deduction of value adjustments from the corresponding asset item;
- own debt securities and similar instruments are offset with the corresponding items in the liabilities;
- offsetting of positive and negative changes in book value with no income effect in the compensation account.

## 5.2.3 Financial instruments

### 5.2.3.1 Liquid assets

Liquid assets are recognised at their nominal value.

### 5.2.3.2 Securities financing transactions

The item "Amounts due to and from securities financing transactions" comprises any receivables or payables from securities repurchase agreements effected with other banks through the Eurex REPO platform. The guarantees, which are part of the SNB basket, are revaluated on a daily basis, and any excess or shortage of coverage is settled directly through the clearing-house (SIX Group AG).

### 5.2.3.3 Amounts due from banks, amounts due from customers and mortgage loans

These are entered at their nominal value.

Receivables are evaluated individually according to uniform standards established to analyse the borrowers' solvency and the value of the collateral provided. For non-performing and impaired loans, value depreciation is covered by individual value adjustments which are directly offset by assets, with collateral considered at its liquidation value.

Value adjustments for risk of default that are no longer economically necessary, and that are not used for other similar requirements, are released through the income statement via the item "Changes in value adjustments for default risk and losses from interest operations". Interest due beyond 90 days is considered to be in default and no longer considered as interest income; it is directly provisioned and offset against assets.

Precious metal account deposits are valued at fair value provided the precious metal concerned is traded on a price-efficient, liquid market.

### 5.2.3.4 Trading activities

The valuation of the portfolio of securities and metals held for trading purposes is at fair value.

Gains and losses, as well as adjustments to the above-mentioned rate changes and the revenue from interest and dividends, are booked under "Result from trading activities and fair value option".

### 5.2.3.5 Positive and negative replacement values of derivative financial instruments

Derivative financial instruments include options, futures and forward contracts concluded on behalf of customers and on own account. These instruments are booked at their market value (mark to market).

Gross positive and negative replacement values of derivative instruments open at the balance sheet date are recorded in the corresponding item of the balance sheet.

At closing date, the derivative financial instruments held were primarily for hedging purposes. The gain or loss from the revaluation of hedging positions is taken to the same item in the income statement as the gain or loss from the transaction hedged. For trading positions, resulting gains or losses form part of "Result from trading activities and fair value option".

### 5.2.3.6 Financial investments

Debt securities purchased to be held until maturity are recognised at acquisition cost, with the allocation of premiums and discounts over the duration of the instrument. Any profit or loss resulting from the early disposal of these securities is spread over their residual duration, i.e. until their original maturity. Any value adjustment resulting from the deterioration of the debtor's solvency is booked to the income statement under "Changes in value adjustments for default risks and losses from interest operations".

Debt securities acquired in view of subsequent sale before maturity (securities which are not in the trading portfolio) are valued at the lower of their cost or market value. The balance of price changes is included in "Other ordinary expenses" (if the market value is lower than the purchase value) or in "Other ordinary income" (for revaluations up to the acquisition cost). Gains and losses are booked in the income statement under "Result from the disposal of financial investments".

Equity securities, shares in investment funds and precious metals are valued at the lower of their cost or market value.

Buildings reacquired by the Bank in connection with lending activities and intended for sale are entered in the balance sheet at the lower of purchase or sale price.

### 5.2.4 Non-consolidated participations

This item comprises company equity stakes, in terms of capital, held as long-term investments.

Non-consolidated participations are recorded at acquisition value less economically necessary depreciation, providing the preconditions for a valuation based on the equity method are not given.

Companies on which a significant influence, but no control, can be exerted are valued according to the equity method. The booked value of the participation is adjusted to the net portion of assets held. Influence is deemed to be significant when the shares range between 20% and 50% of capital with voting rights.

Participation in the capital of the Central Mortgage Bond Issuing Body of the Swiss Cantonal Banks has been partially paid-up. The commitment to pay up the outstanding amount is posted in off-balance sheet under the item "Obligations to pay up and make further contributions". To ensure prompt availability of liquidity in the event of a crisis, the shareholding banks have agreed on a limit for the amount contributed. This amount is not shown in off-balance sheet under "Irrevocable commitments" in order to avoid duplication.

### 5.2.5 Tangible fixed assets

This item includes Group premises, computer hardware and telecommunication equipment, licenses and software, technical facilities, furniture and vehicles.

Tangible fixed assets are valued at purchase price less economically necessary depreciation.

Depreciation rates are calculated on a straight-line basis from the time the items are first utilised over the estimated useful life as follows:

Depreciation rates are calculated on the following durations:

• land and buildings (masonry)	40 years (up to the official estimated value of the land)
• equipment	15 years
• banking facilities	5 years
• hardware	5 years
• licenses and software	2 years
• furniture	5 years
• works of art	5 years
• vehicles	3 years

Fixed assets which are no longer in use, or under extraordinary depreciation, are written down (impairment of fixed assets).

### 5.2.6 Intangible fixed assets

Goodwill is recognised on the balance sheet applying a straight-line depreciation over a 5-year period. An analysis is performed on a half-year basis in order to define the possible need for extraordinary depreciation.

### **5.2.7 Amounts due to banks and amounts due in respect of customer deposits**

These commitments are recognised at their nominal value.

Amounts due in respect of precious metal account deposits are valued at fair value provided the precious metal concerned is traded on a price-efficient, liquid market.

### **5.2.8 Provisions**

This item includes probable commitments whose amounts and/or due date are uncertain but can be reliably estimated. It also comprises a provision for deferred taxes in connection to Axion's reserves for general banking risks.

### **5.2.9 Reserves for general banking risks**

In compliance with the FINMA guidelines on financial statement reporting (FINMA Circ. 2015/1 Accounting Rules - banks), the reserves for general banking risks are prudently created reserves set aside to cover latent risks related to banking activities. As laid down in Art.21c of the Swiss Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders (CAO) such reserves are considered as equity. Only the reserves for general banking risks of the parent company BancaStato are not subject to taxation. Any addition or release is booked in the income statement under "Changes in reserves for general banking risks".

### **5.2.10 Off-balance sheet**

Off-balance sheet operations are reported at their nominal value. Individual provisions are made under "Provisions" for any risk of loss.

### **5.2.11 Foreign currency translation**

The Group accounts are in Swiss francs.

Assets and liabilities denominated in foreign currency are converted into Swiss francs at the rate of exchange at the balance sheet closing date. Resulting gains or losses are taken to the income statement under "Result from trading activities and fair value option".

Proceeds and expenses generated in foreign currency are converted at the exchange rate applicable at the time the individual transactions are entered, or the single economic flows are effected.

Maturing proceeds and maturing expenses (pro-rata) are accounted for in the income statement at the exchange rate applicable at the balance sheet closing date.

Exchange rates applied at the end of the financial year for the major currencies were as follows:

EUR/CHF 1.1269 (2017: 1.1703)  
USD/CHF 0.9842 (2017: 0.9747)

### **5.2.12 Treatment of the refinancing of trading positions**

Income from interest and dividend from trading are offset against refinancing costs of the trading portfolio.

### **5.2.13 Consolidation principles**

#### **5.2.13.1 Consolidation perimeter**

Banks and finance companies in which BancaStato directly or indirectly holds a majority of voting rights or capital, or in which it has a controlling interest, are consolidated by the full consolidation method.

Minority participations (i.e. below 20%) or participations in non-financial activities, as well as participations held solely with a view to their future disposal, are excluded from the consolidation perimeter and are entered at their purchase value less appropriate depreciation. If the participation share is comprised between 20% and 50% of voting rights, the evaluation is based on the equity method.

#### **5.2.13.2 Consolidation method**

Capital is consolidated following the purchase method. Acquisition costs of the stake are offset by existing equity at the time of purchase. Any goodwill is recognised on the balance sheet under "Intangible assets" and depreciates over a five-year period. Conversely, any negative goodwill (badwill) is immediately booked in the income statement under "Extraordinary income" if it is an authentic "lucky buy", while outflows of future resources are booked in the balance sheet under "Other liabilities". An impairment test is performed half-yearly. Should this test reveal that an asset value is no longer justified, additional amortisations would be effected at that time.

Following the full consolidation method, and considering the above-mentioned offsets, the amounts of all balance sheet, off-balance sheet and income statement items of the subsidiaries are aggregated with the corresponding amounts of the Parent

Bank's balance sheet, off-balance sheet and income statement.

Transactions between the various entities within the Group annual each other out.

### 5.2.13.3 Consolidation period

The consolidation period corresponds to the calendar year beginning 1 January and ending 31 December. Acquisitions effected during the year are included in the income statement from the date of purchase. The statutory end-year closing for all Group entities is 31 December.

## 5.3 ADJUSTMENT OF THE ACCOUNTING PRINCIPLES FOR THE PRESENTATION OF FINANCIAL STATEMENTS

There were no changes in accounting principles in 2018.

## 5.4 RISK MANAGEMENT

The Group, like any other financial institute, is subject to various banking-specific risks, namely credit, market, liquidity and operational risks.

Risk management is a priority for the Group. Its goal is to identify, measure, limit and monitor banking risks in order to preserve the Group's assets and to enhance profitability.

Risk management is defined in the Group's Rules and Regulations as well as in the Rules and Regulations of the single legal entities, and is reviewed annually. The Group's Rules and Regulations define the parameters the single legal entities must abide by.

The key elements of risk management are:

- a comprehensive risk policy;
- the use of recognised risk measurement and risk management principles;
- the definition of various risk limits for each type of risk and the ongoing monitoring of compliance to these limits;
- timely and comprehensive reporting;
- the allocation of adequate financial, technical and human resources to risk management;
- emphasis on risk awareness and promoting a risk-sensitive corporate culture at all staff levels.

The Board of Directors exercises the ultimate responsibility, supervision and control and is therefore the supreme organ for managing risk. It defines the key elements of risk management. The Executive Board is responsible for implementing the Board of Directors' policies. In particular, it is the Executive Board's duty to ensure that a suitable risk management process is in place and that an effective risk monitoring system is activated.

This includes the implementation of an organisation for its supervision at the consolidated level, and as regards outsourced activities.

Risk is identified, measured and monitored by operationally independent units that report to the Executive Board, which in turn reports to the Board of Directors on a regular basis.

An information system ensures that the members of the Board of Directors as well as the Executive Board are updated regularly regarding the Bank's and the Group's asset and financial position, as well as on the meeting of set targets and risks incurred.

Both the Board of Directors and the Executive Board periodically analyse, within their own area of expertise, the information received as regards credit, market, liquidity and operational risks.

In its meeting of 25 April 2018, the Audit and Risk Committee of the Board of Directors of the Parent Bank and, subsequently, the Board of Directors of the Parent Bank in its meeting of 28 May 2018, assessed the Group's risk profile.

In this regard, the Board of Directors annually reviews the applicable regulations, risk limits and tolerance. Capital and liquidity planning is prepared annually for a minimum period of three years.

### 5.4.1 Credit risk

Credit risk stems from the inability of a counterparty to fulfil its contractual obligations, or from the reduced value of collateral or financial instruments issued by a third party (value of equity type securities, interest rate instruments, shares in collective capital investments) due to the worsening of its financial standing.

The Group's exposure to credit risk is primarily linked to lending activities, mostly mortgage, commercial and Lombard loans granted to clients.

BancaStato operates essentially in the local market of Ticino

and only marginally in other Cantons and abroad. Axion Swiss Bank SA operates primarily by granting Lombard loans to its clients.

Credit risk is managed by setting lending margins on collateral and credit granting procedures at different hierarchical levels on the basis of the aggregate amounts granted and risk incurred.

Procedures for the delegation of competences on the part of the Board of Directors, as well as the specific internal organisational structure, ensure that the units that assume risk are independent from those that manage risk.

The Board of Directors is responsible for approving large credit exposures as well as loans to members of the governing bodies. At BancaStato, other loan granting competencies are entrusted to the Credit Risk Committee, and at Axion to the Executive Board who may delegate some *ad personam*. The Credit Risk Committee is composed of three members of the Executive Board, the Head of Credit Management and Analysis or a Credit Officer. This Committee deals with all credit matters delegated to it and draws up notices to the Board of Director for decisions falling within the Board's competence.

In addition, at BancaStato, competencies are delegated to Credit Officers who are independent of client advisory units. Still at BancaStato, the specific authority to grant loans involving low risk profiles is delegated *ad personam* to client advisers. However, such loans may be granted only within the limits of the predefined parameters used in the IT-based decision-making process. An internal control system ensures loan granting processes and competency delegation rules are complied with. Loans reviewed and approved by the competent authorities are managed by the Credit Competence Center which is independent of client advisers and credit officers.

Credit risk management and monitoring are defined in the Banks' Rules and regulations. These state that the Group's Banks assume credit risk only after an in-depth analysis of the operation, including a review of credit-worthiness, transaction structure, integrity of the counterparties and collateral has been carried out. Each credit application is treated on the basis of standardised criteria set within each institute. Lending regulations are reviewed annually and supplemented by internal directives, service orders and operational manuals.

To assess creditworthiness, the Group's Banks refer to external ratings prepared by first-class rating agencies when available. BancaStato also utilises a rating model for granting mortgage

and business loans to its private and commercial clients. The rating model ensures a classification of clients based on standard criteria divided into 10 rating classes, assigning a probability of default to each counterparty. This rating is used to determine borrowing capacity as well as to define the interest rate on the loan as a function of risk.

Credit exposure to counterparties are restricted by credit limits. Sustainability calculation procedures are regulated by internal rules and regulations. The maximum loan amount granted to businesses is determined on the basis of a calculation of their financing potential which, in turn, is closely linked to the durable income (cash flow) that the business is able to generate to remunerate debt capital. This same sustainability (cash flow over capital) principle is applied to calculate loans to private clients. In particular, sustainability calculations for mortgage loans are performed by comparing durable available income with expenses (i.e. interests, loan amortisation and maintenance costs).

Maximum loan values are set for each type of collateral on the basis of common banking standards. The maximum amount for a mortgage loan is established based on the debtor's ability to pay and on the value of the real estate being mortgaged. The valuation principles applied to collateral are described in the Section 5.6 "Valuation of collateral". For Lombard loans, the assigned limit is determined on the basis of a foreseeable value of pledged assets which are revalued at market value on a daily basis.

The Group's Rules and Regulations and the Banks' Rules and Regulations set the limits within which the various Group entities are authorised to assume a country risk.

The credit risk on financial instruments owned by the Group's Banks is managed by adhering to product, diversification and quality restrictions as established by the Board of Directors.

Interbank business, which is derived from client and own business, is carried out within a predefined limit system with primary Swiss and international banks. The maximum amount set depends on the counterparty's solvency which is constantly monitored. Counterparty limits are reviewed at least once a year. The compliance to these limits is monitored by business units which are independent from risk assuming units.

Concentration risk is monitored by the Risk Management unit and results are submitted to the Executive Board and the Board of Directors. The Group undertakes periodic stress tests in relation to its own credit risk concentration.

The Executive Board and the Board of Directors are provided on a regular basis with updated information on the risk profile of the loan portfolio.

## 5.4.2 Market risk

### 5.4.2.1 Interest rate risk

As the Group is heavily involved in balance sheet transactions, interest rate risk may have a significant impact on the principal sources of income, and therefore on the interest margin. The Group's exposure to rate risk is primarily due to the time lapse between fundraising and application. The measurement and control of risk resulting from this imbalance are of primary importance to any bank, and form part of the assets & liabilities management (ALM) function undertaken by BancaStato's ALCO. This committee is composed of the following members with voting rights: members of the Executive Board, the Head of Financial Markets and Asset Management and the Head of Financial and Risk Management, and the Axion Risk Committee.

As regards the ALM activity, the Group's risk policy, as approved by the Board of Directors, defines the modes of operation, the tolerance and limitations, and regulates risk monitoring. The rate risk related to balance and off-balance sheet operations is managed and monitored centrally by the ALCO within assigned operational limits. Operations at Axion are managed by its Risk Committee. Competencies are determined in terms of changes in current equities for a 1% sudden parallel shift in market rates (value effect) and a movement in interest margin in the following 12 months still with the same market parameter variations (income effect). On the basis of the chosen methodology, monitoring refers to the present value of equity and to the variation of net interest income in the 12 months following measurement. A software feature enables the Risk Management Unit to regularly provide the ALCO and Axion's Risk Committee with information on risk exposure, simulations of the interest margin, as well as to perform stress tests, i.e. analyses based on predetermined potentially negative scenarios.

For the management of the rate risk inherent to variable rate products without fixed maturity, replication models are used to assess such risk. These models take into consideration both the correlation with the evolution of interest rates and the impact on balance sheet volumes as a result of client behaviour. The validity of these replication models is verified annually.

To cover or mitigate exposure to interest rate risk, hedging derivative instruments may be used (these are substantiated to match the hedged item, and their effectiveness is periodically monitored by Risk Management Unit).

The Treasury, Forex & Trading Department guarantees long-term refinancing and manages the interest rate risk by considering the Bank's objectives, i.e.:

- record, measure and manage all interest rate risks arising from client transactions with the Bank;
- generate risk-adjusted income within the risk limits;
- ensure cost-effective refinancing in line with the development of the balance sheet;
- monitor liquidity and avoid potential liquidity shortfalls.

### 5.4.2.2 Currency risk

The Group's currency risk management serves to minimise any negative impact on its earnings due to interest rate changes. Basically, the goal is to balance the assets denominated in foreign currencies with the liabilities in the same currency. This exposure is under constant monitoring.

### 5.4.2.3 Trading activities

The Group's exposure to market risks arising from trading operations is limited and mostly in relation to client requirements. In this respect, prudent limits of maximum exposure have been established based on the asset value at risk (position and loss limits). The Group does not engage in market making activities. The limits for trading positions are verified daily by the Risk Management Unit.

The Risk Management Unit submits to the Executive Board, on a regular basis, detailed information on exposures and compliance to the set limits. The latter subsequently informs the Board of Directors.

## 5.4.3 Liquidity risk

Liquidity risk is managed and monitored actively by setting a risk tolerance, a minimum reserve of liquidity, a system of limits and indicators, as well as the diversification of refinancing (source, currencies and durations) and the implementation of stress scenarios. In fact, the internal policy regarding liquidity risk prescribes that the Group must have available the needed

liquidity on a permanent basis to fulfil its own payment commitments, even in stress situations, as well as comply with the applicable banking provisions.

The ALCO manages liquidity and draws up the strategy, the limits and the objectives in compliance with the mandate received by the Board of Directors. Liquidity at Axion is managed by its Risk Committee. The treasury function guarantees that limits and objectives are adhered to. The Risk Management Unit monitors liquidity, the financing situation and concentration risks.

The emergency liquidity plan is a key aspect of the crisis management plan. It includes intervention measures to counter any liquidity crisis, considering liquidity indicators and ratios, and outlining emergency procedures.

#### **5.4.4 Operational risk**

Operational risk is directly related to banking operations and includes the possibility of direct or indirect losses resulting from inadequate or incorrect internal processes, inappropriate business conduct on the part of individuals, system malfunctions or external events. Operational risk also comprises legal and compliance risks.

The management of operational risk consists primarily in the adoption of risk mitigating measures aimed at eliminating or reducing risk as much as possible.

In-house rules and guidelines define the organisation of work and limit the extent of such risk. An appropriate system of controls at various levels, as well as specific structures designed to oversee the application of established rules and procedures have been implemented so as to limit the exposure to operational risk. Key controls are documented in a standardised manner.

The Legal and Compliance Department is responsible for verifying the adherence to applicable regulatory provisions, as well as due diligence duties. It also ensures that the internal guidelines are continually being adapted to new legal and regulatory provisions.

The Security Service Unit sets up appropriate organisational and technical measures in order to mitigate risks related to external and internal events or actions (natural occurrences, criminal acts of any kind, both physical and IT-related). This service also prepares and regularly updates a corporate continuity plan.

The Parent Company records and analyses all information on occurrences of operational malfunction which result in a financial impact (gain and loss) and classifies these data on the basis of standardised criteria. The frequency, seriousness and causes of the various events are duly assessed, and corrective measures implemented as needed. Periodic reporting to the Group's authorities is carried out by independent units.

The Banks perform periodic reviews of internal control procedures during which they assess the operational effectiveness of control with regard to existing risks, implementing improvement measures as needed.

The Group invests in training staff and in the promotion of risk awareness, particularly for those employees who are in direct contact with customers.

The Group has established a specific organisation and defined processes and responsibilities in order to oversee the providers of outsourced services.

Every month, the organisational units Risk Management, Internal Control, Security, Human Resources, Competence Center and the Legal and Compliance Department submit to the Parent Company's Risk Committee their findings resulting from the internal priority control system within the various Group entities along with a summary notice on major risks. The Risk Committee is responsible for ensuring appropriate surveillance of overall risks and particularly operational risks. A condensed analysis of information on these issues is forwarded to the Board of Directors.

#### **5.4.5 Required capital and other risk indicators**

The information requested on the basis of FINMA Circular 2016/1 "Disclosure – banks" regarding disclosure requirements with respect to required capital and other risk indicators are provided on BancaStato's website ([www.bancastato.ch](http://www.bancastato.ch)).

### **5.5 METHODS USED FOR IDENTIFYING DEFAULT RISKS AND DETERMINING THE NEED FOR VALUE ADJUSTMENTS**

Credits are monitored in a differentiated manner according to established procedures based on the risk profile of exposures.

In order to guarantee the periodic and seamless monitoring of all assumed credit risks, all credit facilities must be renewed.

Credit monitoring is performed through a variety of periodic analysis carried out by the responsible client adviser, the Credit Office and the Recovery and Repositioning unit with the aim of identifying any sign of reduced creditworthiness, and forestalling circumstances which might impair loans or require action to reduce risk. The prerequisites for the renewal of credit facilities are modelled on those for the granting of new loans. The results of these periodic analyses determine whether the limit can be maintained or requires adjustments.

The renewal conditions are established for each individual loan based on the type of client and product, as well as the collateral and loan characteristics. Moreover, each loan must be subjected to a fresh review in those circumstances affecting the debtor's solvency or if the debtor is more than 90 days overdue in interest, amortisation or commission payments or is unable to fully reimburse capital (non-performing loan).

Non-performing or impaired loans that have been granted by BancaStato are monitored by "Recovery and Repositioning", a designated organisational unit specialising in recovery which is independent of client interface.

Outstanding loans and value of collateral for securities-based loans are monitored daily. If the collateral value of the securities falls below the amount of the credit line, the amount of the loan is either reduced or additional collateral is requested. In the absence of a settlement, the securities may be utilised, and the credit position closed out.

Non-performing and impaired loans are assessed individually, considering existing collateral at its liquidation value. Any risk of default is provisioned individually. The provision represents the expected loss with the counterparty with regard to the corresponding transaction. The organisational unit proposing the loan is responsible for setting any necessary provisions which will be decided upon by the Credit Office Unit or the Executive Board. Similarly, the Recovery and Repositioning unit which is in charge of litigation procedures at BancaStato is tasked with proposing adequate provisions or adjustments with regard to the credits it was entrusted with.

BancaStato's ALCO and Axion's Investment Committee monitor the risk of loss in the financial investment portfolio on the basis of market values or specific analyses.

Portfolio analyses, along with stress tests performed by the Risk Management Unit, are used to identify any possible risk of loss present in the loan portfolio.

## 5.6 VALUATION OF COLLATERAL

### 5.6.1 Mortgage-based loans

Within the Group, only BancaStato grants mortgage-based loans.

An up-to-date valuation of the collateral exists for each loan which is secured by real estate. Real estate pledged as loan collateral is re-evaluated periodically.

Both the characteristics of the asset pledged, and its present and future economic use are taken into account in the appraisal of real estate. As a general rule, the valuation is based on market value, an amount corresponding to the price that may be obtained within a period of one year under normal market conditions as a result of offer and demand.

Owner-occupied residential properties may be evaluated, within specified limits, with the help of hedonic valuation models that compare property transactions data on the basis of the detailed characteristics of each property.

In the case of multi-family housing, commercial buildings and special properties, internal real estate appraisers, as well as any external certified appraiser, calculate these values amongst others by taking into consideration rental income. If the credit rating is low, a liquidation value is calculated.

The lowest value resulting from the internal valuation, purchase price and any external estimate, defines the value of the pledged collateral.

Properties pledged as collateral against impaired loans are estimated at their liquidation value.

### 5.6.2 Securities-based loans

In general, transferable financial instruments (such as bonds and shares) that are liquid and actively traded, are accepted for Lombard loans and other securities-based loans. Similarly, transferable structured products for which there is regular market information and a market maker are also accepted.

To calculate the value of liquid and negotiable securities, the Banks apply a discount to the market value in order to cover the market risk associated with these securities. Discounts may vary depending upon the type of product, the counterparty's rating, the residual duration of the financial instrument and the currency. The discounts used for structured products are higher than those for liquid securities. For life insurance policies and bank guarantees, these discounts are determined on the basis of the product and counterparty.

## **5.7 BUSINESS POLICY REGARDING THE USE OF DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING**

Derivative financial instruments are used for trading and hedging purposes.

Derivative financial instruments are traded exclusively by specially trained traders. The Group's Banks do not act as market makers. Trading is undertaken both with standardised and OTC instruments on own account and on behalf of clients, especially interest-, currency-, equity-/index-based instruments. There is no trading in credit derivatives.

Derivative financial instruments are principally used in risk management to hedge interest rate and currency risks.

In general, recognition in the income statement of the result of a hedging transaction follows the same principles applied to the secured underlying. As a consequence, results from hedging operations with derivative financial instruments within the framework of the structural management of the balance sheet are booked on a pro rata basis (accrual method).

If the impact of a hedging transaction exceeds that of the hedged items, the excess fraction of the derivative instrument is considered as a trading transaction. This revaluation is booked under "Results from trading activities and fair value option".

The use of interest rate swaps (IRS) in the structural management of the balance sheet serves to hedge interest rate variations. Primarily plain vanilla swaps, both payer and receiver, may be used. In general, receiver swaps are used to hedge specific individual fixed rate items in liabilities and are therefore considered micro hedges. On the other hand, fixed rate portfolio items under assets are hedged through payer swaps and are therefore considered macro hedges.

Short term interest rate swaps and tom next / overnight interest rate swaps are used to manage the gap between assets and liabilities with maturities below 12 months as well as for the current management of liquidity.

Treasury swaps are used within the framework of the structural management of the balance sheet in order to manage currency risk resulting from the conversion of the available liquidity in foreign currency into Swiss francs or from the need to refinance loans in foreign currency. These instruments are used as an alternative to either an interbank investment in foreign currency of excess liquidity, particularly in the case of uncertainty with regard to the quality of foreign counterparts or interbank refinancing in foreign currency. With treasury swaps, the

Bank can transform excess liquidity in foreign currency into Swiss francs, for a fixed period, thus enabling its placement in domestic currency without incurring an exchange rate risk or convert excess liquidity in domestic currency into foreign currency in order to finance loans in foreign currency.

Spot exchange, forward forex and currency options are used within the framework of the structural management of the balance sheet to hedge currency risk on economic flows (whether interest margins or commissions) in foreign currency.

## **5.8 EXPLANATIONS OF MATERIAL EVENTS OCCURRING AFTER THE BALANCE SHEET DATE**

No significant event occurred after the closing of the balance sheet date that could have led to changes in the balance sheet or the income statement at 31 December 2018.

## **5.9 REASONS WHICH HAVE LED TO EARLY RESIGNATION OF THE AUDITORS**

PricewaterhouseCoopers AG, Lugano were designated as External Auditors for the Group, and are still in office.

## 5.10 INFORMATION ON THE BALANCE SHEET

### 5.10.1 Breakdown of securities financing transactions (assets and liabilities)

(CHF thousands)	31.12.2018	31.12.2017
<b>Securities lending, securities borrowing and repurchase agreements</b>		
Book value of receivables from cash collateral delivered in connection with securities borrowing and reverse repurchase transactions <sup>1</sup>	-	-
Book value of obligations from cash collateral received in connection with securities lending and repurchase agreements <sup>1</sup>	171,290	70,000
Book value of securities lent in connection with securities lending or delivered as collateral in connection with securities borrowing as well as securities in own portfolio transferred in connection with repurchase agreements	170,569	68,641
<i>of which with unrestricted right to resell or repledge</i>	170,569	68,641
Fair value of securities received and serving as collateral in connection with securities lending or securities borrowed in connection with securities borrowing as well as securities received in connection with reverse repurchase agreements with an unrestricted right to resell or repledge	-	-
<i>of which repledged</i>	-	-
<i>of which resold</i>	-	-

<sup>1</sup> Before any netting agreement.

### 5.10.2 Presentation of collateral for loans / receivables and off-balance sheet transactions, as well as impaired loans / receivables at 31.12.2018

(CHF thousands)	Type of collateral			
	Secured by mortgage	Other collateral	Unsecured	Total
<b>Loans (before netting with value adjustments)</b>				
Amounts due from customers	164,435	479,749	652,299	1,296,483
Amounts due from public corporations	306	573	704,945 <sup>1</sup>	705,824
Mortgage loans	9,386,986 <sup>1</sup>			9,386,986
<i>Residential property</i>	6,958,942			6,958,942
<i>Office and business premises</i>	1,180,473			1,180,473
<i>Commercial and industrial premises</i>	521,130			521,130
<i>Other</i>	726,441			726,441
<b>Total loans (before netting with value adjustments)</b>	<b>9,551,727</b>	<b>480,322</b>	<b>1,357,244</b>	<b>11,389,293</b>
Previous year	9,024,734	482,500	1,262,859	10,770,093
<b>Total loans (after netting with value adjustments)</b>	<b>9,533,845</b>	<b>474,606</b>	<b>1,322,950</b>	<b>11,331,401</b>
Previous year	9,003,841	475,674	1,228,528	10,708,043
<b>Off-balance sheet</b>				
Contingent liabilities	6,494	37,459	71,005	114,958
Irrevocable commitments	44,835	8,853	253,579 <sup>2</sup>	307,267
Obligations to pay up shares and make further contributions	-	-	14,180	14,180
<b>Total off-balance sheet</b>	<b>51,329</b>	<b>46,312</b>	<b>338,764</b>	<b>436,405</b>
Previous year	13,215 <sup>3</sup>	73,098	300,483 <sup>3</sup>	386,796 <sup>3</sup>

(CHF thousands)	Gross debt amount	Estimated liquidation value of collateral	Net debt amount	Individual value adjustments
<b>Impaired loans</b>				
<b>Current year</b>	<b>150,386</b>	<b>92,494</b>	<b>57,892</b>	<b>57,892</b>
Previous year	158,429	96,379	62,050	62,050

<sup>1</sup> Including loans to entities related to public institutions for CHF 117.8 million (2017: 134.9 million).

<sup>2</sup> Including CHF 37.4 million (2017: CHF 35 million) as a required share for deposit guarantee purposes.

<sup>3</sup> The amount of irrevocable commitments for 2017 was adjusted with the inclusion rules applied in 2018.

This adjustment is the result of a change in inclusion perimeter of this item due to a different and more restrictive interpretation of the concept of callable loans.

### 5.10.3 Breakdown of trading portfolios and other financial instruments at fair value

(CHF thousands)	31.12.2018	31.12.2017
<b>Trading portfolio assets</b>		
Debt securities, money market securities	1,643	2,269
<i>of which listed</i>	1,643	2,269
Equity-type securities	30	121
Shares in investment funds	10,684	18,388
Precious metals and commodities	12,565	20,055
Structured products	2,698	-
<b>Total trading portfolio assets</b>	<b>27,620</b>	<b>40,833</b>
<i>of which determined using a valuation model</i>	-	-
<i>of which securities eligible for repo transactions in accordance with liquidity requirements</i>	-	-

### 5.10.4 Presentation of derivative financial instruments (assets and liabilities)

(CHF thousands)	Trading instruments			Hedging instruments		
	Replacement values		Contract volume	Replacement values		Contract volume
	positive	negative		positive	negative	
<b>Interest rate instruments</b>						
IRS	-	-	-	5,222	15,936	734,000
Options (OTC)	-	-	-	-	-	-
<b>Total interest rate instruments</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,222</b>	<b>15,936</b>	<b>734,000</b>
<b>Foreign currencies / precious metals</b>						
Forward contracts	1,236	893	132,167	-	-	-
Combined currency and interest rate Swaps	1,862	2,187	323,492	496	17,318	2,158,319
Options (OTC)	1,076	1,000	222,253	-	-	-
<b>Total foreign currencies / precious metals</b>	<b>4,174</b>	<b>4,080</b>	<b>677,912</b>	<b>496</b>	<b>17,318</b>	<b>2,158,319</b>
<b>Total before netting agreements</b>	<b>4,174</b>	<b>4,080</b>	<b>677,912</b>	<b>5,718</b>	<b>33,254</b>	<b>2,892,319</b>
<i>of which determined using a valuation model</i>	4,174	4,080	-	5,718	33,254	-
Total previous year	5,615	5,596	716,769	45,992	23,067	2,651,413
<i>of which determined using a valuation model</i>	5,615	5,596	-	45,992	23,067	-

	Positive replacement values (cumulated)	Negative replacement values (cumulated)
<b>Total after netting agreements</b>	<b>9,892</b>	<b>37,334</b>
Total previous year	51,607	28,663

### Breakdown by counterparty

(CHF thousands)	Central clearing houses	Banks and securities dealers	Other customers
Positive replacement values (after netting agreements)	-	7,227	2,665

## 5.10.5 Breakdown of financial investments

(CHF thousands)	Book value		Fair value	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Debt securities	332,799	257,209	334,312	258,854
<i>of which intended to be held to maturity</i>	304,168	257,209	305,681	258,854
<i>of which not intended to be held to maturity (available for sale)</i>	28,631	-	28,631	-
Shares in investment funds	17,304	26,885	17,775	27,696
Equity-type securities	4,386	9,830	4,879	10,261
<i>of which qualified participations (at least 10% of capital or votes)</i>	-	-	-	-
Precious metals	103	126	103	126
Real estate	1,445	1,363	1,445	1,363
<b>Total financial investments</b>	<b>356,037</b>	<b>295,413</b>	<b>358,514</b>	<b>298,300</b>
<i>of which securities eligible for repo transactions in accordance with liquidity requirements</i>	205,989	153,502	207,963	154,953

## Breakdown of counterparties by rating

(CHF thousands)	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Book value of debt securities	242,251	41,367	24,309	399	-	24,473

The valuations of debt securities are based on ratings by Standard & Poor's.

## 5.10.6 Presentation of non-consolidated participations

(CHF thousands)	Acquisition cost	Accumulated value adjustments and/or changes in book value (equity method)	Book value 31.12.17	2018					Book value 31.12.2018	Market value
				Reclassifications	Additions	Disposals	Value adjustments	Changes in book value of participations valued using the equity method / depreciation reversals		
Participations valued using the equity method										
listed	-	-	-	-	-	-	-	-	-	-
unlisted	400	77	323	-	-	329	-	6	-	-
Other participations										
listed	-	-	-	-	-	-	-	-	-	-
unlisted	14,784	8,578	6,206	-	123	-	16	-	6,313	-
<b>Total non-consolidated participations</b>	<b>15,184</b>	<b>8,655</b>	<b>6,529</b>	<b>-</b>	<b>123</b>	<b>329</b>	<b>16</b>	<b>6</b>	<b>6,313</b>	<b>-</b>



### 5.10.7 Disclosure of companies in which the Bank holds a permanent direct or indirect significant participation

Companies are recognized on the basis of the full consolidation method.

Company name	Head office	Business activity	Company capital (CHF thousands)	Share of		Held	
				capital in %	votes in %	direct	indirect
Axion SWISS Bank SA	Lugano	Banking	43,000	100.0%	100.0%	100.0%	-

### Participations recorded in the balance sheet under "Non-consolidated participations"

Company name	Head office	Business activity	Company capital (CHF thousands)	Share of		Held	
				capital in %	votes in %	direct	indirect
<b>Financial and services companies held with cantonal banks</b>							
Newhome.ch AG	Zurich	Real estate portal	100	5.40%	5.40%	5.40%	-
<b>Other participations</b>							
Autosilo Piazza del Sole SA	Bellinzona	Car park	2,000	10.00%	10.00%	10.00%	-
Centro Sci Nordico Campra SA	Blenio	Real estate company	2,000	5.00%	5.00%	5.00%	-
Teleticino SA	Melide	Radio and television productions	4,950	23.15%	16.98%	16.98%	-

The Group holds other permanent participations with a non-significant share of capital.

As at end 2018, the Group relinquished its minority participation (30%) in Soave Asset Management Ltd, Lugano and in Londinium Dac, Dublin.

### 5.10.8 Presentation of tangible fixed assets

(CHF thousands)	Acquisition cost	Accumulated depreciation	Book value 31.12.2017	2018					Book value 31.12.2018
				Reclassifications	Additions	Disposals	Depreciation	Reversals	
Bank buildings	179,688	121,357	58,331	-	1,128	-	4,074	-	55,385
Other real estate	26,773	13,400	13,373	-	88	-	542	-	12,919
Acquired software	84,567	80,264	4,303	-	3,882	-	4,208	-	3,977
Other tangible fixed assets	108,757	104,653	4,104	-	2,971	-	1,236	-	5,839
<b>Total tangible fixed assets</b>	<b>399,785</b>	<b>319,674</b>	<b>80,111</b>	<b>-</b>	<b>8,069</b>	<b>-</b>	<b>10,060</b>	<b>-</b>	<b>78,120</b>

### 5.10.9 Presentation of intangible assets

(CHF thousands)	Cost value	Accumulated amortisation	Book value 31.12.2017	2018					Book value 31.12.2018
				Reclassifications	Additions	Disposals	Amortisation	Reversals	
Goodwill	37,077	22,775	14,302	-	-	1,296	5,995	-	7,011
<b>Total intangible assets</b>	<b>37,077</b>	<b>22,775</b>	<b>14,302</b>	<b>-</b>	<b>-</b>	<b>1,296</b>	<b>5,995</b>	<b>-</b>	<b>7,011</b>

### 5.10.10 Breakdown of other assets and other liabilities

(CHF thousands)	31.12.2018	31.12.2017
<b>Other assets</b>		
Compensation account	6,073	6,365
Indirect taxes	678	637
Other different assets	184,819 <sup>1</sup>	10,772
<b>Total other assets</b>	<b>191,570</b>	<b>17,774</b>
<b>Other liabilities</b>		
Direct/indirect taxes	4,479	5,174
Unredeemed cash bonds	1,634	2,312
Compensation account	615	737
Other different liabilities	4,174	117,712 <sup>2</sup>
<b>Total other liabilities</b>	<b>10,902</b>	<b>125,935</b>

<sup>1</sup> of which a balance of CHF 184.3 million resulting from in-house banking operations.

<sup>2</sup> of which CHF 91.1 million from in-house banking operations and CHF 23.4 million additional payment to the Canton for 2016.

## 5.10.11 Disclosure of assets pledged or assigned to secure own commitments and of assets under reservation of ownership

(CHF thousands)	31.12.2018		31.12.2017	
	Book value	Effective commitments	Book value	Effective commitments
<b>Pledged / assigned assets</b> (excluding securities financing transactions)				
Book value of mortgages set as collateral for bonds and loans with the SCB Central	2,384,523	1,981,000	2,501,045	2,042,000
Book value of securities delivered as collateral to SIX Group AG	1,416	-	1,417	-
Book value of securities delivered as collateral in connection with Repo Light credit with SNB	21,760	-	23,503	-
Book value of assets pledged to secure own commitments	30,659	27,450	11,315	9,363
<b>Total pledged / assigned assets</b>	<b>2,438,358</b>	<b>2,008,450</b>	<b>2,537,280</b>	<b>2,051,363</b>
<b>Assets under reservation of ownership</b> Assets under reservation of ownership	-	-	-	-

## 5.10.12 Disclosure on the economic situation of pension schemes

### 5.10.12.1 Disclosure of liabilities relating to own pension schemes, and number and nature of equity instruments of the bank held by own pension schemes

The Group has no obligations towards pension schemes.

### 5.10.12.2 Disclosures on the economic situation of own pension schemes

#### a) Employer contribution reserves (ECR)

There were no employer contribution reserves as at 31.12.2018.

#### b) Presentation of the economic benefit / obligation and pension expenses

	Over / underfunding at the end of 2018	Economic interest of the Bank		Change in economic interest and/or commitment versus previous year	Contributions paid for 2018	Pension expenses in personnel expenses	
		31.12.2018	31.12.2017			31.12.2018	31.12.2017
<b>Group</b> Pension plans without over- / underfunding	-	-	-	-	8,712	14,143 <sup>1</sup>	8,869

Contributions are paid to the insurance company. The employer's contributions are carried under "Personnel expenses".

The Group has opted for affiliation to the Group Plan LPP Swiss Life, a legally independent pension fund. The pension plan is a defined-contribution scheme and provides the basic compulsory coverage as stated in the Swiss LPP (Federal Law on Occupational Benefits), as well as complementary coverage.

At the end of the accounting period the Group had no obligation towards the pension funds. There are no contribution reserves on the part of the employers and the relationships between the Group's banks and their pension funds are based on global affiliation contracts.

The pension funds reinsure all pension risks by means of a comprehensive insurance contract. Within the framework of these contracts, no possibility of under-coverage exists and, consequently, there are no obligations in this regard on the part of the employers.

<sup>1</sup> Including the provision for an early retirement plan to be carried out by the parent company over a two-year period (2019 and 2020).



### 5.10.13 Presentation of bonds outstanding, mortgage bonds from central issuing institutions and mandatory convertible bonds

#### 5.10.13.1 Presentation of bonds outstanding, mortgage bonds from central issuing institutions and mandatory convertible bonds

(CHF thousands)

Interest rate	Type of bond	Issue year	Due date	Net amount
3.750%	Subordinated without PONV clause <sup>1</sup>	2011	15.12.2021	175,000
0.000%	Non-subordinated <sup>2</sup>	2016	04.03.2022	50,000
0.500%	Non-subordinated <sup>2</sup>	2015	24.06.2024	150,000
0.300%	Non-subordinated <sup>2</sup>	2017	15.06.2027	200,000
0.375%	Non-subordinated <sup>2</sup>	2018	08.02.2028	250,000
<b>Total bonds</b>				<b>825,000</b>
Bonds and loans from central issuing institutions <sup>3</sup>				1,981,000
<b>Total outstanding bonds and mortgage bonds from central mortgage bond institutions and mandatory convertible bonds</b>				<b>2,806,000</b>

<sup>1</sup> Early repayment only under certain conditions.

<sup>2</sup> No early repayment.

<sup>3</sup> Average interest rate 0.86%

### 5.10.13.2 Overview of maturities of bonds and mortgage bonds from central issuing institutions and mandatory convertible bonds

(CHF thousands)	Within one year	> 1 - ≤ 2 years	> 2 - ≤ 3 years	> 3 - ≤ 4 years	> 4 - ≤ 5 years	> 5 years	Total
Bonds	-	-	175,000	50,000	-	600,000	825,000
Mortgage bonds from central issuing institutions	84,000	183,000	120,000	121,000	158,000	1,315,000	1,981,000
<b>Total</b>	<b>84,000</b>	<b>183,000</b>	<b>295,000</b>	<b>171,000</b>	<b>158,000</b>	<b>1,915,000</b>	<b>2,806,000</b>

### 5.10.14 Presentation of value adjustments and provisions, reserves for general banking risks and changes therein during the current year

(CHF thousands)	Status 31.12.2017	2018					Status 31.12.2018
		Use in conformity with designated purpose	Currency differences	Past due interest, and recoveries	New creations charged to income	Releases to income	
<b>Provisions</b>							
Provisions for default risks	39	-	-	-	43	-	82
Provisions for other business risks	459	-	-	-	-	-115	344
Additional pension provision	2,102	-208	-	-	7,140	-	9,034
Provisions for deferred taxes	900	-	-	-	-	-	900
Other provisions	100	-90	-	-	317	-10	317
<b>Total provisions</b>	<b>3,600</b>	<b>-298</b>	<b>-</b>	<b>-</b>	<b>7,500</b>	<b>-125</b>	<b>10,677</b>
<b>Reserves for general banking risks</b>	<b>438,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>26,000</b>	<b>-</b>	<b>464,000</b>
<b>Value adjustments for default and country risks</b>	<b>62,099</b>	<b>-3,519</b>	<b>20</b>	<b>-</b>	<b>10,042</b>	<b>-10,701</b>	<b>57,941</b>
of which value adjustments for default risks in respect of impaired loans	62,099	-3,519	20	-	10,042	-10,701	57,941
of which value adjustments for latent risks	-	-	-	-	-	-	-

### 5.10.15 Disclosure of amounts due from / to related parties

(CHF thousands)	31.12.2018		31.12.2017	
	Amounts due from	Amounts due to	Amounts due from	Amounts due to
Holders of qualified participations	15,000	157,605	12,000	181,913
Group companies	-	78	-	78
Linked companies <sup>1</sup>	129,903	177,549	111,850	190,178
Transactions with members of governing bodies	111,062	8,367	109,786	7,761

The above figures also include any off-balance sheet operation that may have been effected.

Loans to companies or entities related to the Canton consist of operating and investment loans granted on the basis of standard lending parameters.

Receivables from and payables to companies or entities related to the Canton are concluded at market conditions.

Loans to governing bodies primarily consist of mortgage loans and are granted at market conditions in compliance with standard lending parameters.

<sup>1</sup> The 2017 figure pertaining to linked companies was adjusted with the new rules applied in 2018.

### 5.10.16 Presentation of the maturity structure of financial instruments

(CHF thousands)	At sight	Cancellable	Due				No maturity	Total
			within 3 months	within 3 to 12 months	within 1 to 5 years	after 5 years		
<b>Assets / Financial instruments</b>								
Liquid assets	2,022,904	-	-	-	-	-	-	2,022,904
Amounts due from banks	277,984	-	-	-	-	-	-	277,984
Amounts due from customers	17,196	434,914	444,525	215,471	540,874	309,316	-	1,962,296
Mortgage loans	5,530	157,360	814,882	1,181,190	3,995,050	3,215,093	-	9,369,105
Trading portfolio assets	27,620	-	-	-	-	-	-	27,620
Positive replacement values of derivative financial instruments	9,892	-	-	-	-	-	-	9,892
Financial investments	17,579	-	1,000	13,180	170,613	152,220	1,445	356,037
<b>Total</b>	<b>2,378,705</b>	<b>592,274</b>	<b>1,260,407</b>	<b>1,409,841</b>	<b>4,706,537</b>	<b>3,676,629</b>	<b>1,445</b>	<b>14,025,838</b>
Previous year	2,437,763	641,152	1,173,711	1,154,083	4,795,877	3,191,334	1,363	13,395,283
<b>Debt capital / Financial instruments</b>								
Amounts due to banks	367,117	20,037	222,493	-	30,000	-	-	639,647
Liabilities from securities financing transactions	-	-	171,290	-	-	-	-	171,290
Amounts due in respect of customer deposits	5,058,275	3,620,343	395,931	8,576	224,488	109,528	-	9,417,141
Negative replacement values of derivative financial instruments	37,334	-	-	-	-	-	-	37,334
Cash bonds	-	-	34	252	450	-	-	736
Bond issues and central mortgage institution loans	-	-	-	84,000	807,000	1,915,000	-	2,806,000
<b>Total</b>	<b>5,462,726</b>	<b>3,640,380</b>	<b>789,748</b>	<b>92,828</b>	<b>1,061,938</b>	<b>2,024,528</b>	<b>-</b>	<b>13,072,148</b>
Previous year	5,125,976	3,380,148	863,139	186,070	1,040,283	1,741,232	-	12,336,848

## 5.10.17 Presentation of assets and liabilities by domestic and foreign origin in accordance with the domicile principle

(CHF thousands)	31.12.2018		31.12.2017	
	Switzerland	Foreign	Switzerland	Foreign
<b>Assets</b>				
Liquid assets	2,022,691	213	2,036,557	69
Amounts due from banks	143,769	134,215	109,317	153,444
Amounts due from customers	1,650,770	311,526	1,578,904	296,327
Mortgage loans	9,369,105	-	8,832,812	-
Trading portfolio assets	16,406	11,214	21,776	19,057
Positive replacement values of derivative financial instruments	7,219	2,673	44,358	7,249
Financial investments	208,603	147,434	171,314	124,099
Accrued income and prepaid expenses	11,975	1,019	11,312	690
Non-consolidated participations	6,182	131	6,234	295
Tangible fixed assets	78,120	-	80,111	-
Intangible assets	7,011	-	14,302	-
Other assets	191,570	-	17,774	-
<b>Total assets</b>	<b>13,713,421</b>	<b>608,425</b>	<b>12,924,771</b>	<b>601,230</b>
<b>Liabilities</b>				
Amounts due to banks	488,597	151,050	289,323	228,206
Liabilities from securities financing transactions	171,290	-	70,000	-
Amounts due in respect of customer deposits	7,012,220	2,404,921	6,743,248	2,359,303
Negative replacement values of derivative financial instruments	32,793	4,541	25,021	3,642
Cash bonds	736	-	1,105	-
Bond issues and central mortgage institution loans	2,806,000	-	2,617,000	-
Accrued expenses and deferred income	41,160	113	41,750	262
Other liabilities	10,902	-	125,935	-
Provisions	10,677	-	3,600	-
Reserves for general banking risks	464,000	-	438,000	-
Endowment capital	430,000	-	300,000	-
Statutory retained earnings reserve	243,514	-	234,772	-
Group profit	49,332	-	44,834	-
<b>Total liabilities</b>	<b>11,761,221</b>	<b>2,560,625</b>	<b>10,934,588</b>	<b>2,591,413</b>

The breakdown by domestic and foreign origin is made on the basis of the customer's domicile, with the exception of mortgage loans where the domicile of the property is the relevant criterion. Liechtenstein is deemed to be a foreign country.

### 5.10.18 Breakdown of total assets by country or group of countries (domicile principle)

(CHF thousands)	31.12.2018		31.12.2017	
	Absolute	Share as %	Absolute	Share as %
<b>Assets held abroad</b>				
<b>Europe</b>	<b>371,756</b>	<b>2,60</b>	<b>337,418</b>	<b>2,49</b>
Croatia	3,150		3,401	
France	23,602		29,827	
Germany	24,766		13,318	
Guernsey	18,632		8,991	
Italy	127,273		105,121	
Liechtenstein	13,896		15,713	
Luxembourg	59,848		64,396	
Malta	4,755		19,519	
Norway	15,105		10	
Netherlands	11,022		10,767	
United Kingdom	56,065		51,890	
Other countries	13,642		14,465	
<b>North America</b>	<b>123,420</b>	<b>0,86</b>	<b>146,996</b>	<b>1,09</b>
Canada	5,823		6,032	
United States	117,597		140,964	
<b>Asia</b>	<b>76,885</b>	<b>0,54</b>	<b>83,620</b>	<b>0,61</b>
United Arab Emirates	7,496		-	
Kazakhstan	61,030		68,340	
Singapore	4,946		4,893	
Other countries	3,413		10,387	
<b>Caribbean</b>	<b>29,105</b>	<b>0,20</b>	<b>20,185</b>	<b>0,15</b>
Panama	20,596		15,157	
Other countries	8,509		5,028	
<b>South America</b>	<b>7,107</b>	<b>0,05</b>	<b>7,587</b>	<b>0,06</b>
Mexico	5,480		5,866	
Other countries	1,627		1,721	
<b>Oceania</b>	<b>2</b>	<b>0,00</b>	<b>5,312</b>	<b>0,04</b>
<b>Other countries</b>	<b>150</b>	<b>-</b>	<b>112</b>	<b>-</b>
<b>Total assets abroad</b>	<b>608,425</b>	<b>4,25</b>	<b>601,230</b>	<b>4,44</b>
Switzerland	13,713,421	95,75	12,924,771	95,56
<b>Total assets</b>	<b>14,321,846</b>	<b>100,00</b>	<b>13,526,001</b>	<b>100,00</b>



### 5.10.19 Breakdown of total assets by credit rating of country groups (risk domicile view)

Bank's own country rating (CHF thousands)	Standard & Poor's Rating	31.12.2018		31.12.2017	
		Net foreign exposure	Share as %	Net foreign exposure	Share as %
1 Excellent and high quality	AAA to AA-	361,286	59,4%	355,822	59,2%
2 Greater quality than average	A+ to A-	8,919	1,5%	22,763	3,8%
3 Medium quality	BBB+ to BBB-	215,351	35,4%	193,791	32,2%
4 Default risk	BB+ to BB	3,281	0,5%	9,035	1,5%
5 Default risk material	BB-	1,310	0,2%	2,083	0,3%
6 Speculative, high default risk	B+ to B-	5,517	0,9%	435	0,1%
7 Poor quality, very high risk	CCC+ to D	9	0,0%	8	0,0%
Unrated	-	12,752	2,1%	17,293	2,9%
<b>Total assets</b>		<b>608,425</b>	<b>100,0%</b>	<b>601,230</b>	<b>100,0%</b>

The breakdown by domestic and foreign origin is made on the basis of the customer's domicile, with the exception of mortgage loans where the domicile of the property is the relevant criterion. Liechtenstein is deemed to be a foreign country.

## 5.10.20 Presentation of assets and liabilities broken down by the most significant currencies for the Bank

(CHF thousands)	Currencies				Total
	CHF	EUR	USD	Other	
<b>Assets</b>					
Liquid assets	1,957,129	62,242	2,185	1,348	2,022,904
Amounts due from banks	31,039	49,853	96,075	101,017	277,984
Amounts due from customers	1,443,195	341,057	165,104	12,940	1,962,296
Mortgage loans	9,369,105	-	-	-	9,369,105
Trading portfolio assets	3,989	7,022	4,045	12,564	27,620
Positive replacement values of derivative financial instruments	8,861	231	787	13	9,892
Financial investments	226,980	39,183	89,770	104	356,037
Accrued income and prepaid expenses	11,780	536	671	7	12,994
Non-consolidated participations	6,182	131	-	-	6,313
Tangible fixed assets	78,120	-	-	-	78,120
Intangible assets	7,011	-	-	-	7,011
Other assets	191,569	1	-	-	191,570
<b>Total assets shown in balance sheet</b>	<b>13,334,960</b>	<b>500,256</b>	<b>358,637</b>	<b>127,993</b>	<b>14,321,846</b>
Delivery entitlements from spot exchange, forward forex and forex options transactions <sup>1</sup>	84,842	1,867,802	695,220	188,245	2,836,109
<b>Total assets</b>	<b>13,419,802</b>	<b>2,368,058</b>	<b>1,053,857</b>	<b>316,238</b>	<b>17,157,955</b>
<b>Liabilities</b>					
Amounts due to banks	344,356	98,899	162,382	34,010	639,647
Liabilities from securities financing transactions	-	171,290	-	-	171,290
Amounts due in respect of customer deposits	6,754,406	1,828,186	631,517	203,032	9,417,141
Negative replacement values of derivative financial instruments	36,334	231	759	10	37,334
Cash bonds	736	-	-	-	736
Bond issues and central mortgage institution loans	2,806,000	-	-	-	2,806,000
Accrued expenses and deferred income	41,246	-	2	25	41,273
Other liabilities	10,586	195	55	66	10,902
Provisions	10,677	-	-	-	10,677
Reserves for general banking risks	464,000	-	-	-	464,000
Endowment capital	430,000	-	-	-	430,000
Statutory retained earnings reserve	243,514	-	-	-	243,514
Group's profit	49,332	-	-	-	49,332
<b>Total liabilities in balance sheet</b>	<b>11,191,187</b>	<b>2,098,801</b>	<b>794,715</b>	<b>237,143</b>	<b>14,321,846</b>
Delivery obligations from spot exchange, forward forex and forex options transactions <sup>1</sup>	2,247,769	264,080	264,055	75,157	2,851,061
<b>Total liabilities</b>	<b>13,438,956</b>	<b>2,362,881</b>	<b>1,058,770</b>	<b>312,300</b>	<b>17,172,907</b>
<b>Net position per currency</b>	<b>-19,154</b>	<b>5,177</b>	<b>-4,913</b>	<b>3,938</b>	<b>-14,952</b>
Net position per currency in the previous year	36,279	-1,069	657	421	36,288

<sup>1</sup> Options have been delta-weighted.



## 5.11 INFORMATION CONCERNING OFF-BALANCE SHEET TRANSACTIONS

### 5.11.21 Breakdown of contingent liabilities and contingent assets

(CHF thousands)	31.12.2018	31.12.2017
<b>Contingent liabilities</b>		
Guarantees to secure credits and similar	70,771	74,505
Performance guarantees and similar	31,787	28,787
Irrevocable commitments arising from documentary letters of credit	12,400	36,789
<b>Total contingent liabilities</b>	<b>114,958</b>	<b>140,081</b>

### 5.11.22 Breakdown of fiduciary transactions

(CHF thousands)	31.12.2018	31.12.2017
Fiduciary investments	265,627	183,624
Fiduciary loans	7,923	8,334
<b>Total fiduciary transactions</b>	<b>273,550</b>	<b>191,958</b>

## 5.12 INFORMATION ON THE INCOME STATEMENT

### 5.12.23 Breakdown of the result from trading activities and fair value option

(CHF thousands)	2018	2017
Result from trading activities from:		
Foreign currencies	17,783	9,998
Banknote trading	-1,245	6,567
Commodities / precious metals	-335	1,292
Securities trading	-1,107	434
<b>Total result from trading activities</b>	<b>15,096</b>	<b>18,291</b>

### 5.12.24 Disclosure of material refinancing income in the item Interest and discount income as well as material negative interest

Refinancing income in the item "Result from interest operations"		
Interest and dividend income from trading portfolio is offset with costs of refinancing of that portfolio.		
(CHF thousands)	2018	2017
<b>Negative interest</b>		
Negative interest on assets (decrease in interest and discount income)	4,675	4,718
Negative interest on liabilities (decrease in interest expenses)	3,385	3,242

### 5.12.25 Breakdown of personnel expenses

(CHF thousands)	2018	2017
Salaries	67,184	65,857
<i>of which expenses relating to share-based compensation and alternative forms of variable compensation</i>	-	-
Social insurance benefits <sup>1</sup>	20,784	15,203
Other personnel expenses	3,084	2,874
<b>Total personnel expenses</b>	<b>91,052</b>	<b>83,934</b>

### 5.12.26 Breakdown of general and administrative expenses

(CHF thousands)	2018	2017
Office space expenses	5,847	5,500
Expenses for information and communications technology	22,622	20,378
Expenses for vehicles, equipment, furniture and other fixtures as well as operating lease expenses	436	426
Fees of audit firm	961	834
<i>of which for financial and regulatory audits</i>	821	792
<i>of which for other services</i>	140	42
Other operating expenses	12,224	11,633
<i>of which compensation for any State guarantee</i>	-	-
<b>Total general and administrative expenses</b>	<b>42,090</b>	<b>38,771</b>

<sup>1</sup> The increase is attributable to the pre-retirement plan to be carried out over a two-year period (2019 and 2020).

## 5.12.27 Explanations regarding material losses, extraordinary income and expenses, as well as material releases of hidden reserves, reserves for general banking risks, and value adjustments and provisions no longer required

<p><b>5.12.27.1 Material losses</b> No material losses were incurred during the financial year.</p>
<p><b>5.12.27.2 Extraordinary income and extraordinary expenses</b> The extraordinary income of CHF 4.6 million is mainly due to the proceeds from the last portion of the variable component pertaining to the sales price of our participation in Swisscanto Holding AG which was concluded in 2015.</p>
<p><b>5.12.27.3 Hidden reserves</b> The Group does not hold any hidden reserve as it discloses its financial statements on the basis of the true and fair view principle.</p>
<p><b>5.12.27.4 Reserves for general banking risks</b> CHF 26 million were deducted from "Changes in reserves for general banking risks" to create reserves for general banking risks.</p>
<p><b>5.12.27.5 Value adjustments and provisions no longer required</b> There is no relevant information to provide under this heading.</p>
<p><b>5.12.27.6 Revaluations of participations and tangible fixed assets</b> There were no revaluations of participations or tangible fixed assets during the reporting year. .</p>

## 5.12.28 Presentation of current and deferred taxes, and disclosure of tax rate

(CHF thousands)	31.12.2018	31.12.2017
Current taxes	1,091	710
Real estate tax	314	317
Provisions for deferred taxes	-	-
<b>Total taxes</b>	<b>1,405</b>	<b>1,027</b>
<b>Average tax rate weighted on the basis of the operating result<sup>1</sup></b>	<b>1,5%</b>	<b>1,0%</b>

<sup>1</sup> The Parent company Banca dello Stato del Cantone Ticino is exempt from federal, cantonal and communal taxation. It is subject to real estate taxation.

# Auditors' Report



## Report of the auditor

**to the Council and to the Cantonal Parliament of the Republic and Canton of Ticino, Bellinzona**

### Report on the audit of the consolidated financial statements

#### Opinion

We have audited the consolidated financial statements of the Group Banca dello Stato del Cantone Ticino and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2018, consolidated income statement, consolidated cash flow statement, consolidated statement of changes in equity and notes for the year then ended, including a summary of significant accounting policies (pages 36-66).

In our opinion, the consolidated financial statements as at 31 December 2018 give a true and fair view of the financial position, the results of operations and the cash flow in accordance with accounting rules for banks and comply with Swiss law and the Law on Banca dello Stato del Cantone Ticino.

#### Basis for opinion

We conducted our audit in accordance with Swiss law and Swiss Auditing Standards. Our responsibilities under those provisions and standards are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements" section of our report.

We are independent of the Group in accordance with the provisions of Swiss law and the requirements of the Swiss audit profession and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Our audit approach

##### Overview



- Overall group materiality: CHF 3.63 million
  - We performed full scope audits at Banca dello Stato del Cantone Ticino and Axion Swiss Bank SA.
- Our audit work covers 100% of the operating result of the Group.

As key audit matter the following area of focus has been identified:

- Impairment of amounts due from customers and mortgage loans.

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### ***Audit scope***

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated financial statements. In particular, we considered where subjective judgements were made; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

### ***Materiality***

The scope of our audit was influenced by our application of materiality. Our audit opinion aims to provide reasonable assurance that the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

<i>Overall group materiality</i>	CHF 3.63 million
<i>How we determined it</i>	5% of the operating result (result of the period before tax, changes in reserves for general banking risks and extraordinary items).
<i>Rationale for the materiality benchmark applied</i>	We chose the operating result (result of the period before tax, changes in reserves for general banking risks and extraordinary items) because it is the benchmark against which the performance of a banking group is most commonly measured and it is the generally accepted benchmark in the financial industry.

We agreed with the Audit Committee of the Board of Directors that we would report to them misstatements above CHF 181'650 identified during our audit as well as any misstatements below that amount which, in our view, warranted reporting for qualitative reasons.



### ***Report on key audit matters based on the circular 1/2015 of the Federal Audit Oversight Authority***

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

#### **Impairment of amounts due from customers and mortgage loans**

<b><i>Key audit matter</i></b>	<b><i>How our audit addressed the key audit matter</i></b>
<p>As shown in note 5.10.2 of the annual report 2018, the Group grants loans and advances to customers and mortgage loans (79% of total assets or CHF 11'331 million). We consider the valuation of amounts due from customers and mortgage loans that show signs of potential default of debtor or need impairment of the loan to be a key audit matter on the basis of the magnitude of the related balance sheet positions. Moreover, the determination of the amount of any impairment is based on the customer's capacity to repay the amount due and/or the liquidation value of the collateral, both of which may be influenced by subjective factors.</p> <p>The Group has a control system in place that allows to identify and to analyze the risk of default, to take precautionary measures and to calculate the necessary impairment charges.</p> <p>The accounting and valuation principles for amounts due from customers and mortgage loans and the methods used to identify default risks and to determine the need for impairment are described in the notes to the consolidated financial statements (notes 5.2.3.3, 5.4.1 and 5.5).</p>	<p>We checked and tested the key controls relating to amounts due from customers and mortgage loans:</p> <ul style="list-style-type: none"><li>• controls aimed to identify signs of potential default in order to determine the scope of non-performing and/or impaired loans;</li><li>• controls relating to the calculation of value adjustment including the determination of the market value of the collaterals.</li></ul> <p>In addition, we tested on a sample basis that:</p> <ul style="list-style-type: none"><li>• the risk category given to the selected credit was adequate;</li><li>• the market value of the collateral was determined or updated in accordance with market practice;</li><li>• the impairments were calculated and recorded in accordance with the accounting principles.</li></ul>

#### ***Responsibilities of the Board of Directors for the consolidated financial statements***

The Board of Directors is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with accounting rules for banks, the provisions of Swiss law and the Law on Banca dello Stato del Cantone Ticino, and for such internal control as the Board of Directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.



In preparing the consolidated financial statements, the Board of Directors is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

#### ***Auditor's responsibilities for the audit of the consolidated financial statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Swiss law and Swiss Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Swiss law and Swiss Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made;
- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.



We communicate with the Board of Directors or its relevant committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors or its relevant committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors or its relevant committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

### ***Report on other legal and regulatory requirements***

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of consolidated financial statements according to the instructions of the Board of Directors.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers Ltd

A handwritten signature in blue ink, appearing to read 'Glenda Brändli'.

Glenda Brändli  
Audit expert  
Auditor in charge

A handwritten signature in blue ink, appearing to read 'Lorenzo Morelli'.

Lorenzo Morelli  
Audit expert

Lugano, 28 March 2019



# Individual Financial Statements

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# 1. Balance Sheet

(CHF thousands)	Annex	31.12.2018	31.12.2017	Change
<b>Assets</b>				
Liquid assets		1,322,640	1,328,273	-5,633
Amounts due from banks		310,779	299,948	10,831
Amounts due from customers	5.6.2	1,679,674	1,595,118	84,556
Mortgage loans	5.6.2	9,369,105	8,832,812	536,293
Trading portfolio assets	5.6.3	25,472	33,889	-8,417
Positive replacement values of derivative financial instruments	5.6.4	11,838	54,679	-42,841
Financial investments	5.6.5	336,733	288,487	48,246
Accrued income and prepaid expenses		12,663	11,885	778
Participations		70,156	72,668	-2,512
Tangible fixed assets		77,252	78,051	-799
Other assets	5.6.6	191,190	17,312	173,878
<b>Total assets</b>		<b>13,407,502</b>	<b>12,613,122</b>	<b>794,380</b>
Total subordinated claims		30,718	40,929	-10,211
<i>of which subject to mandatory conversion and/or debt waiver</i>		30,718	40,929	-10,211
<b>Liabilities</b>				
Amounts due to banks		817,961	726,130	91,831
Liabilities from securities financing transactions	5.6.1	171,290	70,000	101,290
Amounts due in respect of customer deposits		8,325,104	7,980,856	344,248
Negative replacement values of derivative financial instruments	5.6.4	37,375	29,382	7,993
Cash bonds		736	1,105	-369
Bond issues and central mortgage institution loans	5.6.7	2,806,000	2,617,000	189,000
Accrued expenses and deferred income		33,821	35,957	-2,136
Other liabilities	5.6.6	9,637	123,926	-114,289
Provisions	5.6.9	9,460	2,600	6,860
Reserves for general banking risks	4 and 5.6.9	464,000	438,000	26,000
Endowment capital	4 and 5.6.10	430,000	300,000	130,000
Statutory retained earnings reserve	4	252,074	240,028	12,046
Profit (result for the period)	4	50,044	48,138	1,906
<b>Total liabilities</b>		<b>13,407,502</b>	<b>12,613,122</b>	<b>794,380</b>
Total subordinated liabilities		175,273	255,273	-80,000
<i>of which subject to mandatory conversion and/or debt waiver</i>		-	80,000	-80,000
<b>Off-balance sheet transactions</b>				
Contingent liabilities	5.6.2	112,537	133,497	-20,960
Irrevocable commitments	5.6.2	297,055	219,767	77,288
Obligations to pay up and make further contributions	5.6.2	14,180	14,180	-

## 2. Income Statement

(CHF thousands)	Annex	2018	2017	Change
<b>Income and expenses arising from ordinary banking operations</b>				
<b>Result from interest operations</b>				
Interest and discount income		181,243	178,862	2,381
Interest and dividend income from financial investments		2,858	2,657	201
Interest expense		-40,230	-45,173	4,943
<b>Gross result from interest operations</b>		<b>143,871</b>	<b>136,346</b>	<b>7,525</b>
Changes in value adjustments for default risk and losses from interest operations		915	-7,290	8,205
<b>Net result from interest operations</b>		<b>144,786</b>	<b>129,056</b>	<b>15,730</b>
<b>Result from commission business and services</b>				
Commission income from securities trading and investment activities		23,883	24,282	-399
Commission income from lending activities		3,577	3,680	-103
Commission income from other services		7,921	7,927	-6
Commission expenses		-6,708	-6,839	131
<b>Result from trading activities and fair value option</b>	5.8.15	<b>12,298</b>	<b>14,726</b>	<b>-2,428</b>
<b>Other results from ordinary activities</b>				
Result from the disposal of financial investments		-299	1,289	-1,588
Income from participations		3,089	2,873	216
Result from real estate		904	827	77
Other ordinary income		3,765	3,836	-71
Other ordinary expenses		-2,495	-168	-2,327
<b>Net revenues</b>		<b>190,721</b>	<b>181,489</b>	<b>9,232</b>
<b>Operating expenses</b>				
Personnel expenses	5.8.17	-73,785	-68,529	-5,256
General and administrative expenses	5.8.18	-35,846	-33,359	-2,487
<b>Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets</b>		<b>-8,044</b>	<b>-7,641</b>	<b>-403</b>
<b>Changes to provisions and other value adjustments, and losses</b>		<b>-45</b>	<b>80</b>	<b>-125</b>
<b>Operating result</b>		<b>73,001</b>	<b>72,040</b>	<b>961</b>
<b>Extraordinary income</b>	5.8.19.02	<b>3,677</b>	<b>2,545</b>	<b>1,132</b>
<b>Extraordinary expenses</b>	5.8.19.02	<b>-320</b>	<b>-16</b>	<b>-304</b>
<b>Changes in reserves for general banking risks</b>	5.8.19.04	<b>-26,000</b>	<b>-26,114</b>	<b>114</b>
<b>Taxes</b>	5.8.20	<b>-314</b>	<b>-317</b>	<b>3</b>
<b>Profit (result for the period)</b>		<b>50,044</b>	<b>48,138</b>	<b>1,906</b>

### 3. Proposed Appropriation of Available Earnings

(CHF thousands)	2018	2017	Change
<b>Appropriation of available earnings</b>			
Profit (result of the period)	50,044	48,138	1,906
Profit carried forward	-	-	-
<b>Balance sheet profit</b>	<b>50,044</b>	<b>48,138</b>	<b>1,906</b>
<b>Proposal of the Board of Directors</b>			
Assignment to the statutory retained earnings reserve	11,681	12,046	-365
5% interest on the endowment capital	15,000	12,000	3,000
Additional payment to the Canton	23,363	24,092	-729
<b>Amount carried forward</b>	<b>-</b>	<b>-</b>	<b>-</b>

## 4. Statement of Changes in Endowment Capital

(CHF thousands)	Endowment capital	Statutory earnings reserve	Reserves for general banking risks	Result of the period	<b>Total</b>
<b>Endowment capital at 1.1.2018</b>	300,000	240,028	438,000	48,138	1,026,166
<b>Appropriation of retained earnings 2017</b>					
<i>Assignment to statutory retained earnings reserve</i>	-	+12,046	-	-12,046	-
<i>5% interest on the endowment capital</i>	-	-	-	-12,000	-12,000
<i>Additional payment to the Canton</i>	-	-	-	-24,092	-24,092
Endowment capital increase	+130,000	-	-	-	130,000
Allocation to reserves for general banking risks	-	-	+26,000	-	26,000
Profit (result for the period)	-	-	-	+50,044	50,044
<b>Total endowment capital at 31.12.2018</b>	<b>430,000</b>	<b>252,074</b>	<b>464,000</b>	<b>50,044</b>	<b>1,196,118</b>

## 5. Annex

### 5.1 ACTIVITIES OF THE BANK AND STAFF

#### 5.1.1 Activities of the Bank

Banca dello Stato del Cantone Ticino (BancaStato or the Bank), based in Bellinzona, is an autonomous banking institution under public law whose primary aim is to favour the development of the economy in Ticino.

Its operations have evolved over 100 years and comprise the complete range of banking services provided by full service banks.

In 2010 and 2013, as part of a move to diversify its sources of revenue, BancaStato acquired the entire capital of AHSA Holding SA, Lugano, in order to gain indirect control over Axion SWISS Bank SA, Lugano (Axion). At end-2016, BancaStato acquired the entire capital of Axion from AHSA Holding SA. During 2017 the capital of AHSA Holding SA was entirely reimbursed, and the company was cancelled from the Commerce Registry of Canton Ticino in 2018.

Axion's core business focus is on portfolio management for private and institutional clients, and it operates on primary international markets. In the first quarter of 2016, within the framework of a strategy aimed at strengthening its asset administration business, Axion acquired a portion of client assets and infrastructure from Société Générale Private Banking (Lugano-Svizzera) SA.

Effective at end 2018, BancaStato ceded its minority share (30%) in Soave Asset Management Ltd., Lugano, a company active in asset management, as well as its share in Londinium Dac, Dublin, a company authorised to operate as an investment enterprise in accordance with the MiFID.

#### 5.1.2 Personnel

As at 31 December 2018, the Bank had a total of 419 employees on payroll (380.95 FTEs) with apprentices calculated at 50%, compared to 427 staff at the end of 2017 (388.05 FTEs).

### 5.2 ACCOUNTING AND VALUATION PRINCIPLES

#### 5.2.1 General principles

The financial statements of BancaStato as at 31 December 2018 were prepared in accordance with applicable legal and regulatory provisions as well as the true and fair view principle, in compliance with the provisions of the Swiss Code of Obligations and the Swiss Banking legislation, in particular the guidelines of the Swiss Financial Market Supervisory Authority FINMA, the Swiss listing rules and the accompanying directive.

All business transactions are recorded at the time they are closed. The balance sheet is presented on a transaction date basis.

#### 5.2.2 Accounting and valuation principles

The valuation rules for the individual financial statements reflect those of the consolidated financial statements (refer to Section 5.2.2 and following of the Annex to the Group Financial Statements) except for the item "Participations".

#### 5.2.3 Participations

Participations comprise company equity stakes held by the Bank as long-term investments.

Participations are carried at cost less appropriate depreciation, regardless of the share held.

Participation in the capital of the Central Mortgage Bond Issuing Body of the Swiss Cantonal Banks has been partially paid-up. The commitment to pay up the outstanding amount is posted in off-balance sheet under the item "Obligations to pay up shares and make further contributions". To ensure prompt availability of liquidity in the event of a crisis, the shareholding banks have agreed on a limit for the amount contributed. This amount is not shown in off-balance sheet under "Irrevocable commitments" in order to avoid duplication.

### 5.3 FOREIGN CURRENCY TRANSLATION

Assets and liabilities denominated in foreign currency are converted into Swiss francs at the rate of exchange as at the balance sheet closing date. Resulting gains or losses are disclosed in the income statement under "Result from trading activities and fair value option".

Proceeds and expenses are converted at the exchange rate applicable on the date the individual transactions are recorded.

Exchange rates applied at the close of the financial year for the major currencies were as follows:

EUR 1.1269 (2017: 1.1703)

USD 0.9842 (2017: 0.9747)

### 5.4 CHANGES IN FINANCIAL STATEMENTS AND PRESENTATION OF ACCOUNTS

There were no changes in the accounting principles or in the presentation of accounts in 2018.

### 5.5 OTHER INFORMATION

For information on "Risk management", "Methods used for identifying default risks and determining the need for value adjustments", "Valuation of collateral", "Business policy regarding the use of derivative financial instruments and hedge accounting", "Explanations of material events occurring after the balance sheet date" and "Reasons which have led to early resignation of the auditors", refer to the Annex to the Group Financial Statements as these points are also applicable to BancaStato's Individual Financial Statements.

The information regarding capital adequacy and liquidity required by the FINMA Circular 2016/1 "Disclosure – banks" is published on BancaStato's website ([www.bancastato.ch](http://www.bancastato.ch)).

### 5.6 INFORMATION ON THE BALANCE SHEET

#### 5.6.1 Breakdown of securities financing transactions (assets and liabilities)

(CHF thousands)	31.12.2018	31.12.2017
<b>Securities lending, securities borrowing and repurchase agreements</b>		
Book value of receivables from cash collateral delivered in connection with securities borrowing and reverse repurchase transactions <sup>1</sup>	-	-
Book value of obligations from cash collateral received in connection with securities lending and repurchase agreements <sup>1</sup>	171,290	70,000
Book value of securities lent in connection with securities lending or delivered as collateral in connection with securities borrowing as well as securities in own portfolio transferred in connection with repurchase agreements.	170,569	68,641
<i>of which with unrestricted right to resell or repledge</i>	170,569	68,641
Fair value of securities received and serving as collateral in connection with securities lending or securities borrowed in connection with securities borrowing as well as securities received in connection with reverse repurchase agreements with an unrestricted right to resell or repledge.	-	-
<i>of which repledged securities</i>	-	-
<i>of which resold securities</i>	-	-

<sup>1</sup> Before any netting agreement.

## 5.6.2 Presentation of collateral for loans / receivables and off-balance sheet transactions, as well as impaired loans/receivables at 31.12.2018

(CHF thousands)	Type of collateral			
	Secured by mortgage	Other collateral	Unsecured	Total
<b>Loans (before netting with value adjustments)</b>				
Amounts due from customers	164,435	200,423	648,984	1,013,842
Amounts due from public corporations	306	573	704,945 <sup>1</sup>	705,824
Mortgage loans	9,386,986 <sup>1</sup>			9,386,986
<i>Residential property</i>	6,958,942			6,958,942
<i>Office and business premises</i>	1,180,473			1,180,473
<i>Commercial and industrial premises</i>	521,130			521,130
<i>Other</i>	726,441			726,441
<b>Total loans (before netting with value adjustments)</b>	<b>9,551,727</b>	<b>200,996</b>	<b>1,353,929</b>	<b>11,106,652</b>
Previous year	9,024,734	205,172	1,260,038	10,489,944
<b>Total loans (after netting with value adjustments)</b>	<b>9,533,845</b>	<b>195,299</b>	<b>1,319,635</b>	<b>11,048,779</b>
Previous year	9,003,841	198,372	1,225,717	10,427,930
<b>Off-balance sheet</b>				
Contingent liabilities	6,494	25,583	80,460	112,537
Irrevocable commitments	44,835	-	252,220 <sup>2</sup>	297,055
Obligations to pay up shares and make further contributions	-	-	14,180	14,180
<b>Total off-balance sheet</b>	<b>51,329</b>	<b>25,583</b>	<b>346,860</b>	<b>423,772</b>
Previous year	13,214 <sup>3</sup>	51,036	303,194 <sup>3</sup>	367,444 <sup>3</sup>

(CHF thousands)	Gross debt amount	Estimated liquidation value of collateral	Net debt amount	Individual value adjustments
<b>Impaired loans</b>				
<b>Current year</b>	<b>149,117</b>	<b>91,244</b>	<b>57,873</b>	<b>57,873</b>
Previous year	156,149	94,135	62,014	62,014

<sup>1</sup> Including loans to entities related to public institutions for CHF 117.5 million (2017: CHF 136.4 million).

<sup>2</sup> Including CHF 36 million (2017: CHF 35 million) as a required share for deposit guarantee purposes.

<sup>3</sup> The amount of irrevocable commitments for 2017 was adjusted with the inclusion rules applied in 2018. This adjustment is the result of a change in inclusion perimeter for this item due to a different and more restrictive interpretation of the concept of callable loans.

### 5.6.3 Breakdown of trading portfolios and other financial instruments at fair value

(CHF thousands)	31.12.2018	31.12.2017
<b>Trading portfolio assets</b>		
Equity-type securities	30	121
Shares in investment funds	10,179	13,713
Precious metals and commodities	12,565	20,055
Structured products	2,698	-
<b>Total trading portfolio assets</b>	<b>25,472</b>	<b>33,889</b>
<i>of which determined using a valuation model</i>	-	-
<i>of which securities eligible for repo transactions in accordance with liquidity requirements</i>	-	-

### 5.6.4 Presentation of derivative financial instruments (assets and liabilities)

(CHF thousands)	Trading instruments			Hedging instruments		
	Replacement values		Contract volume	Replacement values		Contract volume
	positive	negative		positive	negative	
<b>Interest rate instruments</b>						
IRS	-	-	-	5,222	15,936	734,000
<b>Total interest rate instruments</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,222</b>	<b>15,936</b>	<b>734,000</b>
<b>Foreign currencies / precious metals</b>						
Forward contracts	1,219	907	132,160	-	-	-
Swaps (interest rate/currency)	1,862	2,187	323,492	2,459	17,345	2,763,208
Options (OTC)	1,076	1,000	222,253	-	-	-
<b>Total foreign currencies / precious metals</b>	<b>4,157</b>	<b>4,094</b>	<b>677,905</b>	<b>2,459</b>	<b>17,345</b>	<b>2,763,208</b>
<b>Total before netting agreements</b>	<b>4,157</b>	<b>4,094</b>	<b>677,905</b>	<b>7,681</b>	<b>33,281</b>	<b>3,497,208</b>
<i>of which determined using a valuation model</i>	<i>4,157</i>	<i>4,094</i>	<i>-</i>	<i>7,681</i>	<i>33,281</i>	<i>-</i>
Total previous year	5,681	5,423	720,253	48,998	23,959	3,213,997
<i>of which determined using a valuation model</i>	<i>5,681</i>	<i>5,423</i>	<i>-</i>	<i>48,998</i>	<i>23,959</i>	<i>-</i>

(CHF thousands)	Positive replacement values (cumulated)	Negative replacement values (cumulated)
<b>Total after netting agreements</b>	<b>11,838</b>	<b>37,375</b>
Total previous year	54,679	29,382

### Breakdown by counterparty

(CHF thousands)	Central clearing houses	Banks and securities dealers	Other customers
Positive replacement values (after netting agreements)	-	11,457	381

### 5.6.5 Breakdown of financial investments

(CHF thousands)	Book value		Fair value	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Debt securities	317,278	250,283	319,006	251,902
<i>of which intended to be held to maturity</i>	288,647	250,283	290,375	251,902
<i>of which not intended to be held to maturity (available for sale)</i>	28,631	-	28,631	-
Shares in investment funds	13,521	26,885	13,991	27,696
Equity-type securities	4,386	9,830	4,879	10,261
<i>of which qualified participations (at least 10% of voting capital)</i>	-	-	-	-
Precious metals	103	126	103	126
Real estate	1,445	1,363	1,445	1,363
<b>Total financial investments</b>	<b>336,733</b>	<b>288,487</b>	<b>339,424</b>	<b>291,348</b>
<i>of which securities eligible for repo transactions in accordance with liquidity requirements</i>	205,489	153,002	207,460	154,442

### Breakdown of counterparties by rating

(CHF thousands)	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Book value of debt securities	236'906	38'128	17'771	-	-	24'473

The valuations are based on ratings by Standard & Poor's.

### 5.6.6 Breakdown of other assets and other liabilities

(CHF thousands)	31.12.2018	31.12.2017
<b>Other assets</b>		
Compensation account	6,073	6,365
Indirect taxes	671	611
Various other assets	184,446 <sup>1</sup>	10,336
<b>Total other assets</b>	<b>191,190</b>	<b>17,312</b>
<b>Other liabilities</b>		
Direct / indirect taxes	3,885	4,425
Unredeemed cash bonds	1,634	2,312
Various other liabilities	4,118	117,189 <sup>2</sup>
<b>Total other liabilities</b>	<b>9,637</b>	<b>123,926</b>

<sup>1</sup> of which a balance of CHF 184.3 million for in-house banking transactions.

<sup>2</sup> of which a balance of CHF 91.1 million from in-house banking operations and CHF 23.4 million additional payment to the Canton for 2016.

## 5.6.7 Disclosure of assets pledged or assigned to secure own commitments and of assets under reservation of ownership

(CHF thousands)	31.12.2018		31.12.2017	
	Book value	Effective commitments	Book value	Effective commitments
<b>Pledged / assigned assets</b> (excluding securities financing transactions)				
Book value of mortgages set as collateral for bonds and loans with the SCB Central	2,384,523	1,981,000	2,501,045	2,042,000
Book value of securities delivered as collateral to SIX Group AG	1,416	-	1,417	-
Book value of securities delivered as collateral in connection with Repo Light credit with SNB	21,760	-	23,503	-
Book value of assets pledged with the SNB to secure own commitments	24,611	24,611	1,241	1,241
<b>Total pledged / assigned assets</b>	<b>2,432,310</b>	<b>2,005,611</b>	<b>2,527,206</b>	<b>2,043,241</b>
<b>Assets under reservation of ownership</b> Assets under reservation of ownership	-	-	-	-

## 5.6.8 Disclosure on the economic situation of pension schemes

### 5.6.8.1 Disclosure of liabilities relating to own pension schemes, and number and nature of equity instruments of the Bank held by own pension schemes

The Bank has no obligations towards pension schemes.

### 5.6.8.2 Disclosures on the economic situation of own pension schemes

#### a) Employer contribution reserves (ECR)

The Bank had no ECR as at 31.12.2018.

#### b) Presentation of the economic benefit / obligation and the pension expenses

	Over- / underfunding at the end of 2018	Economic interest of the Bank		Change in economic interest (benefit and/or commitment) versus previous year	Contributions paid for 2018	Pension expenses in personnel expenses	
		31.12.2018	31.12.2017			31.12.2018	31.12.2017
Pension plans without overfunding / underfunding	-	-	-	-	7'534	12'813 <sup>1</sup>	7'778

Contributions are paid to the insurance company. The employer's contributions are carried under "Personnel expenses".

The Bank has opted for affiliation to the Group Plan LPP Swiss Life, a legally independent pension fund. The pension plan is a defined-contribution scheme and provides the basic compulsory coverage as stated in the Swiss LPP (Federal Law on Occupational Benefits), as well as complementary coverage.

At the end of the accounting period the Bank had no obligation towards the pension funds. There are no contribution reserves on the part of the employer and the relationship between the Bank and its pension fund is based on a global affiliation contract.

The pension fund reinsures all pension risks by means of a comprehensive insurance contract. Within the framework of this contract, no possibility of underfunding exists and, consequently, there are no obligations in this regard on the part of the employer.

<sup>1</sup> Including a provision for a pre-retirement plan to be carried out over a two-year period (2019 and 2020).

## 5.6.9 Presentation of value adjustments and provisions, reserves for general banking risks and changes therein during the current year

(CHF thousands)	Status 31.12.2017	2018					Status 31.12.2018
		Use in conformity with designated purpose	Currency differences	Past due interest and recoveries	New creations charged to income	Releases to income	
<b>Provisions</b>							
Provisions for default risks	39	-	-	-	43	-	82
Provisions for other business risks	459	-	-	-	-	-115	344
Additional pension provision	2,102	-208	-	-	7,140	-	9,034
<b>Total provisions</b>	<b>2,600</b>	<b>-208</b>	<b>-</b>	<b>-</b>	<b>7,183</b>	<b>-115</b>	<b>9,460</b>
<b>Reserves for general banking risks</b>	<b>438,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>26,000</b>	<b>-</b>	<b>464,000</b>
<b>Value adjustments for default and country risks</b>	<b>62,063</b>	<b>-3,518</b>	<b>21</b>	<b>-</b>	<b>10,030</b>	<b>-10,674</b>	<b>57,922</b>
of which value adjustments for default risks in respect of impaired loans	62,063	-3,518	21	-	10,030	-10,674	57,922

## 5.6.10 Presentation of the Bank's endowment capital

(CHF thousands)	31.12.2018			31.12.2017		
	Total par value	Quantity	Capital eligible for dividend	Total par value	Quantity	Capital eligible for dividend
<b>Endowment capital</b>						
Endowment capital	430,000	430,000	430,000	300,000	300,000	300,000
of which paid up	430,000	430,000	430,000	300,000	300,000	300,000
<b>Total endowment capital</b>	<b>430,000</b>	<b>430,000</b>	<b>430,000</b>	<b>300,000</b>	<b>300,000</b>	<b>300,000</b>

On 19 June 2017, the Grand Council (Cantonal Parliament) approved a request for an increase of the endowment capital from CHF 240 million to CHF 500 million. This increase was granted with the transformation into endowment capital of perpetual subordinated loans for a total of CHF 140 million and the authorisation to increase the capital by an additional CHF 120 million.

On 22 August 2018 the State Council authorised a CHF 130 million increase.

The Bank did not issue participation rights.

## 5.6.11 Disclosure of amounts due from / to related parties

(CHF thousands)	31.12.2018		31.12.2017	
	Due from	Due to	Due from	Due to
Holders of qualified participations	15,000	157,605	12,000	181,913
Group companies	67,660	193,053	71,863	232,482
Linked companies <sup>1</sup>	129,203	177,549	111,850	190,178
Transactions with members of governing bodies	111,016	7,692	109,744	6,957

The amounts indicated include any off-balance sheet operation that may have been effected.

Loans to companies or entities related to the Canton consist of operating and investment loans granted on the basis of standard lending parameters.

Receivables from and payables to companies or entities related to the Canton are concluded at market conditions.

Loans to governing bodies primarily consist of mortgage loans and are concluded at market conditions.

## 5.6.12 Disclosure of holders of significant participations

(CHF thousands)	31.12.2018		31.12.2017	
	Nominal	% of equity	Nominal	% of equity
Canton Ticino With voting rights	430,000	100	300,000	100

<sup>1</sup> The 2017 figure pertaining to linked companies was adjusted with the new rules applied in 2018.

### 5.6.13 Breakdown of total assets by credit rating of country groups (risk domicile view)

Bank's own country rating (CHF thousands)	Standard & Poor's rating	31.12.2018		31.12.2017	
		Net foreign exposure	Share as %	Net foreign exposure	Share as %
1 Excellent and high quality	AAA to AA-	286,405	82.7%	289,146	82,8%
2 Greater quality than average	A+ to A-	2,222	0.6%	2,028	0,6%
3 Medium quality	BBB+ to BBB-	53,076	15.3%	47,564	13,6%
4 Default risk	BB+ to BB	130	0.0%	804	0,2%
5 Default risk material	BB-	3	0.0%	1,305	0,4%
6 Speculative, high default risk	B+ to B-	103	0.0%	1	0,0%
7 Poor quality, very high risk	CCC+ to D	-	0.0%	-	0,0%
Unrated	-	4,935	1.4%	8,287	2,4%
<b>Total assets</b>		<b>346,874</b>	<b>100.0%</b>	<b>349,135</b>	<b>100,0%</b>

The breakdown by domestic and foreign origin is made on the basis of the customer's domicile, with the exception of mortgage loans where the domicile of the property is the relevant criterion. Liechtenstein is deemed to be a foreign country.

## 5.7 INFORMATION CONCERNING OFF-BALANCE SHEET TRANSACTIONS

### 5.7.14 Breakdown of fiduciary transactions

(CHF thousands)	31.12.18	31.12.17
Fiduciary investments	94,804	38,899
<b>Total fiduciary transactions</b>	<b>94,804</b>	<b>38,899</b>

## 5.8 INFORMATION ON THE INCOME STATEMENT

### 5.8.15 Breakdown of the result from trading activities and fair value option

(CHF thousands)	2018	2017
Result from trading activities from:		
Foreign currencies	13,210	9,860
Banknote trading	276	3,181
Commodities / precious metals	-336	1,292
Securities trading	-852	393
<b>Total result from trading activities</b>	<b>12,298</b>	<b>14,726</b>

### 5.8.16 Disclosure of material refinancing income in the item Interest and discount income as well as material negative interest

Refinancing income in the item "Result from interest operations"		
Interest and dividend income from trading portfolio is offset with costs of refinancing of that portfolio.		
(CHF thousands)	2018	2017
<b>Negative interest</b>		
Negative interest on assets (decrease in interest and discount income)	182	62
Negative interest on liabilities (decrease in interest expenses)	3,750	3,979

### 5.8.17 Breakdown of personnel expenses

(CHF thousands)	2018	2017
Salaries	53,100	53,191
<i>of which expenses relating to share-based compensation and alternative forms of variable compensation</i>	-	-
Social insurance benefits <sup>1</sup>	18,368	13,078
Other personnel expenses	2,317	2,260
<b>Total personnel expenses</b>	<b>73,785</b>	<b>68,529</b>

### 5.8.18 Breakdown of general and administrative expenses

(CHF thousands)	2018	2017
Office space expenses	5,153	4,992
Expenses for information and communications technology	19,099	17,082
Expenses for vehicles, equipment, furniture and other fixtures as well as operating lease expenses	418	398
Fees of audit firm	569	476
<i>of which for financial and regulatory audits</i>	438	456
<i>of which for other services</i>	131	20
Other operating expenses	10,607	10,411
<i>of which compensation for any State guarantee</i>	-	-
<b>Total general and administrative expenses</b>	<b>35,846</b>	<b>33,359</b>

### 5.8.19 Explanations regarding material losses, extraordinary income and expenses, material releases of hidden reserves, reserves for general banking risks, and value adjustments and provisions no longer required

<b>5.8.19.1 Material losses</b> No material losses were incurred during the financial year.
<b>5.8.19.2 Extraordinary income and extraordinary expenses</b> The extraordinary income of CHF 3.7 million is mainly due to the proceeds from the last portion of the variable component pertaining to the sales price of our participation in Swisscanto Holding AG which was concluded in 2015.
<b>5.8.19.3 Hidden reserves</b> The Bank does not hold any hidden reserve as it discloses its individual financial statements on the basis of the true and fair view principle.
<b>5.8.19.4 Reserves for general banking risks</b> CHF 26 million were deducted from "Changes in reserves for general banking risks" and allocated to reserves for general banking risks.
<b>5.8.19.5 Value adjustments and provisions no longer required</b> There is no relevant information to be provided under this heading.
<b>5.8.19.6 Revaluations of participations and tangible fixed assets</b> There were no revaluations of participations or tangible fixed assets during the financial year.

### 5.8.20 Presentation of current and deferred taxes, and disclosure of tax rate

(CHF thousands)	31.12.2018	31.12.2017
Real estate tax	314	317
Provisions for deferred taxes	-	-
<b>Total taxes</b>	<b>314</b>	<b>317</b>

The Bank is exempt from federal, cantonal and communal taxation. It is subject to real estate taxation.

<sup>1</sup> This increase was brought about by the pre-retirement plan to be carried out over a two-year period (2019 and 2020).

# Auditors' Report



## Report of the auditor

to the Council and to the Cantonal Parliament of the Republic and Canton of Ticino, Bellinzona

### Report on the audit of the financial statements

#### Opinion

We have audited the financial statements of Banca dello Stato del Cantone Ticino, which comprise the balance sheet as at 31 December 2018, income statement, statement of changes in equity and notes for the year then ended, including a summary of significant accounting policies (pages 74-86).

In our opinion, the financial statements as at 31 December 2018 give a true and fair view of the financial position, the results of operations and the cash flow in accordance with accounting rules for banks and comply with Swiss law and the Law on Banca dello Stato del Cantone Ticino.

#### Basis for opinion

We conducted our audit in accordance with Swiss law and Swiss Auditing Standards. Our responsibilities under those provisions and standards are further described in the "Auditor's responsibilities for the audit of the financial statements" section of our report.

We are independent of the entity in accordance with the provisions of Swiss law and the requirements of the Swiss audit profession and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Our audit approach

##### Overview



- Overall materiality: CHF 3.63 million
- We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the entity, the accounting processes and controls, and the industry in which the entity operates.

As key audit matter the following area of focus has been identified:

- Impairment of amounts due from customers and mortgage loans.

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### ***Audit scope***

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we considered where subjective judgements were made; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

### ***Materiality***

The scope of our audit was influenced by our application of materiality. Our audit opinion aims to provide reasonable assurance that the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

<b><i>Overall materiality</i></b>	CHF 3.63 million
<b><i>How we determined it</i></b>	5% of the operating result (result of the period before tax, changes in reserves for general banking risks and extraordinary items).
<b><i>Rationale for the materiality benchmark applied</i></b>	We chose the operating result (result of the period before tax, changes in reserves for general banking risks and extraordinary items) because it is the benchmark against which the performance of a bank is most commonly measured and it is the generally accepted benchmark in the financial industry.

We agreed with the Audit Committee of the Board of Directors that we would report to them misstatements above CHF 181'650 identified during our audit as well as any misstatements below that amount which, in our view, warranted reporting for qualitative reasons.

### ***Report on key audit matters based on the circular 1/2015 of the Federal Audit Oversight Authority***

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



## Impairment of amounts due from customers and mortgage loans

<i>Key audit matter</i>	<i>How our audit addressed the key audit matter</i>
<p>As shown in the note 5.6.2 of the annual report 2018, the Bank grants loans and advances to customers and mortgage loans (82% of total assets or CHF 11'049 million). We consider the valuation of amounts due from customers and mortgage loans that show signs of potential default of debtor or need impairment of the loan to be a key audit matter on the basis of the magnitude of the related balance sheet positions. Moreover, the determination of the amount of any impairment is based on the customer's capacity to repay the amount due and/or the liquidation value of the collateral, both of which may be influenced by subjective factors.</p> <p>The Bank has a control system in place that allows to identify and to analyze the risk of default, to take precautionary measures and to calculate the necessary impairment charges.</p> <p>The accounting and valuation principles for amounts due from customers and mortgage loans and the methods used to identify default risks and to determine the need for impairment are described in the notes to the consolidated financial statements (notes 5.2.3.3, 5.4.1 and 5.5).</p>	<p>We checked and tested the key controls relating to amounts due from customers and mortgage loans:</p> <ul style="list-style-type: none"><li>• controls aimed to identify signs of potential default in order to determine the scope of non-performing and/or impaired loans;</li><li>• controls relating to the calculation of value adjustment including the determination of the market value of the collaterals.</li></ul> <p>In addition, we tested on a sample basis that:</p> <ul style="list-style-type: none"><li>• the risk category given to the selected credit was adequate;</li><li>• the market value of the collateral was determined or updated in accordance with market practice;</li><li>• the impairments were calculated and recorded in accordance with the accounting principles.</li></ul>

## *Responsibilities of the Board of Directors for the financial statements*

The Board of Directors is responsible for the preparation of the financial statements that give a true and fair view in accordance with accounting rules for banks, the provisions of Swiss law and the Law on Banca dello Stato del Cantone Ticino, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors is responsible for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

## *Auditor's responsibilities for the audit of the financial statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Swiss law and Swiss Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if,



individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Swiss law and Swiss Auditing Standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made;
- Conclude on the appropriateness of Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.

We communicate with the Board of Directors or its relevant committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors or its relevant committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors or its relevant committee, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



### ***Report on other legal and regulatory requirements***

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of financial statements according to the instructions of the Board of Directors.

We further confirm that the proposed appropriation of available earnings complies with Swiss law and the company's articles of incorporation. We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers Ltd

A handwritten signature in blue ink, appearing to read 'Glenda Brändli', written over a light blue horizontal line.

Glenda Brändli  
Audit expert  
Auditor in charge

A handwritten signature in blue ink, appearing to read 'Lorenzo Morelli', written over a light blue horizontal line.

Lorenzo Morelli  
Audit expert

Lugano, 28 March 2019

# Board of Directors

at 31.12.2018

## Chairman

Bernardino Bulla

## Deputy Chairman

Carlo Danzi<sup>1</sup>

## Secretary

Raoul Paglia<sup>1,2</sup>

## Members

Marco Fantoni<sup>1</sup>

Giovanni Jelmini<sup>1,2</sup>, attorney

Michele Morisoli<sup>1,2</sup>

Luca Soncini<sup>1</sup>

# Public Mandate Control Commission

at 31.12.2018

## Chairman

Maurizio Agustoni

## Deputy Chairman

Gabriele Pinoja

## Members

Omar Balli

Nicola Brivio

Claudia Crivelli Barella

Pelin Kandemir Bordoli

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<sup>1</sup> Independent members as specified in FINMA Circular 2017/01

<sup>2</sup> Members of the Audit and Risk Committee

# External Auditors as defined by the Swiss Federal Law on Banks and Savings Banks

PricewaterhouseCoopers SA

# Internal Auditors

## **Head of Internal Auditors**

Gabriele Guglielmini

## **Deputy**

Guido Gianetti

## Executive Board

at 31.12.2018

### President of the Executive Board

Fabrizio Cieslakiewicz

### Members of the Executive Board

Daniele Albisetti

Claudio Genasci

Patrick Lafranchi

Gabriele Zanzi

## Members of the Management

at 31.12.2018

### Bellinzona Branch

Domenico Albertoni

Romano Bär  
(until May 2018)

Mauro Bazzotti

Lucamaria Beeler

Enrico Bertozzi

Luca Bordonzotti

Omar Cadola

Dario Caramanica

Medardo Caretti

Curzio De Gottardi

Maurizio Derada

Adolfo Genzoli

Luca Ghiringhelli

Manuel Giambonini

Clio Indemini

Gabrio Lavizzari

Daniele Manzoni

Raffaele Marti

Roberto Meyer

Marco Molteni

Massimiliano Morelli

Roberto Nuschak

Massimo Penzavalli

Ivo Pini  
(until August 2018)

Francesco Pisano

Fiorenzo Poretti

Giulio Ruggeri

Giorgio Sala

Matteo Saladino  
(since December 2018)

Michele Schandroch

Lorenzo Squellati

Norman Stampanoni

Fabrizio Stöckli

Carlo Tomasini

Ferruccio Unternährer

Mirko Zoppi

### Lugano Branch

Roberto Barbera

Gianluca Colpo

Filippo Dotti

Andrea Ferrari  
(until September 2018)

Luigi Longoni

Gabriele Mantegazzi

Alberto Pedrazzi

Carlo Ruggia

Luca Todesco

Jvan Zatta

### Locarno Branch

Boris Ceschi

Fabrizio Conti-Rossini

Verena Gaggetta

Claudio Gnesa

Stephan Mair

Marco Meschiari

Marco Pellanda

Franco Storni

### Chiasso Branch

Maurizio Brenta

Claudio Cereghetti

Mario Grassi

Lorenzo Imperiali

Gilberto Pittaluga

Marco Soragni

## Head Office

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Casella Postale  
**6501 Bellinzona**

## Branches

Corso S. Gottardo 4  
**6830 Chiasso**

Via Naviglio Vecchio 4  
**6600 Locarno**

Via Pioda 7  
**6900 Lugano**

# Agencies

Via Cantonale

**6982 Agno**

**6780 Airolo**

Viale Papio 5

**6612 Ascona**

Via Pini 2

**6710 Biasca**

Via Leoncavallo

**6614 Brissago**

Via Pretorio 3

**6675 Cevio**

**6715 Dongio**

Piazza S. Franscini 5

**6760 Faido**

Largo Libero Olgiati 81a

**6512 Giubiasco**

Via San Gottardo 77

**6596 Gordola**

Via Trevano 97

**6904 Lugano-Molino Nuovo**

**6900 Lugano-Piazza Riforma**

Via Pobiette 1

**6928 Manno**

Via Lavizzari 18

**6850 Mendrisio**

Via Pietro Fontana

**6950 Tesserete**

## ONLINE AGENCY

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Tel 091 803 33 33

agenziavicina@bancastato.ch

c/o Bank Headquarters

## ATM ONLY

Lugano-Agno Airport

**6982 Agno**

San Giovanni Hospital

**6500 Bellinzona**

Piazza Collegiata

**6500 Bellinzona**

Via San Francesco 1

**6600 Locarno-Città vecchia**

Via Emmaus 1

(Cattori Shopping Center)

**6616 Losone**

Civico Hospital

**6900 Lugano**

Via Turconi 23

**6850 Mendrisio**

Via Cantonale 19

**6805 Mezzovico**

Via alle Brere 5

**6598 Tenero**

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