

CHALLENGES AND OPPORTUNITIES FOR THE SAN MARINO FINANCIAL SYSTEM

POSITION PAPER

December 2025



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Challenges and opportunities for the San Marino financial system

Position Paper

“Interventi” Series – No. 7



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ACRONYMS ⁽¹⁾

AA EU	San Marino – European Union Association Agreement
AI	Artificial Intelligence
AMLA	Anti-Money Laundering Authority
AQR	Asset Quality Review (or asset quality review)
BSL	Business Situation Letter (“Lettera di Situazione Aziendale”)
CBSM	Central Bank of the Republic of San Marino (or Supervisory Authority)
EBA	European Banking Authority
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESAS	European Supervisory Authorities: EBA, ESMA, EIOPA, AMLA
ESMA	European Securities and Markets Authority
EU	European Union
FSS	Financial System Strategy or Strategy for the Financial System
IMF	International Monetary Fund
MOU	Memorandum of Understanding
PFS	Protocol on Financial Services, included in the Association Agreement

⁽¹⁾ The acronyms listed above appear in the text in small CAPITAL LETTERS.



1 ABSTRACT

Over the last 15 years, the banking system of the Republic of San Marino has recorded a trend characterized by two opposite dynamics. Up until 2019, exogenous and endogenous factors led San Marino banks to face multiple critical issues with negative repercussions on their respective business conditions, as outlined in the publication “*Data and trends of the San Marino banking system*” ⁽²⁾ by the Central Bank of the Republic of San Marino (CBSM).

Over the following 5 years, thanks to the definition and the implementation of the Financial System Strategy (FSS), as outlined in the aforementioned publication, the technical soundness of the banking system was progressively strengthened, both at the aggregate level and across individual institutions, leading to the current position described in this paper.

In particular, the banking sector, which is the main component of the financial system in terms of significance and impact on the economy, shows good levels of liquidity and capitalization (both at the aggregate level and across individual intermediaries), adequate profitability, governance updated according to the highest European quality standards, with significantly improving asset quality.

In the process described, the CBSM, the sole Supervisory Authority for the San Marino financial system, played a leading and coordinating role in the activities of the various stakeholders, in line with its objectives of pursuing system stability and protecting savings, as set forth in its Statute, established by Law 96/2005.

The transparent approach adopted in implementing the FSS, involving all key stakeholders, has led to significant results, as described in this position paper. However, the improvement process is not yet complete, and the San Marino financial system continues to face evolving challenges. Firstly, the initiatives aimed at significantly reducing critical weaknesses, primarily stemming from non-interest-bearing or low-yield assets, must be brought to completion (see paragraphs 6.3 and 11). Secondly, the financial system must strengthen its preparedness across all sectors. This would not only ensure full alignment of processes, procedures, and operating practices with the European regulatory framework, but also enable the system to compete in a broader and more complex competitive landscape, which also offers new opportunities arising from the European integration process envisaged under the Association Agreement.

In this context, similarly to the previous 2019 publication, in this paper the Supervisory Authority also outlines the path to be taken and the activities to be implemented, including policy recommendations that CBSM, in accordance with its institutional functions, brings to the attention of the competent institutional bodies of the Republic of San Marino.

⁽²⁾ <https://www.bcsml.sm/publicazioni-e-statistiche/collana-interventi>



2 INTRODUCTION

Six years after publishing its strategic analysis of banking sector dynamics in April 2019, the CBSM has updated its study by extending the scope of assessment to the entire financial system.

This document sets out the current and prospective challenges and opportunities to be addressed in an ever-evolving geopolitical scenario, particularly in the context of the forthcoming implementation of the Association Agreement with the European Union (AA EU).

Since the previous publication, which marked the launch of the new communication policy promoted by the CBSM Governance in line with best practices in transparency and accountability, several developments have taken place. The FSS outlined in 2019 has been largely implemented, fostering a substantial strengthening of the technical profiles of the system and intermediaries.

At the same time, CBSM has intensified the production of international statistics for supranational bodies (such as the International Monetary Fund and the European Central Bank) as well as publications on the performance of the financial sector. In this context, it introduced the Quarterly Bulletin, which provides data on the financial system as well as on the activities carried out by the CBSM in the exercise of its statutory functions ⁽³⁾.

In the context described and in line with the existing strategy, this position paper – following the structure of the 2019 publication – outlines the degree of implementation of the FSS, provides a comprehensive overview of the current state of public accounts as well as of the financial system, based on data from the various sectors and a comparative analysis with the Italian banking sector. Furthermore, it identifies the challenges and opportunities that may emerge from the Association Agreement with the European Union and concludes with the CBSM's position on possible strategic directions for the development of the financial system, together with the corresponding policy recommendations.

⁽³⁾ <https://www.bcsmsm/pubblicazioni-e-statistiche/bollettino-informativo-trimestrale>



3 THE DEGREE OF IMPLEMENTATION OF THE STRATEGY FOR THE FINANCIAL SYSTEM

3.1 The Financial System Strategy (FSS)

The FSS was defined in early 2019, against a backdrop of significant challenges affecting the financial system, and in particular the banking sector. The internal and external drivers of such challenges and their impact on the technical profiles of intermediaries and the sector as a whole, were comprehensively described in the aforementioned publication "*Data and trends of the San Marino Banking System*" (see note 2), to which reference is made for details.

In this regard, it should be noted that the formalization and implementation of the FSS was a system initiative, in which the various stakeholders (Government, Central Bank and intermediaries making up the banking sector) participated in a coordinated manner, with the technical assistance of the IMF, which had recommended its adoption.

The FSS initially focused on the banking sector due to its predominant size within the financial system, but also due to its importance to the San Marino economy through its credit granting function.

Furthermore, in the development of the FSS, a number of initiatives were identified. Some of them could be implemented autonomously by the CBSM, while others required the involvement of the institutional bodies of the Republic (Government and Great and General Council), and were therefore framed as policy recommendations.

The following paragraphs illustrate the level of implementation of the two components of the strategy, highlighting how the improvement in the technical profiles of the banking sector is an expression of the effectiveness of the FSS, which in turn is the result of the synergistic action of all the stakeholders involved.

Experience has shown that the first concrete step in implementing the FSS was its publication on the CBSM website. This choice was not only consistent with international best practices in transparency and accountability, but also instrumental in ensuring that all stakeholders could become familiar with the Strategy and apply it in an informed and effective manner, as indeed occurred.

3.2 Strategic initiatives implemented by the Central Bank

The first component of the FSS under the CBSM's remit is the **disclosure of the results of the Asset Quality Review** (AQR), which triggered a series of subsequent supervisory interventions, although it took place in December 2018, before the strategic guidelines were published.

The AQR, intended as a statistical exercise of a prudential nature, was developed during 2016 and updated during 2017, but never officially communicated to banks until the establishment of the new CBSM Governance and the renewed strengthening of Supervision, which took place



starting in 2018. In this context, it was evident that the non-disclosure of the AQR prevented banks from fully understanding the implicit risks in their loan portfolios, thereby limiting their ability to mitigate them effectively.

Transparency regarding numerical results and credit positions requiring major adjustments was the necessary prerequisite for a new supervisory approach through the integrated analysis of the various relevant technical profiles (capital adequacy, asset quality, governance-organization, profitability, liquidity, and risk sensitivity). The findings were formalized through Business Situation Letters (BSLs) addressed to each intermediary, containing requests for resolution and mitigation plans for the critical issues identified.

A second area of intervention, closely related to the first and also addressed within the BSLs, was the **assessment of capital adequacy**. The impact analyses carried out as part of the AQR, and the consequent increase in credit loss provisions, represented potential risks to both current and prospective capital adequacy where such amounts could not be absorbed by the intermediary's capital position. CBSM therefore initiated supervisory dialogue with individual institutions in order for them to present prospective capital needs, requiring the submission of specific recapitalization plans. These plans were expected to set out in detail, and within a clearly defined timeline, all measures available to the bank to restore full prospective capital adequacy in line with applicable prudential requirements, including those relating to calendar provisioning.

In cases where the capital requirement was so large that the bank could not address it on its own, CBSM initiated a second supervisory dialogue with the controlling shareholders to facilitate their synergistic action through capital strengthening measures that could support and amplify the bank's own actions – including the issuance of hybrid or subordinated financial instruments, reduction of capital-intensive asset components, increased earning capacity, etc.

As a result of the interventions launched, the banking institutions improved their capital adequacy in the reference period (2019 – 2025), all reaching a level above the minimums required by supervisory regulations.

A third area of intervention, also included in the BSL, was the **restoration/strengthening of income generating capacity**. This was particularly important not only for its positive effects in terms of supporting capital adequacy through the provision of undistributed profits (as in some cases specifically requested by the Supervisory Authority in the five-year period in question), but also for its primary function of supporting the development of the intermediary as a whole.

In the BSLs sent to intermediaries, CBSM highlighted, where necessary, weaknesses in the income flow and the resulting need for corrective action, targeting either the cost side (to be reduced) and/or the revenue side (to be consolidated and expanded). The initiatives, urged by CBSM and carried out by the intermediaries, together with the interest rate dynamics recorded



over the last three years, have allowed the banking sector to achieve an aggregate profit at the system level since 2021 and from the following year (2022), to restore the earning capacity of all banks. These two trends, both at the aggregate level and for individual intermediaries, have also been confirmed in subsequent years.

Two specific areas of intervention reported in the BSLs (NPL **stock reduction** and **system-wide initiatives**) can be unified in the analysis, as they were initiated in close correlation. Indeed, the reduction of the high level of non-performing loans (NPLs) was initiated precisely through a system-wide initiative, which initially involved the CBSM, the Government, and the Great and General Council for the enactment, in 2021, of a specific law on securitization. Subsequently, in full compliance with the legislative provisions, banks with high NPL levels cooperated to define and initiate the transfer of a large portion of their NPLs from their assets to the system-wide vehicle responsible for their management. This initiative, which led to a significant reduction in bad loans in the banking sector, will be discussed in detail in the chapter dedicated to system-wide securitization.

Improving **intermediary governance** is a key factor within the FSS framework for banks to identify concrete and sustainable development paths. As such, it has been initiated as a priority, as it is instrumental in the structural consolidation of technical balances, thus preventing the recurrence of past critical issues but also ensuring stability for the entire credit system.

Governance initiatives included both a general strengthening of requirements for corporate officers and specific supervisory initiatives to address critical situations within individual intermediaries. Regarding the first aspect, the process began with a self-assessment exercise required of intermediaries against European standards (so-called Fit&Proper). In 2020, based on the results of the assessment, regulations aligned with European standards were issued.

During the same period, the Supervisory Authority also intervened in specific situations by activating the tools permitted by current regulations for the purpose of removing officers unable to ensure the sound and prudent management of the intermediary, that is to facilitate the turnover of banks' administrative and supervisory bodies.

The FSS also included measures to improve the regulatory framework and the strengthening of supervision and international cooperation. With regard to the first, please refer to the specific descriptions that are reported on a quarterly basis in the CBSM Bulletins regarding the process of continuous updating of the legislative and regulatory framework in financial matters ⁽⁴⁾.

Regarding **strengthening supervision and international cooperation**, the CBSM governance first implemented a plan to consolidate senior supervisory positions, which was concluded in 2020, restoring previous levels of functional coverage and operational efficiency. International cooperation, on the other hand, was the subject of specific interventions detailed in a specific

⁽⁴⁾ <https://www.bcsml.sm/pubblicazioni-e-statistiche/bollettino-informativo-trimestrale>

action plan launched in 2023, which led to new and more effective forms of technical cooperation and information exchange, not only through MOUs, increased from 3 to 8 as at the date of publication of this report, but also through agreements based on a ‘case-by-case’ approach that allow for effective information exchange even in the absence of specific MOUs in place.

3.3 The implementation status of CBSM policy recommendations

The first policy recommendation suggested within the framework of the FSS by CBSM was the **raising of external financial resources**, capable of supporting the reform and consolidation processes of the banking system. The recommendation was accepted by the Government through the issuance of a specific bond on the Euromarket in 2021, for a total of 340 million and its rollover in 2023. The foreign debt initiated with these issues, in relation to which further information will be provided in the following chapters, enabled the Government to secure the liquidity required to intervene in the financial system, in particular by injecting liquidity into the system's main bank, owned by the State.

Again, with reference to the same intermediary, the Great and General Council issued Law No. 223 of 2020 to proceed with the conversion of the accounting item recorded in the bank's assets representing public debt amounting to 455 million of nominal value into perpetual securities (so-called Article 5-ter). This action implemented the second CBSM recommendation, regarding the **resolution of technical issues regarding the quality of the assets** of the system's main bank.

Law no. 154 of 2021 (Provisions on Civil Procedure and Law) introduced regulatory amendments designed to improve the effectiveness of procedures for creditors' recovery of collateral assets, in line with a further recommendation included by CBSM in the FSS. The potential benefits of the introduced rules may take years to be fully evaluated and measured, even with objective time indicators such as reduced asset recovery timelines. Nevertheless, the reform is moving in the right direction, as it aims to enhance credit risk management practices, including in the more critical stages of imminent or declared debtor insolvency.

At present, some recommendations remain not fully implemented, although they are the subject of discussion at a technical level. These include recommendations involving greater implementation complexity (such as the transformation of tax credits into transferable assets), a longer time horizon (for example, the development of asset management), or those superseded by supervisory initiatives that have reintroduced, from a prudential perspective, effects not fully reflected at the accounting level (such as the immediate recognition of AQR adjustments in supervisory capital).

3.4 Conclusions: How the FSS contributed to improving technical profiles



The framework outlined in the previous paragraphs highlights how the FSS, made public and accessible from the outset, has been largely implemented. The effects have been tangible and long-lasting, as will be noted in the following paragraphs of this document.

Specifically, external liquidity has improved the performance of individual banks and the sector as a whole. Specific capital strengthening and cost reduction plans have brought all banks back to full compliance with prudential requirements and sustained, widespread profitability. The governance of individual banks has also been improved in certain specific situations, and the minimum qualifications for appointment as corporate officers have been raised. Last but not least, the asset quality of individual banks (the country's largest bank) and the sector as a whole has been improved through specific regulatory measures and a system-wide initiative (securitization), which will be discussed in greater detail later in this paper.

Overall, there are still areas for improvement (e.g., greater development of asset management and the issue of tax credits), a clear sign that the FSS will need to continue to be implemented, also in light of the challenges that will emerge from the Association Agreement, for its full implementation in a context of European integration.



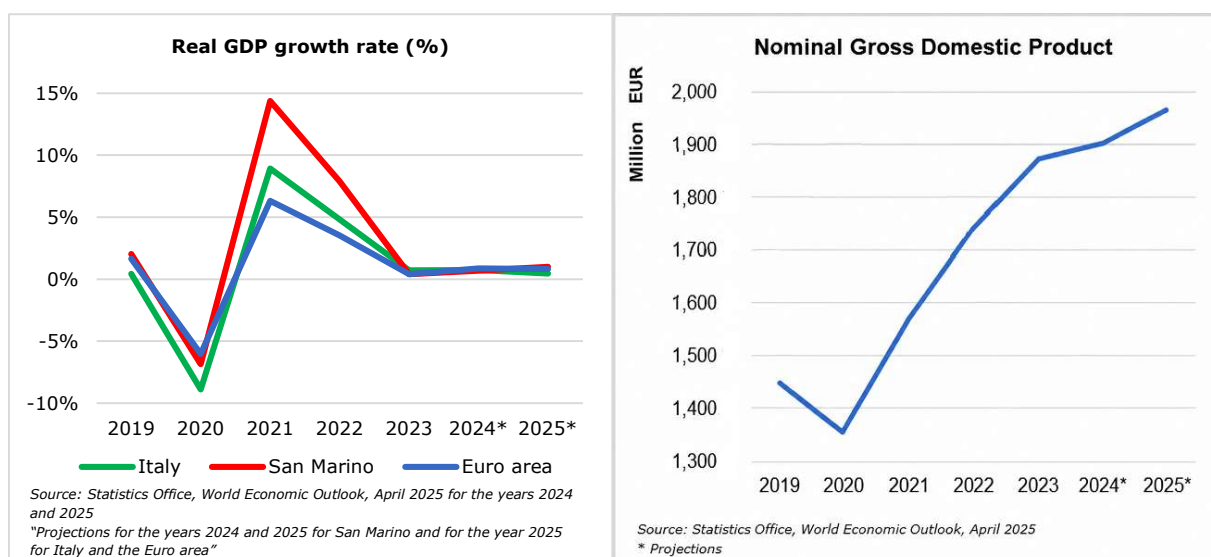
4 THE TREND OF THE ECONOMY AND THE STATE OF PUBLIC ACCOUNTS

After a sharp slowdown in 2020, caused by the spread of the COVID-19 epidemic and the resulting measures adopted to contain the virus, San Marino's economy recorded strong growth the following year, driven primarily by manufacturing and trade, placing it among the most dynamic among advanced economies that year.

The sustained growth rate continued in 2022, then stabilized in the following years at positive values, with real GDP, based on the latest available data, estimated to increase by 0.7% and 1%, respectively, in 2024 and 2025 (estimated at nominal values at EUR 1,907 million and EUR 1,966 million respectively, a significant increase compared to EUR 1,444 million at the end of 2019).

The manufacturing sector is the one that contributes most to the creation of added value (equal to over 1/3) also in terms of foreign trade, followed by wholesale and retail trade (15% at the end of 2023).

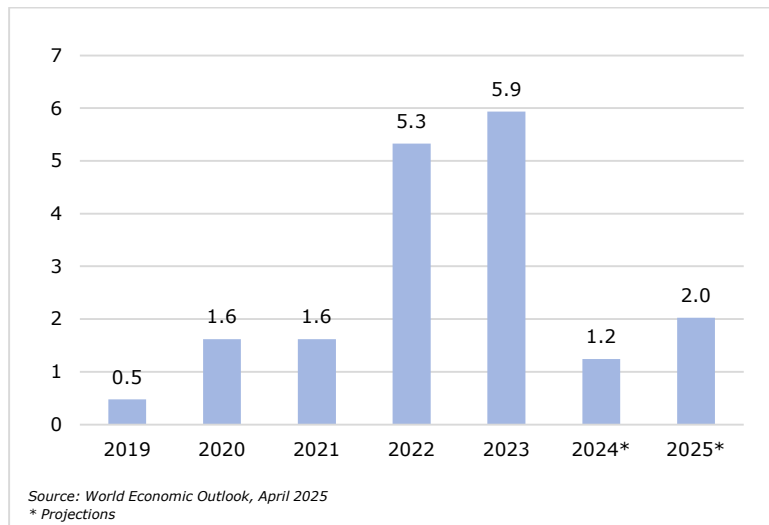
Figure 1– Trend of Gross Domestic Product (GDP)



After years of moderate price growth, supply-side tensions resulting from the pandemic and the Russian-Ukrainian conflict have led to sharp inflation since 2022, with consumer price growth expected to reach 5.3% in 2022 and 5.9% in 2023. Estimates for 2024 and 2025 show a decline in consumer price growth to 1.2% and 2%, respectively.

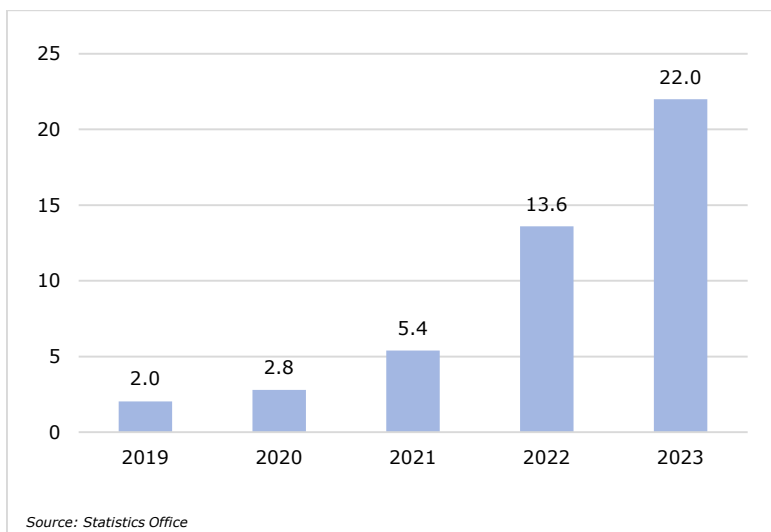


Figure 2– Inflation (annual % change)



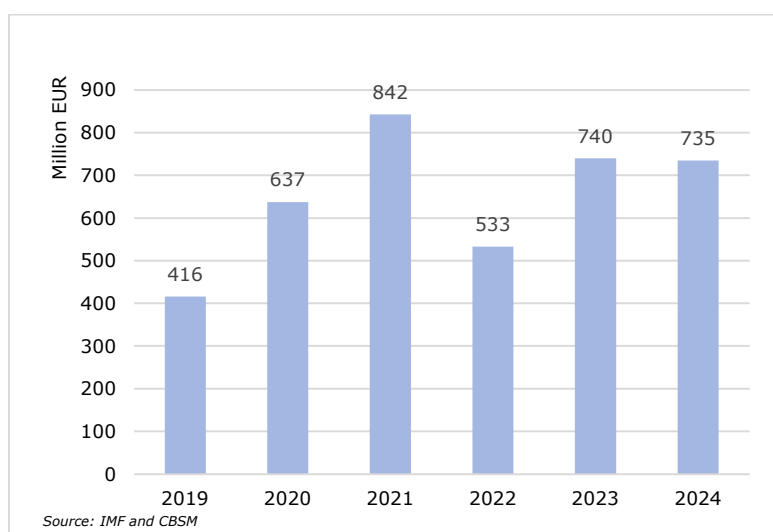
Since 2019, the current account balance as a percentage of GDP has shown an increasing trend, from 2% to 22% from 2019 to 2023, supported by the increasing trend in the trade balance (exports – imports) throughout the period under review.

Figure 3 – Current account balance (% GDP)



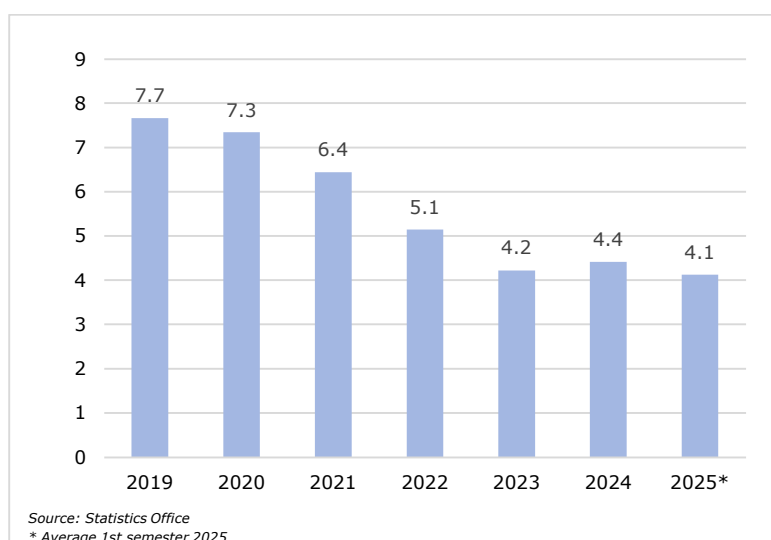
Reserve assets, consisting primarily of readily marketable foreign financial instruments and the Central Bank's deposits abroad, as well as International Monetary Fund (IMF) Special Drawing Rights and the IMF's reserve position, stood at 735 million at the end of 2024, essentially stable compared to the same figure of 740 million the previous year. The value of foreign reserves at the beginning of the period under review was 416 million, and the trend is largely influenced by the performance of bank and public administration deposits.

Figure 4 – Foreign reserves



In the period under review, the average annual total unemployment rate decreased from 7.7% in 2019 to 4.4% in 2024, lower than the unemployment rate recorded in the Eurozone (20 countries) which stood at 6.4% ⁽⁵⁾ and in Italy equal to 6.5% ⁽⁶⁾. The average figure for the first half of 2025, equal to 4.1%, highlights a further improvement in the indicator's downward trend.

Figure 5 – Unemployment rate (% values - annual average)



The ratio of public debt to nominal GDP has shown a downward trend since 2020, reaching 63.5% at the end of 2024. Estimates for 2025 indicate a further decline to 57.3%.

The public debt figure includes, among other things, the following bond issues of the Republic of San Marino placed, for the first time in 2021, on international markets: RSM 3.25% gross

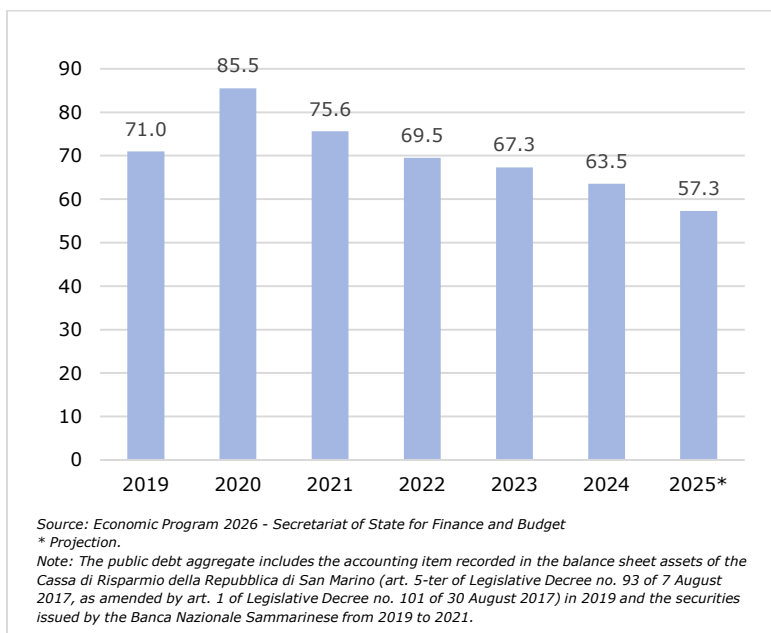
⁽⁵⁾ Source: oecd.org

⁽⁶⁾ Source: oecd.org



annual coupon, issued on February 24, 2021 and maturing on February 24, 2024, with a nominal value of 340 million. RSM 6.25% gross annual coupon, issued on May 19, 2023 and maturing on January 19, 2027, with a nominal value of 350 million.

Figure 6 – Public debt (% GDP)



The government's revenue-expenditure balance for 2024 (based on the preliminary outturn estimate) is expected to be -14 million, down from the -18 million figure for 2023. Excluding interest payments, the primary balance is expected to be positive by 25 million in 2024, compared to 24 million in 2023. For 2025, the revenue-expenditure balance is expected to be -17 million (24 million net of interest payments).

Table 1– State budget indicators

	2019	2020	2021	2022	2023	2024 forecast (change)	2024 budget hypothesis	2025 forecast
Revenue	323	292	324	384	393	406	400	417
Tax revenues	233	196	251	295	305	326	313	338
Non-tax revenue	90	96	73	89	88	80	87	80
Expenses	321	353	392	377	411	425	414	435
Primary expenses	316	340	362	355	369	385	375	393
Payment of interest	5	13	30	22	42	40	39	42
Balance	2	-61	-67	7	-18	-19	-14	-17
Primary balance	7	-48	-37	30	24	21	25	24

Source: Economic Program 2026 - Secretariat of State for Finance and Budget

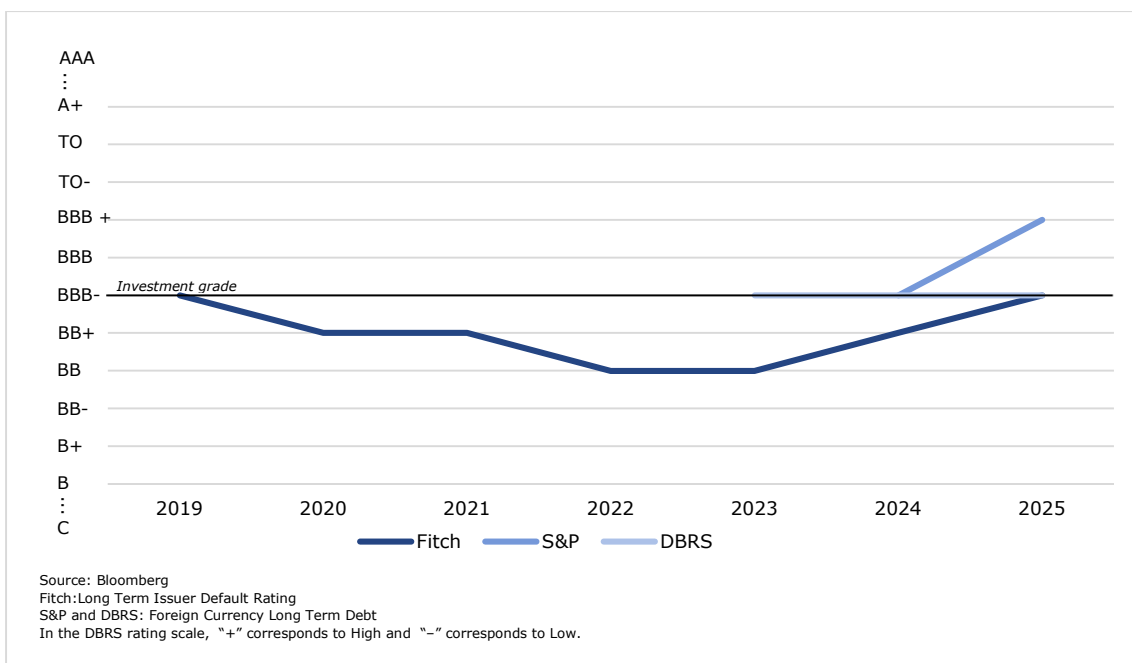
The rating for the Republic of San Marino, after a phase of downgrades by the Fitch agency up to BB, was upgraded to BB+ in 2024. In June of the following year the outlook was improved to



positive and in December 2025 the rating was raised to BBB-, therefore to the *investment grade level*, with a positive outlook.

The *investment grade* rating was assigned to the Republic of San Marino by both DBRS Morningstar at the end of 2023 (BBB Low, with the trend improving to positive at the end of 2025) and by Standard & Poor's in 2024 (BBB-). The latter agency upgraded the rating to BBB+ in 2025.

Figure 7 – Rating for the Republic of San Marino (recorded at the end of the year)



5 THE STRUCTURE OF THE FINANCIAL SYSTEM

As of July 31, 2025, the Register of Authorized Parties includes 12 Sammarinese financial companies and 51 foreign financial companies authorized to carry out reserved activities under the Provision of Services Without Establishment (PSSS) regime.

Table 2 – Authorized entities

Authorized parties – SM financial institutions	2019	2020	2021	2022	2023	2024	31/07/2025
Banks	5	5	4	4	4	4	4
<i>Number of branches</i>	36	34	32	32	32	32	32
Financial/fiduciary companies	2	1	1	1	1	1	1
Investment firms	0	0	0	0	0	0	0
Asset management companies	3	3	3	3	3	3	3
Insurance companies	2	2	2	1	1	1	1
Payment institutions/EMIs	1	1	1	1	2	3	3
Total	13	12	11	10	11	12	12
Authorized parties - Foreign financial institutions	2019	2020	2022	2022	2023	2024	31/07/2025
Banks	0	0	0	0	1	1	1
Financial/fiduciary companies	0	0	0	0	1	1	1
Insurance companies	0	0	0	0	0	46	46
Payment institutions/EMIs	0	0	1	2	3	3	3
Total of foreign financial institutions	0	0	1	2	5	51	51

In the period between the end of 2019 and the end of July 2025, the number of financial companies in San Marino decreased by one unit, going from 13 to 12, due to:

- the cancellation of a fiduciary company due to the renunciation of the exercise of reserved activities which occurred in 2020.
- the conclusion of the resolution procedure of Banca Nazionale Sammarinese SpA (formerly Banca CIS SpA) registered in 2021 with consequent cancellation of the same from the Register of Authorized Parties.
- the compulsory administrative liquidation measure (pursuant to art. 85 of the LISF) taken in 2022 against an insurance company.
- the registration in the Register of Authorized Entities (in 2023 and 2024) of two payment institutions/EMIs.

Over the same period, also in line with commitments to streamline the commercial network and reduce costs, the number of bank branches decreased from 36 in 2019 to 32 in 2024.

With regard to foreign financial institutions, in 2024, 46 insurance companies were registered in the Register of Authorized Parties, 45 of which were already registered in the previous "List

of foreign insurance companies authorized to conclude insurance contracts in San Marino" of the repealed Regulation no. 2007-02.

Furthermore, the following foreign financial companies are registered in the Register of Authorized Entities:

- a bank authorized in 2023 exclusively to carry out the reserved activity referred to in letter B of Annex 1 of the LISF.
- a finance company authorized in 2023 exclusively to grant financing in the form of car leasing.
- three payment institutions/EMIs authorized in 2021, 2022 and 2023.



6 THE SAN MARINO BANKING SECTOR

6.1 Introduction

For the purposes of this analysis, the following data refer to the individual sectors of the financial system as a whole, and therefore do not represent the situation of all the individual institutions that make up the sector, but only their aggregation, with inevitable offsetting phenomena between values.

In the period 2019–2024, the banking system was impacted by significant external and internal events that affected the structure of the sector, its technical profiles, and the dynamics of intermediated volumes, including:

- the health crisis resulting from the COVID-19 pandemic, which, among other things, led to significant uncertainty in the macroeconomic framework and financial markets in 2020.
- the issuance, pursuant to Law 223/2020, of perpetual public debt securities with a nominal value of 455 million, reserved for Cassa di Risparmio della Repubblica di San Marino SpA for the conversion of the accounting item recorded in the assets of the aforementioned bank (Article 5-ter of Legislative Decree no. 93 of 7 August 2017, as amended by Article 1 of Legislative Decree no. 101 of 30 August 2017).
- the completion of the resolution procedure of Banca Nazionale Sammarinese SpA (BNS) which took place in 2021.
- the Russia–Ukraine conflict, which began in 2022, contributed to a sharp rise in inflation and interest rates, which remained at elevated levels throughout much of 2022 and 2023.
- the transfer of NPLs for approximately 118 million (311 million gross of write-downs) to the System Vehicle through the completion of the securitization transaction which took place in December 2023.

6.2 Total assets, direct deposits and assets under administration and assets under management of the banking system ⁽⁷⁾

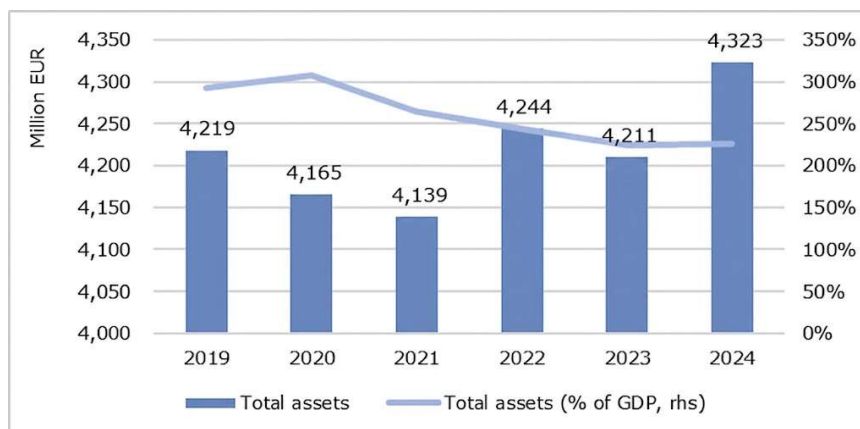
As of December 31, 2024, total assets of the banking system stood at EUR 4,323 million, an increase of 105 million (+2.5%) compared to 2019. In particular, the aforementioned aggregate decreased in 2020 (-1.3%), 2021 (-0.6%) and 2023 (-0.8%) and increased in 2022 (+2.5%) and 2024 (+2.7%).

⁽⁷⁾ Source: Supervisory reports “Balance sheet data” and “Financial report on the activities carried out and on the performance of the financial system”, various years.



In the period under review, despite the increase in total assets of the banking system, the ratio of this amount to nominal Gross Domestic Product decreased from 292% in 2019 to 227% in 2024.

Figure 8 – Total assets of the banking system



The trend in direct deposits shows a substantial stabilization of the amount. In particular as at 31 December 2024 it stood at 3,716 million, an increase of 85 million (+2.3%) compared to the figure at the end of 2019, equal to 3,631 million.

In the period under review, the incidence of direct deposits by non-residents on total direct deposits decreased from 15% to 9%.

Figure 9 – Direct deposits, assets under administration and assets under management



Assets under administration in the period under review show an increasing trend, reaching 2,774 million at the end of 2024 compared to 1,617 million at the end of 2019, an increase of 1,157 million (+71.6%).

This trend is influenced, among other things, by further investments in customer financial instruments, by the increase in assets held by open-ended mutual funds managed by



management companies and the resulting increase in custodian banking activity, as well as by the issuance of securities held in custody attributable to the system securitization transaction.

6.3 Asset quality and capitalization

The incidence of interest-bearing assets⁽⁸⁾ on the total assets of the banking system has recorded significant progress in recent years. In particular, a first significant improvement of 12 percentage points occurred between 2019 and 2020 (from 51% to 63%) thanks, mainly, to the conversion at the end of 2020 of the accounting item recorded in the balance sheet assets of Cassa di Risparmio della Repubblica di San Marino SpA (art. 5-ter of Legislative Decree 7 August 2017 n.93, as amended by art. 1 of Legislative Decree 30 August 2017 n.101) - excluded from interest-bearing assets at the end of 2019 - with perpetual public debt securities for 455 million, accounted for at nominal value, recorded at the end of 2020⁽⁹⁾. Adopting the IMF valuation metric, which entirely excludes non-performing loans amounting to 128 million at the end of 2024, the ratio of interest-bearing assets to total assets stands at 74% at the end of the period under review, i.e., at the end of 2024.

The non-interest-bearing components of the assets also include:

- assets acquired by the bank resulting from debt collection activities amounted to 196 million at the end of 2024, an increase of 50 million compared to 2019 (146 million).
- The amount of AQR provisions which, pursuant to Article 40 of Law No. 173/2018, are recognized in the income statement over a maximum period of five financial years, subject to any changes to the deadline authorized by the Central Bank and provided for in paragraph 2 of the aforementioned Law. The amount of the aforementioned provisions not recognized in the income statement, although already fully deducted from regulatory capital, and deferred to subsequent years, stands at 24 million as of December 31, 2024, a decrease of 29 million compared to the end of 2019.
- Tax credits for deferred tax assets⁽¹⁰⁾ and the tax credits connected to the acquisition of assets and liabilities of banking intermediaries in crisis starting from 2011 which amount to 109 million and 137 million respectively as of 31.12.2024. The aforementioned components were, respectively, equal to 112 million and 213 million at the end of 2019⁽¹¹⁾.
- ABS Junior issued in 2023 by system securitization, held by banks directly and indirectly through closed-end funds established pursuant to specific legislative

⁽⁸⁾ The interest-bearing assets are calculated by adding the loans to customers and banks, net of NPLs (IMF metric), to the financial instruments portfolio, net of ABS Junior issued by the system securitization held directly and indirectly through closed-end funds established pursuant to specific legislative provisions.

⁽⁹⁾ During 2025, 55 million were repaid and therefore the residual amount of the aforementioned perpetual securities amounts to 400 million.

⁽¹⁰⁾ The amount also includes deferred tax assets related to Legislative Decree no. 112/2007.

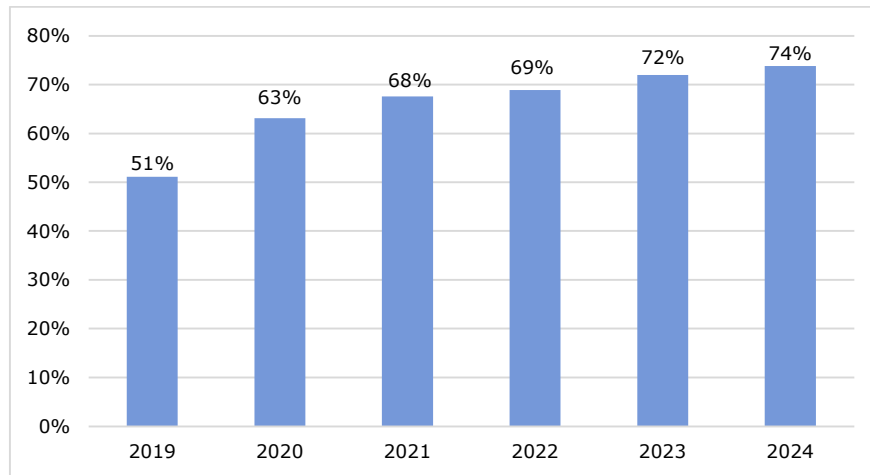
⁽¹¹⁾ The decrease in tax credits associated with the acquisition of assets and liabilities of distressed banking intermediaries is mainly due to the BNS' exit from the banking system and its transformation into an Asset Management Company formerly known as BNS SpA (SGA).



provisions amounted to 33.6 million as of December 31, 2024 and 36.9 million in the previous year.

- NPLs for 128 million.

Figure 10 – Share of interest-bearing assets in total assets



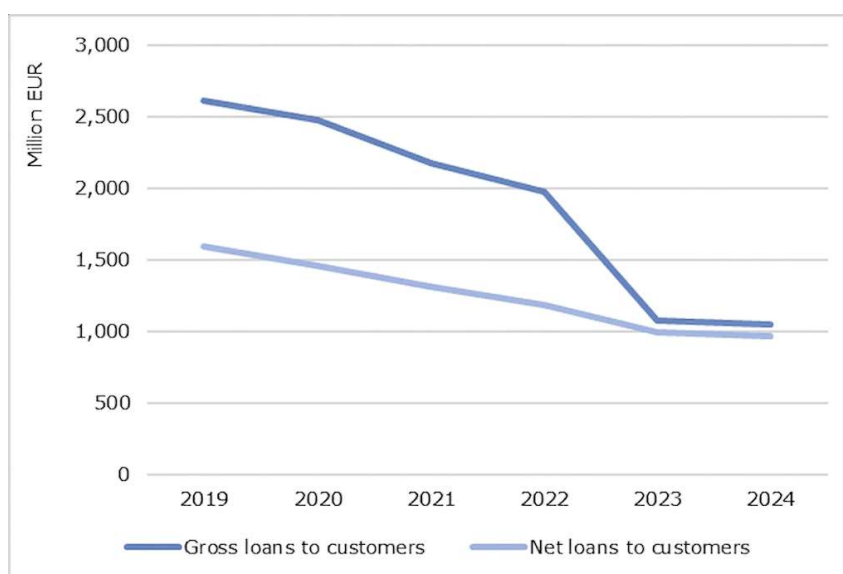
With regard to loans, it should be noted that the new classifications as defined in Article I.I.3 of CBSM Regulation No. 2016-02 for the purpose of harmonizing the credit taxonomy with EU technical standards came into force on 1 January 2024.

Among other things, new definitions of credit exposures have been introduced, some pre-existing credit quality classifications (doubtful loans, problem loans, unsecured loans to countries at risk) have been eliminated, and new classifications have been introduced (including NPLs and unlikely to pay).

Gross customer loans at the end of 2024 stood at 1,043 million, down 1,565 million (-60%) compared to the same figure of 2,609 million in 2019.



Figure 11 – Loans to customers



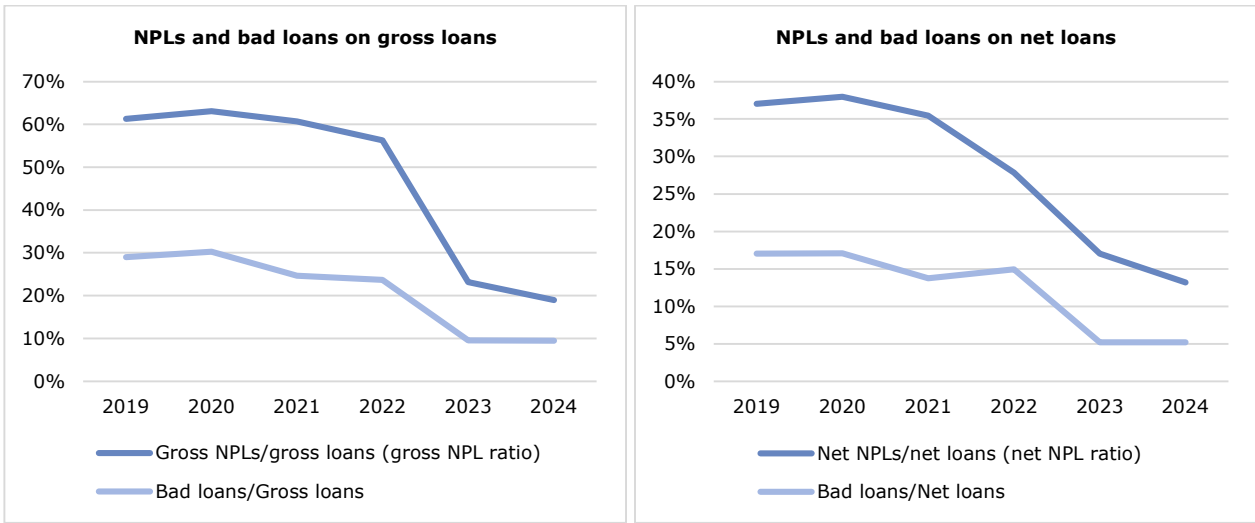
The decrease is primarily due to loan write-offs, particularly those carried out in 2023 by a bank on already fully written-off NPLs. The aforementioned aggregate was also affected by the deletion of the BNS from the Register of Authorized Entities in 2021, resulting in the exclusion of that bank's data from the system's scope, as well as certain securitization transactions, including the System Securitization carried out in 2023 and loan repayments (net of new concessions).

In the same period, net loans to customers decreased by 624 million (-39%), from 1,591 million in 2019 to 967 million in 2024.

The NPL ratio before write-downs decreased from 61.3% in 2019 to 19% in 2024, after reaching a peak of 63.1% in 2020.

Over the same period, the ratio of bad loans to total loans before write-downs fell from 29% to 9.5%, also reaching a peak in 2020 of 30.3%.

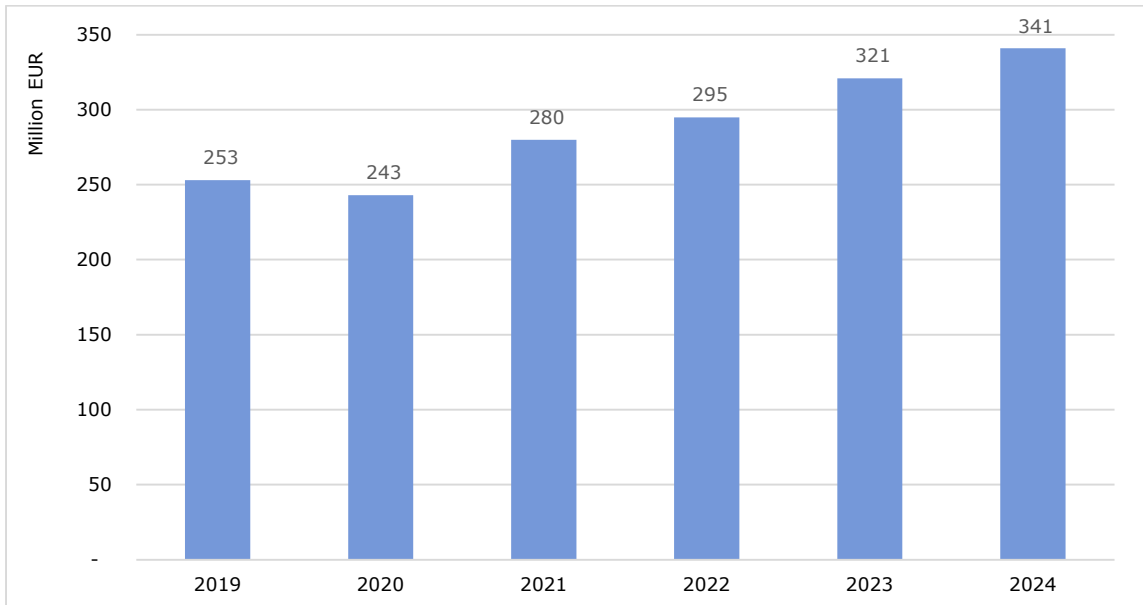
Figure 12 – NPLs and bad loans on gross and net loans



Net of write-downs, the NPL ratio decreased from 37% in 2019 to 13.2% in 2024, peaking at 38% in 2020. Over the same period, the ratio of bad loans to total loans fell from 17% to 5.2%.

In the period under review, the net result of the banking system, equal to 253 million in 2019, after a 4% decrease (-10 million) recorded in 2020, recorded an increasing trend in the following four years until reaching the maximum level in 2024, equal to 341 million, an increase of 88 million compared to 2019 (+34.8%).

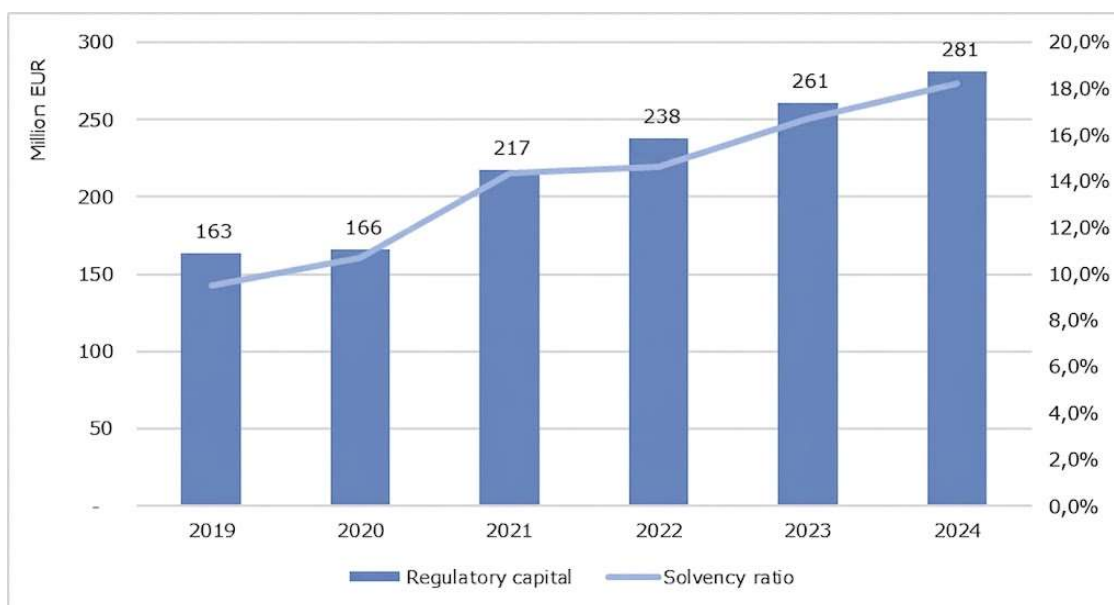
Figure 13 – Net capital



banking system's regulatory capital shows an increasing trend in the period under review, going from 163 million in 2019 to 281 million in 2024.

The solvency ratio, determined by dividing regulatory capital by risk-weighted assets for debtor default risk, was below the regulatory limit of 11% in 2019 and 2020 (9.5% and 10.7%, respectively), and increased significantly in the following years, reaching 18.2% at the end of 2024.

Figure 14 – Regulatory capital and solvency ratio



With regard to prudential requirements, it should be noted that starting from the 2024 financial year, the supervisory expectations for minimum coverage of non-performing exposures pursuant to CBSM Circular 2023-01 will apply to loans granted until 2023, as well as the missing capital coverage for non-performing loans pursuant to Article VII.III.11 of Regulation No. 2007-07 for loans granted from 2024.

6.4 Profitability

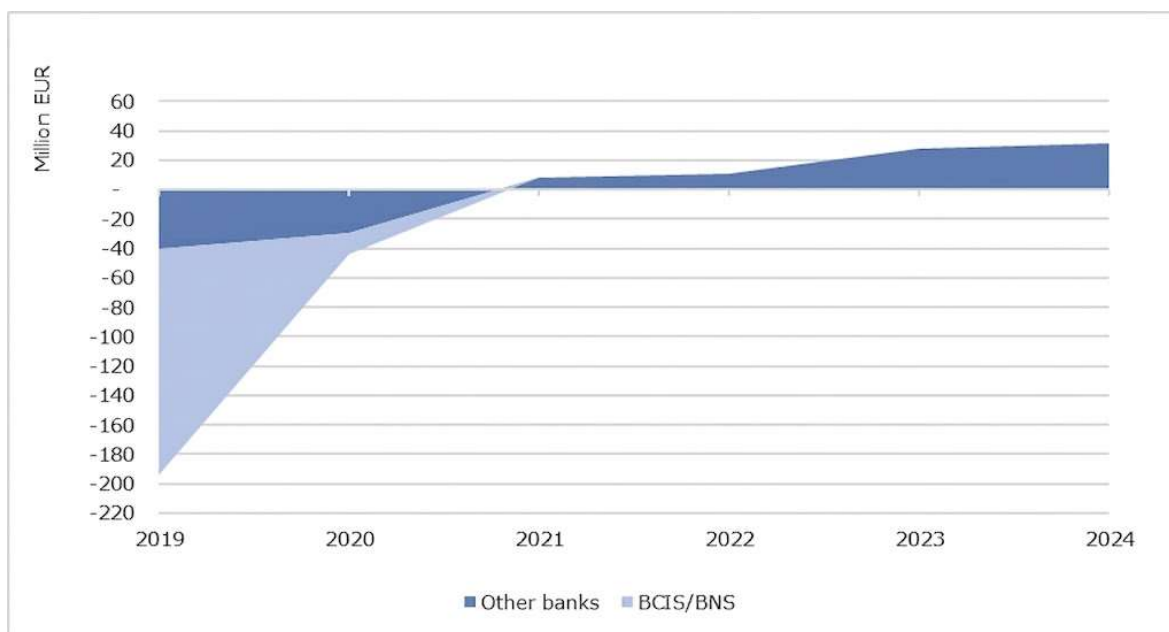
The banking system's net result showed losses of 194 million and 44 million in 2019 and 2020, respectively, mainly due to write-downs made to Banca CIS SpA's assets during the extraordinary administration procedure and subsequent resolution process, as well as losses recorded by Cassa di Risparmio della Repubblica di San Marino SpA.

After 11 years of uninterrupted losses, the banking system's net result returned to positive and resumed growth in 2021, with net profits of 8 million in 2021, 11 million in 2022, 28 million in 2023, and 31 million in 2024.

The improvement in the net result is determined, among other things, taking into account what has already been indicated for the years 2019 and 2020, by the positive effects on the interest margin resulting from the increase in market rates, which increased from the second half of

2022 with a peak in the second half of 2023 (and decreased from then on), as well as by the reduction in operating costs.

Figure 15 – Net result



The profitability trend and the reduction of administrative expenses have contributed to improving the *cost-income ratio indicator* (ratio between operating costs and gross operating income, both net of the capital portion of leasing fees) which went from 109.1% in 2019 to 56.7% in 2024, reaching a low of 52.9% in 2023.

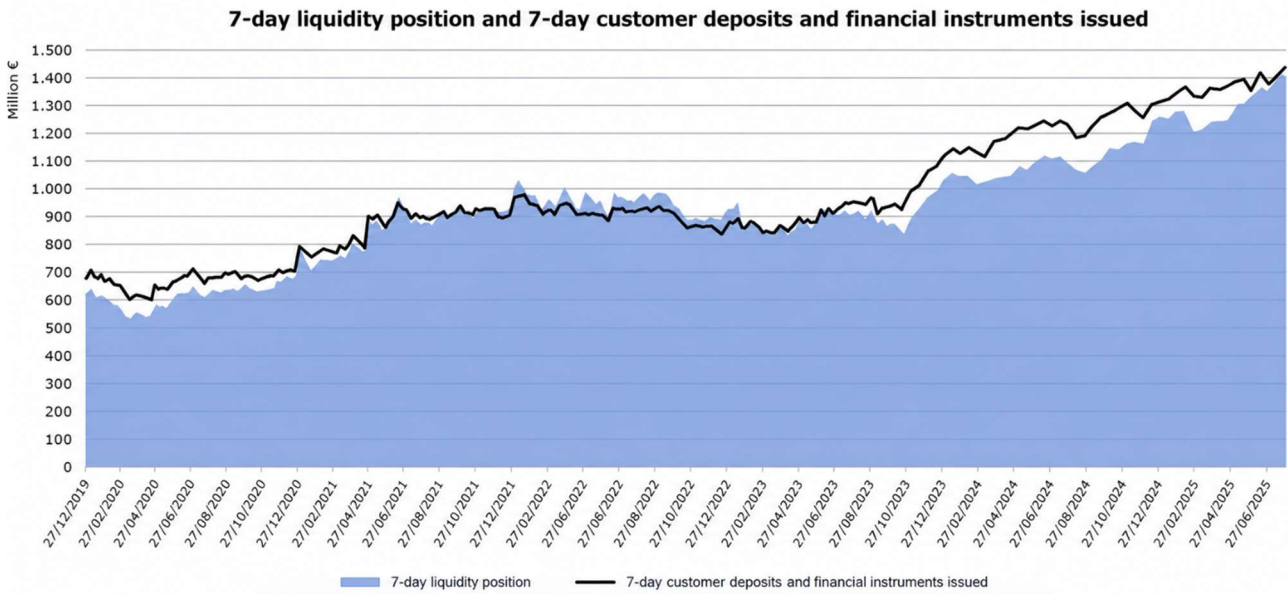
6.5 Liquidity

The 7-day liquidity position ⁽¹²⁾ of the banking system at the end of July 2025 reached the highest values of the period under review, standing at 1,373 million, an increase of 746 million compared to the same figure at the end of 2019 equal to 626 million.

⁽¹²⁾ The 7-day liquidity position is calculated as the sum of assets that can be liquidated within 7 days (cash and financial instruments) and credits, net of debts, towards foreign banks and the Central Bank (excluding banks' time deposits for the purposes of compulsory reserves) also due within 7 days.



Figure 16 – Liquidity situation of the banking system



The coverage ratio of the 7-day liquidity position on customer deposits and financial instruments issued up to 7 days is equal to 66.7%, showing an increase compared to the 31.5% figure at the end of 2019. Including in the numerator the reserve requirements and term deposits with the CBSM, the aforementioned indicator reaches 72.8% at the end of July compared to 36.8% at the end of 2019 ⁽¹³⁾.

⁽¹³⁾ Data source: Supervisory reporting "Liquidity Monitoring". Starting from 6 October 2023, the transmission frequency has been reduced from weekly to every other week. Starting from 8 January 2021, the banking system liquidity data do not include those relating to Banca Nazionale Sammarinese SpA. Banks' time deposits at the Central Bank for reserve requirements purposes are not included in the calculation of the 7-day liquidity position.

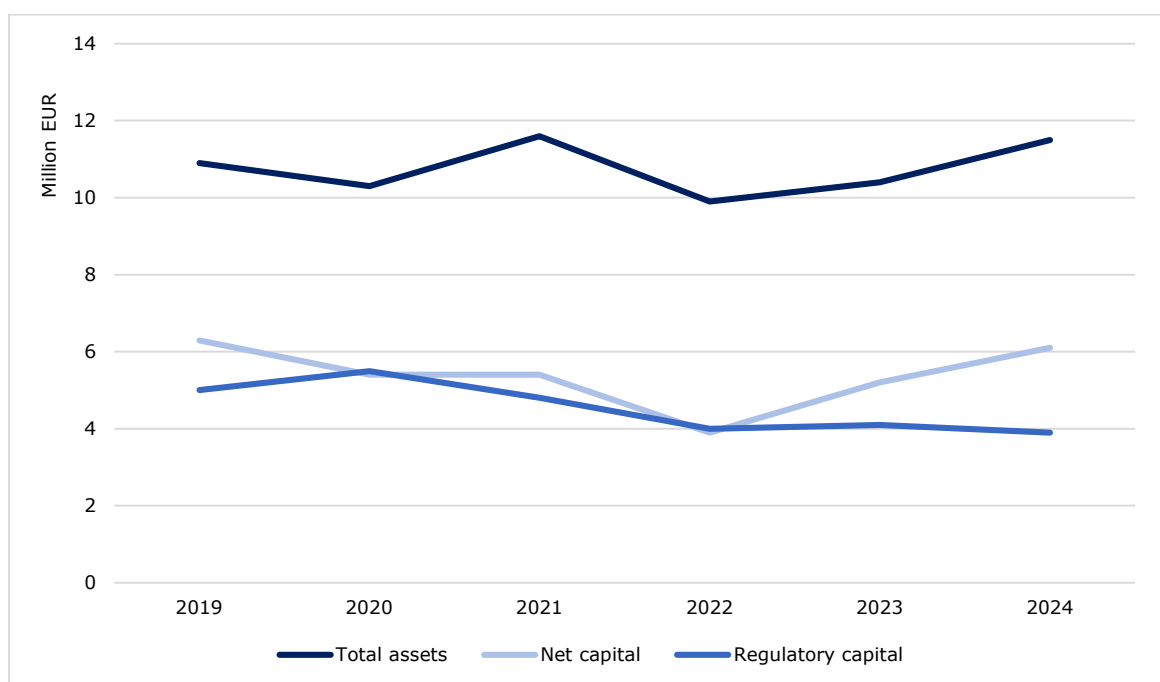
7 THE REMAINING SECTORS OF THE FINANCIAL SYSTEM

7.1 Financial companies

The financial companies sector, which consisted of two companies in 2019, saw a decrease of one unit in 2020 following the withdrawal of one company from its fiduciary business in 2020.

Total assets as of December 31, 2024, amount to approximately 11.5 million, a slight increase compared to 2019 (10.9 million). Net result, which reached 6.3 million in 2019 after reaching a low of 3.9 million in 2022, stabilized at 6.1 million in 2024. Regulatory capital as of December 31, 2024, stands at 3.9 million (5 million in 2019).

Figure 17 – Total assets, net capital and regulatory capital of financial companies



The amount of asset management amounts to 72.5 million in 2024 (81.1 million in 2019), while assets under fiduciary management amount to 7.8 million, a sharp decrease compared to 2019 (59 million in 2019).

In this regard, it should be noted that in 2020, following the aforementioned renunciation of fiduciary activity by one company, the mandates were transferred to the parent bank. Gross loans, including finance leases, amount to 3.9 million in 2024 (4.8 million in 2019).



7.2 Asset Management Companies

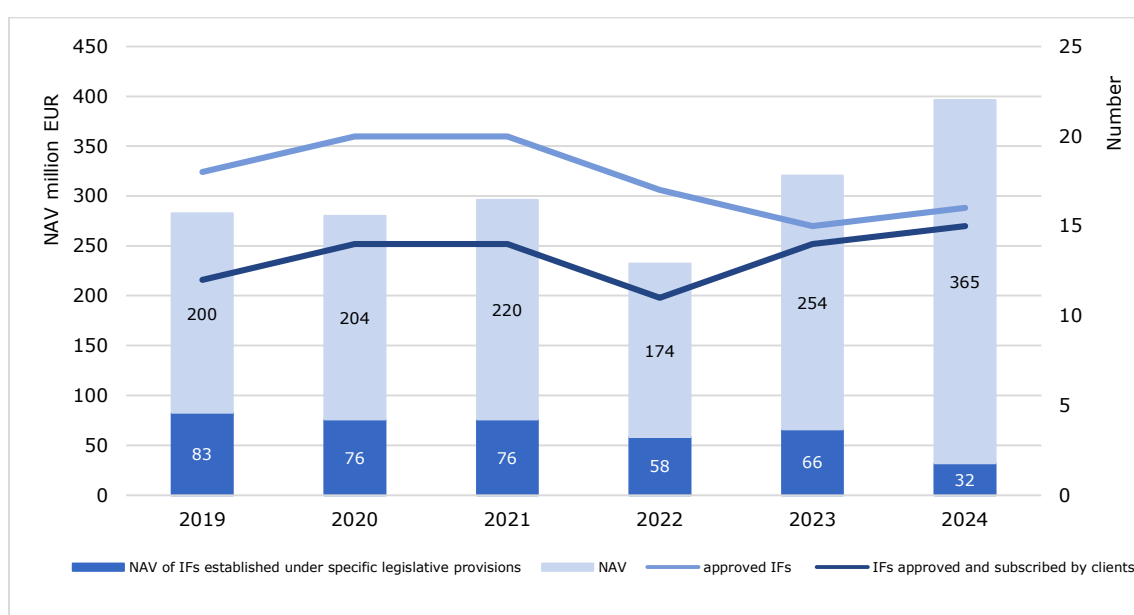
The sector comprises 3 Asset Management Companies (AMCs) authorised to provide collective investment services.

At the end of December 2019, there were 12 Investment Funds under San Marino law managed by the three AMCs and subscribed by clients (an additional 6 Investment Funds had also been approved although not yet subscribed by clients). Out of these, 4 were closed-end alternative Investment Funds reserved for professional clients, established pursuant to specific legislative provisions in connection with system operations and interventions aimed at protecting savings and whose assets originally consisted predominantly of non-performing loans. At the end of December 2024, the subscribed Investment Funds rose to 15 (an additional fund had also been approved although not yet subscribed by clients), of which 2 Investment Funds were established pursuant to the aforementioned legislative provisions.

The net result of the aforementioned Investment Funds increased from 200 million in 2019 (of which 82.5 million relating to the 4 Investment Funds established pursuant to the aforementioned specific legislative provisions) to 364.6 million in 2024 (of which 31.8 million relating to the 2 Investment Funds established pursuant to legislative provisions), with a significant upward trend (with the exception of 2022 when liquidation requests relating to 3 Investment Funds were initiated and concluded).

Furthermore, it should be noted that the liquidation of the remaining two mutual funds established pursuant to specific legislative provisions began in 2025, with the distribution of the related assets, such as liquidity, financial instruments, and items deriving from the securitization transaction, to the participating entities.

Figure 18 – NAV performance and IF number



7.3 Payment and electronic money issuing institutions

The sector in question consists of three entities: one payment institution authorized in 2023 (not operational) and two payment institutions authorized in 2016 and 2024, respectively. The latter two institutions are also authorized to carry out the reserved activity referred to in letter J) of the LISF (Electronic Money Issuance Services), which began operations in 2023 and 2024, respectively.

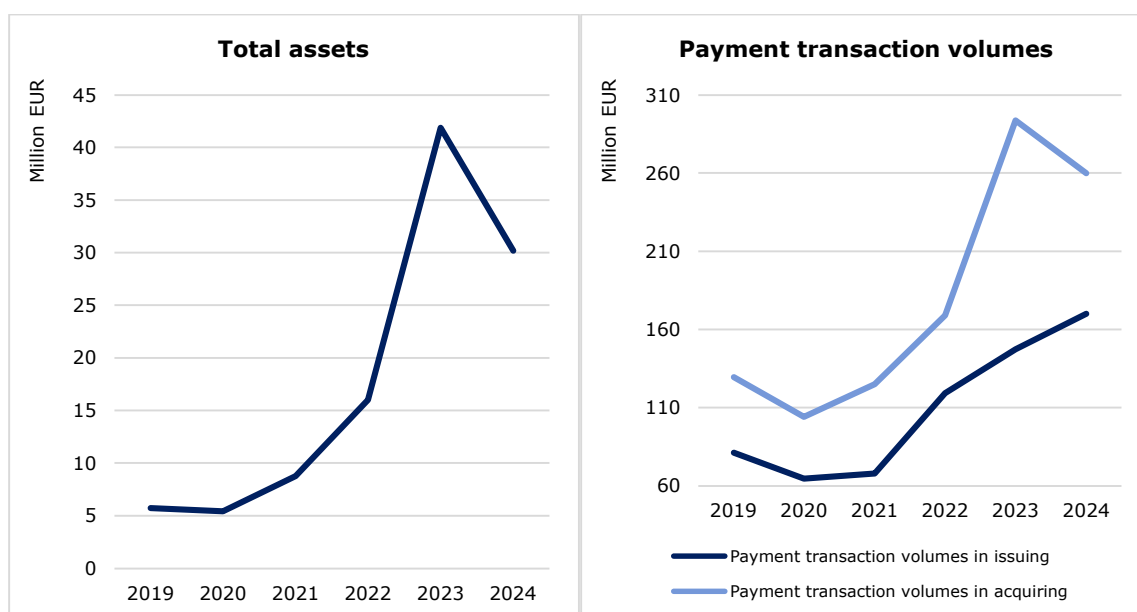
In the period under review, total assets showed a significant increase from 5.7 million in 2019 to 41.9 million in 2023 and then settled at 30.2 million in 2024. The main changes were recorded in intangible assets and in receivables included in the other assets item.

Regulatory capital also increased from 0.5 million in 2019 to 9.5 million in 2023, before settling at 6.9 million in 2024.

The volume of payment transactions settled via payment cards and electronic money in *issuing* amounted to 170.1 million in 2024 (81.1 million in 2019), while the volume of *acquiring transactions* amounted to 259.8 million in 2024 and 130 million in 2019⁽¹⁴⁾.

A growing trend is also observed in the number of credit cards in circulation, rising from 10,000 cards in 2019 to approximately 13,000 cards in 2024.

Figure 19 – Trend in total assets and payment transaction volumes



7.4 Insurance companies

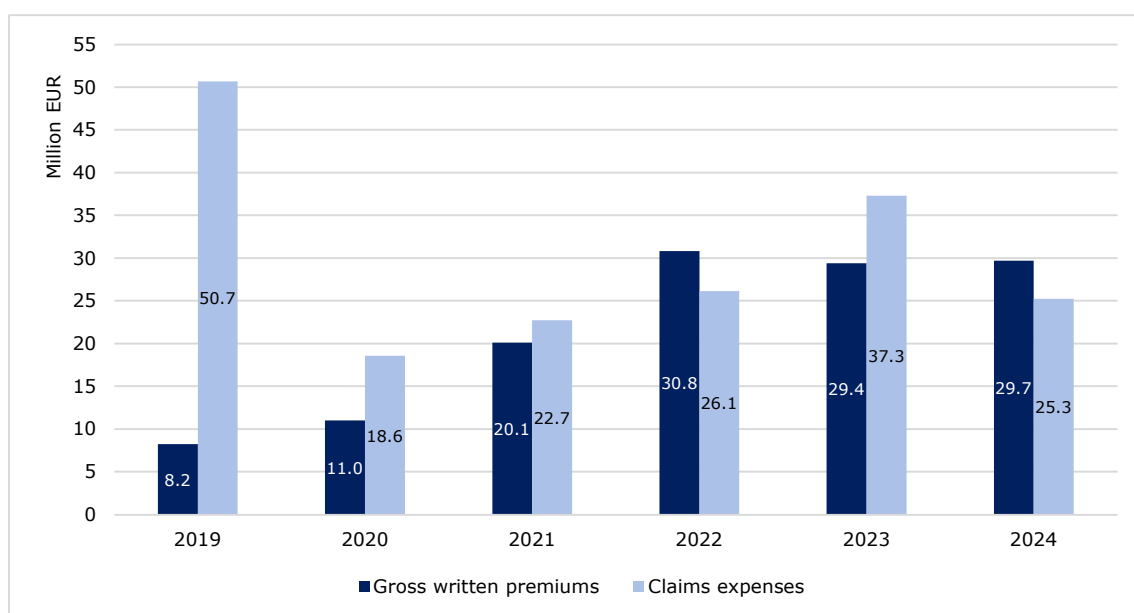
⁽¹⁴⁾ The issuing and acquiring activities concern respectively the issuing of credit cards to customers and the management of card payments on behalf of merchants, therefore including both the issuing and administration of the cards and the services that allow merchants to accept transactions made with them.



Until 2022, the sector in question consisted of two insurance companies authorized to carry out the reserved activities referred to in letter G) of Annex 1 of the LISF with regard to life insurance. In that year, a domestic insurance company exited the market following the issuance of a compulsory administrative liquidation order by the Central Bank. In this regard, it should be noted that prior to the aforementioned compulsory administrative liquidation order, the transfer of part of the Class I customer portfolio to the other San Marino company had been finalized, allowing customers to be fully protected from the company's insolvency.

In the period under review, gross premiums written⁽¹⁵⁾ went from 8.2 million in 2019 to 29.7 million in 2024, reaching a maximum of 30.8 million in 2022. With regard to claims-related costs⁽¹⁶⁾, in 2019 these amounted to 50.7 million – the maximum level in the period observed – and then settled at 25.3 in 2024 also in relation to the compulsory administrative liquidation of a company and the consequent exit from the market.

Figure 20 - Gross written premiums and claims expenses

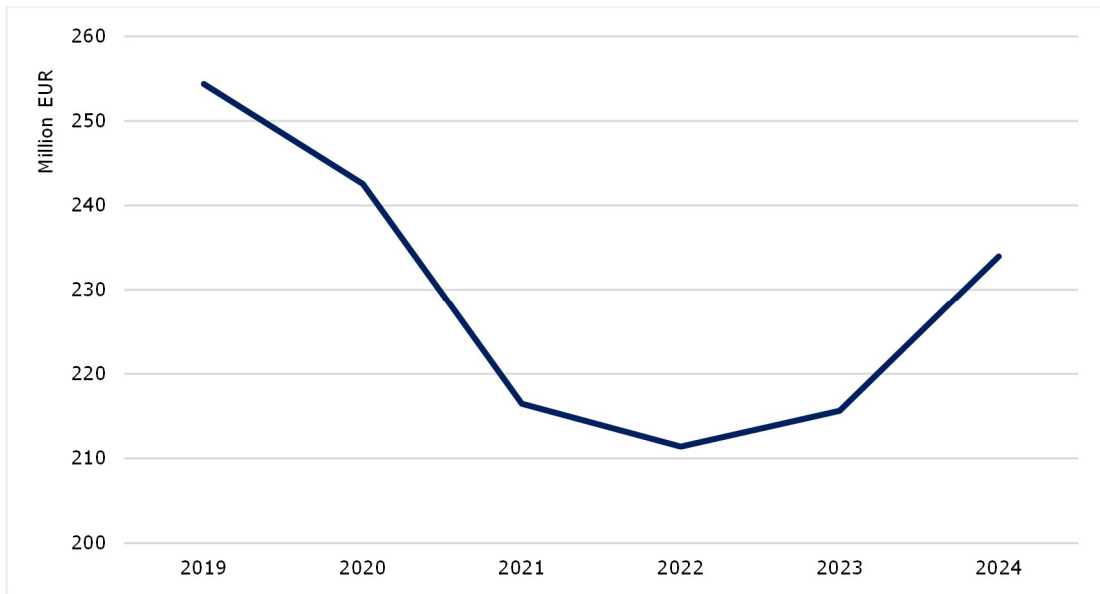


Technical reserves, from 254 million in 2019, reached a minimum level in 2022 (211 million) and then settled at 234 million in 2024.

⁽¹⁵⁾ The relevant definition is provided in Annex F to the CBSM Regulation 2009-01 to which reference is made.

⁽¹⁶⁾ The item claims charges, net of reinsurance transfers, includes redemptions and claims incurred during the financial year, the change in the reserve for sums to be paid and the reallocation of general expenses relating to settlements.

Figure 21 – Technical reserves



8 NPL SYSTEM SECURITIZATION TRANSACTION

8.1 Summary framework and legislative and regulatory aspects

The system securitization transaction – completed in December 2023 – was the result of a complex coordination process at both the regulatory and institutional levels, on the one hand, and the technical and operational levels, on the other.

From a regulatory perspective, in light of the regulatory framework outlined by Delegated Decree No. 126/2020 and Law No. 157/2021, in November 2022, CBSM issued the following two provisions:

- “Circular No. 2022-01 on the prudential regime for system securitization”, implementing Law No. 157 of 30 August 2021 “Measures and instruments for the securitization of credit” and more specifically the related Article 18, paragraph 2.
- “Regulation no. 2022-04 on securitization transactions and related servicers”, pursuant to the aforementioned Law no. 157/2021, and more specifically Article 4, paragraph 3 and Article 6, paragraph 2, as well as Article 5 of Delegated Decree no. 126 of 27 July 2020 “New mission of Banca Nazionale Sammarinese SpA”.

These are two regulatory sources that converge on the supervisory level and apply to the same transaction and which constitute its logical-regulatory basis:

- the former concerns the capital impacts on originator banks that receive ABS Junior and Mezzanine in exchange for the sale of securitized assets.
- the latter regulates *servicing activity*, introducing a specific supervisory regime for operators specialized in the management and recovery of securitized assets.

The prudential regime for securitization requires that capital absorption be determined by applying a specific weighting factor, determined on the basis of a specific calculation process, to the book value of each tranche of ABS securities held from time to time by each originator bank.

The cornerstone of the methodology under examination is what is defined as the average risk weighting factor of the portfolio of assets subject to securitization. Such a factor is specific for each originator bank (i.e. contributing impaired loan positions) and is determined as the weighted average of the credit risk weighting factors pursuant to the prudential regulations set forth in the aforementioned CBSM Regulation no. 2007-07 relating to the assets subject to securitization by each bank. This average risk weighting factor, specific for each originator bank, is in fact the weighting factor to be applied to the positions held in ABS Mezzanine securities ⁽¹⁷⁾.

⁽¹⁷⁾ For the sake of completeness, it should be noted that for any ABS Mezzanine securities not held by originator banks, a risk weighting factor of 135% has been set.



On the basis of this average (and pivotal) risk weighting factor, the specific weighting factor for each originator bank to be applied to the relevant ABS Junior securities is then determined.

Positions in ABS Junior securities are in fact subject to a risk weighting factor three times that applied to ABS Mezzanine securities, however this only applies to the first year following the issuance of the ABS. The risk weighting factor applied to ABS Junior securities is not constant over time, as it is subject to annual adjustment from the beginning of the second year until the maturity of the ABS Junior securities, based on a calculation mechanism that – while aiming for full coverage at the end of the transaction period – takes into account the deviation recorded between the cumulative net cash flows generated year after year by the total assets being securitized and the cumulative net cash flows forecast for the same period in the transaction program, based on the transaction's performance.

In any case, it is expected that the risk weighting factor to be applied year by year for ABS Junior securities will never be lower than the weighting factor envisaged for the first year.

For ABS Junior securities, given their intrinsic risk characteristics, instead of providing for their immediate and total deduction from the regulatory capital, in accordance with prudential supervision principles, the specific regulation provides for their gradual deduction over time, in line with the general framework underlying the system securitization transaction itself, with a phase-in approach that determines the complete deduction at the end of the transaction.

As regards the risk weighting factor to be applied to any ABS Senior securities held by banks, this has been set at 75% (constant over time), with a reduction to 20% in the (abstract) case of an insurance guarantee or to 0% in the (effective) case of a state guarantee.

Finally, with reference to the prudential treatment of the *escrow account*, it is envisaged that this item will essentially be weighted at 75%, equal to the risk weighting factor envisaged for senior ABS securities, without however being reduced in the event of the presence of an insurance or state guarantee, considering the characteristics of the *escrow account* established by Article 19 of the aforementioned Law no. 157/2021, *primarily* the guarantee of timely payment of ABS Senior securities.

Given that the ABS Mezzanine and ABS Junior securities have been classified by the banks as financial fixed assets, i.e., allocated to the fixed asset portfolio, they are currently valued in accounting and on the banks' balance sheets at their nominal issue value. Subsequently, depending on the evolution of the securitization transaction over time, given their intrinsic risk characteristics, they may likely be subject to accounting write-downs, pursuant to the aforementioned current provisions.

In this regard, CBSM, taking into account the intrinsic risk profile of ABS Mezzanine and ABS Junior securities and therefore the lower probability of repayment, at least in full, compared to



ABS Senior securities, intervened in April 2024 by requiring banks to provide, in the notes to the financial statements, an explanation of the valuation and accounting criteria for ABS Mezzanine and ABS Junior securities resulting from system-wide securitization.

8.2 Regulation of Servicers

With regard to servicing activities, Regulation No. 2022-04 outlines the characteristics that the servicer's activity must conform to and places particular emphasis on the servicer's guarantee function towards the market and the subscribers of ABS securities, regarding the correct execution of securitization transactions, establishing stringent behavioral rules and organizational requirements.

In the first quarter of 2024, CBSM issued the operating manuals relating to:

1. "Quarterly reporting of special purpose vehicles and servicing activities (SERV)".
2. "Half-yearly report on securitization transactions (CART)" and the related reporting model.

In particular, the purpose of the "Quarterly Reporting of Special Purpose Vehicles and *Servicing Activities* (SERV)" is to collect information relating to the special purpose vehicle and the *servicing activity*, with particular emphasis on the assets subject to securitization.

The "Half-Year Report on Securitization Transactions (CART)" aims to identify the main characteristics and collection trends of individual securitizations, including:

- the Cumulative Profitability Ratio (CPR): calculated as the ratio between the actual collections from closed positions and the corresponding value indicated in the original *business plan* and any updated one.
- the Net Present Value Profitability Ratio (NPVPR): calculated as the ratio between the discounted value of actual net collections and the carrying value in the *business plan* (initial and possibly updated) of closed positions.

8.3 Features of the transaction

The securitization transaction involved 6 originators, 3 banking institutions (BAC, BSM, and CRSM) and 3 non-banking financial institutions (SGA ex BNS, 739SG, Public Pension Fund Segregation Vehicle), which transferred a total of 1,267 credit positions, with a gross value of 611.4 million and a carrying amount (net of related write-downs) of 161.4 million, as shown in the following table.



Table 3: Entities transferring impaired positions (originators)

Originators	Number of Positions	%	Total Bank Assets Sold (Gross Value EUR)	%
Banking Entities	838	66%	310,933,643	51%
Other Non-Banking	429	34%	300,457,957	49%
Total	1,267	100%	611,391,600	100%

In detail, the banking *originators* transferred 838 positions compared to 429 positions sold by non-banking entities.

The transaction therefore involved the issuance of ABS securities structured into three distinct tranches (Senior, Mezzanine and Junior), which were allocated to the originators based on the *sizing* of the portfolio sold.

Table 4: ABS securities issued

Title / Class	Expiration	Nominal Value (EUR)	%
ABS / Senior	31/12/2036	70,000,000	43%
ABS / Mezzanine	31/12/2046	42,248,885	26%
ABS / Junior	31/12/2046	50,265,458	31%
Total		162,514,343	100%

8.4 Progress of the transaction

From the start of the recovery activity on the credits transferred to the system securitization, up to May 31, 2025, the gross collections recorded amounted to 43,626,313, or 7,558,855 more than the Business Plan forecast, which assumed collections for 36,067,458 for the same period.

Specifically, the first period of recovery activity runs from the cut-off dates of each originator's credit portfolio to the collection date of May 31, 2024. In this period, gross collections recorded amounted to 26,383,712, compared to the collection forecast of 24,528,272, thus determining an overperformance of 1,855,440.

The second recovery period runs from June 1, 2024, to the collection date of November 30, 2024. In this second period, gross collections amounted to 9,271,554, compared to the collection forecast of 4,087,693, resulting in an overperformance of 5,183,861.

Finally, in the third period of recovery activity, which runs from December 1, 2024 to the collection date of May 31, 2025, gross collections recorded amounted to 7,971,047 against the collection forecast of 7,451,493, resulting in an overperformance of 519,544 in this period as well.



With regard to the recoveries highlighted above, it should be noted that a portion of the collections expected in the future have in fact already been collected by the *servicers*, just as on some positions (NDG) collections higher than expected have been recorded with reference to the period considered.

During 2024 and in the first half of 2025, through the use of available funds, the System Vehicle was able to repay the senior tranche of the ABS securities for an amount equal to 41,756,718.9 also through the use of pre-established reserves (*escrow account* and additional cash reserve).

In particular, on the first payment date of June 28, 2024, securities amounting to EUR 25,454,258 were redeemed, on the second payment date of December 30, 2024, for an amount equal to EUR 9,475,949, and on the third payment date of June 30, 2025, for an amount equal to 6,826,512.

It follows that the value of the senior tranche in circulation is equal to 28,243,281, therefore the risk of enforcement of the guarantee provided by the State is reduced by 60% compared to the nominal issue value described above (equal to 70,000,000).

8.5 Protocol with Supervisory Body

On 8 April 2025, the Central Bank signed the Memorandum of Understanding with the Supervisory Body provided for by Article 5, paragraph 2, of Regulation no. 24 adopted by the Congress of State on 20 December 2024.

The Supervisory Body, established by Article 1-bis of Delegated Decree no. 176 of 4 December 2023 and regulated by Delegated Decree no. 55 of 19 March 2024, has *"the main function of monitoring the securitization transaction from a legal and accounting perspective as well as supporting the Permanent Council Committee on Finance and Budget in the half-yearly evaluation that it must receive by law", all "in order to administratively safeguard the State guarantee with reference to the system securitization transaction"*.

Given that the *servicers*, including IGRC and S3, are entities supervised by the Central Bank pursuant to Article 6, paragraph 2, of Law No. 157 of 30 August 2021 and implementing Regulation No. 2022-04, the interest in collaboration is mutual and finds its regulatory framework in the aforementioned Article 5 of the Regulations of the Congress of State, which provides that the Central Bank shall provide technical support to the Supervisory Body in the analysis of documents directly acquired by the latter in the exercise of its audit powers.

The signing of the Memorandum of Understanding is aimed at making the system of controls that affect system securitization even more efficient, in the interests of all parties involved (investors, *originators*, and the State).

8.6 Concluding remarks



Analyzing the results achieved and ongoing activities, it emerges that the centralized management of bank assets within the system vehicle has eliminated management differences among originators, ensuring a more uniform and effective approach. Furthermore, it is highlighted:

- a standardization of recovery strategies.
- an optimization of legal management with a reduction in the number of assignments assigned to lawyers, both San Marino and Italian.
- an improvement in property management: 50% of the disposed assets had been classified as bad loans for over 10 years.

Overall, therefore, the system-wide transaction for the securitization of NPLs reduced the NPLs present in the system, allowing banks in particular to increase their credit provision capacity to support the economy, but economies of scale and scope were also achieved thanks to the centralized management of impaired credit positions.



9 COMPETITIVE ANALYSIS OF THE BANKING AND FINANCIAL SECTOR

9.1 Competitive analysis of San Marino banking institutions

Integration into the European Union banking market undoubtedly represents a major opportunity for the Republic of San Marino's financial sector. However, it is also important to consider the ability of San Marino operators to compete not only on the external market but also on the domestic market, especially with banks operating in neighboring regions. This requires a careful analysis of the competitive positioning of San Marino banks to draw conclusions about the directions they should take to fully benefit from the proposed integration, refocusing their objectives in terms of profitability, capitalization, cost structure, operational efficiency, and, more generally, their business model.

The issue of competitive positioning was also addressed by the IMF on the sidelines of its latest Article IV mission, which published an in-depth note attached to the Staff Report with data referring to 2022.

9.2 Identification of the Italian comparison group – CBSM's analysis

The Central Bank also recently developed a positioning analysis of San Marino banks compared to a group of Italian banks, selected with the aim of comparing their technical profiles. The following Italian banks were therefore selected from Moody's Bank focus platform:

- similar in size, characterized by total assets at the end of 2023 in the *range* between 500 million and 2 billion.
- similar in terms of *business model* (characterized by sources of financing attributable to direct deposits from customers and, on the asset side, by credit activities and securities portfolios).
- based on geographical location, i.e. located in the regions of central Italy (Emilia-Romagna, Marche, Umbria, Tuscany).

Using these search criteria, 26 banks were selected.

It should be noted that the comparison sample identified with the above criteria differs from that identified by the IMF in its analysis conducted in October 2024, as banks with very high total assets, even exceeding 140 billion, were excluded. Banks located in the Tuscany and Umbria regions were also included.

The indicators were compared for the three-year period 2021-2022-2023. Given the different sample sizes (the Italian sample consists of 26 banks, while the San Marino sample consists of 4 banks), the average figure was generally compared, along with the minimum and maximum values.



9.3 Main findings

An analysis of the indicators reveals that San Marino banks are positioned above the Italian average in some respects, and below it in others. Therefore, the picture is not uniform.

When interpreting the data, it is essential to take into account the still profoundly different legislative and regulatory landscapes in which banks in the two countries operate. Specifically, Italy is subject to the Basel III prudential framework, which, among other things, has significant implications for banks' technical profiles in terms of capital, earnings, and organizational structure.

In the Republic of San Marino, the implementation of this prudential framework has recently commenced, including regulations on capital requirements for market risks, first-pillar calendar provisioning, and credit classification. Additional significant capital impacts have been projected for the future.

In this context, when comparing the 2024 financial statements of the two groups, some significant data emerge.

From a **structural** point of view:

- the **number of branches** is significantly higher in the Italian sample: 18 on average, compared to 8 in the Sammarinese group, a figure which remained practically constant for both groups in the three-year period 2022-2024.
- The average **number of employees** is considerably higher for the Italian sample: 149, compared to 95 for the San Marino group. the figure increased by 2 units in the three-year period for the Italian group, while it remained constant for the San Marino group.
- total **assets** average 1.068 billion for Italian banks, while for Sammarinese banks they average 1.081 billion.
- Total **direct deposits** average 871 million for Italian banks, while the figure for Sammarinese banks is higher, at 927 million. for both groups, the figure increased over the three-year period.
- The **total direct deposits / average number of employees** is higher for Sammarinese banks, equal to 10 million compared to 6 for Italian banks.

From an **asset quality** perspective, differences emerge between the two groups, primarily regarding the **amount of total interest-bearing assets**, which for the San Marino banks is lower on average than for the Italian group: 794 million compared to 950 million. The trend over the three-year period was the opposite: while for the San Marino banks, it increased from 726 million in 2022, for the Italian group, it decreased from 1.076 billion in the same year.



Consistently, the **percentage of interest-bearing assets as a percentage of total assets** is also higher on average for Italian banks than for those in San Marino: 89% compared to 74%. For this indicator too, the trend over the three-year period was the opposite: while for San Marino banks it increased from 70% in 2022, for the Italian group it decreased from 91% in the same year.

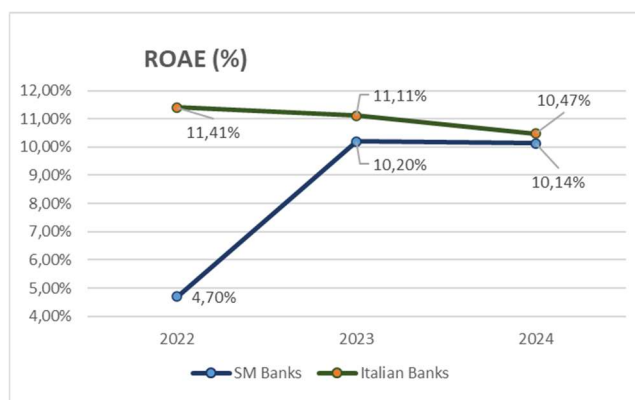
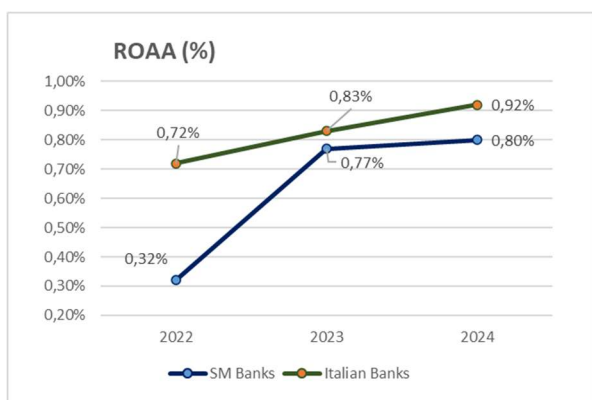
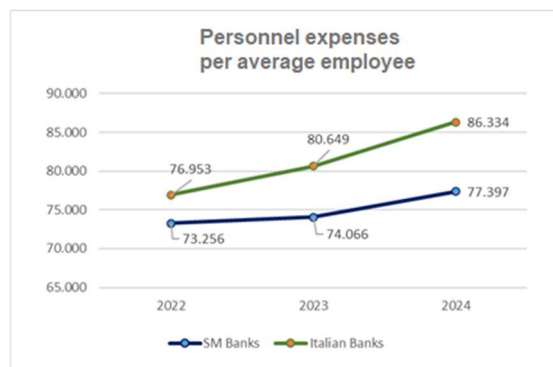
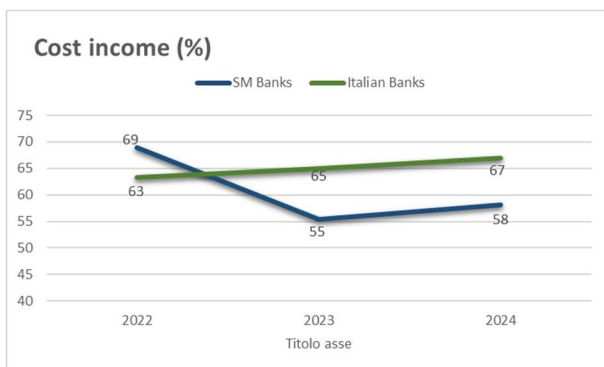
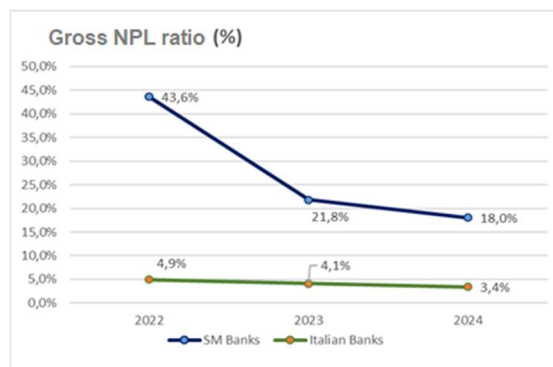
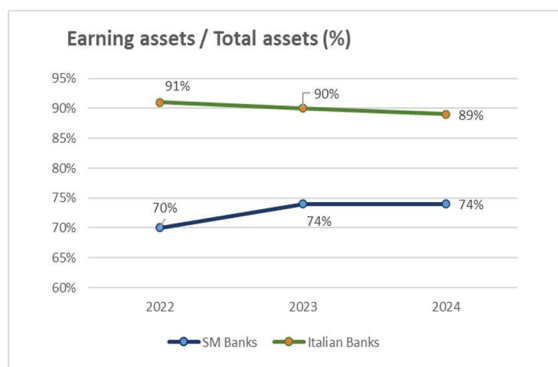
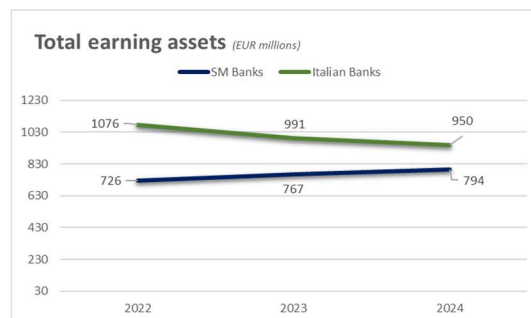
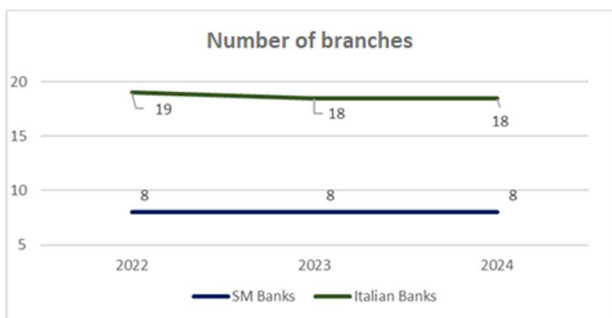
Another significant deviation from the Italian situation concerns the **NPL ratio**, which measures total non-performing loans (NPLs) relative to total loans. This ratio, based on gross values, averages 3.4% for Italian banks, while for those in San Marino it remains at a still high level of 18%, although this is more than half the average for previous years, when the 2022 average was 43.6%. The Italian group also recorded a decrease over the three-year period, compared to the 2022 average of 4.9%.

Regarding **tax assets**, the average figure for the Italian group is 33 million, while the figure is significantly higher for the San Marino group, averaging 62 million. Consequently, the **tax assets ratio to total assets** averages 3.1% for Italian banks, while it is 4.5% for those in San Marino.

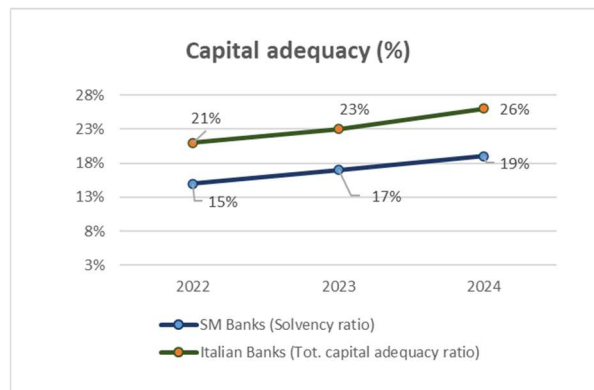
With regards to **profitability and efficiency**, the following are highlighted:

- for Sammarinese banks, a **cost-to-income ratio** of 58%, a significant drop compared to 69% in 2022, while for Italian banks the indicator is on average 67%, up from 63% in 2022.
- for Sammarinese banks, **personnel expenses per average employee** are approximately 77,000, while the same figure for Italian banks is higher, at approximately 86,000.
- a **ROAA (return on average assets)**, calculated on the net result) equal to 0.80% for the Sammarinese banks and 0.92% for the Italian banks, with an increasing trend for both groups: for the Sammarinese banks it increased from 0.32% in 2022 and for the Italian group from 0.72% in the same year.
- a **ROAE (return on average equity)**, calculated on the net result) equal to 10.14% for the Sammarinese banks and 10.47% for the Italian banks with opposite trends between the two groups: while for the Sammarinese banks it increased from 4.70% in 2022, for the Italian group it decreased from 11.41% in the same year.





With regard to **capital adequacy**, it should be noted that the indicator is calculated differently, given that the San Marino one, as of 2024, only considers credit risk, while the Italian one also takes into account market and operational risk.



Despite these methodological differences, Sammarinese banks have a significantly lower **solvency ratio, averaging 19%**, and **Italian banks have a total capital adequacy ratio averaging 26%**. For both groups, the indicator has increased over the three-year period (from 15% for Sammarinese banks and from 21% for Italian banks).

10 CHALLENGES AND OPPORTUNITIES ARISING FROM THE ASSOCIATION AGREEMENT

10.1 Introduction

The Association Agreement with the European Union (AA EU) and, specifically, the Protocol on Financial Services (PFS) included in the Agreement, which regulates this matter, envision entirely new growth scenarios for the San Marino financial system. The new regulatory framework will enable San Marino financial companies, in compliance with the conditions and timeframes set out in the Agreement, to access the European Union's single market for financial services, based on the so-called *passporting system*, overcoming critical issues that currently impact the local financial system and limit its potential for development.

Positive impacts of the Association Agreement can be identified, in addition to development opportunities for financial firms, also with regard to financial stability and supervisory activity. The PFS defines a new institutional framework for supervision and cooperation between the CBSM and EU financial supervisory authorities, especially with the so-called European Supervisory Authorities (ESAs): EBA, ESMA, EIOPA, AMLA, with which the protocol defines the need for specific MOUs as a condition for access to the European Single Market.

The new opportunities that the protocol on financial services foresees, in order to be effectively seized, require the satisfaction of a series of conditions a priori and, more precisely, the overcoming of *initial assessments* conducted by the EU with regard to 3 areas:

1. implementation and enforcement of the relevant EU acquis, to verify its full and effective implementation.
2. the adequacy of the supervisory infrastructure.
3. review of the financial system, with specific focus on the balance sheets and asset quality of the banking and insurance sectors.

After the *initial assessments* have been passed a continuous monitoring system by the EU is also envisaged with reference to the first two areas.

The PFS recognizes the possibility of accessing the single market on a partial and progressive basis, proceeding sector by sector within the financial system through a so-called *staggered approach*. Such an approach would enable the calibration of the financial integration process in accordance with the specific characteristics and needs of San Marino, including through the distribution over time of the costs/benefits deriving from the required adjustments.

This right to sectoral and phased access to the single market for financial services is temporary, although granted for a period of 15 years from the entry into force of the Association Agreement.



However, from a strategic perspective, it is of primary importance for San Marino's financial system to pursue full compliance and integration into the EU single market across all sectors within a significantly shorter timeframe, and this will be the commitment of the Central Bank in its role as Supervisory Authority for the San Marino Financial System.

The sectors envisaged for partial access to the EU single market for financial services are the following:

- ❖ banking.
- ❖ insurance and reinsurance.
- ❖ asset management.
- ❖ securities markets.

In the event of access to the Single Market under the aforementioned staggered approach, initial assessments shall be recalibrated in relation to the specific sectors for which market access is to be activated. This shall be without prejudice to the requirement that a set of general preconditions, as well as compliance with cross-sector regulatory frameworks, must in any case be met, including, inter alia, those pertaining to anti-money laundering (AML) standards.

The PFS also safeguards the principle of symmetric market opening, whereby access rights are granted on a reciprocal basis. Accordingly, until a given sector of the San Marino financial system is authorised for passporting into the EU Single Market, financial intermediaries from the corresponding EU sector shall likewise not be permitted to access the San Marino market. In the meantime, the existing authorisation frameworks governing entry into the respective markets shall remain fully applicable.

As a consequence, the opportunities arising from EU integration in the financial services sector, in order to materialize and establish an effective right for San Marino intermediaries to operate cross-border in the single market, require a prior set of complex and coordinated multi-year adaptation and preparation activities that involve the institutions, the CBSM and the intermediaries, each within their respective remits.

This chapter is divided into four parts: the first part provides an estimate of the impacts of the Association Agreement on the Central Bank, the second part provides an analysis of the general regulatory aspects relating to the Agreement, the third part provides an in-depth analysis for the banking sector and finally, and the fourth part provides some concluding considerations.

10.2 Expected impacts for CBSM



Before examining the expected impacts of the Association Agreement (AA EU) on the Central Bank and the banking and financial system, it is appropriate to recall the involvement of CBSM in supporting the institutions in the negotiation process that has developed over the years.

Since the phase preceding the start of negotiations on the Association Agreement with the European Union, CBSM has consistently provided its collaboration and technical assistance to San Marino institutions on matters relating to the banking and financial system.

The ways in which the Central Bank has provided its collaboration over the years have taken on a variety of configurations, ranging from the completion of questionnaires, and the preparation of analytical and regulatory documents, to the preparation of opinions and sharing of studies, as well as participation in domestic working groups in San Marino and in international fora (for example, the EFTA Group meetings). This engagement has also extended to direct participation in negotiation sessions addressing issues pertaining to the financial system.

Among the macro-issues in which CBSM has been involved, in addition to the central issue of financial services and financial supervisory structures within the European Union and the single market, there are also those relating to the regulation of consumer credit agreements, the free movement of capital – the latter addressed in particular in the 2018-2019 period – and the regulation of State aid to the financial sector, which was examined and discussed both in 2019 and, more recently, in the 2022-2023 negotiations.

In relation to the above, it is also worth mentioning the activity carried out in 2018 to implement in San Marino a European Union technical assistance initiative on banking and financial legislation under the TAIEX (*Technical Assistance and Information Exchange Instrument*) program, as well as, more recently, between the end of 2024 and the beginning of 2025, CBSM's participation in the ABS training project on the AA EU and CBSM's institutional communication initiatives at Italian universities, also aimed at providing greater awareness of the Republic of San Marino's path to integration into the European Union.

In order to assess the adjustments required (impact analysis) by the PFS, including for the subsequent definition of a multi-year action plan, CBSM, in addition to having initiated discussions with the relevant institutional counterparts at the European level, has also already conducted in-depth technical studies on the European Union financial acquis provided for by the aforementioned protocol. In this context, particular attention was paid to the most efficient methods of transposing and maintaining alignment over time, as well as the expected impacts on the CBSM structure, especially with regard to the supervisory function. The results of these impact analyses were brought to the attention of the competent San Marino institutional bodies in early 2024.

The impact analysis, which also drew on data from other supervisory authorities that had previously undergone comparable processes of European integration, specifically underscored the need to adapt and reinforce the institutional structure of the Central Bank.



This requirement arises from the transition from a supervisory framework designed for a domestically operating financial system to one aligned with the architecture of a system fully integrated into the EU single market, and therefore compliant with EU standards.

From the human resources perspective, it should be noted that the Supervision Department currently comprises 21 FTE staff members⁽¹⁸⁾, compared to a total of 72 FTE staff members employed in the CBSM, organized into five Services (Supervisory Regulation and Studies, On-site Supervision, Supervisory Reporting and Methodologies, Off-site Supervision and International Relations) and two Offices (Studies Office and Central Credit Register).

The supervisory staff is responsible for carrying out supervisory activities on (data as of 31 July 2025):

- ❖ 12 authorized Sammarinese entities (4 banks, 1 financial company, 3 asset management companies, 1 insurance company, 3 payment and electronic money institutions).
- ❖ 51 foreign authorized entities (46 insurance companies, 3 payment institutions, 1 financial company, 1 bank, limited to the granting of financing for profiles pertaining to operations in the territory).
- ❖ 33 insurance intermediaries, of which 18 are Italian and operate through a permanent establishment.

for a total of 96 supervised entities, excluding activities carried out in support of institutional bodies in the form of consultancy and opinions, as well as the ongoing management of relations with supranational and international bodies (primarily the ECB and IMF) and with rating agencies on matters within their respective remit.

Conversely, the institutions considered as benchmarks and with competence only in financial supervision activities, and in some cases in the AML-CFT area, have a significantly higher number of staff.

In view of the necessary reorganization of its Supervision Department, and to reduce potential impacts on staff, CBSM has long since initiated internal assessments and relationships with leading industry providers in the field of Artificial Intelligence (AI). Activities related to the Association Agreement, particularly regarding the adaptation and ongoing updating of the San Marino regulatory framework, will require the management of a large number of EU legal acts that will need to be analyzed and adopted. The use of AI tools could significantly facilitate the activities related to this process.

The analyses conducted highlighted the need to strengthen the CBSM staff dedicated to supervisory functions. This need arises both in the initial phase of implementation of the significant adjustments required to align with EU standards, even under the staggered

⁽¹⁸⁾ The term FTE (Full Time Equivalent) takes into account the actual presence of available resources, considering part-time and long-term absences.

approach described above, and for the ordinary performance of supervisory action. The market is indeed expected to become broader, more diversified and more complex than the current one, reflecting ever-growing cross-border operations and the need for continuous dialogue with foreign supervisory authorities and with the ESAs.

10.3 General regulatory profiles

The PFS establishes, as one of the conditions required for access to the single market, the implementation and enforcement of the EU acquis in financial matters within the domestic legal system. In order for San Marino intermediaries to operate cross-border in the single market on the basis of the so-called passporting⁽¹⁹⁾, it is therefore necessary – although not in itself sufficient – to first align the San Marino financial framework with the EU regulatory framework.

The management of this regulatory alignment process will fall within the remit of CBSM, in its capacity as the single supervisory authority for the financial system, and will require, as previously highlighted, the allocation of adequate resources, given the scope and complexity of the regulatory framework to be adopted and implemented.

Indeed, the EU legal acts relating to banking and finance that San Marino (as well as Andorra) is required to transpose into its domestic legal order currently amount to 451, in addition to 13 European Commission Recommendations that must also be taken into consideration. These legal acts are listed in a specific annex to the AA EU (Annex IX), a summary of which is presented in Figure 22 below.

⁽¹⁹⁾ Passporting is a legal mechanism used mainly within the European Union which allows a company authorized in one Member State to also operate in other Member States without having to obtain a new national authorization in each of them.



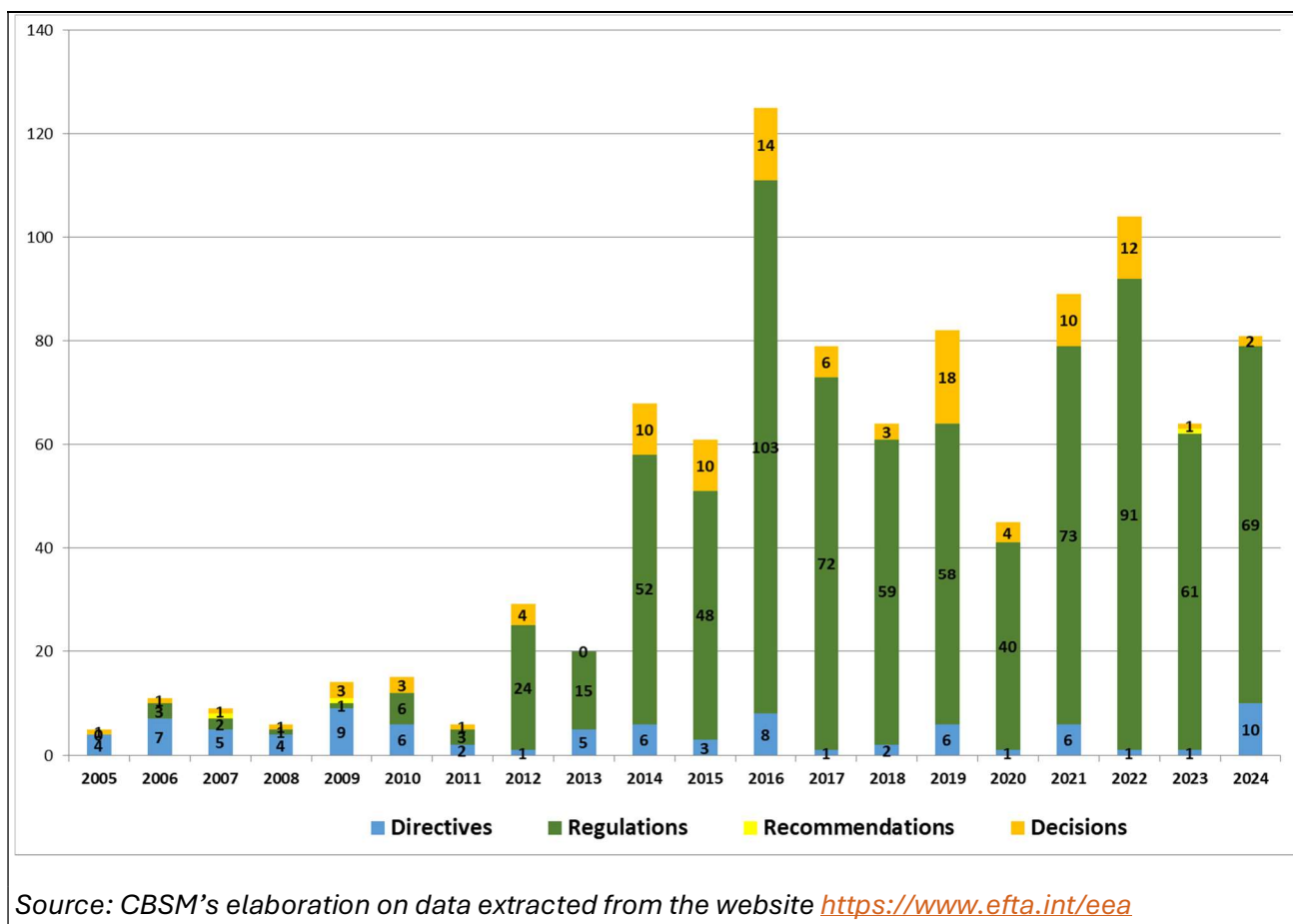
Figure 22: EU legal acts to be transposed

Eu Legal Acts Annex IX - Financial Services	No.
Chapter 1 - Insurance	67
Section A - Non-life and Life insurance	54
Section B - Motor insurance	8
Section C - Supervision and accounts	1
Section D - Other issues	4
Chapter 2 - Banks and Other Credit Institutions	124
Section A - Coordination of legislation on establishment and freedom to provide services	92
Section B - Prudential requirements and regulations	23
Section C - Supervision and accounts	9
Chapter 3 - Stock Exchange and Securities	202
Section A - Stock exchange listing and transactions	33
Section B - Undertakings for Collective Investment in Transferable Securities (UCITS)	8
Section C - Investment services	161
Chapter 4 - Occupational Retirement Provisions	1
Chapter 5 - Provisions applying to all kinds of financial services	57
Acts of which the Associated Parties shall take note	13
TOTAL	464

The list of 451 legal acts currently represents a snapshot of the European Union financial acquis requiring transposition into domestic law. The list is subject to updates over time to ensure consistency between domestic law and the evolving EU financial framework, in accordance with the procedures set out in the Association Agreement.

This process essentially entails an initial and comprehensive adaptation of San Marino's financial legislation to the EU framework, to be implemented progressively across individual sectors, followed by constant fine-tuning activity, in order to maintain alignment with the high pace of evolution of the EU acquis in financial matters (see Figure 23 below for a representation of the number of new EU legal acts issued or updates to existing legal acts).

Figure 23: Dynamics of the issuance of legal acts on financial services in the European Union (new provisions or updates of existing ones)



The data presented confirm that, even assuming the use of artificial intelligence systems to support the analysis, monitoring, and implementation of the continuously evolving EU regulatory framework, it will nonetheless be necessary to strengthen the supervisory structures of the CBSM, as previously outlined, in order to ensure its effective and efficient management.

Even in the case of progressive, sectorally phased adjustments implemented over time (as further elaborated below), a set of cross-sector legal acts will in any event require prior transposition into domestic law, as a necessary precondition for enabling even a single sector of the financial system to gain access to the single market.

This is, moreover, an activity similar to that which has been carried out for about ten years under the provisions of the current Monetary Agreement, although at present in more limited terms, both due to the (lower) number of legal acts whose adoption is required, and due to the level of depth of the analyses on the correspondence of what has been transposed with European standards, considering that under the Monetary Agreement, unlike what is provided



for by the Association Agreement, no passporting right is recognized, and consequently the assessments on the full compliance of what has been transposed in order to guarantee the so-called *level playing field* ⁽²⁰⁾ and the integrity of the single market have not so far assumed the stringent characteristics which will instead be required under the Association Agreement.

In the regulatory alignment activity, it will therefore be necessary to also analyze the transpositions of EU legal acts on financial matters already carried out, and proceed, where necessary, to integrate them, in order to achieve a complete and updated transposition of the relevant EU legal acts.

On this topic, it is also worth noting, given the implications for San Marino, that the EU approach to regulating the financial sector has evolved over time. The complexity and scope of the EU financial system have grown exponentially over the last decade, with increasing use of regulations, directly applicable in member states, to better ensure regulatory consistency across the single market, compared to directives, which instead require implementation at the national level.

The body of regulations should also encompass the so-called second-level EU legal acts, namely the set of more technical measures adopted by the European Commission upon proposal of the aforementioned ESAs (primarily Commission Implementing Regulations and Commission Delegated Regulations), which are intended to implement and give effect to provisions contained in first-level directives and regulations. Reliance on such second-level EU legal acts further contributes to ensuring regulatory harmonization across the single market, including highly technical and analytical matters, thereby limiting national divergences.

In this context, it follows that, under the San Marino legal framework, financial directives must be transposed in the strict sense through first and second-level legal acts, depending on the subject matter and the regulatory delegations conferred upon the CBSM. Conversely, EU regulations are not transposed as such; instead, they are incorporated into and implemented within the national law through a simplified regulatory adoption procedure.

10.4 Specific regulatory profiles relating to the banking sector

More specifically, with regard to the regulatory compliance required for the banking sector, the most significant harmonization activity to be implemented concerns the adoption of EU provisions on prudential requirements and capital adequacy, i.e., the adoption into domestic law of that set of rules implemented in the European context through the framework currently known as CRD6-CRR3, namely Directive 2013/36/EU and EU Regulation 575/2013, as consolidated and amended by Directive 2024/1619 and EU Regulation 2024/1623 respectively.

⁽²⁰⁾ A '*level playing field*' in this context means that all financial institutions – regardless of their country of origin, size or legal form – are placed in a position to compete on equal terms according to harmonized rules, ensuring that none gains an unfair advantage.



Another significant part of the adjustments required with an impact on the banking sector concerns the adoption of the overall EU framework on recovery and resolution, namely the so-called BRRD and BRRD2.

In relation to the above, it is worth noting that within the EU single market, the international Basel III standards, adopted with the aforementioned CRD6-CRR3 framework, apply to all banks. Therefore, even San Marino banks, regardless of their size and/or international operations, will be required to comply with these standards.

From a purely regulatory perspective, this involves the incorporation of these EU provisions into domestic law. Such provisions address a variety of technical aspects related to the measurement and management of the various risks inherent in banking, as well as the determination of banks' capital requirements and their adequacy with respect to the risks assumed. These provisions therefore address the very essence of banking activity, with a direct impact on the main technical and capital requirements on which banking authorization is based.

The adoption of this complex framework therefore requires the prior preparation of a detailed multi-year alignment plan, which includes transitional periods for the gradual implementation of the provisions, with the so-called phase-in, phase-out and with adequate time lags between the moment of adoption of the various provisions and their application.

The objective to be achieved, also in order to seize the opportunities of participation in the single market for banking services, should be to achieve full adoption and implementation of the aforementioned CRD6-CRR3 framework within a timeframe significantly shorter than the maximum foreseen by the Agreement (15 years).

In the banking sector, the aforementioned EU prudential framework, whose transposition is required, implies a review/integration of the technical regulations currently in force in San Marino, given that the latter, although updated over the years, are anchored to international Basel standards that predate Basel III.

The main macro-areas relating to the prudential requirements of banks that require intervention, to a greater or lesser extent, can be identified as follows:

1. Own Funds (regulatory/supervisory capital)
2. Capital buffer
3. Credit risk
4. Market risk
5. Operational risk
6. Interest rate risk
7. Liquidity risk (Liquidity Coverage Ratio + Net Stable Funding Ratio)



8. Pillar 2 measures (Internal Capital Adequacy Assessment Process + Internal Liquidity Adequacy Assessment Process + Supervisory Review and Evaluation Process)
9. Pillar 3 measures

Overall, these provisions are aimed at strengthening banks' resilience, given that, generally speaking, they imply more precise measurement and management of the risks inherent in banking activity, as well as higher capital requirements, or their determination based on more stringent criteria.

While it is therefore necessary, on the one hand, to bridge the existing regulatory gap, also determined by the aforementioned marked evolution recorded by EU regulation, on the other, it is equally important to support the local banking system in the transition to these more advanced requirements.

In relation to the above, it is important to note that alignment with EU prudential standards is not a new process, given that, as previously mentioned, the process of adapting San Marino's banking prudential framework to that of the EU has already been underway since 2019, pursuant to the provisions of the Monetary Agreement. With the issuance of Delegated Decree No. 50/2019 in 2019, the aforementioned Directive 2013/36/EU and EU Regulation 575/2013 were transposed into primary legislation (and therefore into principles) as well.

In implementation of this primary legislation, CBSM has already issued implementing provisions over the years, including the following:

- ❖ In 2020, Regulation No. 2020-01 introduced requirements for corporate officers of banks in line with those of the EU and known as fit&proper (also in application of the FSS set out in the previous chapters).
- ❖ in 2023, Regulation no. 2023-02, which introduced the provisions on calendar provisioning referred to in EU Regulation no. 630/2019, and aligned the credit taxonomy with that established at European level.
- ❖ in 2024, Regulation No. 2024-05, which introduced, among other things, the rules on market risks and settlement risks in accordance with those provided for by the aforementioned EU Regulation 575/2013 (standardized approach).

The foregoing therefore indicates the need to continue, at the regulatory level – albeit now more extensively or more fully – the alignment to the most advanced EU banking prudential standards. This alignment must be completed within a timeframe that is also significantly shorter than the 15-year maximum deadline set by the Association Agreement. In the meantime, the impacts on the local banking system must be adequately managed, including by modulating transitional measures, while maintaining the objective of full participation of the San Marino financial system in the EU single market. **Conclusions: gradual integration by sector - conclusions**



As already highlighted, the Protocol on Financial Services provides for the possibility of accessing the single market in a partial and progressive manner on a sector-by-sector basis, according to the so-called staggered approach, thus allowing the financial integration process to be modulated, taking into account the specific characteristics and needs of San Marino, also in terms of the distribution over time of the cost/benefit effects of the required adjustments.

This recognized option represents a highly innovative and qualifying aspect of the financial services protocol, even from an international perspective. It is therefore highly appropriate for San Marino to avail itself of this opportunity.

Of the four sectors envisaged by the Protocol on Financial Services, those for which the required conditions could be met first by San Marino and for which cross-border operations in the EU single market could therefore be achieved first are, at present, asset management (mutual fund sector) and insurance and reinsurance.

As regards the banking sector, given the greater complexity and impact of the required adjustments to EU standards, especially on banks' prudential and capital adequacy parameters, the integration timeframe will likely be longer.

For the asset management, insurance, and reinsurance sectors, the required alignment activity primarily concerns aligning domestic regulations with EU regulations, with no impacts on capital adequacy profiles similar to those of the banking sector.

Even the number of EU legal acts attributable to these two sectors requiring transposition and implementation into domestic law, although significant, is lower than those envisaged for the banking and securities markets sectors. This less complex regulatory alignment particularly concerns the asset management sector, which, given its structure, is characterized by greater potential for cross-border operations, also considering the dynamics present in the European Union single market.

In any case, as already mentioned, to achieve access to the EU single market, even if limited to these two sectors, beyond alignment with specific EU sector legislation, the transposition and implementation of a non-marginal set of cross-sector financial regulations is also required, as well as the implementation of the more general EU legal acts provided for in Annex XII on the free movement of capital and in Annex XXII on company law.

However, adapting the internal financial system to EU standards is not something new for San Marino, given the constant and progressive transposition of the EU financial *acquis* into primary internal legislation and into the CBSM supervisory regulations, pursuant to the provisions of the Monetary Agreement with the EU signed in 2012.

In this regard, it may be sufficient to recall, by way of example, the regulations issued in recent years by CBSM in implementation of EU legal acts regarding the area of payment and investment



services, regarding the classification of credit exposures and calendar provisioning, as well as regarding insurance distribution.

It is therefore a question of continuing, albeit now in more extensive or more properly complete terms, the adaptation to EU regulatory and supervisory standards, along a path on which the San Marino system and CBSM have already acquired certain expertise over the years.

In relation to the above, the initial assessments that may be required first will likely concern, in order, the asset management and insurance and reinsurance sectors, for which CBSM, in addition to the activity of adapting the supervisory regulations, will also be called upon to strengthen its supervisory infrastructure, based on the guidelines already mentioned above.

In conclusion, the strategic importance of the European integration process for San Marino's financial system is once again emphasized, not so much – and not only – for its opening to new markets, but above all for the strengthening process this will bring for individual intermediaries and, consequently, for the positive impact on the system as a whole, both in terms of greater stability and improved development prospects.



11 STRATEGIC DIRECTION AND POLICY RECOMMENDATIONS

The structural characteristics of the San Marino financial system and the institutional dynamics that foreshadow a completely different competitive scenario from the current one confirm the supervisory actions undertaken to ensure a gradual and sustainable process of alignment to the rules and best practices of the European Union.

This objective does not stem so much from the constraints imposed by international agreements in force (Monetary Agreement) or soon to be implemented (Association Agreement) but, rather, from the evidence that banks and intermediaries with robust technical profiles and effective and efficient governance and control systems contribute to the country's financial stability and the development of its economy.

As outlined in the previous paragraphs, the Central Bank is addressing **the challenge of regulatory compliance by prioritizing the dynamic implementation** of the EU acquis, with primary and secondary acts proportionate to the size and complexity of the supervised intermediaries. Indeed, these acts refer directly to the second-level EU acts (designated for the implementation of technical and regulatory standards), ensuring full alignment of internal regulations over time.

In this context, the priorities in the supervisory activity will be increasingly harmonized with those adopted by the **Single Supervisory Mechanism** so as to facilitate dialogue with European authorities such as the EBA, ESMA, and EIOPA, while reducing the risk of duplicating compliance burdens for supervised entities. For the banking sector, relevance is attached to resilience to macroeconomic shocks that impact credit quality and the ability to manage interest rate risk in the banking book, verifying banks' ability to perform early diagnoses of vulnerable portfolios and present credible plans for managing non-performing exposures.

For CBSM, dialogue and technical support from equivalent EU institutions contribute to the best implementation of rules, processes, and tools that have already been tested and proven effective in carrying out the complex tasks of analyzing, evaluating, and intervening on the technical situations of the financial institutions under supervision.

Technical cooperation with Deutsche Bundesbank began in 2023, covering eight areas, and exchanges are ongoing with the Andorran Financial Authority, which is undergoing a similar process of operational and regulatory alignment. Further operational agreements will be drawn up in this area in the coming months.

These instruments foster the exchange of expertise, the development of mentoring initiatives, peer-assistance missions, and the implementation of joint training modules. This creates a virtuous circle: we learn from European best practices while simultaneously sharing San Marino's experience.



These initiatives also reflect CBSM's commitment to strengthening skills through structured upskilling paths of staff. Strengthening technical and transversal capabilities means better monitoring financial stability, adopting updated risk-based supervisory methodologies, mastering digital innovations, and improving the quality of analyses on operational resilience, cyber risk, and sustainable finance. Above all, it means ensuring that the San Marino financial system speaks the same language as its European counterparts.

Continuing education is, therefore, the bridge between our identity and our European ambition. Investing in people means building stronger institutions, more transparent markets, and more effective protection of savers and the country's reputation.

This training commitment necessarily involves trade associations and individual intermediaries, for whom raising levels of professionalism is a necessary condition for dealing with an increasingly integrated market.

Further progress is expected over the next year through collaboration agreements with universities and European institutions, in order to enhance access to the EU knowledge base on supervisory application practices.

On the international side, CBSM is strongly committed to signing new cooperation agreements for the exchange of information for supervisory purposes. These agreements enable the acquisition of fundamental information about potential foreign investors who, also attracted by the future European perspective, are making requests to establish new financial operators or acquire significant stakes in those already operating.

Over the last three years, the Supervisory Department has exchanged data and documents with 15 foreign authorities in the context of authorization procedures (of the CBSM or of the analogous foreign authority), without taking into account informal exchanges, which are nonetheless equally useful in guiding the attention of CBSM analysts in the performance of market entry controls.

From a broader perspective and taking into account the dynamics of the banking and financial sector, CBSM has long been implementing initiatives aimed at ensuring the durable resolution of the remaining vulnerabilities affecting the banking sector. These actions have contributed to a continued reduction in non-performing loans (NPLs), as well as to improvements in profitability, capital adequacy, and liquidity ratios.

Given the expected regulatory impact of the European framework, the CBSM will continue to constantly assess prospective capital needs with a view to strengthening capital buffers, also taking into account the need to invest in technology and human resources, including both the enhancement of staff skills and the hiring of new specialised staff.

The capital strengthening process undertaken by banks must continue: the progressive implementation of calendar provisioning regulations, the increasing weighting of non-operating real estate, and the application of capital requirements for market risks, while

aligning prudential measures with those of European banks, require action to broaden the capital base, in line with developments observed in Europe over the past 15 years, particularly among smaller institutions.

Banking institutions' profitability must be consistent and sustained, so as to support their medium- to long-term growth, and enable the build-up and maintenance of adequate capital buffers, even in the presence of interest rate dynamics that differ from those observed in recent years.

In particular, specific cost-reduction strategies must be identified and implemented, including through the widespread use of digital banking services that can reduce the size of the sales network or at least its human resource costs, in line with ongoing processes in the European banking sector.

The successful completion of the system securitization will prompt further necessary considerations on the phase following the completion of the repayment of Senior ABS, with a view to assessing the balance between the costs of the transaction and possible further benefits in terms of debt recovery and the resulting actions, such as new securitizations or the alignment of the value of the ABS in banks' portfolios with the losses incurred.

As far as NPLs are concerned, beyond the new rules on calendar provisioning, CBSM expects banks to continue their prudent write-down policy in order **to achieve in the short term an NPL ratio (net of write-downs and prudential provisions) lower than 10%**, a value not far from that recorded by less significant banks in Eurozone countries.

There remain areas of concern on which the Supervisory Authority is focusing its efforts, also considering some gaps identified by the competitive positioning analysis, starting with the necessary increase in the ratio of interest-bearing assets. The recovery of non-performing loans, especially bad loans, has increased the non-instrumental real estate assets managed by banks, which, in the long run, will have to be divested.

System-wide initiatives, such as the establishment of real estate funds, the updating of accounting regulations for leasing, incentives to attract foreign investment, and the redevelopment of residential buildings, could facilitate the reallocation of part of these fixed assets back into the market.

Regulatory or administrative measures aimed at expanding the pool of potential buyers of real estate in the Republic of San Marino, albeit with gradual implementation and rigorous preliminary controls, could, on the one hand, have a positive impact on the economy as a whole and, on the other, amplify the effects of supervisory initiatives aimed at reducing the impact of real estate on banks' balance sheets. In this context, the full adoption of European prudential regulations and the associated increased capital absorption of investments in non-instrumental real estate could accelerate the consolidation of such assets.



Transparency in the real estate market is a further prerequisite for its orderly functioning. The creation of a permanent observatory of sales by type of use, including detailed information on prices per square metre by location within each “Castello” (municipality), would represent an important step towards enhancing market depth in what otherwise remains an inefficient segment.

This will accelerate the disposal of assets and facilitate the full application of the new European standards, including those regarding the full weighting of properties.

The tax credit component of balance sheet assets also requires close attention, as it represents, together with real estate, the most significant non-interest-bearing component. Regulatory interventions aimed at enabling their mobilization, as occurred in other EU countries ahead of the more stringent Basel rules on bank capital, are not only desirable but necessary.

In this context, tools should be established to convert **tax credits** into interest-bearing/tradable assets or assets eligible as collateral, under a clear prudential framework (including concentration limits, eligibility criteria, and repayment schedule) to free up capital to support lending to the real economy (also by replacing incentives, such as tax breaks, for starting new businesses in sectors deemed strategic for San Marino), albeit with all the necessary safeguards to reduce the impact on the state budget so as to make it gradual and sustainable.

Adapting information systems will be essential. Banks and other financial institutions must complete the modernization of core systems, transition to modular and API-first architectures, and standardize operating models. This is the foundation for timely reporting, reliable risk models, and data-driven supervision, as well as for maintaining competitiveness in the face of the challenges posed by open banking.

At the same time, operational resilience must be strengthened to provide a competitive advantage: clear governance, mapping of critical functions, disruption tolerance, periodic testing, and robust third-party management, with a focus on timely detection and response capabilities for potential vulnerabilities, ensuring operational continuity in line with the requirements of the relevant EU legislation (DORA).

To reduce compliance costs and improve the quality of controls, the RegTech/SupTech combination will increasingly become a structural lever for establishing secure and automated digital channels for data exchange with CBSM, enabling timelier supervisory and inspection cycles.

It also appears necessary to fully digitize customer interaction tools end-to-end, from onboarding to the provision of advanced and secure services in the areas of credit, payments, investments, and insurance, with full use of electronic signatures and remote KYC, to ensure responsible customization of the offering.



With regard to the EU prudential framework for banking, following the transposition of the market risk legislation, over the next three years, steps will be completed to fully implement the rules on credit and operational risk requirements, while also adapting the rules for liquidity risk by adopting indicators similar to those of the European Union (Liquidity Coverage Ratio and Net Stable Funding Ratio). At the same time, the rules on the composition of own funds will be revised, which, together with appropriate legislative measures regarding tax credits, will allow for a smoother transition to the new provisions.

In terms of **policy recommendations**, there remains a need to strengthen **the CBSM's financial autonomy**. This issue has been raised on several occasions and has also been highlighted in the IMF's most recent reports on San Marino, particularly in light of the current budget constraints.

For years, the Bank has adopted a policy of cost containment and expense control. However, given the numerous and increasingly complex tasks entrusted to us, we are aware that – as already stated in the 2023 budget – *"no intervention will be sufficient unless accompanied by full recovery of the costs incurred for services rendered to the system and the State. These costs are extensively documented and inherent to the complexity and breadth of the activities performed with a spirit of service, including the ongoing and qualified technical support provided to the Secretariats of State and related Departments... As repeatedly reiterated, the Central Bank's financial autonomy is not only a safeguard of stability for the entire system but also a means of safeguarding its independence, to avoid interference and influences that could compromise its action. The Central Bank must work with even greater determination, also taking into account the future commitments arising from the Association Agreement with the European Union, in the exclusive interest of the country."*

In the banking and financial sector, in addition to the considerations outlined above regarding the real estate market and tax credits, it is necessary to promote a **regulatory environment conducive to the adoption of the most advanced technologies for storing, processing, and managing data acquired by banks and other authorized entities**. This would support a more efficient provision of financial services and help overcome existing constraints that continue to affect the competitiveness of domestic institutions, including with regard to the remote provision of financial services.

Equally relevant may be measures aimed at encouraging **the repatriation of liquidity held abroad, including through an extraordinary and voluntary mechanism**, limited in time, designed to incentivise the return of liquidity to supervised Sammarinese intermediaries, with **full AML/CFT compliance**, proportionate tax incentives and investment restrictions on domestic instruments to support the economy.



Another important area relates to the further **strengthening of the debt recovery framework**, through continued **monitoring of the effects** of the 2021 reform (collection times, recovery rates) and the identification and resolution of any regulatory and judicial bottlenecks.

At the same time, in line with the actions already undertaken, the gradual replacement of the perpetual government bonds held on the Cassa di Risparmio's balance sheet with securities, including long-term ones, at market rates must continue, with a view to facilitating their early mobilization and increasing the liquidity of the bank's assets.



The Central Bank will continue to provide advisory support to San Marino institutions in identifying the most appropriate solutions to address forthcoming challenges and in tackling the remaining vulnerabilities that require timely and targeted interventions.

We face these challenges with firm resolve, aware of the significant results achieved in recent years, thanks to constructive dialogue and loyal collaboration with supervised entities, as well as the essential coordination with the institutions of the Republic. These elements provide a solid foundation for the path that lies ahead.