
Risk management

MAIN RISKS AND UNCERTAINTIES

The macroeconomic scenario and the high volatility of the financial markets require constant monitoring of the factors that make it possible to pursue sustainable profitability: high liquidity, funding capability, low leverage, adequate capital base, and prudent asset valuations.

Group liquidity remains high: as at 31 March 2019, both regulatory indicators LCR and NSFR, also adopted as internal liquidity risk measurement metrics, were well above fully phased-in requirements established by Regulation 575/2013 and Directive 2013/36/EU. At the end of March, the Central Banks eligible liquidity reserves came to 194 billion euro (175 billion euro at the end of December 2018), of which 99 billion euro, net of haircut, was unencumbered (89 billion euro at the end of December 2018) and unused.

The loan to deposit ratio at the end of March 2019, calculated as the ratio of loans to customers to direct deposits from banking business, came to 93%.

In terms of funding, the widespread branch network remains a stable, reliable source: 75% of direct deposits from banking business come from retail operations (319 billion euro). In addition, 1 billion euro of covered bonds, 13.2 billion Yen of unsecured senior Tokyo Pro-Bonds were placed during the quarter.

With regard to the targeted refinancing operation TLTRO II, at the end of March 2019, the Group's participation amounted to 61 billion euro.

The Intesa Sanpaolo Group's leverage ratio was 6.0% as at 31 March 2019.

The capital base also remains high. Own funds, risk-weighted assets and the capital ratios at 31 March 2019 have been calculated according to the harmonised rules and regulations for banks and investment companies contained in Directive 2013/36/EU (CRD IV) and in Regulation (EU) 575/2013 (CRR) of 26 June 2013, which have transposed the banking supervision standards defined by the Basel Committee (the Basel 3 Framework) to European Union laws, and on the basis of Bank of Italy Circulars 285, 286 and 154.

At the end of the period, Own Funds – taking account of the transitional treatment adopted to mitigate the impact of IFRS 9 – came to 48,719 million euro, against risk-weighted assets of 283,641 million euro, which primarily reflected credit and counterparty risk and, to a lesser extent, market and operational risk.

The Total Capital Ratio stood at 17.2%, while the ratio of the Group's Tier 1 capital to its total risk-weighted assets (Tier 1 ratio) was 14.8%. The ratio of Common Equity Tier 1 capital (CET1) to risk-weighted assets (the Common Equity Tier 1 ratio) was 13.1%.

Having met the regulatory requirements for its inclusion pursuant to article 26(2) of the CRR, the Common Equity Tier 1 Capital as at 31 March 2019 took account of the figure of 20% of the net income for the period (net of foreseeable costs), in consideration of the payout ratio of 80% established for 2019 in the dividend policy of the 2018-2021 Business Plan.

The Group's risk profile remained within the limits approved by the Risk Appetite Framework, consistent with the intention to continue to privilege commercial banking operations.

In relation to market risk, the Group's average risk profile, measured in terms of VaR, during the first three months of 2019 was 177 million euro, compared to an average amount of approximately 95 million euro in the previous quarter. The trend in the Group's VaR in the period - mainly determined by Banca IMI - described in greater detail later in this chapter, derives from an increase in the risk measures, mainly attributable to government bonds dealing, consistently with the 2019 Risk Appetite Framework.

The macroeconomic environment and the financial market volatility heighten the complexity of assessing credit risk and measuring financial assets.

Intesa Sanpaolo has developed a set of instruments which ensure analytical control over the quality of loans to customers and financial institutions, and of exposures subject to country risk.

With regard to performing loans to customers, the "collective" adjustments, equal to 2,029 million euro, provide a coverage ratio of 0.5%, which is sufficient for the intrinsic risk of the Stage 1 and Stage 2 portfolios.

The methods used to classify non-performing loans and to measure both non-performing and performing loans ensure that the impacts of the deteriorating economic environment on a debtor's position are promptly recognised. The economic context has called for constant review of the values of loans that had already shown problematic symptoms and of loans with no obvious signs of impairment. All categories of non-performing loans are carefully assessed. Bad loans and unlikely-to-pay loans had coverage levels of 66.2% and 37.1% respectively.

Constant attention has been paid to the valuation of financial items. The majority of the financial assets are measured at fair value. Excluding the insurance segment whose financial assets are almost all measured using level 1 inputs, the fair value measurement of the remaining financial assets measured at fair value through profit and loss was carried out as follows: around 62% using level 1 inputs, around 31% using level 2 inputs and only around 7% using level 3 inputs.

Investment levels in structured credit products and hedge funds remained low. The structured credit products generated a positive contribution of 16 million euro during the period, whereas the hedge funds generated a profit of 2 million euro over the three months, as described in more detail in the specific paragraphs of this chapter.

In volatile market environments, measuring the recoverable amount of intangible assets is also particularly delicate. However, with regard to intangible assets and goodwill, no problem issues were identified during the quarter – also in consideration of the short length of time since the last impairment test – requiring the remeasurement of their recoverable values. In any event, it should be noted that, with regard to the scenario forecasts included in the income projections used for the 2018 impairment test, the latest macroeconomic estimates appear to envisage a possible reduction of Italian GDP growth

from 0.6% to 0.2% for 2019. However, even if we assume that this reduction takes place and persists throughout the plan scenario, this would result in a potential risk, understood as an adverse impact on the Group's net income, that would not generate critical impairment issues for any of the Cash Generating Units (CGUs) to which intangible assets with an indefinite useful life have been allocated. In addition, the analyses conducted did not identify any changes to the main parameters and macroeconomic aggregates that could have an adverse impact on the discount rates underlying the models used to verify the carrying amount of the intangible assets with an indefinite useful life. Specifically, there was a general decrease in both the rates used to discount the cash flows over the "explicit" forecast period and those relating to the terminal value. On the other hand, for the intangible assets with finite useful lives, no critical factors have arisen regarding the stability of the recoverable amount, thanks to both the positive trend in insurance reserves and in volumes (Assets under Management and Client relationships).

THE BASIC PRINCIPLES OF RISK MANAGEMENT

The policies relating to risk taking and the processes for the management of the risks to which the Group is or could be exposed are defined by the Board of Directors of Intesa Sanpaolo as the Parent Company, with the support of the Risks Committee. The Management Control Committee, which is the body with control functions, supervises the adequacy, efficiency, functionality and reliability of the risk management process and of the Risk Appetite Framework.

The Managing Director and CEO has the power to submit proposals for the adoption of resolutions concerning the risk system and implements all the resolutions of the Board of Directors, with particular reference to the implementation of the strategic guidelines, the RAF and the risk governance policies.

The Corporate Bodies also benefit from the action of some Management Committees on risk management. These committees, which include the Steering Committee, operate in compliance with the primary responsibilities of the Corporate Bodies regarding internal control system and the prerogatives of corporate control functions, and in particular the risk control function.

Subject to the powers of the Corporate Bodies, the Chief Risk Officer Governance Area is responsible for: (i) governing the macro-process of definition, approval, control and implementation of the Group's Risk Appetite Framework with the support of the other corporate functions involved; (ii) cooperating with the Corporate Bodies in setting the Group's risk management guidelines and policies in accordance with the company's strategies and objectives; (iii) coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, including within the various corporate departments; (iv) ensuring the management of the Group's overall risk profile by establishing methods and monitoring exposure to the various types of risk and reporting the situation periodically to the Corporate Bodies.

The Parent Company performs a guidance and coordination role with respect to the Group companies, aimed at ensuring effective and efficient risk management at Group level, exercising responsibility in setting the guidelines and methodological rules for the risk management process, and pursuing, in particular, integrated information at Group level to the Bodies of the Parent Company, with regard to the completeness, adequacy, functioning and reliability of internal control system. For the corporate control functions in particular, there are two different types of models within the Group: (i) the centralised management model based on the centralisation of the activities at the Parent Company and (ii) the decentralised management model that involves the presence of locally established corporate control functions that conduct their activities under the direction and coordination of the same corporate control functions of the Parent Company, to which they report in functional terms.

Irrespective of the control model adopted within their company, the corporate bodies of the Group companies are aware of the choices made by the Parent Company and are responsible for the implementation, within their respective organisations, of the control strategies and policies pursued and promoting their integration within the Group controls.

The risk measurement and management tools contribute to defining a risk-monitoring framework at Group level, capable of assessing the risks assumed by the Group from a regulatory and economic point of view. The level of absorption of economic capital, defined as the maximum "unexpected" loss the Group might incur over a year, is a key measure for determining the Group's financial structure, risk appetite and for guiding operations, ensuring a balance between risks assumed and shareholder returns. It is estimated on the basis of the current situation and also as a forecast, based on the budget assumptions and projected economic scenario. The assessment of capital is included in business reporting and is submitted quarterly to the Steering Committee, the Risks Committee and the Board of Directors, as part of the Group's Risks Tableau de Bord. Risk hedging, given the nature, frequency and potential impact of the risk, is based on a constant balance between mitigation/hedging action, control procedures/processes and capital protection measures.

THE BASEL 3 REGULATIONS

In view of compliance with the reforms of the previous accord by the Basel Committee ("Basel 3"), the Intesa Sanpaolo Group has undertaken adequate project initiatives, expanding the objectives of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.

Having regard to the credit risk, the development of the IRB systems is proceeding according to the plan presented to the Supervisory Authority. There have been no updates since 31 December 2018.

There were no changes in the scope of application of the internal models concerning counterparty risk for OTC derivatives and operational risks compared to 31 December 2018.

The annual Internal Capital Adequacy Assessment Process (ICAAP) Report, based on the extensive use of internal approaches for the measurement of risk, internal capital and total capital available, was approved and sent to the ECB in April 2019.

As part of its adoption of Basel 3, the Group publishes information concerning capital adequacy, exposure to risks and the general characteristics of the systems aimed at identifying, monitoring and managing them in a document entitled "Basel 3 - Pillar 3" or simply "Pillar 3".

The document is published on the website (group.intesasanpaolo.com) on a quarterly basis.

CREDIT RISK

The Intesa Sanpaolo Group has developed a set of techniques and tools for credit risk measurement and management which ensures analytical control over the quality of loans to customers and financial institutions, and loans subject to country risk.

In particular, with regard to loans to customers, risk measurement is performed by means of different internal rating models according to borrower segment (Corporate, Retail SME, Retail, Sovereigns, Italian Public Sector Entities and Banks). These models make it possible to summarise the counterparty's credit quality in a value, the rating, which reflects the probability of default over a period of one year, adjusted on the basis of the average level of the economic cycle. These ratings are then made comparable with those awarded by rating agencies, by means of a consistent scale of reference.

Ratings and credit-risk mitigating factors (guarantees, loan types and covenants) play a key role in the loan granting and managing process.

Credit quality

Captions	31.03.2019		01.01.2019		Change		
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	
Bad loans	20,975	-13,893	7,082	21,734	-14,596	7,138	-56
Unlikely to pay	14,046	-5,205	8,841	14,268	-5,167	9,101	-260
Past due loans	503	-127	376	473	-121	352	24
Non-Performing Loans	35,524	-19,225	16,299	36,475	-19,884	16,591	-292
<i>Non-performing loans in Stage 3 (subject to impairment)</i>	35,416	-19,199	16,217	36,396	-19,865	16,531	-314
<i>Non-performing loans designated at fair value through profit or loss</i>	108	-26	82	79	-19	60	22
Performing loans	375,877	-2,029	373,848	373,877	-2,105	371,772	2,076
<i>Stage 2</i>	44,312	-1,277	43,035	43,880	-1,316	42,564	471
<i>Stage 1</i>	331,119	-752	330,367	329,555	-789	328,766	1,601
<i>Performing loans designated at fair value through profit or loss</i>	446	-	446	442	-	442	4
Performing loans represented by securities	5,426	-22	5,404	5,131	-19	5,112	292
<i>Stage 2</i>	1,397	-18	1,379	986	-16	970	409
<i>Stage 1</i>	4,029	-4	4,025	4,145	-3	4,142	-117
Loans held for trading	44	-	44	75	-	75	-31
Total loans to customers	416,871	-21,276	395,595	415,558	-22,008	393,550	2,045
<i>of which forbore performing</i>	7,931	-359	7,572	8,322	-385	7,937	-365
<i>of which forbore non-performing</i>	8,960	-3,700	5,260	9,192	-3,755	5,437	-177
Loans to customers classified among non-current assets held for sale and discontinued operations(*)	1,135	-267	868	1,244	-310	934	-66

Figures restated, where necessary and material, considering the changes in the scope of consolidation and discontinued operations.

(*) As at 31 March 2019, this caption included the portfolio of bad loans/unlikely-to-pay loans and performing loans soon to be sold (gross exposure of 351 million euro, total adjustments of 136 million euro, net exposure of 215 million euro) and the so-called "high-risk" loans originating from the Aggregate Set of Banca Popolare di Vicenza and Veneto Banca, reclassified as bad loans and/or unlikely-to-pay loans, for which the sale contract provides the option to transfer them to the Banks in compulsory administrative liquidation (gross exposure of 785 million euro, total adjustments of 132 million euro, net exposure of 653 million euro).

As at 31 March 2019, the Group's net non-performing loans amounted to 16.3 billion euro, down by 1.8% compared with the beginning of the year, continuing the progressive decline that marked the previous year. Non-performing assets decreased as a percentage of total net loans to customers, down to 4.1%. The coverage ratio for non-performing loans remained high at 54.1%, in accordance with the de-risking strategy outlined in the Business Plan.

In further detail, bad loans came to 7.1 billion euro, net of adjustments, at the end of March 2019, confirming the figure of the beginning of the year, and continued to represent 2.6% of total loans. During the same period, the coverage ratio stood at 66.2%. Loans included in the unlikely-to-pay category amounted to 8.8 billion euro, down by 2.9%, accounting for 2.2% of total loans to customers, with a coverage ratio of 37.1%. Past due loans amounted to 376 million euro, up 6.8% since the beginning of the year, with a coverage ratio of 25.2%. Within the non-performing loan category, forbore exposures, generated by forbearance measures for borrowers experiencing difficulties in meeting their financial obligations, amounted to 5.3 billion euro, with a coverage ratio of 41.3%, while forbore exposures in the performing loans category amounted to 7.6 billion euro.

Overall, the coverage ratio of performing loans amounted to 0.5%, sufficient for the intrinsic risk of the Stage 1 and Stage 2 portfolios.

MARKET RISKS

TRADING BOOK

During the first quarter of 2019, the market risks generated by Intesa Sanpaolo and Banca IMI increased compared to the average values of the fourth quarter of 2018, consistently with the 2019 RAF. The average VaR for the period totalled 177 million euro compared to 95.2 million euro in the previous quarter.

Daily VaR of the trading book for Intesa Sanpaolo and Banca IMI^(a)

	2019			2018			
	average 1st quarter	minimum 1st quarter	maximum 1st quarter	average 4th quarter	average 3rd quarter	average 2nd quarter	average 1st quarter
Intesa Sanpaolo	16.9	14.1	19.0	13.9	14.4	11.8	7.8
Banca IMI	160.1	102.6	192.3	81.3	75.9	50.1	40.3
Total	177.0	116.7	208.8	95.2	90.4	61.9	48.1

(a) Each line in the table sets out past estimates of daily VaR calculated on the quarterly historical time-series of Intesa Sanpaolo and Banca IMI, respectively; minimum and maximum values for the two companies are recalculated using aggregate historical time-series and therefore do not correspond to the sum of the individual values in the column.

In the first three months of 2019, the Group's average VaR was 177 million euro, up from 48.1 million euro in the same period of 2018.

	2019			2018		
	average 1st quarter	minimum 1st quarter	maximum 1st quarter	average 1st quarter	minimum 1st quarter	maximum 1st quarter
Intesa Sanpaolo	16.9	14.1	19.0	7.8	6.9	9.5
Banca IMI	160.1	102.6	192.3	40.3	24.6	52.0
Total	177.0	116.7	208.8	48.1	33.7	59.9

(a) Each line in the table sets out past estimates of daily VaR calculated on the historical time-series of the first three months of the year of Intesa Sanpaolo and Banca IMI, respectively; minimum and maximum values for the two companies are recalculated using aggregate historical time-series and therefore do not correspond to the sum of the individual values in the column.

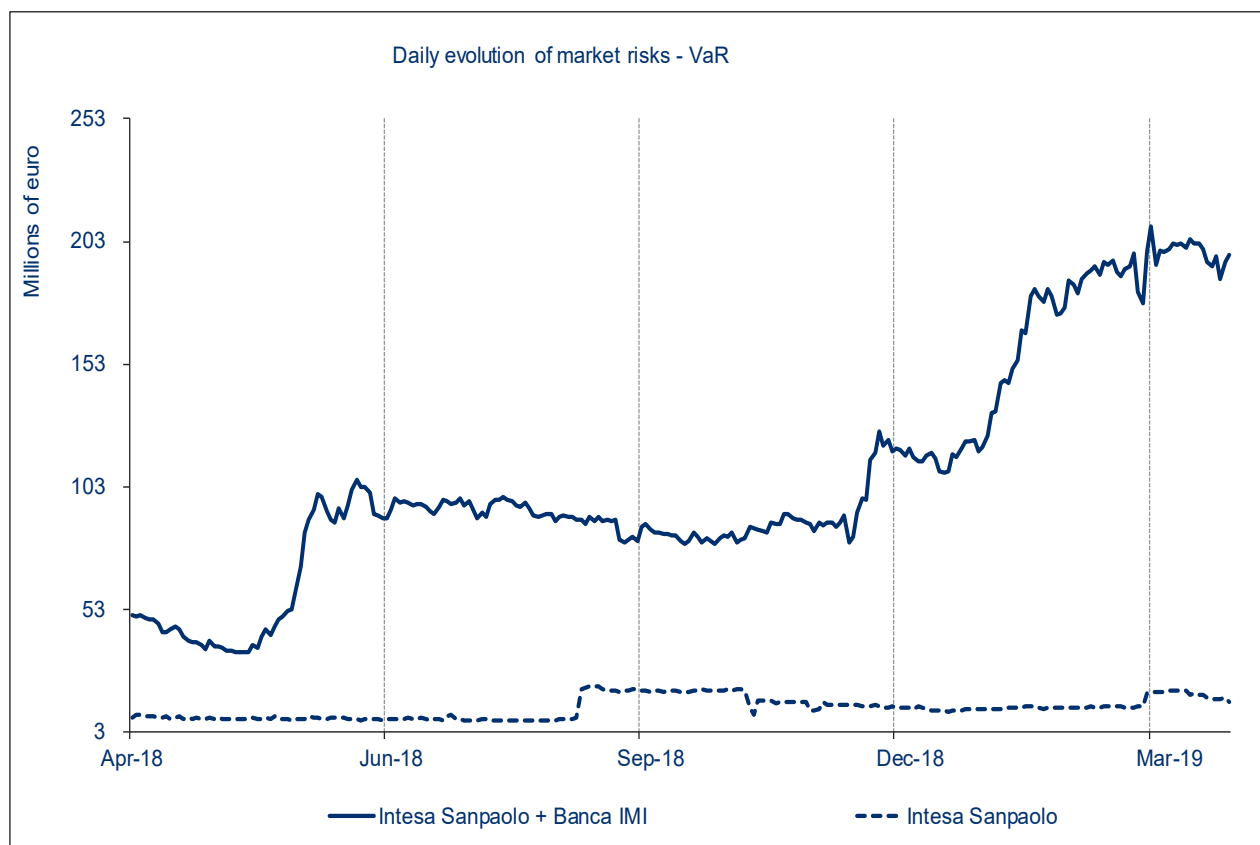
For Intesa Sanpaolo, the breakdown of risk profile in the first quarter of 2019 with regard to the various factors shows the prevalence of credit spread risk, equal to 61% of total operational VaR; for Banca IMI too credit spread risk was the most significant, representing 87% of total VaR.

Contribution of risk factors to total VaR^(a)

1st quarter 2019	Shares	Hedge funds	Interest rates	Credit spreads	Foreign exchange rates	Other parameters	Commodities
Intesa Sanpaolo	1%	2%	23%	61%	12%	1%	0%
Banca IMI	2%	0%	8%	87%	0%	2%	1%
Total	2%	0%	10%	85%	1%	2%	0%

(a) Each line in the table sets out the contribution of risk factors considering the overall VaR 100%, calculated as the average of daily estimates in the first quarter of 2019, broken down between Intesa Sanpaolo and Banca IMI and indicating the distribution of overall VaR.

The trend in VaR is mainly attributable to Banca IMI's operations. During the first quarter of 2019, the risk measures increased, mainly as a result of dealings in government bonds. However, as stated above, the increase in risks is consistent with the 2019 RAF.



Risk control with regard to the trading activity of Intesa Sanpaolo and Banca IMI also uses scenario analyses and stress tests. The impact on the income statement of selected scenarios relating to the evolution of stock prices, interest rates, credit spreads and foreign exchange rates as at the end of March is summarised in the following table: The shocks applied to the portfolio were updated annually.

	EQUITY		INTEREST RATES		CREDIT SPREADS		FOREIGN EXCHANGE RATES		COMMODITIES	
	Crash	Bullish	+40bp	lower rate	-25bp	+25bp	-10%	+10%	Crash	Bullish
Total	17	7	-158	105	638	-605	22	2	-2	1

Among these:

- for stock market positions, there would be a profit in both crash and bullish scenarios, given the portfolio non-linearity;
- for positions in interest rates, there would be a loss of 158 million euro in the event of an increase in rate curves of 40 bps;
- for positions in credit spreads, a widening of credit spreads of 25 bps would entail a loss of 605 million euro (referred to government bonds);
- for foreign exchange positions, there would be a profit in both appreciation and depreciation scenarios, given the portfolio non-linearity;
- finally, for positions in commodities, there would be a loss of 2 million euro in the event of a reduction in commodity prices of 20% accompanied by an increase in the price of precious metals of 15%.

Backtesting

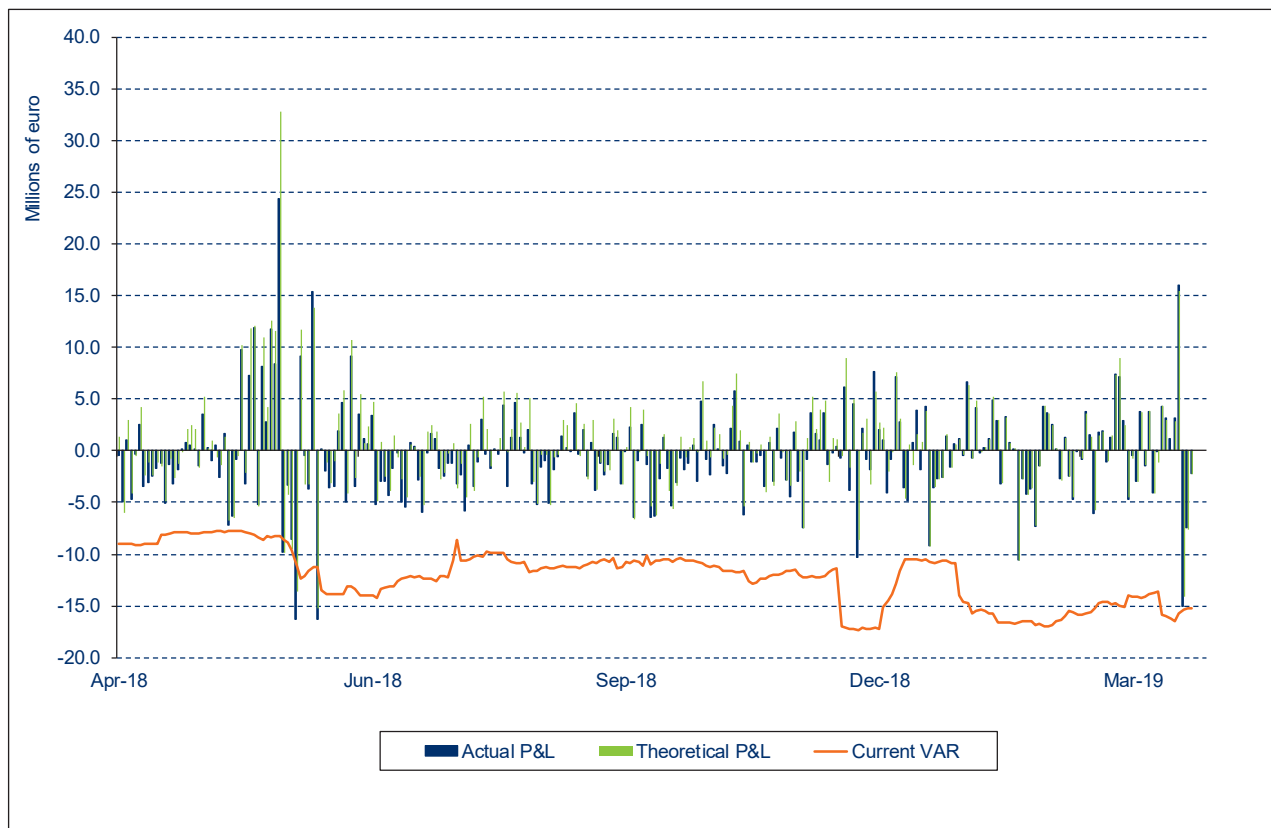
The soundness of the VaR calculation methods must be monitored daily via backtesting which, for the regulatory backtesting, compares:

- the daily estimates of value at risk;
- the daily profits/losses based on backtesting are calculated using the daily profits and losses achieved by the individual desks. This measure therefore needs to be stripped of the products and/or components that are not relevant to the backtesting checks: these include fees, financial costs of managing the positions and P&L reserves that are regularly reported within the managerial area.

Backtesting allows verification of the model's capability of correctly seizing, from a statistical viewpoint, the variability in the daily valuation of trading positions, covering an observation period of one year (250 estimates). Any critical situations relative to the adequacy of the internal model are represented by situations in which daily profits/losses based on backtesting highlight more than four occasions, in the year of observation, in which the daily loss is higher than the value at risk estimate. In accordance with the current regulations, the backtesting used by Intesa Sanpaolo involves both the P&L series actually recorded and the hypothetical series.

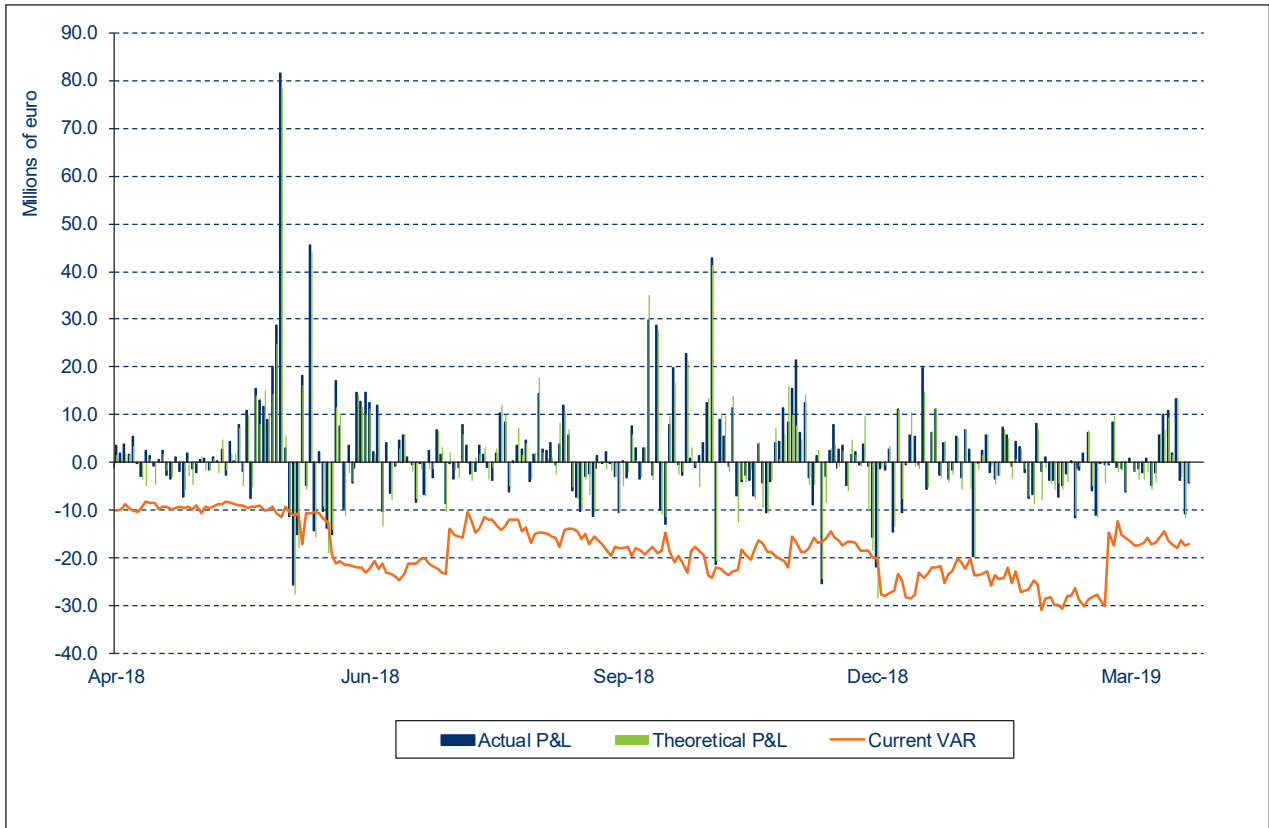
Backtesting in Intesa Sanpaolo

Over the last twelve months there have been three backtesting exceptions. The breaches were caused by the credit component of the portfolio, which was particularly affected by the volatility in the second half of May 2018. The volatility was particularly high for buy positions hedging credit indices.



Backtesting in Banca IMI

The credit spread volatility was very high in 2018. This volatility led to seven backtesting breaches for both hypothetical and actual P&L. The portfolio was particularly sensitive to the performance of the financial sector and to a lesser extent to the government sector.



BANKING BOOK

In the first three months of 2019, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity of value, averaged 954 million euro, with a minimum value of 702 million euro and a maximum value of 1,226 million euro, reaching a figure of 702 million euro at the end of March 2019 (1,143 million euro at the end of 2018), almost entirely concentrated on the euro currency.

The sensitivity of net interest income – assuming a +50, -50 and +100 basis point change in interest rates – amounted to 959 million euro, -982 million euro and 1,875 million euro, respectively, at the end of March 2019. The last of these figures was up on the 1,759 million euro recorded at the end of 2018.

Interest rate risk, measured in terms of VaR, recorded an average of 85 million euro in the first three months of 2019 (91 million euro at the end of 2018), with a minimum value of 74 million euro and a maximum value of 105 million euro; the latter figure coincides with the value at the end of March 2019. Price risk generated by minority stakes in listed companies, mostly held in the HTCS category and measured in terms of VaR, recorded an average level of 66 million euro in the first three months of 2019 (52 million euro at the end of 2018), with a minimum value of 60 million euro and a maximum value of 75 million euro; the latter figure coincides with the value at the end of March 2019.

Lastly, an analysis of banking book sensitivity to price risk, measuring the impact on Shareholders' Equity of a price shock on the above quoted assets recorded in the HTCS category shows sensitivity to a 10% negative shock equal to 58.8 million euro at the end of March 2019.

The table below shows the changes in the main risk measures during the first quarter of 2019.

	1st quarter 2019			(millions of euro)	
	average	minimum	maximum	31.03.2019	31.12.2018
Shift Sensitivity of the Economic Value +100 bp	954	702	1,226	702	1,143
Shift Sensitivity of Net Interest Income -50bp	-970	-952	-982	-982	-928
Shift Sensitivity of Net Interest Income +50bp	941	914	959	959	886
Shift Sensitivity of Net Interest Income +100bp	1,841	1,786	1,875	1,875	1,759
Value at Risk - Interest Rate	85	74	105	105	91
Value at Risk - Equity investments in listed companies	66	60	75	75	52

Lastly, the table below shows a sensitivity analysis of the banking book to price risk, measuring the impact on Shareholders' Equity of a price shock of $\pm 10\%$ for the abovementioned quoted assets recorded in the HTCS category.

Price risk: impact on Shareholders' Equity

		1st quarter 2019 impact on shareholders' equity at 31.03.2019	Impact on shareholders' equity at 31.12.2018
Price shock	10%	59	39
Price shock	-10%	-59	-39

LIQUIDITY RISK

In the first three months of 2019, the Group's liquidity position remained within the risk limits provided for in the Group's Liquidity Policy: both the LCR and NSFR indicators were largely respected, as they reached levels well above the regulatory and internal limits.

In 2019, the Liquidity Coverage Ratio (LCR) of the Intesa Sanpaolo Group, measured according to Delegated Regulation (EU) 2015/61, amounted to an average of 160%. For the purposes of compliance with the internal limits, the LCR indicator takes account also of the prudential estimate of the "additional outflows for other products and services", assessed based on the provisions of Delegated Regulation (EU) 2015/61 (Article 23).

As at 31 March 2019, the eligible liquidity reserves for the Central Banks, including the reserves held with Central Banks (cash and deposits), amounted to a total of 194 billion euro (175 billion euro at the end of December 2018), of which 99 billion euro, net of haircut, was unencumbered (89 billion euro at the end of December 2018) and unused. The HQLA component represented 64% of the own portfolio and 96% of the unencumbered one. The other eligible reserves mainly consist of retained self-securitisations.

The stress tests, when considering the high availability of liquidity reserves (liquid or eligible), yielded results in excess of the maximum threshold for the Intesa Sanpaolo Group, with a liquidity surplus capable of meeting extraordinary cash outflows for a period considerably longer than 3 months.

Adequate and timely information regarding the development of market conditions and the position of the Bank and/or Group was provided to the corporate bodies and internal committees in order to ensure full awareness and manageability of the main risk factors.

FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND LIABILITIES

Fair value hierarchy – Excluding insurance companies

Assets / liabilities at fair value	31.03.2019			01.01.2019		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets designated at fair value through profit or loss	17,075	28,547	2,579	11,037	28,462	2,616
a) <i>Financial assets held for trading</i>	16,786	27,614	379	10,748	27,655	403
<i>of which: Equities</i>	653	-	-	500	-	-
<i>of which: quotas of UCI</i>	905	1	45	913	2	47
b) <i>Financial assets designated at fair value</i>	-	198	-	-	208	-
c) <i>Other financial assets mandatorily designated at fair value</i>	289	735	2,200	289	599	2,213
<i>of which: Equities</i>	2	94	178	2	96	178
<i>of which: quotas of UCI</i>	287	101	1,283	267	-	1,334
2. Financial assets designated at fair value through other comprehensive income	59,011	6,945	484	53,527	6,399	543
<i>of which: Equities</i>	628	2,068	442	593	2,119	447
3. Hedging derivatives	-	2,908	11	-	2,983	10
4. Property and equipment	-	-	5,684	-	-	5,720
5. Intangible assets	-	-	-	-	-	-
Total	76,086	38,400	8,758	64,564	37,844	8,889
1. Financial liabilities held for trading	22,159	26,149	125	14,928	26,824	143
2. Financial liabilities designated at fair value	-	4	-	-	4	-
3. Hedging derivatives	-	9,062	4	-	7,216	5
Total	22,159	35,215	129	14,928	34,044	148

Fair value hierarchy – Insurance companies

Assets / liabilities at fair value	31.03.2019			01.01.2019		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	215	11	47	231	11	47
<i>of which: Equities</i>	-	-	-	-	-	-
<i>of which: quotas of UCI</i>	63	-	47	61	-	47
2. Financial assets designated at fair value through profit or loss	77,496	119	322	73,920	121	273
<i>of which: Equities</i>	2,011	-	-	1,678	-	-
<i>of which: quotas of UCI</i>	71,013	-	19	67,729	-	19
3. Financial assets available for sale	74,279	1,198	1,517	71,254	2,286	1,382
<i>of which: Equities</i>	1,068	-	-	979	-	-
<i>of which: quotas of UCI</i>	10,448	-	1,517	10,256	1	1,382
4. Hedging derivatives	-	36	-	-	21	-
5. Property and equipment	-	-	-	-	-	-
6. Intangible assets	-	-	-	-	-	-
Total Voice 35	151,990	1,364	1,886	145,405	2,439	1,702
1. Financial liabilities held for trading	3	53	-	3	41	-
2. Financial liabilities designated at fair value through profit or loss	-	70,899	-	-	67,755	-
3. Hedging derivatives	-	-	-	-	1	-
Total Voice 15	3	70,952	-	3	67,797	-

(millions of euro)

INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure in structured credit products amounted to 2,497 million euro as at 31 March 2019, related to funded and unfunded ABS/CDOs, compared to an exposure of 2,018 million euro as at 31 December 2018. As at 31 March 2019, there were no exposures in structured packages, in line with the situation as at 31 December 2018.

The strategy for this portfolio involved investments aimed at exploiting market opportunities, on the one hand, and disposals of the portfolio affected by the financial crisis, on the other hand.

The exposure in funded and unfunded ABSs measured at fair value rose from 1,818 million euro in December 2018 to 2,227 million euro in March 2019, a significant increase mainly attributable to Banca IMI and due to the higher level of investments made compared to the disposals in the portfolio of assets measured at fair value through other comprehensive income and of financial assets held for trading.

The exposure in securities classified as assets measured at amortised cost, rose from 200 million euro in December 2018 to 270 million euro in March 2019, a sharp increase attributable to the higher level of investments made in the period by Banca IMI.

The investments made by Banca IMI in the measured at fair value portfolio and the measured at amortised cost portfolio consisted of securities with underlying residential mortgages and CLOs with mainly AA ratings.

From an income statement perspective, a profit of +16 million euro was posted for the first three months of 2019, compared to a profit of +4 million euro for the first three months of 2018.

Specifically, as at 31 March 2019, the profits (losses) on trading - caption 80 of the income statement - for the exposures in funded and unfunded ABSs amounted to +4 million euro (+2 million euro in March 2018), whereas the positions in multi-sector CDOs were at nil, as in 2018.

The profits (losses) from financial assets mandatorily measured at fair value amounted to +12 million euro (nil in March 2018) and related to the funded and unfunded ABS positions in the Parent Company's loan portfolio, reclassified in 2018 into the new accounting category upon First-Time Adoption (FTA) of IFRS 9. This result was made up of +10 million euro of valuation components and +2 million euro of realisation components.

The exposure in funded and unfunded ABSs in securities classified as assets measured at fair value through other comprehensive income mainly related to the subsidiary Banca IMI and recorded an essentially nil net change in fair value in the Shareholders' Equity Reserve in 2019 (from a nil reserve at the end of December 2018 to a nil reserve in March 2019) and no impact from sales because none were made during the period, in line with the first three months of 2018.

No impacts were recognised for the securities classified as assets measured at amortised cost in the first three months of 2019 (in March 2018 the impact was +2 million euro).

With regard to the monoline and non-monoline packages, as in 2018, there were no positions held in 2019.

INFORMATION ON ACTIVITIES PERFORMED THROUGH SPECIAL PURPOSE ENTITIES (SPE)

For the purpose of this analysis, legal entities established to pursue a specific, clearly defined and limited objective (raising funds on the market, acquiring/selling/managing assets both for asset securitisations, acquisition of funding through self-securitisations and the issue of covered bonds, developing and/or financing specific business initiatives, undertaking leveraged buy-out transactions, or managing credit risk inherent in an entity's portfolio) are considered Special Purpose Entities.

The sponsor of the transaction is normally an entity which requests the structuring of a transaction that involves the SPE for the purpose of achieving certain objectives. In some cases, the Bank is the sponsor and establishes a SPE to achieve one of the objectives cited above.

For the SPE categories identified as not consolidated structured entities, no amendments are recorded to the criteria based on which the Intesa Sanpaolo Group decides on whether to include the companies in the scope of consolidation, compared to the information already provided in the 2018 financial statements.

In the first quarter of 2019, under the multi-originator programme guaranteed by ISP OBG, the securities of the 13th and 14th series were redeemed in advance in February for a total of 2.75 billion euro and two new series, the 32nd and 33rd, were issued for an amount of 1.65 billion euro each. The securities, both with variable interest rates and a maturity of 5 and 13 years respectively, are listed on the Luxembourg Stock Exchange with a DBRS rating of A High, were subscribed by the Parent Company, and are eligible for the Eurosystem.

With regard to the covered bond issue programme guaranteed by ISP CB Pubblico, in January the 13th series was partially redeemed (for an amount of 600 million euro), bringing the nominal amount to 1.05 billion euro.

Under the covered bond issue programme guaranteed by ISP CB Ipotecario, the 25th series was placed on the institutional market in March. This was a public benchmark issue for an amount of 1 billion. The bond, with a fixed rate coupon of 0.50% and a 5-year maturity, is listed on the Luxembourg Stock Exchange and has a Moody's rating of Aa3.

INFORMATION ON LEVERAGED FINANCE TRANSACTIONS

In May 2017, the ECB published specific Guidance on Leveraged Transactions, which applies to all significant entities subject to direct supervision by the ECB. The declared purpose of the regulations is to strengthen company controls over “leveraged” transactions, where such transactions increase globally and in the context of a highly competitive market, marked by a long period of low interest rates and the resulting search for yields.

The scope identified in the ECB Guidance includes exposures in which the borrower’s level of leverage, measured as the ratio of total financial debt to EBITDA, is greater than 4, in addition to exposures to parties whose majority of capital is held by one or more financial sponsors. Moreover, counterparties with Investment Grade ratings, individuals, credit institutions, companies in the financial sector in general, public entities, non-profit entities, as well as counterparties with credit facilities below a certain materiality threshold (5 million euro), Retail SME counterparties and Corporate SME counterparties if not owned by financial sponsors, are explicitly excluded from the scope of the Leveraged Transactions.

Specialised lending transactions (project finance, real estate, object financing and commodities financing) and certain other types of credit, such as trade finance operations, are also excluded.

As at 31 March 2019, for the Intesa Sanpaolo Group, the transactions that meet the definition of Leveraged Transactions in the ECB Guidance amounted to 23 billion euro, relating to approximately 2,700 credit lines (as at 31 December 2018 the amount was 22.4 billion euro, relating to around 2,900 credit lines).

In accordance with the requirements of the ECB Guidance, a specific limit for the outstanding stock of leveraged transactions was submitted for approval to the Board of Directors, within the framework of the 2019 Credit Risk Appetite.

INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The Hedge Fund portfolio as at 31 March 2019 amounted to 137 million euro in the trading book and approximately 116 million euro in the banking book, compared to 146 million euro and 88 million euro recognised in December 2018. The investments allocated to the banking book are recognised under financial assets mandatorily measured at fair value and relate to investments made in funds that have medium/long-term investment strategies and redemption times that are longer than those of UCITS (Undertakings for Collective Investment in Transferable Securities) funds.

During the first quarter of 2019, the reduction of the trading book continued through distributions and redemptions, with a consequent reduction in the risk level of the exposure. Specifically, the largest redemption in 2019 concerned the Aventicum fund for 9 million euro.

For the banking book, the most significant transactions were the divestment of the Psquared fund of 20 million euro, and the new investments in the Goldentree and Taconic funds of around 20 million euro each, as well as the increase in the exposure in the Eurizon European Leveraged Loan fund by around 5 million euro.

The income statement effect for the profits (losses) on trading - caption 80 of the income statement - at the end of March 2019 was essentially nil, compared to a loss of 8 million euro recorded in this caption in March 2018. None of the funds in the portfolio had significant valuation impacts.

The income statement effect recognised in the net profit (loss) on financial assets mandatorily measured at fair value - income statement caption 110 - at the end of March 2019 was a profit of almost 2 million euro. This result mainly reflected a general improvement in the valuations of the funds in the portfolio, although there were no significant specific cases.

As a whole, the current strategy of the portfolio remains prudent, while waiting for any market opportunities to arise.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 31 March 2019, the Intesa Sanpaolo Group, in relation to derivatives trading with retail customers, non-financial companies and public entities (therefore excluding banks, financial and insurance companies), presented a positive fair value, not having applied netting agreements, of 7,543 million euro (6,602 million euro as at 31 December 2018). The notional value of these derivatives totalled 60,792 million euro (57,047 million euro as at 31 December 2018).

The positive fair value of the contracts outstanding with the 10 customers with the highest exposures was 5,080 million euro.

Conversely, the negative fair value determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 1,457 million euro as at 31 March 2019 (1,412 million euro as at 31 December 2018). The notional value of these derivatives totalled 21,230 million euro (24,649 million euro as at 31 December 2018).

The fair value of derivative financial instruments entered into with customers was determined considering, as for all other OTC derivatives, the creditworthiness of the single counterparty (“Bilateral Credit Value Adjustment”). With regard to contracts outstanding as at 31 March 2019, this led to a negative effect of 21 million euro being recorded under “Profits (Losses) on trading” in the income statement.

For information on the different methodologies used in determining the fair value of financial instruments, see the specific paragraphs in this chapter and the more detailed description provided in the 2018 financial statements.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk and compliance risk, model risk, ICT risk and financial reporting risk; strategic and reputational risk are not included.

The Intesa Sanpaolo Group has for some time defined the overall operational risk management framework by setting up a Group policy and organisational processes for measuring, managing and controlling operational risk.

To determine its capital requirements, the Group employs a combination of the methods allowed under applicable regulations. The capital absorption resulting from this process amounted to 1,414 million euro as at 31 March 2019, unchanged compared to 31 December 2018.

Legal risks

Legal risks are thoroughly analysed by the Parent Company and Group companies. Provisions are made to the allowances for risks and charges in the event of disputes for which it is probable that funds will be disbursed and where the amount of the disbursement may be reliably estimated.

No new significant legal disputes arose during the first quarter of 2019 and there were no significant developments regarding the major disputes indicated in the Notes to the 2018 Financial Statements, to which reference should be made for further details.

Tax litigation

The Group's tax litigation risks are covered by adequate provisions to the allowances for risks and charges.

There was no new litigation of a significant amount in the first quarter.

The only event of note was the ruling in favour of Fideuram by the Court of Cassation in January 2019 in the litigation concerning direct taxes and VAT for the years 2003 and 2004. The favourable outcome resulted in: i) the release of the provision for litigation risks made to cover possible non-recovery; ii) the request for reimbursement of taxes, penalties and interest, totalling 14 million euro (plus accrued interest of 2.3 million euro), paid on a provisional basis.

Finally, as already reported extensively in the comments on the 2018 Financial Statements, Article 6 of the tax decree related to the 2019 Budget Act (Law Decree no. 119/2018) established the possibility of settling pending disputes through the so-called "tax amnesty" and on 1 April 2019 circular no. 6 of the Italian Revenue Agency was published, which examines the legal provisions in detail and provides numerous indications, also of an operational nature.

For details of the effects of the tax amnesty on the Parent Company's litigation and for a complete description of the current litigation, see the Notes to the 2018 Financial Statements.

INSURANCE RISKS

Investment portfolios

The investments of the insurance companies of the Intesa Sanpaolo Group (Intesa Sanpaolo Vita, Intesa Sanpaolo Assicura, Intesa Sanpaolo Life and Fideuram Vita) are made with their free capital and to cover contractual obligations with customers. These refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies. As at 31 March 2019, the investment portfolios of Group companies, recorded at book value, amounted to 158,126 million euro. Of these, a part amounting to 88,583 million euro relates to traditional revaluable life policies (the financial risk of which is shared with the policyholders by virtue of the mechanism whereby the returns on assets subject to segregated management are determined), non-life policies and free capital. The other component, whose risk is borne solely by the policyholders, consists of investments related to Index-linked policies, Unit-linked policies and pension funds and amounted to 77,543 million euro.

Considering the various types of risks, the analysis of investment portfolios, described below, concentrates on the assets held to cover traditional revaluable life policies, non-life policies and free capital.

In terms of breakdown by asset class, net of derivative financial instruments, 83% of assets, i.e. 66,885 million euro, were bonds, whereas equity instruments represented 1.6% of the total and amounted to 1,264 million euro. The remainder (12,414 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (15.4%).

The carrying value of derivatives came to approximately 19 million euro, of which -16 million euro relating to effective management derivatives¹, and the remaining portion (35 million euro) is attributable to hedging derivatives.

At the end of the first three months of 2019, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 977 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 47 million euro.

The breakdown of the bond portfolio in terms of fair value sensitivity to interest rate changes showed that a +100 basis points parallel shift in the curve leads to a decrease of approximately 3,486 million euro.

The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 3.8% of total investments and A bonds approximately 8.6%. Low investment grade securities (BBB) were approximately 85.1% of the total and the portion of speculative grade or unrated was minimal (2.5%).

A considerable portion of the BBB area is made up of securities issued by the Italian Republic.

The analysis of the exposure in terms of the issuers/counterparties produced the following results: securities issued by Governments and Central Banks approximately made up 77% of the total investments, while financial companies (mostly banks) contributed approximately 12.5% of exposure and industrial securities made up approximately 10.5%.

At the end of the first quarter of 2019, the fair value sensitivity of bonds to a change in issuer credit rating, intended as a market credit spread shock of +100 basis points, was 3,557 million euro, with 2,845 million euro due to government issuers and 712 million euro to corporate issuers (financial institutions and industrial companies).

¹ ISVAP Regulation 36 of 31 January 2011 on investments defines as "effective management derivatives" all derivatives aimed at achieving pre-established investment objectives in a faster, easier, more economical or more flexible manner than would have been possible acting on the underlying assets.