Intesa Sanpaolo - Results of the 2011 EU-Wide Stress Test

Intesa Sanpaolo was subject to the 2011 EU-wide stress test conducted by the European Banking Authority (EBA), in cooperation with the Bank of Italy, the European Central Bank (ECB), the European Commission (EC) and the European Systemic Risk Board (ESRB).

The EU-wide stress test, carried out across 90 banks covering over 65% of the EU banking system total assets, seeks to assess the resilience of European banks to severe shocks and their specific solvency to hypothetical stress events under certain restrictive conditions.

The assumptions and methodology were established to assess banks' capital adequacy against a 5% Core Tier 1 capital benchmark and are intended to restore confidence in the resilience of the banks tested. The Adverse Stress test scenario was set by the ECB and covers a two-year time horizon (2011-2012). The stress test has been carried out using a static balance sheet assumption as at December 2010. The stress test does not take into account future business strategies and management actions and is not a forecast of Intesa Sanpaolo profits. As a result of the assumed shock, the estimated consolidated Core Tier 1 capital ratio of Intesa Sanpaolo would change to 8.9% under the adverse scenario in 2012 compared to 7.9 % as of end of 2010.

This result incorporates the effects of the €5 billion capital increase fully committed up to 30 April 2011 and fully subscribed within 22 June 2011 and does not take into account future mitigating actions planned by Intesa Sanpaolo. The Core Tier 1 capital ratio of Intesa Sanpaolo would change to 7.4% under the Adverse Scenario in 2012 excluding the capital increase and the benefit of 458 million euro from the removal of the filter on goodwill detaxation occurred in the first quarter of 2011.

The stress test was carried out based on the EBA common methodology and key common assumptions (e.g. constant balance sheet, uniform treatment of securitisation exposures) as published in the EBA Methodological note. Therefore, the information relative to the Baseline Scenarios is provided only for comparison purposes. Neither the baseline scenario nor the Adverse Scenario should in any way be construed as a bank's forecast or directly compared to bank's other published.

The stress test has been carried out solely on the Group's banking perimeter. Therefore it does not cover the Insurance Hub, which in 2010 contributed 205 million euro to the Group's net income and around 30 billion euro to sovereign risk exposure.

The main assumptions included in the EBA methodology are shown below.

With respect to the **P&L** :

- Net interest income: the exercise involving Net interest income is carried out on assumptions of a static balance sheet, zero growth and a constant business mix. It also assumes inertial evolution in the Group's portfolio as at 31/12/2010 with no additional business and all maturing assets and liabilities being renewed under the original conditions (in terms of maturity, technical form,...) with the exception of the interest rate which is adjusted to the interest rate level assumed under the various scenarios. Moreover, assets transferred to default reduce the performing loan portfolio and are considered as partially no-interest bearing, which impacts materially on the Net interest income leading to a decrease in interest-bearing assets from 2010 to 2012. Under the Adverse Scenario, Net interest income is also negatively impacted by higher funding costs linked to increased sovereign risk (credit spread) that are transferred to the rates applied to customer loans only in part (in the region of 50%). In short, compared to 2010, the exercise on the Net interest income under the Adverse Scenario for 2012 shows a negative impact of around 0.6 billion euro due to the reduction in interest-bearing assets following defaulted asset flows and about 0.8 billion euro due to higher funding costs linked to the increase in the

credit spread (after the partial transfer to customer loan rates). This negative impact is in part offset by the positive impact of around 1.1 billion euro as a result of rising interest rates. Moreover, the exercise does not incorporate the benefit on Net interest income stemming from the liquidity generated by the capital increase.

- Funding cost: in the exercise the funding cost is defined as interests / end-of-the period volumes on an accrual basis. The cost of funding grows to 3.54% in 2012 under the Adverse Scenario from 1.59% in 2010 on the back of a rise in euribor between 1.70% and 1.95% on short-term maturities and on floating rate funding and a further increase of 1.08% due to an increase in the Country credit spread which causes a rise in the Intesa Sanpaolo credit spread. This evolution of the scenario impacts on the diverse types of funding in accordance with different rules. The cost of securities issued reflects the euribor trend in both wholesale and retail funding depending on respective repricing/renewal maturities. It is impacted fully (100%) by a rise in the credit spread with respect to wholesale funding and partially (70%) with respect to retail funding, still based on respective repricing/renewal maturities. Wholesale funding other than securities reflects both the euribor trend and 100% of the increase in the credit spread. The cost of deposits is affected by increased competition and is estimated on the basis of internal models.
- Net commissions: in line with the 2010 levels.
- Trading income: the figure reflects the average profitability of trading activities in the last five years (around 0.7 billion euro for Intesa Sanpaolo). This figure is adjusted by a stress effect which also includes valuation losses due to sovereign haircuts differentiated by Country and maturity.
- Other Operating Income: based on levels as at 2010 under the Baseline Scenario, subject to stress under the Adverse Scenario. Other Operating Income includes dividends and profits (losses) on investments carried at equity and profits (losses) on investments held to maturity and on other investments. The latter is a non-recurring item and in 2010 included 255 million euro from the measurement at fair value of Intesa Vita.
- Operating costs: based on the levels as at 2010.
- Impairments on loans: subject to banks' analytical estimation. This requires the use of internal models to calculate the impact of new defaulted assets following the forecasts of macro-economic variables under the two scenarios; some elements for the estimation of the impairments are prescribed and are different from internal management assumptions, in particular recovery on defaulted assets and transfer from substandard to performing loans are not allowed. The amount of impairments is substantially influenced by assumptions of a sharp rise in short-term rates and marked devaluation of the dollar, in particular under the Adverse Scenario.
- Impairments on participation: the impact derives from the ECB assumptions as regards the equity market trend.
- Other Income (includes extraordinary transactions and other captions): gains/losses from extraordinary transactions which were completed after 31 December 2010 are not recorded in the P&L for 2011 and 2012 (as a consequence, the effect from the disposals of branches and CR La Spezia to Crédit Agricole as well as the remaining stake in Findomestic has not been taken into account). The negative balance of this item results lower under the Adverse Scenario compared to the Baseline scenario due to the decrease in minority interests connected to the worsening of the whole P&L.

With respect to **RWAs**:

- Credit risks: impact from an adverse rating migration, in particular on the RWAs estimated applying IRB methods, but also on those for which the Standard method has been used.
- Securitization (Banking Book and Trading Book): this portfolio undergoes very tough pre-defined shocks of rating migration under both the Baseline and Adverse scenarios.
- Market risks: Banks are requested to apply CRD 3 (stressed VaR), with a consequent increase in requirements.

As regards the **Core Tier 1**:

- Dividends and, consequently, retained earnings: under the Baseline Scenario, payout internal estimates are applied that are consistent with any declared dividend policies. Intesa Sanpaolo assumes a payout ratio at 40%, slightly higher than the payout for 2010 relating to the Group's income statement including the Insurance Hub. Under the Adverse Scenario, the payout ratio is required to be equal to the median of the last three years. Intesa Sanpaolo calculates a payout ratio of around 37%, corresponding to a payout for the years 2009 and 2010 relating to the Group's income statement including the Insurance Hub.
- The 5 billion euro capital increase and the 458 million euro benefit resulting from the removal of the filter on goodwill detaxation are included under the various scenarios.

The definitions adopted for **customer segments and real estate exposure** are the following:

- *Corporate*: includes enterprises or groups of same either with exposure on the part of the banking Group above 1 million euro or having a consolidated turnover above 2.5 million euro;
- *Retail SMEs*: includes enterprises or groups of same either with exposure on the part of the banking Group below 1 million euro and having a consolidated turnover below 2.5 million euro;
- *Residential Mortgages*: include exposures guaranteed by mortgage on residential real estate;
- *Commercial Real Estate*: exposures guaranteed by mortgage on non-residential real estate;
- *Other:* includes other retail exposures;
- *Sovereign*: includes central and local administrations, central banks and public sector entities;
- *Institutions*: include intermediaries subject to supervisory authorities, non-profit entities, multi-lateral banks for development and international organisations.

The **Coverage Ratio** (stock of net provisions on defaulted assets / stock of defaulted assets) decreases compared to year-end 2010. This is mainly due to the fact that in the two-year time horizon of the stress test exercise new defaulted assets show incidence of substandard and past due loans higher than that at year-end 2010, particularly in the retail segment. Allocation to generic or specific coverage differs from that indicated in the financial statements as it is based on regulatory criteria.

EAD (*exposure at default*) includes both on and off-balance sheet exposures and gross of impairments.

The amount of **Deferred Tax Assets** coincides with the figure shown in the financial statements relating to the Group's banking perimeter as at 31/12/10 and not with the pro-forma figure for the purpose of Basel 3. The latter would be lower by about 4.1 billion euro mainly due to the exclusion of items relating to the goodwill detaxation and impairments on loans that would be treated as tax credits.