
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 30 September 2019, both the regulatory indicators LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio), 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 September, the Central Banks eligible liquidity reserves came to 197 billion euro (175 billion euro at the end of December 2018), of which 116 billion euro, net of haircut, was unencumbered (89 billion euro at the end of December 2018). The High Quality Liquid Assets (HQLA), which can be easily and immediately converted to meet liquidity needs, represented 62% of the own portfolio and 96% of the unencumbered one.

The loan to deposit ratio at the end of September 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: 77% of direct deposits from banking business come from retail operations (331 billion euro). In addition, the following were placed in the nine months: 1 billion euro of covered bonds secured by residential mortgages, 13.2 billion Yen of unsecured senior Tokyo Pro-Bonds, 2.25 billion euro and 2 billion USD of unsecured senior bonds, as well as inaugural unsecured senior bonds in Swiss francs of 250 million CHF.

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

The Intesa Sanpaolo Group's leverage ratio was 6.4% as at 30 September 2019.

The capital base also remains high. Own funds, risk-weighted assets and the capital ratios at 30 September 2019 are calculated according to the harmonised rules and regulations for banks and investment companies contained in Directive 2013/36/EU (CRD IV) and in (EU) Regulation 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 September, Own Funds – taking account of the transitional treatment adopted to mitigate the impact of IFRS 9 – came to 53,167 million euro, against risk-weighted assets of 298,393 million euro, which primarily reflected credit and counterparty risk and, to a lesser extent, market and operational risk.

The Total Capital Ratio stood at 17.8%, while the ratio of the Group's Tier 1 capital to its total risk-weighted assets (Tier 1 ratio) was 15.6%. The ratio of Common Equity Tier 1 capital (CET1) to risk-weighted assets (the Common Equity Tier 1 ratio) was 14%.

Having met the regulatory requirements for its inclusion pursuant to article 26(2) of the CRR, the Common Equity Tier 1 Capital as at 30 September 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 in terms of managerial VaR during the first nine months of 2019 was approximately 162 million euro, compared to an average amount of approximately 67 million euro in the same period of 2018. The performance of this indicator – mainly determined by Banca IMI and 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 1,904 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 65.3% and 37.6% respectively.

Constant attention has been paid to the valuation of financial items. The majority of the financial assets are measured at fair value or are represented by hedging derivatives.

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 63% using level 1 inputs, around 31% using level 2 inputs and only around 6% using level 3 inputs.

Investment levels in structured credit products and hedge funds remained low. The structured credit products generated a positive contribution of 28 million euro during the period, whereas the hedge funds generated a profit of 4 million euro over the nine 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. No problematic issues requiring the remeasurement of the recoverable values of intangible assets and goodwill were identified during the first nine months. The analyses conducted did not identify any variance compared with budgeted cash flows generated by the business divisions or 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 Risk 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 exposures to the various types of risk and reporting the situation periodically to the Corporate Bodies; (v) carrying out level 2 controls on credit and other risks and ensuring the validation of internal risk measurement systems.

The Parent Company performs a guidance and coordination role with respect to the Group companies¹, 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 Risk 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.

¹ In this regard, it is specified that Intesa Sanpaolo does not exercise management and coordination over Risanamento S.p.A. and Autostrade Lombarde S.p.A. and their subsidiaries pursuant to Article 2497 et seq. of the Italian Civil Code.

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.

With regard to credit risks, there have been no changes with respect to the situation as at 31 December 2018, except for the extension in May 2019 of the Group’s Institutions, Corporate and Retail internal models to the portfolio acquired from the former Banca Apulia, subsequently merged into Intesa Sanpaolo.

The development and application of IRB systems for the other segments and the extension of the scope of companies is proceeding according to the Group’s Basel 3 roll-out plan.

There were no changes in the scope of application of the internal models concerning counterparty risk for OTC derivatives and Securities Financing Transactions (SFTs) or 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	(millions of euro)						
	30.09.2019			01.01.2019			Change
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Bad loans	19,936	-13,012	6,924	21,734	-14,596	7,138	-214
Unlikely to pay	11,226	-4,220	7,006	14,268	-5,167	9,101	-2,095
Past due loans	471	-118	353	473	-121	352	1
Non-Performing Loans	31,633	-17,350	14,283	36,475	-19,884	16,591	-2,308
<i>Non-performing loans in Stage 3 (subject to impairment)</i>	31,552	-17,330	14,222	36,396	-19,865	16,531	-2,309
<i>Non-performing loans designated at fair value through profit or loss</i>	81	-20	61	79	-19	60	1
Performing loans	376,840	-1,904	374,936	373,877	-2,105	371,772	3,164
<i>Stage 2</i>	41,120	-1,205	39,915	43,880	-1,316	42,564	-2,649
<i>Stage 1</i>	335,075	-699	334,376	329,555	-789	328,766	5,610
<i>Performing loans designated at fair value through profit or loss</i>	645	-	645	442	-	442	203
Performing loans represented by securities	5,972	-29	5,943	5,131	-19	5,112	831
<i>Stage 2</i>	1,806	-23	1,783	986	-16	970	813
<i>Stage 1</i>	4,166	-6	4,160	4,145	-3	4,142	18
Loans held for trading	31	-	31	75	-	75	-44
Total loans to customers	414,476	-19,283	395,193	415,558	-22,008	393,550	1,643
<i>of which forbore performing</i>	7,133	-308	6,825	8,322	-385	7,937	-1,112
<i>of which forbore non-performing</i>	7,196	-3,110	4,086	9,192	-3,755	5,437	-1,351
Loans to customers classified among non-current assets held for sale and discontinued operations(*)	3,262	-1,073	2,189	1,244	-310	934	1,255

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

(*) As at 30 September 2019, this caption included the portfolio of bad loans, unlikely-to-pay loans soon to be sold (gross exposure of 72 million euro, total adjustments of 31 million euro, net exposure of 41 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 393 million euro, total adjustments of 55 million euro, net exposure of 338 million euro) and the loans soon to be sold to Prelios (gross exposure of 2,797 million euro, total adjustments of 987 million euro, net exposure of 1,810 million euro).

As at 30 September 2019, the Group's net non-performing loans amounted to 14.3 billion euro, down by 13.9% compared with the beginning of the year, also due to the posting under discontinued operations of the loans and receivables to be sold shortly to Prelios. Non-performing assets decreased as a percentage of total net loans to customers, down to 3.6%, while the coverage ratio for non-performing loans remained high at 54.8%, in accordance with the de-risking strategy outlined in the Business Plan.

In further detail, at the end of September 2019 bad loans came to 6.9 billion euro net of adjustments (down by -214 million euro on the beginning of the year, or -3%), and represented 1.8% of total loans. During the same period, the coverage ratio stood at 65.3%. Loans included in the unlikely-to-pay category amounted to 7 billion euro, down by 23%, accounting for 1.8% of total loans to customers, with a coverage ratio of 37.6%. Past due loans amounted to 353 million euro, substantially at the same level as the beginning of the year, with a coverage ratio of 25.1%. Within the non-performing loan category, forbore exposures, generated by forbearance measures for borrowers experiencing difficulty in meeting their financial obligations, amounted to 4.1 billion euro, with a coverage ratio of 43.1%, while forbore exposures in the performing loans category amounted to 6.8 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 third quarter of 2019, the managerial market risks generated by the Group decreased compared to the average values of the second quarter of 2019, due to the reduction of Banca IMI.

The average managerial VaR of the Group for the period was 145.3 million euro compared to 164.0 million euro (average figure) in the second quarter.

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

(millions of euro)

	2019					2018			
	average 3 rd quarter	minimum 3 rd quarter	maximum 3 rd quarter	average 2 nd quarter	average 1 st quarter	average 4 th quarter	average 3 rd quarter	average 2 nd quarter	average 1 st quarter
Intesa Sanpaolo	16.8	14.9	18.2	15.0	16.9	13.9	14.4	11.8	7.8
Banca IMI	128.5	111.5	154.7	149.0	160.1	81.3	75.9	50.1	40.3
Total	145.3	127.4	172.3	164.0	177.0	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 respectively of Intesa Sanpaolo and Banca IMI; minimum and maximum values for the two companies are estimated using aggregate historical time-series and therefore do not correspond to the sum of the individual values in the column.

In the first nine months of 2019 the Group's average managerial VaR was 161.8 million euro compared to 67 million euro in the same period of 2018. The performance of this indicator – mainly determined by Banca IMI – derives from an increase in the risk measures, mainly attributable to government bonds dealing, consistently with the 2019 Risk Appetite Framework.

(millions of euro)

	2019			2018		
	average 30.09	minimum 30.09	maximum 30.09	average 30.09	minimum 30.09	maximum 30.09
Intesa Sanpaolo	16.2	13.4	19.0	11.3	6.7	20.9
Banca IMI	145.6	102.5	192.3	55.6	24.6	85.8
Total	161.8	116.6	208.8	67.0	33.7	105.3

(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.

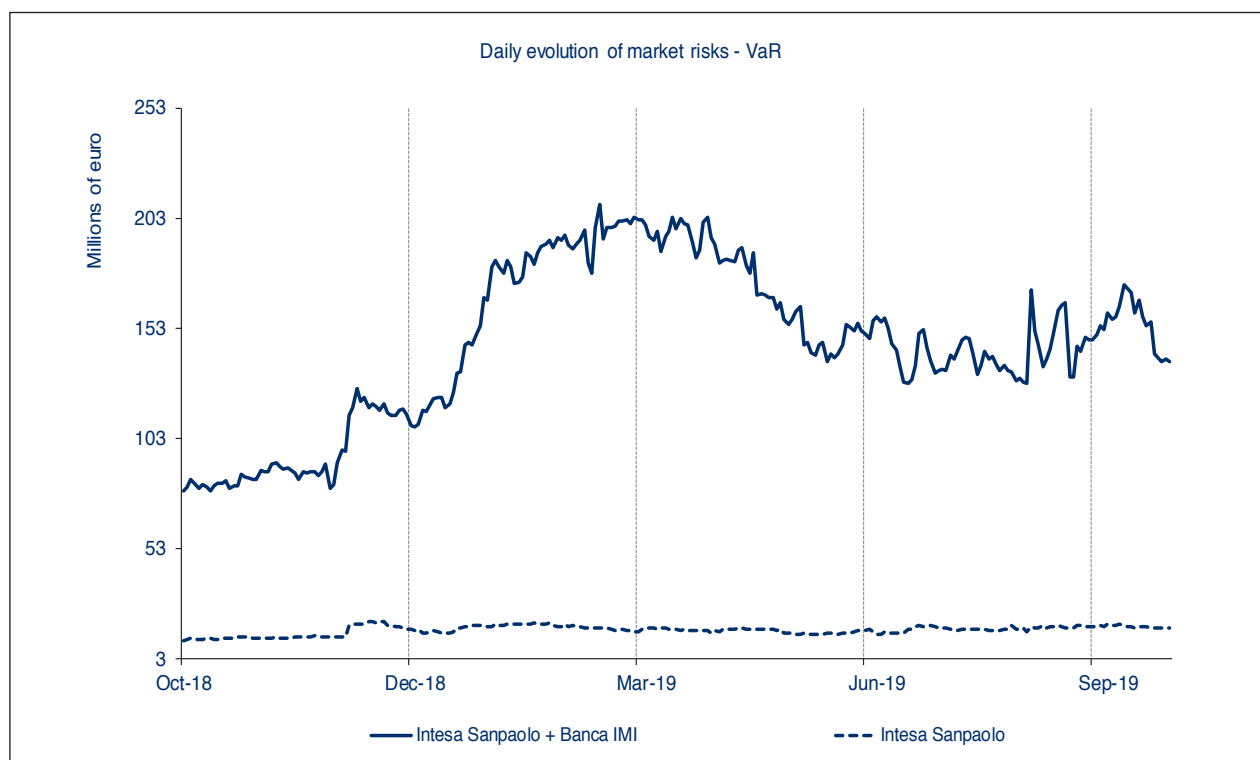
For the Group, the breakdown of risk profile in the third quarter of 2019 with regard to the various factors shows the prevalence of credit spread risk, equal to 74% of total managerial VaR (of which 63% and 76% of the total VaR for Intesa Sanpaolo and Banca IMI, respectively).

Contribution of risk factors to total managerial VaR^(a)

3rd quarter 2019	Shares	Hedge funds	Interest rates	Credit spreads	Foreign exchange rates	Other parameters	Commodities
Intesa Sanpaolo	1%	2%	23%	63%	9%	1%	0%
Banca IMI	2%	0%	20%	76%	0%	2%	0%
Total	2%	0%	20%	74%	1%	2%	0%

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

The performance of the VaR is mainly attributable to the operations of Banca IMI. The indicator increased during the third quarter of 2019, and, specifically, at the start of August, substantially due to the volatility of the credit spread risk factor. The subsequent changes in the measure were mainly attributable to dealing in government bonds and the rolling scenario.



Risk control with regard to the activity of Intesa Sanpaolo and Banca IMI also uses scenario analyses and stress tests. The shocks applied to the portfolio were subject to the usual annual assessment and updating. The impact of selected scenarios relating to the evolution of stock prices, interest rates, credit spreads, foreign exchange rates and commodity prices at the end of September is summarised in the following table:

(millions of euro)

	EQUITY		INTEREST RATES		CREDIT SPREADS		FOREIGN EXCHANGE RATES		COMMODITIES	
	Crash	Bullish	+40bp	lower rate	-25bp	+25bp	-5%	+5%	Crash	Bullish
Total	5	-14	-274	154	824	-787	19	-8	-3	8

In particular:

- for stock market positions, there would be a loss of 14 million euro in the event of a bullish scenario in the stock markets (sharp rise in equity indices along with a significant decrease in volatility);
- for positions in interest rates, there would be a loss of 274 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 787 million euro (primarily relating to government bond positions);
- for positions in exchange rates, there would be a loss of around 8 million euro in the event of appreciation in the Euro;
- lastly, for commodity exposures losses would be recorded for an amount of 3 million euro in case of a 20% decrease in commodity prices (accompanied by an increase in the price of gold of 15%).

Backtesting

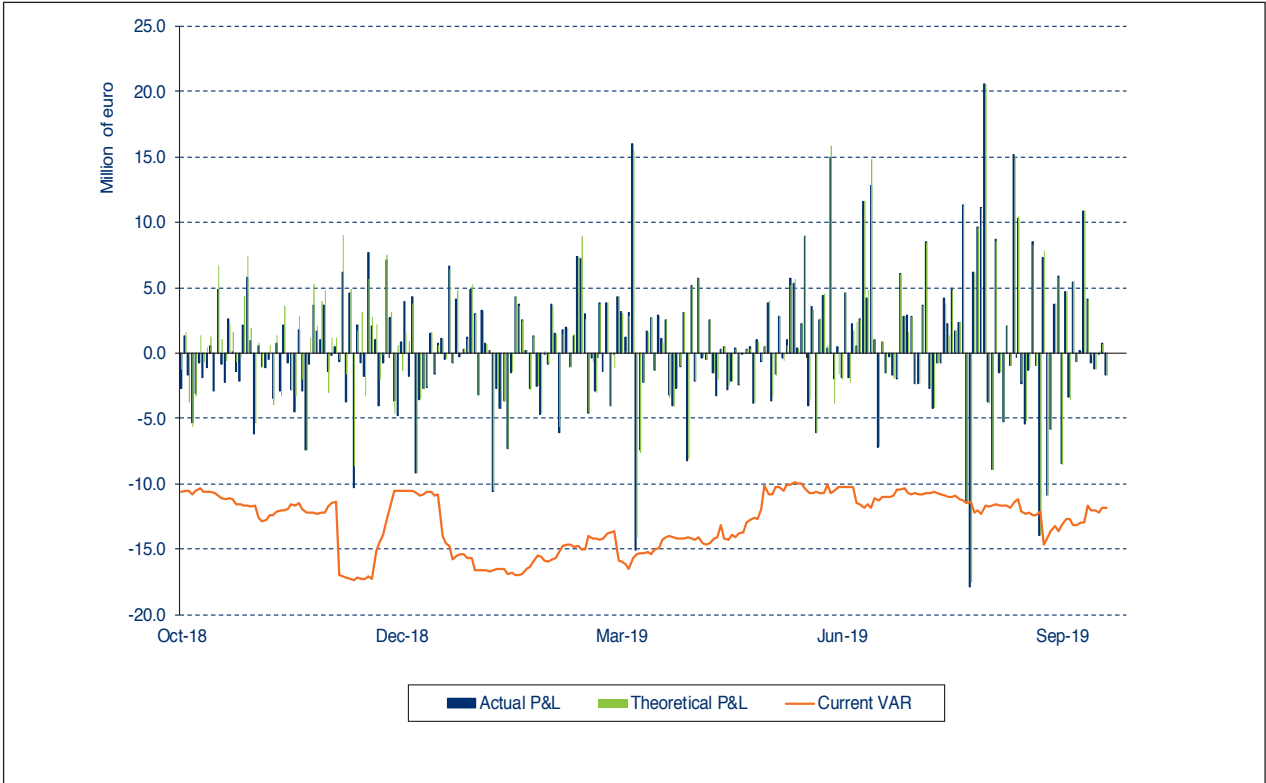
The soundness of the VaR calculation methods must be monitored daily via backtesting which, for the regulatory backtesting, compares:

- the daily estimates of value at risk;
- the daily profits/losses based on backtesting which are determined using actual daily profits and losses achieved by the individual desks, net of components which are not considered in backtesting: 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. Current regulations require that backtesting is performed by taking into consideration both the actual and hypothetical P&L series

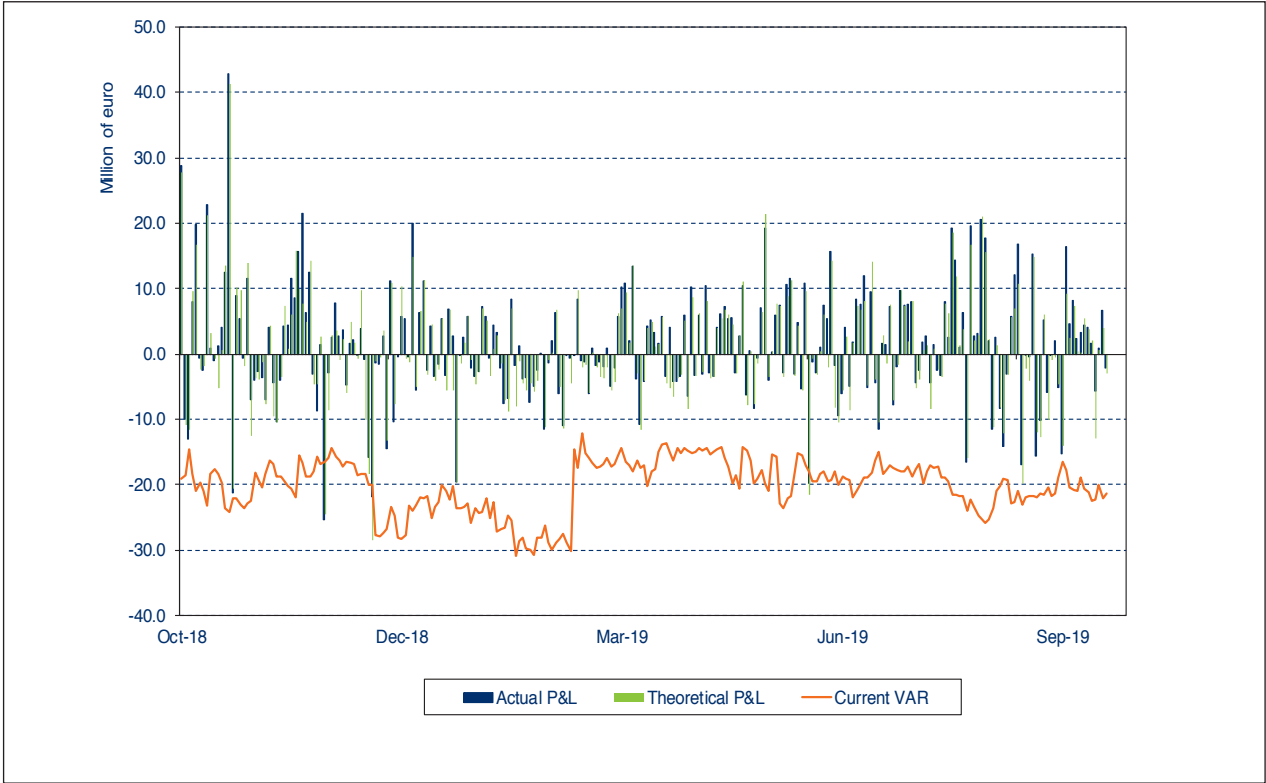
Backtesting in Intesa Sanpaolo

Over the last quarter there have been two backtesting exceptions. The breaches were caused by the volatility of the interest rate component in the trading book.



Backtesting in Banca IMI

Over the last twelve months there have been three backtesting exceptions. The breaches recorded in the second half of 2018 were caused by the credit component of the trading book. Instead, the most recent exception was linked to the volatility of interest rates.



BANKING BOOK

At the end of September 2019, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity of value, amounted to 434 million euro.

The sensitivity of net interest income – assuming a +50, -50 and +100 basis point change in interest rates – amounted to 989 million euro, -1,038 million euro and 1,926 million euro, respectively, at the end of September 2019.

Interest rate risk, measured in terms of VaR, recorded a value of 273 million euro at the end of September 2019.

Price risk generated by minority stakes in listed companies, mostly held in the HTCS (Held to Collect and Sell) category, amounted to 61 million euro at the end of September 2019.

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

	3rd quarter 2019			30.09.2019	(millions of euro) 31.12.2018
	average	minimum	maximum		
Shift Sensitivity of the Economic Value +100 bp	688	333	1,226	434	1,143
Shift Sensitivity of Net Interest Income -50bp	-1,005	-952	-1,041	-1,038	-928
Shift Sensitivity of Net Interest Income +50bp	967	914	1,009	989	886
Shift Sensitivity of Net Interest Income +100bp	1,887	1,786	1,964	1,926	1,926
Value at Risk - Interest Rate	143	74	273	273	91
Value at Risk - Equity investments in listed companies	63	55	75	61	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

		(millions of euro)			
		1st quarter 2019 impact on shareholders' equity at 31.03.2019	2nd quarter 2019 impact on shareholders' equity at 30.06.2019	3rd quarter 2019 impact on shareholders' equity at 30.09.2019	Impact on shareholders' equity at 31.12.2018
Price shock	10%	59	56	52	39
Price shock	-10%	-59	-56	-52	-39

LIQUIDITY RISK

In 2019, the Group's liquidity position remained within the risk limits provided for in the current Group's Liquidity Policy: both the LCR and NSFR indicators were largely respected, as they reached levels well above the EU regulatory requirements. Over the last 12 months, the Liquidity Coverage Ratio (LCR) of the Intesa Sanpaolo Group, measured according to Delegated Regulation (EU) no. 2015/61, has amounted to an average of 161.8%.

As at 30 September 2019, the eligible liquidity reserves for the Central Banks, considering the reserves held with Central Banks (Cash and Deposits), amounted to a total of 197 billion euro (175 billion euro at the end of December 2018), of which 116 billion euro, net of haircut, was unencumbered (89 billion euro at the end of December 2018). The HQLA component represented 62% 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	30.09.2019			31.12.2018		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
(millions of euro)						
1. Financial assets designated at fair value through profit or loss	19,484	33,015	2,787	11,037	28,462	2,616
a) Financial assets held for trading	19,124	32,068	404	10,748	27,655	403
of which: Equities	717	-	-	500	-	-
of which: quotas of UCI	638	2	38	913	2	47
b) Financial assets designated at fair value	-	195	-	-	208	-
c) Other financial assets mandatorily designated at fair value	360	752	2,383	289	599	2,213
of which: Equities	2	96	175	2	96	178
of which: quotas of UCI	337	118	1,354	267	-	1,334
2. Financial assets designated at fair value through other comprehensive income	67,738	7,061	419	53,527	6,399	543
of which: Equities	601	2,043	382	593	2,119	447
3. Hedging derivatives	-	3,671	16	-	2,983	10
4. Property and equipment	-	-	5,653	-	-	5,720
5. Intangible assets	-	-	-	-	-	-
Total	87,222	43,747	8,875	64,564	37,844	8,889
1. Financial liabilities held for trading	22,617	31,217	104	14,928	26,824	143
2. Financial liabilities designated at fair value	-	4	-	-	4	-
3. Hedging derivatives	-	12,879	3	-	7,216	5
Total	22,617	44,100	107	14,928	34,044	148

Fair value hierarchy – Insurance companies

Assets / liabilities at fair value	30.09.2019			31.12.2018			(millions of euro)
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	
1. Financial assets held for trading	286	11	45	231	11	47	
<i>of which: Equities</i>	-	-	-	-	-	-	
<i>of which: quotas of UCI</i>	117	-	45	61	-	47	
2. Financial assets designated at fair value through profit or loss	81,628	43	399	73,920	121	273	
<i>of which: Equities</i>	2,181	-	-	1,678	-	-	
<i>of which: quotas of UCI</i>	74,710	-	-	67,729	-	19	
3. Financial assets available for sale	80,985	1,618	1,740	71,254	2,286	1,382	
<i>of which: Equities</i>	1,314	-	-	979	-	-	
<i>of which: quotas of UCI</i>	10,118	-	1,740	10,256	1	1,382	
4. Hedging derivatives	-	279	-	-	21	-	
5. Property and equipment	-	-	-	-	-	-	
6. Intangible assets	-	-	-	-	-	-	
Total Caption 35	162,899	1,951	2,184	145,405	2,439	1,702	
1. Financial liabilities held for trading	4	97	-	3	41	-	
2. Financial liabilities designated at fair value through profit or loss	-	74,304	-	-	67,755	-	
3. Hedging derivatives	-	-	-	-	1	-	
Total Caption 15	4	74,401	-	3	67,797	-	

INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure in structured credit products, which amounted to 2,018 million euro as at 31 December 2018, came to 3,286 million euro as at 30 September 2019, showing a net increase of 1,268 million euro. The exposure includes investments in ABSs (asset-backed securities) of 1,971 million euro, in CLOs (collateralised loan obligations) of 1,236 million euro and, to a residual extent, in CDOs (collateralised debt obligations) of 79 million euro, subject to constant, gradual disposals, without any plans for additional transactions.

Accounting categories	Exposure as at 30.09.2019			Total	31.12.2018		(millions of euro) changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations		absolute	%		
Financial assets held for sale	388	933	-	1,321	1,031	290	28.1	
Financial assets mandatorily measured at fair value	-	24	-	24	63	-39	-61.9	
Financial assets measured at fair value through other comprehensive income	453	818	-	1,271	724	547	75.6	
Financial assets measured at amortised cost	395	196	79	670	200	470		
Total	1,236	1,971	79	3,286	2,018	1,268	62.8	

In this disclosure structured credit products include debt securities held by the Group divided into tranches upon issue consisting of various degrees of subordination and not issued within the framework of transactions originated by entities of the Intesa Sanpaolo Group or by public entities, in addition to transactions whereby the Group finances its corporate and financial institution customers.

The strategy for transactions in structured credit products involved investments aimed at exploiting market opportunities, on the one hand, and disposals of the portfolio, mainly referring to positions which at the time were affected by the financial crisis, on the other hand.

The exposure in funded and unfunded ABSs/CLOs measured at fair value rose from 1,818 million euro in December 2018 to 2,616 million euro in September 2019, a net increase of 798 million euro attributable to Banca IMI and, only to a marginal extent, to the Parent Company 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 portfolio mandatorily measured at fair value was only subject to sales and redemptions.

The exposure in securities classified as assets measured at amortised cost rose from 200 million euro in December 2018 to 670 million euro in September 2019, also due to the higher level of investments made in the period by Banca IMI.

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

From the perspective of the income statement, a profit of +28 million euro was posted for the first nine months of 2019, against the +8 million euro in the same period of 2018.

Specifically, as at 30 September 2019, the profits (losses) on trading - caption 80 of the income statement - for the exposures in funded and unfunded CLOs/ABSs amounted to +13 million euro, compared with -5 million euro in September 2018.

The profits (losses) from financial assets mandatorily measured at fair value amounted to +14 million euro (+8 million euro in September 2018) and primarily related to sales of funded and unfunded ABS positions in the Parent Company's loan portfolio, which were reclassified in 2018 into the new accounting category upon First-Time Adoption (FTA) of IFRS 9.

The exposures to funded and unfunded ABSs/CLOs in securities classified as assets measured at fair value through other comprehensive income primarily refer to the subsidiary Banca IMI and recorded a net increase in fair value of +2 million euro as at 30 September 2019 through a shareholders' equity reserve (from a nil reserve at the end of December 2018 to a reserve of +2 million euro in September 2019); there was also an impact of +1 million euro from sales made in the first nine months of 2019, a similar result to that seen in September 2018.

Substantially nil impacts were recognised for the securities classified as assets measured at amortised cost in the first nine months of 2019 (in September 2018 the impact was +4 million euro).

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

Income statement results broken down by accounting category	30.09.2019				30.09.2018		(millions of euro) changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total	Total	changes		
						absolute	%	
Financial assets held for sale	2	11	-	13	-5	18		
Financial assets mandatorily measured at fair value	-	14	-	14	8	6	75.0	
Financial assets measured at fair value through other comprehensive income	-	1	-	1	1	-	-	
Financial assets measured at amortised cost	-	-	-	-	4	-4		
Total	2	26	-	28	8	20		

INFORMATION ON ACTIVITIES PERFORMED THROUGH SPECIAL PURPOSE ENTITIES (SPES)

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.

No issues were carried out in the third quarter of 2019. As regards the first six months of the year, reference is made to the Half-yearly Report as at 30 June 2019.

INFORMATION ON LEVERAGED 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 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 30 September 2019, for the Intesa Sanpaolo Group, the transactions that meet the definition of Leveraged Transactions in the ECB Guidance amounted to 22.4 billion euro, relating to approximately 2,000 credit lines (also 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 30 September 2019 amounted to 117 million euro in the trading book and 172 million euro in the banking book, compared to 146 million euro and 88 million euro respectively 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 2019, the reduction of the trading book continued through distributions and redemptions, with a consequent reduction in the risk level of the total exposure. In further detail, total redemptions in the first nine months of 2019 amounted to 31 million euro.

In the banking book, higher investments in new positions for 75 million euro and in positions already held by the Bank for 25 million euro were added, partially offsetting them, to the disposals during the year totalling 20 million euro.

In terms of effects on the income statement, profits (losses) on trading – caption 80 of the income statement – showed a positive contribution of 1 million euro at the end of September 2019, compared to a loss of -11 million euro in September 2018, while the net profit (loss) on financial assets mandatorily measured at fair value – caption 110 of the income statement – recorded a positive contribution of 3 million euro, compared to a loss of -3 million euro in September 2018.

Both positive effects were mainly due to a general improvement in the valuations of the funds in the portfolio. Specifically, systematic long/short equity funds showed good performance and discretionary long/short equity funds showed excellent results, against slighter improvement in US credit/distressed and global macro strategy funds.

Overall, the strategy for the portfolio remained substantially prudent.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 30 September 2019, the Intesa Sanpaolo Group, in relation to derivatives trading with retail counterparties, non-financial companies and public entities (therefore excluding banks, financial and insurance companies), presented a positive fair value, not having applied netting agreements, of 9,250 million euro (6,602 million euro as at 31 December 2018). The notional value of these derivatives totalled 61,287 million euro (57,047 million euro as at 31 December 2018).

Please note that the positive fair value of contracts outstanding with the 10 customers with the highest exposures was 6,253 million euro (4,452 million euro as at 31 December 2018).

Conversely, the negative fair value referring to total contracts outstanding, determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 1,626 million euro as at 30 September 2019 (1,412 million euro as at 31 December 2018). The notional value of these derivatives totalled 19,985 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 30 September 2019, this led to a negative effect of 60 million euro being recorded under "Profits (Losses) on trading" in the income statement.

As regards the methodologies used in determining the fair value of financial instruments, see the specific paragraphs of the section on accounting policies in the Notes to the 2018 Financial Statements and the Half-yearly Report as at 30 June 2019. Please note that contracts made up of combinations of more elementary derivative instruments are considered "structured" and that the aforesaid figures do not include fair value of derivatives embedded in structured bond issues as well as the relative hedges agreed by the Group.

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.

For regulatory purposes, the Group adopts the advanced measurement approach (AMA), in partial use with the standardised (TSA) and basic approaches (BIA), to determine the capital requirement. The capital absorption resulting from this process amounted to 1,468 million euro as at 30 September 2019, unchanged compared to 30 June 2019.

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.

During the quarter, no significant new legal disputes arose, with the exception of that set out below with regard to the subsidiary Sanpaolo Invest.

For the main pending disputes, the significant developments in the third quarter of 2019 are illustrated below, referring to the Notes drawn up for the 2018 Financial Statements and the previous quarters of 2019 for the summary description of those disputes.

Private banker (Sanpaolo Invest) - An inspection conducted by the Audit function showed serious irregularities by a private banker of Sanpaolo Invest, whose portfolio comprises more than 800 customers.

The Company notified the competent authorities of the situation and terminated the agency relationship. The Surveillance Body which keeps the single register of financial advisors ordered the preventive suspension of the former private banker from the register for 180 days pending the completion of the preliminary investigation, while the judicial authorities ordered seizures at banks.

With regard to the accurate definition of the total amount of the misappropriations committed and the untrue account statements sent to customers, precise investigations are under way, and meetings were began on 1 July 2019 with all customers.

Suitable provisions have been allocated, also taking account of the existing insurance coverage.

Dargent Lawsuit – You may refer to the Half-yearly Report as at 30 June 2019 for a broader description of the dispute. The *Juge Rapporteur* filed its report in the third quarter, stating that the appealed decision seems appropriately justified when criticizing the bank's misconduct because of undue granting of credit and unlawful support to the company, which later went bankrupt. However, the report does not introduce any decisive elements to quantify the damages. The hearing before the Court of Cassation has been scheduled on 26 November 2019.

Offering of diamonds - As part of the criminal proceedings initiated by the Milan Public Prosecutor's Office, in the first few days of October, the notice of conclusion of the investigation was served, which showed no significant new elements in relation to what was previously known. Thus, 2 operators are currently under investigation for alleged aggravated fraud (in collusion with other parties to be identified) and other persons are being identified for allegations of self-laundering, while ISP is being charged with the administrative offence pursuant to Italian Legislative Decree 231/2001 in relation to this latter predicate offence.

Tax litigation

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

In the third quarter there was no new litigation of a significant amount involving Intesa Sanpaolo. With regard to the situation of the sold company Infogroup Informatica e Servizi Telematici S.p.A. for 2014 and 2015, refer to the half-yearly report for a summary thereof. During the period, the discussions with the tax authorities continued in relation to the application of the VAT exemption for services provided to the consortium companies in accordance with Article 10, paragraph 2, of Presidential Decree no. 633 of 1972. To date, the company has not been served any assessments.

With regard to the Intesa Sanpaolo branches located abroad, a VAT tax audit is underway on the London branch for the years 2016, 2017 and 2018, as well as an audit on federal direct taxes at the New York branch for the tax period 2016. No claims have been made for the time being.

With regard to IMI Fondi Chiusi SGR, in June a notice of settlement was served, resulting from the disavowal of the IRES credit shown in the withholding agent tax return for 2015, deriving from the loss on operations accrued as at 30 June 2011 by the mutual investment funds administered (value of the dispute: 3.9 million euro, of which 2.7 million euro for taxes, 0.9 million euro for penalties and 0.3 million euro for interest). The disavowal derives from the failure to indicate that the credit was carried forward in the withholding agent tax returns for the years 2011 to 2014.

For Mediocredito Italiano, with the notification on 31 July 2019 of the tax audit report, the Milan Tax Police (Guardia di Finanza) concluded the audit of VAT for 2014, as part of the general audit of direct taxes for the tax years 2015 and 2017 and of VAT for the years 2014 and 2015. For the years 2015 and 2017, the audit, which is currently suspended, will resume in 2020.

In brief, two breaches of VAT regulations were found: the first, referring to the early surrender by two customers who are natural persons of a leased vessel, under the extraterritorial VAT regime pursuant to Art. 7-bis of Presidential Decree no. 633/72 (higher VAT of 0.65 million euro assessed); the second, relating to the application of the VAT exemption regime pursuant to Art. 8-bis of Presidential Decree no. 633/72 to boat lease contracts for ocean-going vessels to be used for commercial activities (higher VAT of 1.7 million euro assessed).

With regard to the former Banca Nuova, the tax audit by the Sicily Regional Office of the Italian Revenue Agency - Large Taxpayers Office on IRES, IRAP and VAT for the tax year 2015 began on 12 June 2019. The auditors were provided with extensive assistance during all the phases of the investigation and, according to the information provided, the audit is expected to be concluded shortly without claims of significant amounts.

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 30 September 2019, the investment portfolios of Group companies, recorded at book value, amounted to 169,658 million euro. Of these, a part amounting to 87,852 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 81,807 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, 84.2% of assets, i.e. 73,809 million euro, were bonds, whereas equity instruments represented 1.7% of the total and amounted to 1,511 million euro. The remainder (12,308 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (14.1%).

The carrying value of derivatives came to approximately 224 million euro, of which -56 million euro relating to effective management derivatives², and the remaining portion (280 million euro) is attributable to hedging derivatives.

At the end of the first nine months of 2019, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 771 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 15 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 3,860 million euro.

The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 5.9% of total investments and A bonds approximately 7.8%. Low investment grade securities (BBB) were approximately 84% of the total and the portion of speculative grade or unrated was minimal (approximately 2.3%).

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 79.1% of the total investments, while financial companies (mostly banks) contributed almost 11% of exposure and industrial securities made up approximately 9.9%.

At the end of the third 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 3,845 million euro, with 3,236 million euro due to government issuers and 609 million euro to corporate issuers (financial institutions and industrial companies).

² 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.