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# Risk management

## 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 approved 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 – reporting directly to the Managing Director and CEO – 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 strategies and objectives; (iii) coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, also 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; and (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 companies<sup>12</sup>, 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.

With regard to the UBI Group, to translate the Parent Company's above-mentioned steering and coordination duties into practice, a decentralised management model has been applied, given the presence of local company functions with standing and resources that can guarantee sound and prudent management of the subsidiary's risk. In particular, during the first quarter the corporate control functions of the Parent Company and the subsidiary, also in anticipation of the subsequent merger by incorporation of UBI Banca SpA into Intesa Sanpaolo SpA, are finalising their sharing of approaches and tools for the integration of the risk management framework, in order to best take advantage of possible synergies.

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 Tableau de Bord of the Group Risks. 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.

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<sup>12</sup> In this regard, it is specified that Intesa Sanpaolo does not exercise management and coordination over Risanamento S.p.A. or its 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 the acquisition of the UBI Group and the impacts on risk management and Pillar 1 internal models for credit, market, counterparty and operational risk, the Group has carried out the necessary analyses and actions, and, with a view to the integration of the UBI Group into Intesa Sanpaolo, in September 2020 it sent the strategic return to compliance plan to the competent Supervisory Authorities, aimed at restoring regulatory compliance by extending the Parent Company’s internal models to the portfolios of UBI Banca and, where appropriate, of its subsidiaries. In this context, the temporary use of the internal models for credit and operational risk (Pillar 1) of the UBI Group was also requested for supervisory reporting purposes at consolidated level until full integration. The activities identified in the plan are continuing according to programme. With regard to credit risk, there were no changes with respect to the situation as at 31 December 2020. The periodic updating and alignment to changes in regulations governing IRB systems and their extension to the Italian subsidiaries originating from the UBI Group and the international subsidiaries (according to the Group’s roll-out plan) continue in accordance with the Regulatory Roadmap agreed with the Supervisory Authorities.

There were no changes in the scope of application of the internal models concerning counterparty risk for derivatives and Securities Financing Transactions (SFTs) or operational risks compared to 31 December 2020.

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 2021.

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](http://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)						
	31.03.2021			31.12.2020			Change
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Bad loans	9,784	-5,816	3,968	9,594	-5,591	4,003	-35
Unlikely to pay	10,424	-4,318	6,106	10,678	-4,455	6,223	-117
Past due loans	523	-99	424	627	-110	517	-93
<b>Non-Performing Loans</b>	<b>20,731</b>	<b>-10,233</b>	<b>10,498</b>	<b>20,899</b>	<b>-10,156</b>	<b>10,743</b>	<b>-245</b>
<i>Non-performing loans in Stage 3 (subject to impairment)</i>	20,656	-10,214	10,442	20,818	-10,132	10,686	-244
<i>Non-performing loans designated at fair value through profit or loss</i>	75	-19	56	81	-24	57	-1
<b>Performing loans</b>	<b>448,567</b>	<b>-2,890</b>	<b>445,677</b>	<b>446,420</b>	<b>-2,807</b>	<b>443,613</b>	<b>2,064</b>
<i>Stage 2</i>	69,840	-2,075	67,765	71,037	-2,014	69,023	-1,258
<i>Stage 1</i>	377,663	-815	376,848	374,305	-793	373,512	3,336
<i>Performing loans designated at fair value through profit or loss</i>	1,064	-	1,064	1,078	-	1,078	-14
<b>Performing loans represented by securities</b>	<b>7,127</b>	<b>-35</b>	<b>7,092</b>	<b>7,231</b>	<b>-37</b>	<b>7,194</b>	<b>-102</b>
<i>Stage 2</i>	2,490	-27	2,463	3,090	-30	3,060	-597
<i>Stage 1</i>	4,637	-8	4,629	4,141	-7	4,134	495
<b>Loans held for trading</b>	<b>19</b>	<b>-</b>	<b>19</b>	<b>22</b>	<b>-</b>	<b>22</b>	<b>-3</b>
<b>Total loans to customers</b>	<b>476,444</b>	<b>-13,158</b>	<b>463,286</b>	<b>474,572</b>	<b>-13,000</b>	<b>461,572</b>	<b>1,714</b>
<i>of which forbore performing</i>	7,961	-433	7,528	5,560	-304	5,256	2,272
<i>of which forbore non-performing</i>	6,323	-2,557	3,766	5,902	-2,360	3,542	224
<b>Loans to customers classified as discontinued operations (*)</b>	<b>5,592</b>	<b>-2,761</b>	<b>2,831</b>	<b>29,602</b>	<b>-3,462</b>	<b>26,140</b>	<b>-23,309</b>

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

(\*) This caption includes the portfolio of bad/unlikely to pay loans (gross exposure of 3,837 million euro, adjustments of 2,751 million euro and net exposure of 1,086 million euro as at 31 March 2021), already reclassified to discontinued operations in the 2020 Annual Report, as well as the loans included in the going concern to be sold to BPER and BPPB (gross exposure of 1,755 million euro, adjustments of 10 million euro and net exposure of 1,745 million euro as at 31 March 2021).

As at 31 March 2021, the Group's net non-performing loans amounted to 10.5 billion euro, an all-time low. The 2.3% reduction from the beginning of the year confirms the virtuous trend already recorded in previous years. Non-performing assets percentage of total net loans to customers amounted to 2.3%, a low proportion in line with the figure recorded in December, while the coverage ratio for non-performing loans was 49.4% (64.9% including the write-offs applied<sup>13</sup>).

In further detail, at the end of March 2021 bad loans came to 4 billion euro net of adjustments (-0.9%) and represented 0.9% of total loans. During the same period, the coverage ratio came to 59.4% (77.9% including the write-offs applied<sup>14</sup>). Loans included in the unlikely-to-pay category amounted to 6.1 billion euro, down by 1.9%, and accounted for 1.3% of total loans to customers, with a coverage ratio of 41.4%. Past due loans amounted to 424 million euro (-+18%), with a coverage ratio of 18.9%. Within the non-performing loan category, forbore exposures, generated by forbearance measures for borrowers experiencing difficulty in meeting their financial obligations, amounted to 3.8 billion euro, with a coverage ratio of 40.4%, while forbore exposures in the performing loans category amounted to 7.5 billion euro.

The coverage ratio of performing loans was 0.6% in line with the figure at the end of 2020.

Loans to customers classified as discontinued operations relate to the performing and non-performing loans included in the going concerns being sold to BPER and Banca Popolare di Puglia e Basilicata, for a net exposure of 1.7 billion euro, as well as the portfolio of bad loans and unlikely-to-pay exposures due to be sold, for a net exposure of 1.1 billion euro.

<sup>13</sup> Taking account of the values of the UBI Group's loans prior to the purchase price allocation, and therefore considering the pre-existing provisions and cumulative write-offs prior to the acquisition.

<sup>14</sup> See the previous note.

## MARKET RISKS

### TRADING BOOK

In the first quarter of 2021, the approval of the ordinary annual update of the market risk managerial framework by the Board of Directors (as part of the 2021 Risk Appetite Framework) set a specific limit for trading portfolio within an overall limit for trading and hold to collect and sell (HTCS) business model.

Below is a summary of the daily managerial VaR for the trading book only, which also shows the overall exposure of the main risk taking centres.

#### Daily managerial VaR of the trading book

(millions of euro)

	2021			2020			
	average 1st quarter	minimum 1st quarter	maximum 1st quarter	average 4th quarter	average 3rd quarter	average 2nd quarter	average 1st quarter
<b>Total GroupTrading Book (a)</b>	<b>41.3</b>	<b>27.9</b>	<b>57.8</b>	<b>59.0</b>	<b>73.3</b>	<b>85.6</b>	<b>41.1</b>
<i>of which: Group Treasury and Finance Department</i>	3.2	2.4	5.6	3.4	9.9	37.9	15.0
<i>of which: IMI C&amp;IB Division</i>	38.1	26.3	51.9	52.5	59.6	47.7	26.1

Each line in the table sets out past estimates of daily VaR calculated on the historical quarterly time-series of the Intesa Sanpaolo Group (including other subsidiaries), the Group Treasury and Finance Department and the IMI C&IB Division respectively; minimum and maximum values for the overall perimeter are estimated using aggregate historical time-series and therefore do not correspond to the sum of the individual values in the column.

(a) The Group Trading Book figure includes the managerial VaR of the Group Treasury and Finance Department, the IMI C&IB Division (Trading Book perimeter) and the other subsidiaries.

During the first quarter of 2021, there was a reduction in the overall trading risks compared to the averages for the fourth quarter of 2020 from 59.0 million euro (fourth quarter average) to 41.3 million euro and, more generally, compared to the averages for the full year 2020. These reductions are mainly attributable to scenario “rolling effects” due to the lower market volatility following the exceptional market shocks in March 2020 related to the spread of the COVID-19 pandemic.

For completeness, the table below shows the average, minimum and maximum managerial VaR for the first quarter of 2021 compared with the same period of 2020.

(millions of euro)

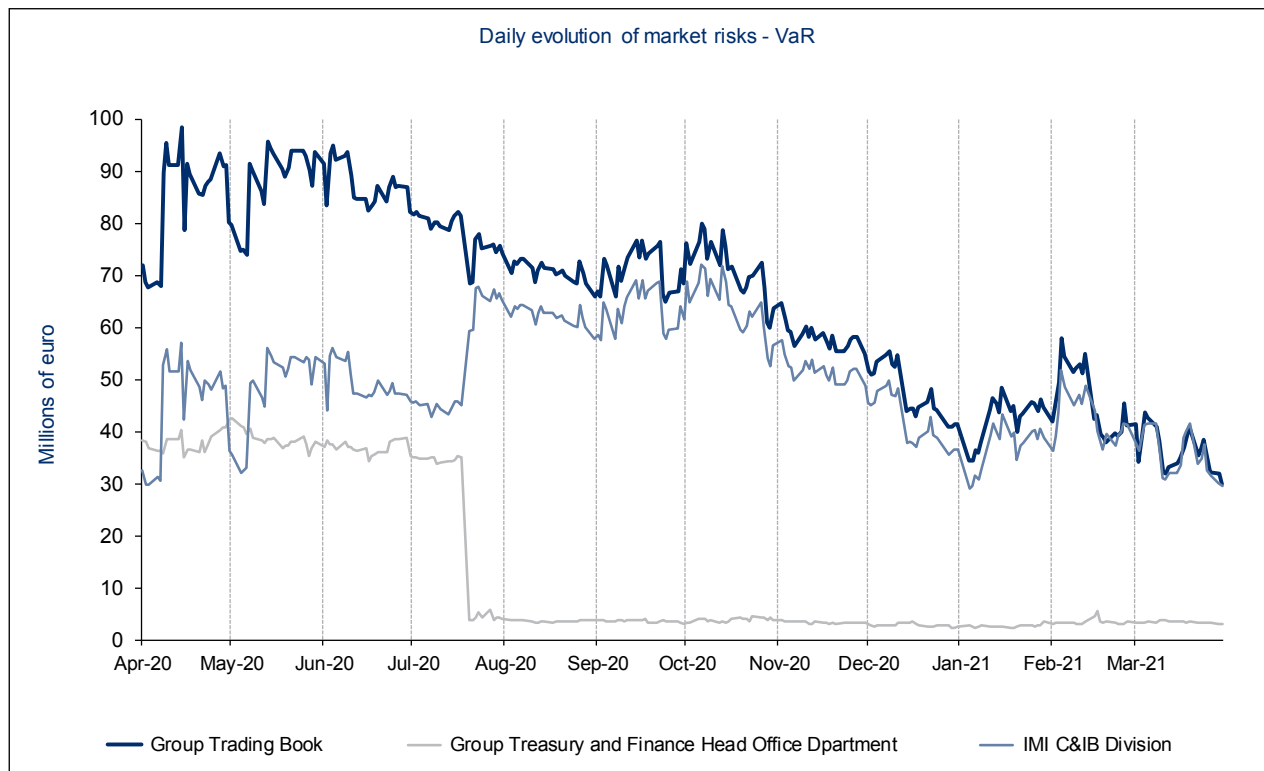
	2021			2020		
	average 1st quarter	minimum 1st quarter	maximum 1st quarter	average 1st quarter	minimum 1st quarter	maximum 1st quarter
<b>Total GroupTrading Book (a)</b>	<b>41.3</b>	<b>27.9</b>	<b>57.8</b>	<b>41.1</b>	<b>31.4</b>	<b>75.7</b>
<i>of which: Group Treasury and Finance Department</i>	3.2	2.4	5.6	15.0	10.1	40.2
<i>of which: IMI C&amp;IB Division</i>	38.1	26.3	51.9	26.1	20.7	41.7

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 Intesa Sanpaolo Group (including other subsidiaries), the year respectively of the Group Treasury and Finance Department and the IMI C&IB Division; minimum and maximum values for the overall perimeter are estimated using aggregate historical time-series and therefore do not correspond to the sum of the individual values in the column.

(a) The Group Trading Book figure includes the managerial VaR of the Group Treasury and Finance Department, the IMI C&IB Division (Trading Book perimeter) and the other subsidiaries.

With regard to the trend in the trading VaR in the first quarter of 2021, the change was mainly due to the combined effect of two factors:

- “rolling scenario” effect: due to the lower volatility of the markets, the most volatile scenarios (mainly related to the health emergency generated by the COVID-19 pandemic) were no longer part of the managerial VaR distributions;
- increases in the indicator limited to January and February, due to the activity in government securities mainly for the IMI C&IB Division.



The breakdown of the Group's risk profile for the trading book in the first quarter of 2021 shows the prevalence of credit spread risk, which accounted for 59% of the Group's total managerial VaR. Instead, the single risk taking centres show a prevalence of interest rate risk and exchange rate risk for the Group Treasury and Finance Head Office Department (48% and 26%, respectively) and the credit spread risk factor is prevalent for the IMI C&IB Division (64%).

#### Contribution of risk factors to total managerial VaR<sup>(a)</sup>

1st quarter 2021	Shares	Interest rates	Credit spreads	Foreign exchange rates	Other parameters	Commodities
Group Treasury and Finance Department	17%	48%	9%	26%	0%	0%
IMI C&IB Division	14%	12%	64%	2%	5%	3%
<b>Total</b>	<b>14%</b>	<b>15%</b>	<b>59%</b>	<b>4%</b>	<b>5%</b>	<b>3%</b>

(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 first quarter of 2021, broken down between the Group Treasury and Finance Department and IMI C&IB Division and indicating the distribution of the Group's overall capital at risk.

Risk control with regard to the activity of the Intesa Sanpaolo Group also uses scenario analyses and stress tests. 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 March 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 Trading Book	56	7	22	-21	35	-26	29	2	-3	4

More specifically:

- for stock market positions, there would be potential gains in both scenarios with greater impacts in the event of a sharp fall in equity prices and an increase in volatility;
- for positions in interest rates, there would be potential losses of 21 million euro in the event of a fall in interest rates;
- for positions in credit spreads, a widening of credit spreads of 25 bps would result in an overall loss of 26 million euro;
- for positions in exchange rates, there would be potential gains in both scenarios with greater impacts in the event of

- depreciation of the Euro against the other currencies;
- finally, for positions in commodities, there would be a loss of 3 million euro in the event of a fall in prices of commodities other than precious metals.

With regard to the use of the overall limit relating to trading and hold to collect and sell (HTCS) business model, there was an overall reduction in the market managerial VaR in the first quarter from 360.9 million euro (average managerial VaR fourth quarter 2020) to 226 million euro (average managerial VaR first quarter 2021). The change was due to the already mentioned rolling scenario effect, which also reduced the contribution from the HTCS segment.

### Backtesting

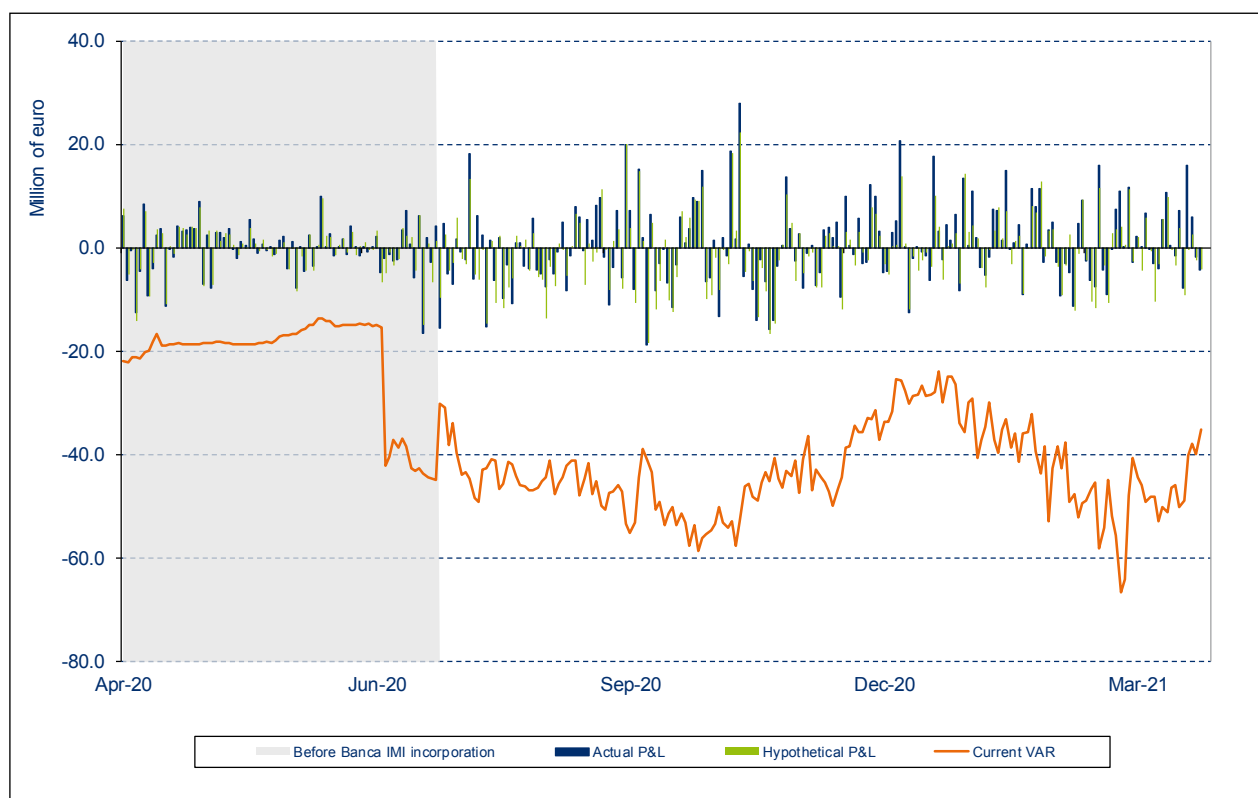
The soundness of the VaR calculation methods must be monitored daily via backtesting which, for the regulatory backtesting, compares:

- the daily estimates of value at risk;
- the daily profits/losses based on backtesting, determined using actual 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, for example, fees, financial costs of managing the positions 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 Intesa Sanpaolo taking into consideration both the actual and hypothetical P&L series.

The increase in the Parent Company's VaR shown in the graph below starting in July is attributable to the effects of the integration of Banca IMI trading book.

In the period April 2020 – March 2021<sup>15</sup>, no backtesting exceptions were recorded. In the same period, Banca IMI had recorded one exception (8 April 2020) linked to the turmoil on the markets as a result of the COVID-19 crisis.



<sup>15</sup> The estimates do not include UBI's trading book.

**BANKING BOOK**

At the end of March 2021, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity of value, amounted to -1,185 million euro.

The sensitivity of net interest income – assuming a +50, -50 and +100 basis point change in interest rates – amounted to 1,288 million euro, -851 million euro and 2,545 million euro, respectively, at the end of March 2021.

Interest rate risk, measured in terms of VaR, recorded a value of 426 million euro at the end of March 2021.

Price risk generated by minority stakes in listed companies, mostly held in the HTCS (Held to Collect and Sell) category, amounted to 152 million euro at the end of March 2021.

The table below shows the changes in the main risk measures during the first quarter of 2021 relating to the Intesa Sanpaolo Group.

	1st quarter 2021			(millions of euro)	
	average	minimum	maximum	31.03.2021	31.12.2020
Shift Sensitivity of the Economic Value +100 bp	-1,250	-1,470	-1,094	-1,185	-1,305
Shift Sensitivity of Net Interest Income -50bp	-923	-1,044	-851	-851	-1,011
Shift Sensitivity of Net Interest Income +50bp	1,265	1,143	1,364	1,288	1,312
Shift Sensitivity of Net Interest Income +100bp	2,499	2,264	2,687	2,545	2,581
Value at Risk - Interest Rate	452	426	498	426	492

Exposures as at 31 March 2021 shown in the table include the metrics of the UBI Group harmonised using the methodologies used by Intesa Sanpaolo, which provide a slight contribution to the overall risk of the Intesa Sanpaolo Group.

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 2021 impact on shareholders' equity at 31.03.2021	Impact on shareholders' equity at 31.12.2020
Price shock	-10%	-152	-155
Price shock	10%	152	155

## LIQUIDITY RISK

The Group's liquidity position - supported by suitable high-quality liquid assets (HQLA) and the significant contribution from stable customer deposits - remained within the risk limits set out in the current Group Liquidity Policy in the first three months of 2021. Both regulatory indicators, LCR and NSFR, were well above 100%. Over the last 12 months, the Liquidity Coverage Ratio (LCR) of the Intesa Sanpaolo Group, measured according to Delegated Regulation (EU) 2015/61, has amounted to an average of 167.2%.

At the end of March 2021, the amount of total unencumbered HQLA reserves at the various Treasury Departments of the Group, considering cash and deposits held with Central Banks, totalled 162 billion euro (170 billion euro in December 2020). With the other marketable reserves and/or eligible Central Bank reserves, including retained self-securitisations, added in, the Group's unencumbered liquidity reserves totalled 169 billion euro (195 billion euro in December 2020).

The stress tests, in view of the high availability of liquidity reserves, 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 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	31.03.2021			31.12.2020		
	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	24,835	28,257	3,500	22,890	31,994	3,362
a) Financial assets held for trading	23,490	27,298	372	21,861	30,900	404
of which: Equities	752	-	10	663	-	1
of which: quotas of UCI	178	2	26	169	3	31
b) Financial assets designated at fair value	-	1	2	-	1	2
c) Other financial assets mandatorily designated at fair value	1,345	958	3,126	1,029	1,093	2,956
of which: Equities	15	160	212	10	191	193
of which: quotas of UCI	1,330	155	1,882	1,018	227	1,740
2. Financial assets designated at fair value through other comprehensive income	52,836	7,920	411	49,681	7,747	430
of which: Equities	1,515	1,454	367	1,559	1,754	387
3. Hedging derivatives	2	1,057	12	1	1,118	15
4. Property and equipment	-	-	7,243	-	-	7,252
5. Intangible assets	-	-	-	-	-	-
<b>Total</b>	<b>77,673</b>	<b>37,234</b>	<b>11,166</b>	<b>72,572</b>	<b>40,859</b>	<b>11,059</b>
1. Financial liabilities held for trading	16,013	37,290	231	15,742	43,168	123
2. Financial liabilities designated at fair value	-	3,087	29	-	3,032	-
3. Hedging derivatives	-	5,494	3	1	7,084	3
<b>Total</b>	<b>16,013</b>	<b>45,871</b>	<b>263</b>	<b>15,743</b>	<b>53,284</b>	<b>126</b>

The Group's assets measured at fair value (excluding the insurance companies), primarily consisted of level 1 instruments (around 62% as at 31 March 2021 compared to around 58% at the end of 2020), measured using market prices and therefore without any discretion by the valuator.

Level 3 assets, which are subject to greater discretion in determining fair value, made up approximately 9% of the total assets measured at fair value. There were no significant changes in these assets, of which around two thirds consisted of property and equipment.

The decrease in level 2 assets compared to 31 December 2020 was also driven by the reduction in exposures to OTC derivative contracts, which had a similar effect on liabilities.

With regard to liabilities specifically, level 3 instruments remained at essentially insignificant levels (well below 1% of total liabilities), while level 2 instruments, mostly OTC derivatives, continued to predominate.



## Fair value hierarchy – Insurance companies

Assets / liabilities at fair value	(millions of euro)					
	31.03.2021			31.12.2020		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	298	9	47	321	33	47
<i>of which: Equities</i>	-	-	-	-	-	-
<i>of which: quotas of UCI</i>	121	-	47	120	-	47
2. Financial assets designated at fair value through profit or loss	88,988	22	304	86,779	51	377
<i>of which: Equities</i>	3,012	-	-	2,749	-	-
<i>of which: quotas of UCI</i>	81,396	-	-	79,538	-	-
3. Financial assets available for sale	80,454	5,448	2,431	82,076	4,845	2,192
<i>of which: Equities</i>	1,940	-	44	1,713	-	43
<i>of which: quotas of UCI</i>	10,424	19	2,284	10,271	20	2,138
4. Hedging derivatives	-	404	-	-	449	-
5. Property and equipment	-	-	8	-	-	8
6. Intangible assets	-	-	-	-	-	-
<b>Total</b>	<b>169,740</b>	<b>5,883</b>	<b>2,790</b>	<b>169,176</b>	<b>5,378</b>	<b>2,624</b>
1. Financial liabilities held for trading	1	56	-	4	54	-
2. Financial liabilities designated at fair value through profit or loss	-	78,503	-	-	77,149	-
3. Hedging derivatives	-	-	-	-	-	-
<b>Total</b>	<b>1</b>	<b>78,559</b>	<b>-</b>	<b>4</b>	<b>77,203</b>	<b>-</b>

For the insurance companies, over 95% of the financial assets measured at fair value were measured using market prices (level 1 inputs) and therefore without any discretion by the valuator.

Level 3 instruments, which are subject to greater discretion in determining fair value, made up 1.6% of the total assets, essentially unchanged on 31 December 2020.

Liabilities at fair value were almost entirely measured using level 2 inputs.

## INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure in structured credit products, came to 3,054 million euro as at 31 March 2021, a net increase of 325 million euro compared to the stock of 2,729 million euro as at 31 December 2020. The exposure includes investments in ABSs (Asset-Backed Securities) of 1,546 million euro, in CLOs (Collateralised Loan Obligations) of 1,434 million euro and, to a residual extent, in CDOs (Collateralised Debt Obligations) of 74 million euro, for which there was a marginal activity during the quarter.

Accounting categories	(millions of euro)						
	31.03.2021			31.12.2020		changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total	absolute	%	
Financial assets held for sale	501	513	-	1,014	849	165	19.4
Financial assets mandatorily measured at fair value	-	3	-	3	4	-1	-25.0
Financial assets measured at fair value through other comprehensive income	560	751	-	1,311	1,119	192	17.2
Financial assets measured at amortised cost	373	279	74	726	757	-31	-4.1
<b>Total</b>	<b>1,434</b>	<b>1,546</b>	<b>74</b>	<b>3,054</b>	<b>2,729</b>	<b>325</b>	<b>11.9</b>

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 (operations implemented by the Group through the subsidiary Duomo Funding Plc).

The strategy for transactions in structured credit products shows a prevalence of investments aimed at exploiting market opportunities over disposals of the portfolio during the period, also relating to positions which were affected by the financial crisis.

The exposure in ABSs and CLOs measured at fair value went from 1,972 million euro in December 2020 to 2,328 million euro in March 2021, a net increase of 356 million euro, mainly attributable to operations on positions of the IMI Corporate & Investment Banking Division, in the assets measured at fair value through other comprehensive income portfolio and to a lesser extent in the assets held for trading portfolio.

The exposure to debt securities classified as assets measured at amortised cost amounted to 726 million euro in March 2021, compared with an exposure of 757 million euro in December 2020.

From profit or loss perspective, a loss of +3 million euro was posted for first quarter of 2021, a significant improvement on -39 million euro recorded in the first three months of 2020.

The profit from trading activities – caption 80 of the income statement – amounting to +5 million euro related to the exposures in ABSs and CLOs, as a result of valuation effects of 3 million euro and realised gains of 2 million euro. As at 31 March 2020, this caption showed a loss of -39 million euro, resulting from valuation effects attributable to the downturn in the markets in the period due to the COVID-19 health emergency. The result as at March 2021 reflected the performance of this segment in the market, in which there has been a progressive narrowing of the spread curves for these instruments and an increase in demand, which has driven up their prices.

The profits (losses) from financial assets mandatorily measured at fair value were nil, as in the first three months of 2020.

The exposures to debt securities classified as assets measured at fair value through other comprehensive income, recorded a net increase in fair value of +3 million euro in the first quarter of 2021 through a shareholders' equity reserve (from a reserve of -4 million euro in December 2020 to -1 million euro in March 2021), in addition to an impact from sales during the period (gains on sales of +1 million euro were recorded in the first three months of 2020).

Adjustments recognised on the debt securities classified as assets measured at amortised cost amounted to -2 million euro as at 31 March 2021, compared to an impact of -1 million euro in first quarter of 2020.

Income statement results broken down by accounting category	31.03.2021			31.03.2020		(millions of euro) changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total		absolute	%
Financial assets held for sale	2	3	-	5	-39	44	
Financial assets mandatorily measured at fair value	-	-	-	-	-	-	-
Financial assets measured at fair value through other comprehensive income	-	-	-	-	1	-1	
Financial assets measured at amortised cost	-	-2	-	-2	-1	1	
<b>Total</b>	<b>2</b>	<b>1</b>	<b>-</b>	<b>3</b>	<b>-39</b>	<b>42</b>	

## 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 (SPEs).

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 2020 financial statements.

In the first quarter of the year, under the programme guaranteed by ISP OBG, the 17th and 18th series were redeemed in advance in January for 1.175 billion euro and 1.572 billion euro respectively. Two new series were also issued in January: the 45th and 46th, for 1.35 billion euro each. The securities are floating rate with a maturity of 15 years for the 45th series and 16 years for the 46th series, both listed on the Luxembourg Stock Exchange with a DBRS rating of A High. The securities were subscribed by the Parent Company and are eligible on the Eurosystem.

With regard to the covered bond issue programme guaranteed by ISP CB Pubblico, in January the 3rd series matured for an amount of 1.5 billion euro.

In February, the 14th series was issued for an amount of 1 billion euro. The security is a floating rate, 5-year security listed on the Luxembourg Stock Exchange with an A2 rating from Moody's. It was subscribed by the Parent Company and is eligible for the Eurosystem.

Under the covered bond issue programme guaranteed by ISP CB Ipotecario, the 11th series matured in January for an amount of 1.353 billion euro.

With regard to the first quarter of 2021, the UBI Banca Group had a programme of covered bonds through the vehicle company UBI Finance Srl. This Programme was launched by the UBI Banca Group in 2008 and gave the UBI Banca the right to issue bonds, to institutional investors, for a maximum amount of 15 billion euro. The programme included a portfolio of residential mortgage loans assigned by the UBI Group's network banks. These banks participated in the programme as Originator Banks and Lending Banks.

In the first quarter of 2021, as part of the reorganisation of the UBI Group's structured finance operations, following its entry into the Intesa Sanpaolo Group, IW Bank exited the UBI Finance Covered Bond Programme, repurchasing the entire portfolio sold in its capacity as Originator. As a result, as at 31 March 2021, only UBI Banca was participating in the UBI Finance Covered Bond Programme as an Originator.

No new bond issues were carried out in the first three months of 2021. In January 2021, the sixth issue with a nominal value of 1 billion euro expired, and issues no. 19 for 500 million euro and no. 32 for 1 billion euro, both held by the issuer UBI Banca, were redeemed in advance. The nominal value of the outstanding bonds as at 31 March 2021 totalled 9.53 billion euro. At the same date, those bonds were assigned an Aa3 rating from Moody's and AA from DBRS.

With regard to the second Covered Bond programme of the UBI Banca Group, a retained programme named UBI Finance Cb2, the early termination of the programme was initiated in December 2020, with the redemption of the bonds issued and the repurchase by the Originators of the entire portfolio sold.

The actual termination of the Programme took place on 25 January 2021 with the signing of the termination agreement by all the external and internal parties involved.

## INFORMATION ON LEVERAGED TRANSACTIONS

In 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 bank 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 perimeter in scope of the ECB Guidance includes exposures in which the borrower's leverage level, 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, financial institutions and 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 (the latter if not owned by financial sponsors) are explicitly excluded from the scope of Leveraged Transactions. Specialised lending transactions (project finance, real estate and object financing) and certain other types of credit, such as trade finance operations, are also excluded.

As at 31 March 2021, for the Intesa Sanpaolo Group, the transactions that meet the definition of Leveraged Transactions as per ECB Guidance amounted – net of the UBI positions classified as Leveraged Transactions and sold to BPER – to 33 billion euro (like-for-like figure of 31 billion euro as at 31 December 2020).

In accordance with the requirements of the ECB Guidance, as part of the Credit Risk Appetite a specific limit for the outstanding stock of leveraged transactions and limits on new transaction flows were submitted for approval to the Board of Directors, in line with the Bank's risk appetite on these types of operations.

## INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The Hedge Fund portfolio as at 31 March 2021 amounted to 34 million euro in the trading book and 314 million euro in the banking book, compared to 39 million euro and 277 million euro respectively in December 2020.

The investments in the banking book are recognised under financial assets mandatorily measured at fair value, pertaining to funds that adopt medium/long-term investment strategies and redemption times that are longer than those of UCITS (Undertakings for Collective Investment in Transferable Securities) funds.

In the first quarter of 2021, stocks increased by 32 million euro compared to 31 December 2020, due to diversified strategies based on the portfolio of allocation of the instruments.

Specifically, the increase is due to new investments for 37 million euro in the banking book, considering a renewed stability of the international financial markets, due to both an economic recovery and the robust support measures implemented by the various monetary and fiscal authorities for COVID-19.

This impact was partially offset by disposals and negative trading valuations of 5 million euro.

In terms of profit or loss effect, the profits (losses) on trading – caption 80 of the income statement (trading book) – showed a loss of 4 million euro as at 31 March 2021, substantially attributable to valuation losses, compared to a loss of -22 million euro in the first quarter of 2020, mainly attributable to sales during the period.

The net profit (loss) on financial assets mandatorily measured at fair value – caption 110 of the income statement (banking book) – recorded a profit of 9 million euro (compared to -8 million euro in March 2020), mainly attributable to valuation components, and continuing the general recovery in this segment.

## INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 31 March 2021, 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 7,833 million euro (8,934 million euro as at 31 December 2020). The notional value of these derivatives totalled 78,272 million euro (75,296 million euro as at 31 December 2020).

The positive fair value of contracts outstanding with the 10 customers with the highest exposures was 5,071 million euro (5,802 million euro as at 31 December 2020).

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 1,326 million euro as at 31 March 2021 (1,460 million euro as at 31 December 2020). The notional value of these derivatives totalled 19,625 million euro (19,222 million euro as at 31 December 2020).

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 2021, this led to a positive effect of 40 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 2020 financial statements.

## OPERATIONAL RISK

Operational risk is defined as the risk of suffering losses due to inadequacy or failures of processes, human resources and internal systems, or as a result of external events.

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 uses a combination of the methods allowed under applicable regulations (advanced measurement approach partially used along with the standardised approach and basic indicator approach). The capital absorption resulting from this process amounted to 2,205 million euro as at 31 March 2021, unchanged compared to 31 December 2020.

## 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.

For the main pending disputes, the significant developments in the quarter are described below. For previous disputes and a detailed illustration of significant individual disputes, see the Notes to the 2020 Annual Report of the Intesa Sanpaolo Group and the 2020 Consolidated Annual Report of the acquired UBI Group.

*Selarl Bruno Raulet (former Dargent Tirmant Raulet) dispute* – A hearing was held in March this year and a ruling is expected by the summer.

*Offering of diamonds* – In April 2021, the Bank learned from press reports that the Public Prosecutor's Office of Milan had requested the indictment of 105 people and 5 of the companies involved (banks and diamond brokers). Neither Intesa Sanpaolo nor the two employees under investigation, whose positions have been separated, were summoned.

With regard to the position of the Bank, which is charged with administrative liability pursuant to Legislative Decree 231/2001 for the predicate offence of self-laundering, the Public Prosecutor's Office accepted the plea bargain submitted by ISP, which proposed the application of only the financial penalty established by Legislative Decree 231/2001, for an amount of

100,000 euro, and the confiscation of only the sums constituting the profit from the offence of self-laundering, quantified at 61,434 euro. The plea bargain request will need to be assessed by the preliminary investigation judge for a final decision.

*Disputes arising from the acquisition of certain assets, liabilities and legal relationships of Banca Popolare di Vicenza S.p.A. in compulsory administrative liquidation and Veneto Banca S.p.A. in compulsory administrative liquidation* – In January 2021, the claims regarding the additional charges accrued up to 30 June 2020 were sent to the Banks in compulsory administrative liquidation.

No disputes have emerged with regard to the claims already served. The deadline for the submission of objections by the compulsory administrative liquidation has been set at 30 September 2021.

*Florida 2000 srl, Conte Anna ed Esposito Guido* – In 2018, Florida 2000 s.r.l., together with two directors of the company, challenged the legitimacy of the contractual terms and conditions applied to the accounts held with the Bank, requesting that the latter be ordered to pay back 22.6 million euro in interest and fees that were not due, plus compensation for damages quantified as an additional amount of 22.6 million euro.

In its ruling of 25 March 2021, the Court upheld the petition in part, ordering the Bank to repay 638 thousand euro, plus interest and costs, and rejecting the request for compensation.

*Ruling of the EU Court of Justice of 11 September 2019 on credit agreements for consumers - so-called Lexitor ruling* – The general case law situation is still uncertain. In the first quarter, while there were a number of unfavourable rulings, mainly from Justices of the Peace, there were 2 rulings in favour of intermediaries (Court of Rome and Court of Cassino). Of particular significance is the ruling of the Court of Rome, which held that the Lexitor ruling cannot be directly applied in our legal system in relations between private individuals.

*Ruling no. 8770/2020 of the Joint Sections of the Court of Cassation on derivatives entered into by local authorities* – With regard to ruling no. 8770/2020 of the Joint Sections of the Court of Cassation on derivatives entered into by local authorities, two new disputes were registered.

- the Municipality of Augusta served a writ of summons requesting a declaration of invalidity of the contract due to the lack of risk awareness and the absence of adequate information on the costs and structure of the instrument, and consequently for the repayment of 3 million euro;
- the Municipality of Cimadolmo initiated a mediation procedure with undetermined value.

In relation to the dispute brought in December 2013 by the Municipality of Mogliano Veneto concerning an IRS collar derivative contract, the Bank lodged an appeal with the Court of Cassation against ruling no. 2393 of 28 September 2020 of the Court of Appeal of Milan. This ruling had confirmed the ruling issued against the Bank by the Court of Milan in 2017.

With regard to the dispute with the Municipality of Perugia, the local authority, after initiating a mediation procedure that ended with a negative outcome, served a summons requesting the nullity of four derivative contracts entered into in 2006. The first court hearing is scheduled for 6 May 2021.

#### Potential assets

In a ruling filed on 5 June 2020, the Lazio Regional Tax Commission – Third Section rejected the appeal filed by the Italian Revenue Agency in relation to registration tax (10.3 million euro) against the ruling issued by the Court of Appeal of Rome on 7 March 2013, upholding the ruling of the court of first instance and awarding costs.

The Italian Revenue Agency did not appeal to the Court of Cassation within the time limit and so the appeal ruling in favour of the Bank has become final. The tax refunded by the Italian Revenue Agency during 2018 can be considered to have been definitively acquired by the Bank.

#### Tax litigation

No new disputes of a significant amount involving Intesa Sanpaolo arose during the quarter. No significant events were reported for either the Italian or international subsidiaries.

The outstanding tax litigation risks are covered by adequate allowances for risks and charges.

With regard to the main outstanding disputes, and in particular with regard to the disputes concerning the application of the proportional registration tax following the reclassification of a transfer of a business and a sale of an equity interest into a sale of a business pursuant to Article 20 of Presidential Decree 131/1986, the Constitutional Court filed its ruling no. 39/2021 of 16 March 2021 whose conclusions confirm the previous ruling no. 158 of 21 July 2020 by that Court. The decision confirms the applicability of Article 20 mentioned above, in its current wording that does not allow the interpretation of documents on the basis of the economic effects of the transaction or of elements not included in the text, also for the interpretation of documents signed before the new rule came into force and, therefore, has effects on proceedings initiated under the old provision. With this second ruling of the Constitutional Court, the long-standing dispute should be considered definitively over and indeed this approach has already been adopted by the Court of Cassation in its ruling no. 9065 of 1 April 2021.

In addition, with ruling no. 244/2021, filed on 25 February 2021, the Regional Tax Commission of Tuscany rejected the Italian Revenue Agency's appeal against the first instance ruling in favour of the Bank regarding the IRAP tax for 2010 of Cassa di Risparmio di Firenze. The Italian Revenue Agency challenged the non-taxation of 50% of the dividend distributed in July 2010 by the subsidiary Casse del Centro, which was merged the following November with tax and accounting effects backdated to 1 January. As a result of the consolidation entries following the merger, the aforementioned dividend was eliminated from the accounts and, consequently, did not contribute to the formation of the IRAP tax base (value of the dispute for tax, penalty and interest totalling 2.2 million euro). The time limits for the filing of an appeal with the Court of Cassation by the Italian Revenue Agency are about to expire.

With regard to Intesa Sanpaolo's branches located abroad, a tax audit has been initiated by the Madrid Revenue Agency on the Madrid branch regarding the deductibility of intercompany costs amounting to 2.2 million euro for the 2015 tax period. The branch is currently preparing its response to the requests from the Tax Authority, which has not yet formally issued any claims.

## INSURANCE RISKS

### Investment portfolios

The investments of the insurance companies of the Intesa Sanpaolo Group (Intesa Sanpaolo Vita, Intesa Sanpaolo Assicura, Intesa Sanpaolo Life, Fideuram Vita, Intesa Sanpaolo RBM Salute and BancAssurance Popolari) 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 2021, the investment portfolios of Group companies, recorded at book value, amounted to 180,270 million euro. Of these, a part amounting to 91,027 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 Unit-linked policies and pension funds and amounted to 89,243 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, 83.3% of assets, i.e. 75,499 million euro, was bonds, whereas equity instruments represented 2.2% of the total and amounted to 1,986 million euro. The remainder (13,156 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (14.5%).

The carrying value of derivatives came to approximately 385.6 million euro, of which 403.72 million euro relating to effective management derivatives<sup>16</sup>, and the remaining portion (-18 million euro) is attributable to hedging derivatives.

At the end of the first three months of 2021, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 1,002 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 4,698 million euro.

The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 5.7% of total investments and A bonds approximately 7.1%. Low investment grade securities (BBB) were approximately 84.5% of the total and the portion of speculative grade or unrated was minimal (2.7%).

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 81.2% of the total investments, while financial companies (mostly banks) contributed almost 10.6% of exposure and industrial securities made up approximately 8.6%.

At the end of the first quarter of 2021, 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 4,800 million euro, with 4,216 million euro due to government issuers and 584 million euro to corporate issuers (financial institutions and industrial companies).

<sup>16</sup> 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.