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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 the 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>13</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.

Following the merger by incorporation of UBI Banca into Intesa Sanpaolo, approaches and tools for integrating the risk management framework are being shared 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.

## 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 former 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 former UBI Group into Intesa Sanpaolo, in September 2020 it sent the strategic return to compliance plan to the competent Supervisory Authorities, aimed 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 former UBI Banca Group was also requested for supervisory reporting purposes at consolidated level until full integration; the activities indicated in the plan continue in the manner agreed with the Supervisory Authority.

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<sup>13</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.

With regard to credit risks, the ECB's authorisations to use the new Institutions and Retail SME models for regulatory purposes were implemented starting from June 2021.

The periodic updating and alignment to changes in regulations governing IRB systems and their extension to the Italian subsidiaries originating from the UBI Banca 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.

The situation as at 30 June 2021 is shown in the following table:

Portfolio	PD - Model Type	LGD - Model Type	EAD - Model Type	Status
<b>Sovereign</b>	Shadow model based on agency rating	Model based on recovery rates estimated by rating agencies	Regulatory parameters	Used for management purposes only; Standardised approach for reporting purposes
<b>Institutions</b>	Default model (Banks) <sup>(4)</sup>	Market model (Banks)	Regulatory parameters (Banks)	AIRB authorised since June 2017
	Default model (Municipalities and Provinces) Shadow model (Regions) <sup>(4)</sup>	Workout model (Municipalities, Provinces, Regions)	Regulatory parameters (Municipalities, Provinces, Regions)	AIRB authorised since June 2017
<b>Corporate</b>	Default model (Corporate)	Workout model (Banking; Leasing and Factoring)	CCF/K factor model (Banking) Regulatory parameters (Leasing and Factoring)	FIRB authorised since December 2008, AIRB LGD authorised since December 2010, EAD authorised since September 2017 <sup>(1)</sup>
	Simulation models (Specialised Lending)	Simulation models (Specialised Lending)	Regulatory parameters (Specialised Lending)	AIRB authorised since June 2012
	Expert-Based Model (Non-Banking Fin. Inst.)	Regulatory parameters (Non-Banking Fin. Inst.)	Regulatory parameters (Non-Banking Fin. Inst.)	Used for management purposes only; Standardised approach for reporting purposes
<b>Retail</b>	Default model (Retail)	Workout model (Retail)	CCF/K factor model (Retail)	AIRB Retail since September 2018 <sup>(2)</sup>
	Default model (Retail SME)	Workout model (Retail SME)	CCF/K factor model (Retail SME)	AIRB authorised since December 2012 <sup>(3)</sup>

1) ISP authorised for FIRB from December 2008, for LGD AIRB from December 2010 and for EAD from 2017, Banca IMI (2012, merged by incorporation into the Parent company since 2020), ISP Ireland (2010), VUB (2010), Intesa Sanpaolo Bank (2017), and ISP Luxembourg (2017). From 2017, the Corporate model has also been used to calculate the risk on the Banking book equity portfolio with LGD 65%/90%.

2) VUB authorised from June 2012 for PD and LGD of Retail Mortgage models.

3) VUB authorised from June 2014.

4) ISP and Banca IMI (merged by incorporation into the Parent company in 2020) authorised from 2017.

With regard to counterparty risk on derivatives (OTC and ETD) and SFTs, the Group has improved the measurement and monitoring, by refining the instruments required under Basel 3. For reporting purposes, Intesa Sanpaolo has been authorised to use internal models (both for the determination of Exposure at default for replacement risk and for the CVA capital charge for migration risk). With respect to 31 December 2020, the approval letter authorising the use of the initial margin simulation model for central counterparties and bilateral counterparties for reporting purposes was received on 6 April 2021. The model was applied starting from June 2021. Also from June 2021, the internal counterparty risk model also covers positions arising from the merger of UBI Banca. Given the small impact of the use of the internal model on these positions, the inclusion did not give rise to any authorisation procedures and will be communicated ex-post to the Supervisory Authorities. In addition, in compliance with the entry into force of Regulation (EU) 2019/876 (CRR II), starting from June 2021 Intesa Sanpaolo adopted the SA-CCR method in place of the Mark-to-Market method when calculating counterparty risk exposures on derivative transactions not covered by an internal model. The same method is used for the entire portfolio of derivatives for the purpose of determining the counterparty risk exposures used as inputs for the calculation of Leverage and reporting on Large Exposures. In compliance with the regulatory transaction thresholds, several of the Group's international subsidiary banks have adopted the simplified original exposure method.

With regard to operational risk, the Group obtained authorisation to use the Advanced Measurement Approach (AMA – internal model) to determine the associated capital requirement for regulatory purposes, with effect from the report as at 31 December 2009. Please note that, on 30 June 2021, the Group was authorised to extend its advanced model to some entities belonging to the former UBI Group, specifically to: UBI Banca (merged by incorporation into Intesa Sanpaolo S.p.A. on 12 April 2021), including the entities of the former Banca Marche, former Banca Etruria and former CariChieti, UBI Sistemi e Servizi and IW Bank Private Investments.

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's strategies, powers and rules for credit granting and management are aimed at:

- achieving a sustainable goal consistent with the Group's risk appetite and value creation objectives, whilst guaranteeing and improving the quality of its lending operations;
- diversifying the portfolio, limiting the concentration of exposures to counterparties/groups, economic sectors or geographical areas;
- efficiently selecting economic groups and individual borrowers through a thorough analysis of their creditworthiness aimed at limiting the risk of insolvency and mitigating potentially associated losses;
- given the current economic climate, favouring lending business aimed at supporting the real economy and production system and at developing relationships with customers;
- constantly monitoring relationships and the related exposures, through the use of both IT procedures and systematic surveillance of positions that show irregularities with the aim of detecting any symptoms of deterioration in a timely manner.

The 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.

With respect to the situation as at 31 December 2020, the Group has obtained authorisation to use from June 2021, for regulatory purposes:

- new Institutions models (for the assessment of Banks and Public Entities) which include significant refinements of statistical methodologies, updating of the data used to build the models and a broader set of internal information used;
- a framework for the Margin of Conservatism (MoC) applicable to all portfolios;
- a new internal model to estimate the downturn component of the LGD parameter for corporate exposures in default;
- a new Retail SME model that involves the use of new data sources and new statistical methodologies.

### Credit quality

Constant monitoring of the quality of the loan portfolio is also pursued through specific operating checks for all the phases of loan management.

The overall watch-list and non-performing loan portfolio is subject to a specific management process which, inter alia, entails accurate monitoring through a control system and periodic managerial reporting. In particular, this activity is performed using measurement methods and performance controls that allow the production of synthetic risk indicators. The quality of the loan portfolio is pursued through specific operating checks for all the phases of loan management, through the use of both IT procedures and systematic supervision of positions with the aim of promptly detecting any symptoms of difficulty and promote corrective measures to prevent possible deterioration of credit risk.

Positions are detected and automatically entered in the credit management processes by way of daily and monthly checks using objective risk indicators that allow timely assessments when any anomalies arise or persist and interact with processes and procedures for loan management and monitoring.

Within the Group, in accordance with pre-set rules, positions which are attributed a persistent high-risk rating are intercepted (manually or automatically) and classified to the following categories based on their risk profile, in accordance with the regulatory provisions on credit quality:

- bad loans: the set of "on-" and "off-balance sheet" exposures to borrowers in default or similar situations;
- unlikely to pay: "on-" and "off-balance sheet" exposures which the bank, based on its opinion, does not deem likely to be completely (as principal and/or interest) repaid by the borrowers without the implementation of actions such as enforcement of guarantees. This assessment is conducted regardless of the presence of any amounts (or instalments) due and unpaid;
- non-performing Past Due exposures: this category includes on-balance sheet exposures, other than those classified as bad loans or unlikely to pay that, as at the reference reporting date, are past due or overdrawn by over 90 days on a continuous basis. The total exposure to a debtor must be recognised as Past Due if, at the reference reporting date, the amount of the principal, interest and/or fees not paid when due exceeds both of the following thresholds (hereinafter, collectively, the "Relevance Thresholds"):
  - o the absolute limit of 100 euro for retail exposures and of 500 euro for non-retail exposures (the "Absolute Threshold"), to be compared with the total amount past due from the borrower;
  - o the relative limit of 1%, to be compared with the ratio of the total amount past due to the total amount of all on-balance sheet exposures to the same borrower (the "Relative Threshold").

Lastly, non-performing exposures also include the individual forbore exposures which comply with the definition of "Non-performing exposures with forbearance measures" envisaged by the EBA ITS (European Banking Authority - Implementing Technical Standards), which are not a separate category of non-performing assets, but rather a sub-category. Similarly, exposures characterised by "forbearance measures" are also included among performing loans.

The management process for such exposures, in close accordance with regulatory provisions concerning classification times and methods, is assisted by automatic mechanisms that ensure pre-established, autonomous and independent management procedures.

(millions of euro)

Captions	30.06.2021			31.12.2020			Change
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Bad loans	9,293	-5,601	3,692	9,594	-5,591	4,003	-311
Unlikely to pay	9,413	-3,874	5,539	10,678	-4,455	6,223	-684
Past due loans	605	-123	482	627	-110	517	-35
<b>Non-Performing Loans</b>	<b>19,311</b>	<b>-9,598</b>	<b>9,713</b>	<b>20,899</b>	<b>-10,156</b>	<b>10,743</b>	<b>-1,030</b>
<i>Non-performing loans in Stage 3 (subject to impairment)</i>	19,240	-9,584	9,656	20,818	-10,132	10,686	-1,030
<i>Non-performing loans designated at fair value through profit or loss</i>	71	-14	57	81	-24	57	-
<b>Performing loans</b>	<b>449,476</b>	<b>-2,910</b>	<b>446,566</b>	<b>447,650</b>	<b>-2,807</b>	<b>444,843</b>	<b>1,723</b>
<i>Stage 2</i>	68,318	-2,063	66,255	71,037	-2,014	69,023	-2,768
<i>Stage 1</i>	380,133	-847	379,286	375,535	-793	374,742	4,544
<i>Performing loans designated at fair value through profit or loss</i>	1,025	-	1,025	1,078	-	1,078	-53
<b>Performing loans represented by securities</b>	<b>7,028</b>	<b>-30</b>	<b>6,998</b>	<b>7,231</b>	<b>-37</b>	<b>7,194</b>	<b>-196</b>
<i>Stage 2</i>	2,051	-23	2,028	3,090	-30	3,060	-1,032
<i>Stage 1</i>	4,977	-7	4,970	4,141	-7	4,134	836
<b>Loans held for trading</b>	<b>20</b>	<b>-</b>	<b>20</b>	<b>22</b>	<b>-</b>	<b>22</b>	<b>-2</b>
<b>Total loans to customers</b>	<b>475,835</b>	<b>-12,538</b>	<b>463,297</b>	<b>475,802</b>	<b>-13,000</b>	<b>462,802</b>	<b>495</b>
<i>of which forbore performing</i>	8,110	-434	7,676	5,560	-304	5,256	2,420
<i>of which forbore non-performing</i>	5,852	-2,382	3,470	5,902	-2,360	3,542	-72
<b>Loans to customers classified as discontinued operations (*)</b>	<b>5,199</b>	<b>-3,731</b>	<b>1,468</b>	<b>29,602</b>	<b>-3,462</b>	<b>26,140</b>	<b>-24,672</b>

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

(\*) As at 30 June 2021, the caption refers to the portfolio of bad and unlikely-to-pay loans soon to be sold (gross exposure of 5,199 million euro, adjustments of 3,731 million euro, net exposure of 1,468 million euro).

As at 30 June 2021, the Group's net non-performing loans amounted to 9.7 billion euro, an all-time low. The 9.6% reduction from the beginning of the year confirms the virtuous trend already recorded in previous years. The non-performing assets percentage of total net loans to customers amounted to 2.1%, a low proportion and down on the figure recorded in December 2020 (2.3%), with an increased coverage ratio for non-performing loans, of 49.7%.

In further detail, at the end of June bad loans came to 3.7 billion euro net of adjustments (-7.8%) and represented 0.8% of total loans. During the same period, the coverage ratio came to 60.3% (78.9% including the write-offs applied). Loans included in the unlikely-to-pay category amounted to 5.5 billion euro, down by 11%, and accounted for 1.2% of total loans to customers, with a coverage ratio of 41.2%. Past due loans amounted to 482 million euro (-6.8%), with a coverage ratio of 20.3%. Within the non-performing loan category, forbore exposures, generated by forbearance measures for borrowers experiencing difficulty in meeting their financial obligations, amounted to approximately 3.5 billion euro, with a coverage ratio of 40.7%, while forbore exposures in the performing loans category amounted to 7.7 billion euro.

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

The Group's Expected Credit Loss (ECL) at 30 June 2021 has been calculated in accordance with IFRS 9 and on the basis of the scenarios detailed in the chapter "The first half of 2021", to which reference is made.

In particular, even in the light of an improved prospective macroeconomic scenario in the updated ECB and Bank of Italy forecasts, the Group has decided, on a prudent basis, not to make any changes to the macroeconomic scenario used in the assessments for the Annual Report as at 31 December 2020, with the IFRS 9 forward-looking credit assessments consequently not benefiting from the effects of these improvements. This takes into account the continued uncertainties on the health front, as the degree of success of the vaccination campaign, at national and global level, may have an impact on expectations, consumption and investment, as well as the continuation in legislative moratoria initiatives in Italy, resulting in a reduction in the ability to fully assess the actual and real possibility of repayment of loans. In the second half of the year, when the effects of the expiry of the moratoria can be measured more accurately, it will also be possible to review the approach in the light of developments in the macroeconomic scenario.

With regard to the specific management overlays aimed at including the ad hoc adjustments, which are not captured by the current modelling, in order to better reflect the particular characteristics of the COVID-19 impacts and given that the underlying reasons continue to apply in substance, the choices already made at the time of the 2020 Annual Report have been maintained, with further calibrations and refinements made in light of the evolution of the overall health and economic situation.

This relates in particular to:

- the adoption of corrective factors on forecast default rates to include, on the one hand, the expected benefits of major economic support initiatives such as government guarantees not captured by satellite models and, on the other hand, to

incorporate the worsening effects of the moratoria during the period of their validity in postponing the transition to default status to future years;

- the one-off treatments to provide more granularity through extraordinary staging triggers for the impacts of the current scenario on counterparties most penalised by the crisis, also in light of the specific analyses on counterparties and the presence of moratoria measures.

With regard to the government guarantees, the mitigating effects on future risk not captured by the satellite models act as factors for the containment of the increase in system-wide default rates, thanks to the increase in the base of customers that can access credit and the increase in the liquidity in circulation in support of companies undergoing temporary difficulties. These effects, introduced in the 2020 Annual Report, have been maintained with the same methodology and limited time effect, even though – based on more up-to-date information, including the Credit Risk Appetite (CRA) analyses updated in February 2021 – the benefit envisaged in terms of decline in expected default rates is lower.

The overlay on the vulnerability of the moratorium/transfer of default flows was incorporated in the results of the forward-looking assessments in the satellite models, as it is aimed at “correcting” the estimated expected default flows (based on the application of the “COVID” macroeconomic scenarios described above) to incorporate the effect that the moratoria have on transfers to default during their period of validity. In substance, it reduces the forecast of default flows during the period of validity of the moratoria and transfers it (in addition to those estimated by the satellite model) to subsequent periods, when the legislative moratoria will expire.

In particular, these led to a postponement to 2021 of part of the defaults forecast by the model in 2020 leading to the potential cliff-edge effect. The persistence of this effect is highlighted by the extension of the moratoria to June 2021, together with the low levels of defaults in the first half of 2021. As a result, this behaviour has been recorded in the half-yearly report as follows:

- the downward effect was extended until the end of the first half of 2021, based on the parameter for the reduction of default flows already used so far (of around 70%) and considering that the moratoria will cease to be renewable en masse;
- defaults avoided through moratoria in the period May 2020 to June 2021 increased the future default flows projected by the satellite models in the period July 2021 to June 2022, i.e. by amplifying the expected cliff-edge effect in the first year of projection for IFRS 9 purposes, except for a portion that is estimated to survive, by taking advantage of the economic rebound to overcome the temporary difficulty, whose estimate has remained unchanged compared to the 2020 Annual Report (15% in the baseline scenario, 30% in the upside scenario and 0% in the downside scenario).

The effect of that overlay acts through the SICR logics of the PD Change, thus increasing the transfers to Stage 2 and ECLs.

Lastly, since the underlying reasons continue to apply, the Group has also substantially maintained the choices already made in the 2020 Annual Report in terms of one-off treatments using extraordinary staging triggers to increase the granularity of the impacts of the scenario considered for the counterparties most penalised by the crisis. These triggers act “downstream” on counterparties not already classified based on the criteria summarised above.

Compared to the Annual Report, the criteria adopted for the extraordinary triggers have been refined based on the developments observed in the first half of 2021, relating to the continuation of existing moratoria, the results of the credit risk monitoring conducted, also through specific action plans, and the progress of specific rating updates made to take account of the pandemic situation. The latter have also enabled the refinement of the assessment of the micro-sector vulnerabilities, where relevant, at individual counterparty level and according to the specific characteristics of the models used.

With the significant progression of rating updates that take into account the COVID situation (and which now cover 99% of positions in moratoria) and with the extension to the lower risk classes of the additional triggers for transition to stage 2, there was no longer a need for micro-sector differentiation, which, on the one hand, in the updated forecast scenarios shows less variance in the expected effects on revenue and earnings compared to the forecasts at the beginning of the crisis, and, on the other hand, is captured, together with other factors, at individual counterparty level by the ratings updated according to the specific characteristics of the models used.

The Group's Expected Credit Loss (ECL) as at 30 June 2021 was subject to sensitivity analysis aimed at analysing the variability with respect to the individual alternative scenarios, also in light of the strengthening of the indications provided in that sense by the Regulators, to increase financial entities' awareness of the need to include appropriate disclosure in the financial statements that allows the market to interpret the possible evolution – and potential impacts – of credit risk in the short/medium-term.

That analysis was conducted on a performing loan portfolio (Stage 1 and Stage 2) relating to the scope representing the Group (Parent Company and banks in the IMI C&IB Division that represent around 80% of the Group's total exposure), assuming as reference scenario the single alternative scenarios (upside and downside) used to determine the add-on, in place of the most-likely scenario, keeping valid the effects deriving from adopting managerial adjustments and overlays, used to consider - in the exceptional context of COVID-19 – the specific elements that make it possible to ensure more consistent estimates of expected losses.

The sensitivity of the portfolio to the downside scenario would see a number of counterparties sliding into Stage 2, with their exposure potentially increasing by 20%, and a resulting increase in the performing ECL estimated at around 16% (around 450 million euro) and greater average coverage by around 10 bps.

Vice versa, the sensitivity analysis of the portfolio in the upside scenario would see a reduction in the stock of positions in Stage 2, which would decrease by 15%, with a potential economic benefit on the performing ECL decreasing by 20% (approximately 600 million euro), and a resulting decrease in the coverage ratio of around 13 bps.



## Counterparty risk

Counterparty risk is a particular type of credit risk, relating to OTC (over the counter) and ETD (exchange-traded derivatives) derivatives and SFTs (Securities Financing Transactions), which refers to the possible default of the counterparty before the expiry of a contract that has a positive market value.

The Group uses techniques to mitigate counterparty risk through bilateral netting arrangements which enable the netting off of credit and debit positions in the event of counterparty default.

This is achieved by entering into ISDA (International Swaps and Derivatives Association) agreements, for OTC derivatives, which also reduce the absorption of regulatory capital in accordance with supervisory provisions.

In addition, the Bank establishes collateral arrangements, where possible, typically calling for daily margins, to hedge bilateral OTC derivatives (credit support annexes - CSAs) and SFTs (Global Master Repurchase Agreements - GMRA e General Market Securities Lending Agreements - GMSLAs).

For reporting purposes, Intesa Sanpaolo has been authorised to use the internal models approach to calculate the counterparty risk requirement for OTC and ETD derivatives and SFTs.

These advanced risk measurement methods are also used at operational level to perform the “use test”: the Market and Financial Risk Management Head Office Department calculates, validates and sends the metrics to the credit monitoring systems on a daily basis to measure the use of the credit lines for OTC and ETD derivatives and SFTs.

The Group's other banks, which have operations that involve a residual counterparty risk requirement with respect to the Parent Company, apply the advanced metrics in a simplified manner at operational level.

To perform the use test of the model, the Group has implemented the processes required by the “Basel 3” regulations. In particular, stress tests are carried out to measure the impacts on risk measures under extreme market conditions. Backtesting is also conducted to ensure the robustness of the model.

In addition, to complete the risk analysis process, the following corporate processes have been activated:

- definition and periodic calculation of stress tests on market scenarios and joint market/credit scenarios on counterparty risk measures;
- definition and periodic analysis of Wrong-Way Risk, i.e. the risk of a positive correlation between the future exposure to a counterparty and that counterparty's probability of default;
- definition and monitoring of management limits;
- contribution of collateral inflow/outflow risk measures, calculated on the basis of the internal counterparty risk model, for margined OTC derivatives and SFTs;
- periodic reporting to the management of measures calculated using the internal exposure model, capital requirement, level of use of management limits, results of stress tests and analyses of wrong-way risk;
- definition and periodic calculation of back-testing analyses to monitor the predictive performance over time of the model with respect to the movements of the risk factors underlying the transactions in the portfolio.

As mentioned, with respect to 31 December 2020, the approval letter authorising the use of the initial margin simulation model for central counterparties and bilateral counterparties for reporting purposes was received on 6 April 2021. The model was applied starting from June 2021. Also from June 2021, the internal counterparty risk model also covers positions arising from the merger of UBI Banca. Given the small impact of the use of the internal model on these positions, the inclusion did not give rise to any authorisation procedures and will be communicated ex-post to the Supervisory Authorities. In addition, in compliance with the entry into force of Regulation (EU) 2019/876 (CRR II), starting from June 2021 Intesa Sanpaolo adopted the SA-CCR method in place of the Mark-to-Market method when calculating counterparty risk exposures on derivative transactions not covered by an internal model. The same method is used for the entire portfolio of derivatives for the purpose of determining the counterparty risk exposures used as inputs for the calculation of Leverage and reporting on Large Exposures. In compliance with the regulatory transaction thresholds, several of the Group's international subsidiary banks have adopted the simplified original exposure method.

## MARKET RISKS

### TRADING BOOK

The quantification of trading risks (managerial calculation scope) is based on daily and periodic analysis of the vulnerability of the trading portfolio of Intesa Sanpaolo, which represents the main portion of the Group's market risks, to adverse market movements of the following risk factors:

- interest rates;
- equities and market indexes;
- investment funds;
- foreign exchange rates;
- implied volatilities;
- spreads in credit default swaps (CDSs);
- spreads in bond issues;
- correlation instruments;
- dividend derivatives;
- asset-backed securities (ABSs);
- commodities.

Some Group subsidiaries hold smaller trading portfolios with a marginal risk (approximately less than 2% of the Group's overall management risk). In particular, the risk factors of the international subsidiaries' trading books are local government bonds, positions in interest rates, and foreign exchange rates relating to linear pay-offs.

### Managerial VaR

The analysis of market risk profiles relative to the trading book (managerial scope) uses various quantitative indicators and VaR is the most important. Since VaR is a synthetic indicator which does not fully identify all types of potential loss, risk management has been enriched with other measures, in particular simulation measures for the quantification of risks from illiquid parameters (dividends, correlation, ABS).

VaR estimates are calculated daily based on simulations of weighted historical time-series, a 99% confidence level and 1-day holding period.

Please note that, 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 within an overall limit for trading and the hold to collect and sell (HTCS) business model.

### Sensitivity and greeks

Sensitivity measures make risk profiling more accurate, especially in the presence of option components. These measure the risk attributable to a change in the value of a financial position to predefined changes in valuation parameters including a one basis point increase in interest rates.

### Level measures

Level measures are risk indicators which are based on the assumption of a direct relationship between the size of a financial position and the risk profile. These are used to monitor issuer/sector/country risk exposures for concentration analysis, through the identification of notional value, market value or conversion of the position in one or more benchmark instruments (so-called equivalent position).

### Stress tests

Stress tests measure the value changes of instruments or portfolios due to changes in risk factors of unexpected intensity and correlation, or extreme events, as well as changes representative of expectations of the future evolution of market variables. Stress tests for management purposes are applied periodically to market risk exposures, typically adopting scenarios based on historical trends recorded by risk factors, for the purpose of identifying past worst-case scenarios, or defining variation grids of risk factors to highlight the direction and non-linearity of trading strategies.

### Internal model validation

For some of the risk factors included in the managerial VaR measurements, with regard to the Parent Company's regulatory trading book, the Supervisory Authority has validated the internal models for the capital requirement of Intesa Sanpaolo.

More specifically, concerning market risk, the risk profiles validated are: (i) generic/specific on debt securities and on equities; (ii) position risk on quotas of CIUs and the hedge fund portfolios with a look-through approach; (iii) position risk on dividend derivatives and (iv) commodity risk.

### Stressed VaR

Capital requirement includes stressed VaR figures. The requirement derives from the determination of the VaR associated with a market stress period. This period was identified considering the following guidelines, on the basis of the indications presented in the Basel document "Revision to the Basel 2 market risk framework":

- the period must represent a stress scenario for the portfolio;
- the period must have a significant impact on the main risk factors for the portfolio of Intesa Sanpaolo;
- the period must allow real time series to be used for all portfolio risk factors.

While using the historical simulation approach for VaR calculation, the latter point is a discriminating condition in the selection of the holding period. Actually, in order to ensure that the scenario adopted is effectively consistent and to avoid the use of driver or comparable factors, the historical period must ensure the effective availability of market data.

As at the date of preparation of this document, the period for the measurement of Stressed VaR for Intesa Sanpaolo was from 11 October 2011 to 28 September 2012.

### Incremental Risk Charge (IRC)

The Incremental Risk Charge (IRC) is the maximum potential loss in the credit trading book resulting from an upgrade/downgrade or bankruptcy of the issuers, over a 1-year period, with a 99.9% confidence level. This measure is additional to VaR and enables the correct representation of the specific risk on debt securities and credit derivatives because, in addition to idiosyncratic risk, it also captures event and default risk.

### Daily managerial VaR of the trading book

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.

	2021				2020			
	average 2 <sup>nd</sup> quarter	minimum 2 <sup>nd</sup> quarter	maximum 2 <sup>nd</sup> quarter	average 1 <sup>st</sup> quarter	average 4 <sup>th</sup> quarter	average 3 <sup>rd</sup> quarter	average 2 <sup>nd</sup> quarter	average 1 <sup>st</sup> quarter
<b>Total Group Trading Book <sup>(a)</sup></b>	25.8	18.8	34.2	41.3	59.0	73.3	85.6	41.1
<i>of which: Group Treasury and Finance Department</i>	2.8	2.3	4.6	3.2	3.4	9.9	37.9	15.0
<i>of which: IMI C&amp;IB Division</i>	25.9	18.9	32.1	38.1	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 second quarter of 2021, there was a reduction in the overall trading risks compared to the averages for the first quarter of 2021 from 41.3 million euro (average for first quarter of 2021) to 25.8 million euro and, more generally, compared to the averages for the full year 2020. These reductions are mainly attributable to the scenario “rolling effect” due to the lower market volatility following the exceptional market shocks in March 2020 related to the spread of the COVID-19 pandemic.

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

	2021			2020		
	average 1 <sup>st</sup> half	minimum 1 <sup>st</sup> half	maximum 1 <sup>st</sup> half	average 1 <sup>st</sup> half	minimum 1 <sup>st</sup> half	maximum 1 <sup>st</sup> half
<b>Total Group Trading Book <sup>(a)</sup></b>	33.5	18.8	57.8	63.5	31.0	97.4
<i>of which: Group Treasury and Finance Department</i>	3.0	2.3	5.6	26.5	10.1	42.6
<i>of which: IMI C&amp;IB Division</i>	32.0	18.9	51.9	37.0	20.7	57.0

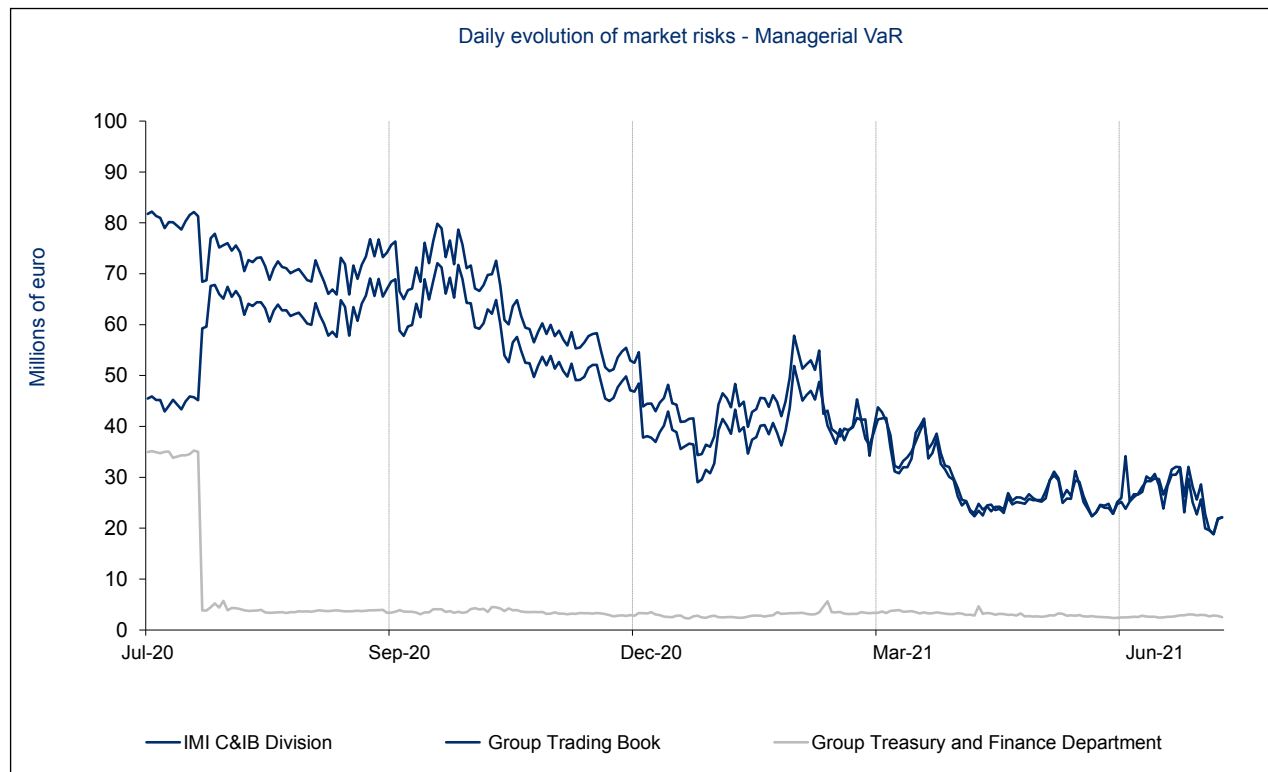
Each line in the table sets out past estimates of daily VaR calculated on the historical time-series of the first six months of the Intesa Sanpaolo Group (including other subsidiaries), the year respectively of the Group Treasury and Finance Department and the IMI C&IB Division; minimum and maximum values 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 half of 2021, the change was mainly due to the IMI C&IB Division. In particular, the following changes were recorded:

- in the first quarter, increases in the indicator in January and February due to dealing in government bonds, followed by a reduction due to the rolling scenario effect caused by lower market volatility;
- in the second quarter, initially an increase in risk measures attributable to activity in government bonds and equity indices and subsequently, starting from the middle of June, a reduction in risks linked to interest rate and equity index transactions.





The breakdown of the Group's risk profile in the trading book in the second quarter of 2021 shows a prevalence of credit spread risk and interest rate risk, accounting for 45% and 24%, respectively, 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 Department (49% and 31%, respectively) and of credit spread and interest rate risk for the IMI C&IB Division (46% and 25%, respectively).

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

2 <sup>nd</sup> quarter 2021	Shares	Interest rates	Credit spreads	Foreign exchange rates	Other parameters	Commodities
Group Treasury and Finance Department	11%	49%	9%	31%	0%	0%
IMI C&IB Division	13%	25%	46%	2%	9%	5%
<b>Total</b>	<b>13%</b>	<b>24%</b>	<b>45%</b>	<b>5%</b>	<b>9%</b>	<b>4%</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 second 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 June 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	61	-3	46	-52	40	-49	18	10	-8	1

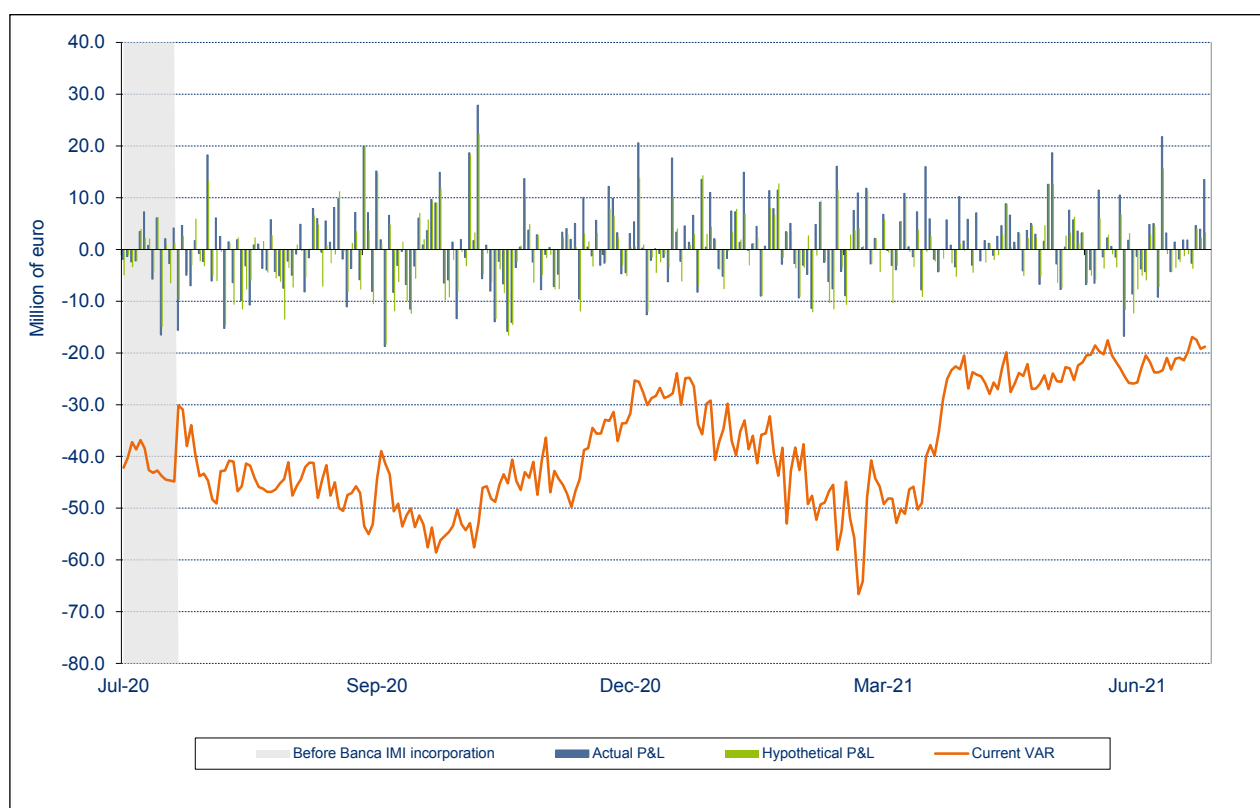
More specifically:

- for stock market positions, there would be potential losses of 3 million euro in the event of a sudden rise in equity prices and a concurrent sharp reduction in volatility;
- for positions in interest rates, there would be potential losses of 52 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 49 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 8 million euro in the event of a fall in prices of commodities other than precious metals.

With regard the overall limit relating to trading and the hold to collect and sell (HTCS) business model, there was an overall reduction in the market managerial VaR in the second quarter from 226 million euro (average managerial VaR first quarter 2021) to 126 million euro (average managerial VaR second quarter 2021). The reduction is mainly due to the rolling scenario effect, given the reduced volatility of the financial markets.

### Backtesting

In the last year, there were no backtesting exceptions. After the increase following the upsurge of the COVID-19 crisis, the gradual reduction in market volatility ensured that the risk measure (Current VaR) was sufficiently conservative over the last four quarters<sup>14</sup>.



<sup>14</sup> From 12 April 2021, estimates include former UBI's trading book. The shaded area refers to the period prior to the merger of Banca IMI (20 July 2020).

## BANKING BOOK

### Qualitative information

The “banking book” is defined as the trade portfolio consisting of all on-balance sheet and off-balance sheet items that are part of the Intesa Sanpaolo Group’s lending and deposit collecting activities; therefore, the interest rate risk of the banking book (hereinafter “interest rate risk” or IRRBB) refers to the current and prospective risk of changes in the Group’s banking book due to adverse changes in interest rates, which are reflected in both economic value and net interest income.

The banking book also includes exposure to market risks deriving from the equity investments in listed companies not fully consolidated, mainly held by the Parent Company.

The internal system for measuring interest rate risk assesses and describes the effect of changes in interest rates on the economic value and the net interest income and identifies all significant sources of risk that affect the banking book:

- repricing risk, i.e. the risk associated with lags in maturity dates (for fixed-rate positions) or in the interest rate revision date (for floating-rate positions) of the Bank’s assets, liabilities and off-balance sheet items;
- yield curve risk, i.e. the risk associated with changes in the inclination and shape of the yield curve;
- basis risk, i.e. the risk arising from imperfect correlation in the adjustment of lending and deposit rates on different instruments, but with otherwise similar repricing characteristics. As interest rates change, these differences can lead to unexpected changes in cash flows and yield spreads between assets, liabilities and off-balance sheet positions having similar maturities or rate revision frequencies;
- optionality risk, i.e. the risk associated with the presence of automatic or behavioural options in the Group’s assets, liabilities and off-balance sheet instruments.

Intesa Sanpaolo’s current measurement system also allows the risk profile to be examined on the basis of two distinct but complementary perspectives:

- **economic value perspective** (EVE - Economic Value of Equity), which considers the impact of interest rate fluctuations and the associated volatility on the present value of all future cash flows;
- **net interest income perspective** (NII - Net Interest Income), which aims to analyse the impact of interest rate fluctuations and their associated volatility on net interest income;

The economic value perspective assesses the medium-to-long term impacts of interest rate fluctuations, while the net interest income perspective provides a short-term assessment.

Interest rate risk is managed by setting limits to both perspectives. Said limits comprise:

- consolidated limits, which are defined in the RAF and approved by the Board of Directors, both in terms of change in EVE (shift sensitivity or  $\Delta$ EVE) and net interest income sensitivity ( $\Delta$ NII). The consolidated  $\Delta$ EVE limits reflect, consistent with the context and regulatory instructions, the average expected exposure of the Group’s EVE. The expected average level is quantified within the RAF and defined as the average exposure that the Group expects to take during the year. The Group’s consolidated shift sensitivity limits are accompanied by a risk indicator, which constitutes an “early warning” threshold approved within the RAF, which makes it possible to control exposure to the risk of yield curve twists;
- individual shift sensitivity and net interest income sensitivity limits, which are part of the “cascading” process of the Group’s RAF limit, and are proposed, after being shared with the operating structures, by the Financial and Market Risks Head Office Department and approved by the Group Financial Risk Committee (GFRC). These limits take account of the characteristics of the banks’ portfolios, with particular reference to intermediated volumes, average durations, the type of instruments traded and the Company’s strategic mission within the Group.

The Financial and Market Risks Head Office Department performs monthly checks that the limits and early warning level approved in the Risk Appetite Framework (RAF) are observed at the consolidated and individual level. In addition, the Group has adopted a specific internal policy document regarding interest rate risk (the IRRBB Guidelines) subject to approval by the Board of Directors, which governs the Group’s entire interest rate risk management framework and in particular the aspects of governance, methods of use and formulation of scenarios.

The IRRBB Guidelines define the methods for measuring the financial risks generated by the Group’s banking book:

1. Sensitivity of economic value ( $\Delta$ EVE);
2. Net interest income sensitivity ( $\Delta$ NII);
3. Credit Spread Risk of the Banking Book (CSRBB);
4. Value at Risk (VaR).

These measures are available for each relevant currency in the banking book.

The **shift sensitivity of the economic value** (or fair value shift sensitivity) measures the change in the economic value of the banking book and is calculated at individual cash flow level for each financial instrument, based on different instantaneous rate shocks and based on historical stress simulations aimed at identifying the worst and best cases. It reflects the changes in the present value of the cash flows of the positions already in the balance sheet for the entire remaining duration until maturity (run-off balance sheet). The cash flows used to determine the present value are developed at the contractual rate, FTP (internal fund transfer price) or risk-free rate (Euribor/Libor) and discounted according to risk-free discount curves. When calculating the present value of loans, the expected loss component is considered; it represents the amount of cash flow that the bank does not expect to recover on a given exposure and that thus reduces its value. The present value of the loan adjusted for credit risk is calculated for this purpose by deducting the corresponding level of expected loss from expected cash flows according to the “cash flow adjustment” (“CFA”) method.

To control the exposure and monitor the limits, the calculation involves determining the algebraic sum of the equivalent in euro of the shift sensitivities of the positions in the various currencies by applying a parallel shock of +100 bps to the interest

rate curves in the various currencies. The calculation for non-parallel shocks for the purposes of controlling the exposure and monitoring the early warning level is performed similarly. The sensitivity of the relevant currencies is then corrected, according to a "currency aggregation" management technique, to take account of the imperfect correlation with the rates of the main currency (the euro).

The **sensitivity of net interest income** focuses the analysis on the impact that changes in interest rates can have on the Group's ability to generate stable profit levels. The component of profits measured is represented by the difference between the net interest income generated by interest-bearing assets and liabilities, including the results of hedging activities through the use of derivatives. The time horizon of reference is commonly limited to the short and medium term (from one to three years) and the impact is assessed on a going concern basis. The change in net interest income must be estimated under expected scenarios as well as under potential interest rate shocks and stress scenarios. Further assumptions must also be made regarding customer behaviour (differentiated according to interest rate scenarios) and market behaviour and the response of Group/Bank management to changes in the economy. Thus, the projection of the net interest income and its sensitivity to changes in market factors require a series of modelling assumptions for the development of volumes and rates (fixed/floating), the reference time horizon, the relevant currencies, as well as the behavioural models introduced (prepayment, core deposits, etc.) and the assumptions regarding the evolution of the portfolio (run-off, constant or dynamic balance sheet).

The net interest income sensitivity limits are defined on the basis of an instantaneous and parallel interest rate shock of +/-50 bp, with a reference time horizon of 1 year and assuming a constant balance sheet. The net interest income sensitivity limit is defined as the limit on the loss in the income statement and, therefore, is exclusively negative (limit on the potential reduction in the net interest income): the use of the limit is represented by the sensitivity that generates a greater reduction in net interest income in the two scenarios of a parallel rise and fall in interest rates. The total sensitivity exposure of net interest income is given by the algebraic sum of the exposure of individual currencies.

The GFRC is also tasked with allocating sub-limits on net interest income sensitivity to the individual Banks/Companies, and may also define sub-limits on net interest income sensitivity by currency. The limit assigned to each Company is defined on the basis of the historical volatility observed in individual net interest income, consistent with the strategies and limits defined for shift sensitivity.

The **Credit Spread Risk of the Banking Book (CSRBB)** is defined as the risk caused by changes in the market's perception of the price of credit risk, liquidity premium and potentially other components of instruments with credit risk that cause fluctuations in the price of credit risk, liquidity premium and other potential components, which is not explained by the interest rate risk of the banking book or by the expected credit risk/jump-to-default risk. In line with the EBA Guidelines, which limit the reference area to assets only (i.e. excluding derivatives and liabilities), specific monitoring is envisaged for the HTCS securities portfolio, whose changes in value have an immediate impact on the Group's capital.

**Value at Risk (VaR)** is a probability-based metric that expresses the maximum potential loss of portfolio value that could be incurred within a specific time horizon, at a pre-defined confidence level. VaR is also used to consolidate exposure to financial risks of the various Group companies which perform banking book activities, also taking into account the benefits of diversification and the correlation between various risk factors and different currencies. This measure is calculated and monitored, for the entire scope, by the Financial and Market Risks Head Office Department;

In calculating the above risk measures, Intesa Sanpaolo adopts behavioural models for representing capital items. For mortgages, statistical techniques are used to determine the probability of prepayment, in order to reduce the Group's exposure to interest rate risk (overhedging) and to liquidity risk (overfunding). The method developed estimates prepayment coefficients diversified according to the type of customer, financial characteristics of the transaction, such as the loan rate type (fixed or floating), the original term of the loan and the seasoning, understood as the age of the loan on the date of the prepayment event. The analysis refers to partial repayments, full repayments and refinancing. The prepayment model also examines the reasons that lead customers to make prepayments. With regard to this aspect, the phenomenon may be divided into a structural component ("Core Prepayment") and a scenario component ("Coupon Incentive"), primarily linked to market variations. Prepayment phenomena are monitored monthly and the prepayment coefficients to be applied to the model are re-estimated at least annually and are subject to periodic backtesting, in accordance with the specific model change document. For core deposits (customer current accounts), a financial representation model is adopted aimed at reflecting the behavioural features of stability of deposits and partial and delayed reaction to market interest rate fluctuations. The model is continuously monitored and periodically revised to promptly reflect changes in volumes and customer characteristics over time, as well as in the relevant regulatory framework.

In order to measure the Group's vulnerability to market turbulence, the interest rate risk measurement system measures the impacts on the bank's economic value and net interest income produced by strains on the market ("scenario analysis"), i.e. sudden changes in the general level of interest rates, changes in the relationships between fundamental market rates (basis risk), in the slope and shape of the yield curve (yield curve risk), in the liquidity of the main financial markets or in the volatility of market rates.

These analyses are conducted by subjecting the portfolio to various interest rate change scenarios:

- regulatory scenarios produced by the Supervisory Outlier Test (SOT), which sets a limit on shift sensitivity loss of 20% of regulatory capital in the event of an instantaneous and parallel shock of +/-200 bps, but introduces an "early warning" of 15% of Tier 1, calculated with reference to the BCBS scenarios (Parallel shock up, Parallel shock down, Steepener shock, Flatten shock, Short rates shock up and Short rates shock down);
- shocks diversified by reference curve of the main risk factors and calculated as the difference between the yields of the curves of the individual factors and those of a curve relating to the selected pivot parameter (basis risk);
- stress scenarios in historical simulation.

Stress tests on behavioural models are also carried out to verify the financial impact of alternative assumptions underlying the behavioural parameters estimated in the models. The methodological assumptions underlying the assumptions contained in the stress scenarios are duly described in the detailed methodologies.

### Impacts from the COVID-19 pandemic

In the first 6 months of 2021 the strategies and controls in place, aimed at managing interest rate risk, were implemented so as to keep the Group's total exposure stable and not significantly affected by the interest rate volatility triggered by the COVID-19 pandemic.

### Quantitative information

In the first six months of 2021, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity of value, averaged -1,291 million euro, with a minimum value of -1,470 million euro and a maximum value of -1,094 million euro, reaching a figure of -1,367 million euro at the end of June 2021 (-1,305 million euro at the end of 2020).

The sensitivity of net interest income – assuming a +50, -50 and +100 basis point change in interest rates – amounted to 1,272 million euro, -816 million euro and 2,467 million euro, respectively, at the end of June 2021. The last of these figures was down on the 2,581 million euro recorded at the end of 2020.

Interest rate risk, measured in terms of VaR, averaged 437 million euro in the first six months of 2021, with a maximum value of 498 million euro and a minimum value of 414 million euro, reaching a figure of 432 million euro at the end of June 2021 (492 million euro at the end of 2020).

Foreign exchange risk expressed by equity investments in foreign currency (banking book) and measured in terms of VaR averaged 59 million euro in the first six months of 2021, with a maximum value of 69 million euro and a minimum value of 48 million euro, with the latter coinciding with the value at the end of June 2021 (78 million euro at the end of 2020).

Price risk generated by minority stakes in listed companies, mostly held in the HTCS category and measured in terms of VaR, recorded an average level during the first six months of 2021 of 216 million euro, with maximum and minimum values of 278 million euro and 182 million euro, respectively, amounting to 216 million euro at the end of June 2021 (304 million euro at the end of 2020).

The table below shows the changes in the main risk measures

	1st half 2021			30.06.2021	(millions of euro) 31.12.2020
	average	minimum	maximum		
Shift Sensitivity of the Economic Value +100 bp	-1,291	-1,470	-1,094	-1,367	-1,305
Shift Sensitivity of Net Interest Income -50bp	-877	-1,044	-803	-816	-1,011
Shift Sensitivity of Net Interest Income +50bp	1,264	1,143	1,364	1,272	1,312
Shift Sensitivity of Net Interest Income +100bp	2,476	2,264	2,687	2,467	2,581
Value at Risk - Interest Rate	437	414	498	432	492
Value at Risk Exchange	59	48	69	48	78
Value at Risk - Equity investments in listed companies	216	182	278	216	304

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)		
	2nd quarter 2021 impact on shareholders' equity at 30.06.2021	1st quarter 2021 impact on shareholders' equity at 31.03.2021	Impact on shareholders' equity at 31.12.2020
Price shock	10%	208	152
Price shock	-10%	-208	-152



## LIQUIDITY RISK

Liquidity risk is defined as the risk that the Bank may not be able to meet its payment obligations due to the inability to obtain funds on the market (funding liquidity risk) or liquidate its assets (market liquidity risk).

Intesa Sanpaolo's internal control and management system for liquidity risk is implemented within the Group Risk Appetite Framework and in compliance with the tolerance thresholds for liquidity risk approved in the system, which establish that the Group must maintain an adequate liquidity position in order to cope with periods of strain, including prolonged periods, on the various funding supply markets, also by establishing adequate liquidity reserves consisting of marketable securities and refinancing at Central Banks. To this end, a balance needs to be maintained between incoming and outgoing funds, both in the short and medium-long term. This goal is implemented by the Group Liquidity Risk Management Guidelines approved by the Corporate Bodies of Intesa Sanpaolo, in implementation of the applicable regulatory provisions.

These Guidelines illustrate the tasks of the various company functions, the rules and the set of control and management processes aimed at ensuring prudent monitoring of liquidity risk, thereby preventing the emergence of crisis situations. To this end, they include procedures for identifying risk factors, measuring risk exposure and verifying observance of limits, conducting stress tests, identifying appropriate risk mitigation initiatives, drawing up emergency plans and submitting informational reports to company bodies.

In particular, a detailed definition is prepared of the tasks assigned to the corporate bodies and reports are presented to the senior management concerning certain important formalities such as the approval of measurement methods, the definition of the main assumptions underlying stress scenarios and the composition of early warning indicators used to activate emergency plans.

In order to pursue an integrated, consistent risk management policy, strategic decisions regarding liquidity risk monitoring and management at the Group level fall to the Parent Company's Corporate Bodies. From this standpoint, the Parent Company performs its functions of monitoring and managing liquidity not only in reference to its own organisation, but also by assessing the Group's overall transactions and the liquidity risk to which it is exposed.

The corporate functions of the Parent Company responsible for ensuring the correct application of these Guidelines are the Group Treasury and Finance Head Office Department and the Planning and Control Department, responsible, within the Chief Financial Officer (CFO) Area, for liquidity management, and the Market and Financial Risk Management Head Office Control Department, which is directly responsible, within the Chief Risk Officer (CRO) Area, for measuring liquidity risk on a consolidated basis.

The Chief Audit Officer assesses the functioning of the overall structure of the control system monitoring the process for measuring, managing and controlling the Group's exposure to liquidity risk and verifies the adequacy and compliance of the process with the requirements established by the regulations. The results of the controls carried out are submitted to the Corporate Bodies, at least once a year.

The liquidity risk measurement metrics and mitigation tools are formalised by the Group Liquidity Risk Management Guidelines which establish the methodology used for both the short-term and structural liquidity indicators.

The short-term liquidity is aimed at providing an adequate, balanced level of cash inflows and outflows the timing of which is certain or estimated to fall within a period of 12 months, while ensuring a sufficient liquidity buffer, available for use as the main mitigation tool for liquidity risk. To that end, and in keeping with the liquidity risk appetite, the system of limits consists of specific short-term indicators, both of a regulatory nature with a holding a period of one month (Liquidity Coverage Ratio - LCR) and internally defined (Survival Period indicators).

The LCR indicator is aimed at strengthening the short-term liquidity risk profile, ensuring that sufficient unencumbered high-quality liquid assets (HQLA) are retained that can be converted easily and immediately into cash on the private markets to satisfy the short-term liquidity requirements (30 days) in an acute liquidity stress scenario. To this end, the Liquidity Coverage Ratio measures the ratio between: (i) the stock of HQLA and (ii) the total net cash outflows calculated according to the scenario parameters defined by Delegated Regulation (EU) 2015/61.

The Survival Period is an internal indicator designed to measure the first day on which the net liquidity position (calculated as the difference between available liquidity reserves and net outflows) becomes negative, i.e. when additional liquidity is no longer available to cover simulated net outflows. To this end, two different scenario hypotheses are considered, baseline and stressed, designed to measure, respectively: (i) the Group's independence from interbank funding on the financial markets and (ii) the survival period in the event of further tensions of a market and idiosyncratic nature, of medium-high severity, managed without envisaging restrictions on credit activity involving customers. For the Survival Period indicator, in stress conditions it is established that a minimum survival period must be maintained with the purpose of establishing an overall level of reserves covering greater cash outflows during a period of time that is adequate to implement the required operating measures to restore the Group to balanced conditions.

The aim of the Intesa Sanpaolo Group's structural Liquidity Policy is to adopt the structural requirement provided for by the regulatory provisions - the Net Stable Funding Ratio (NSFR). This indicator is aimed at promoting the increased use of stable funding, to prevent medium/long-term operations from giving rise to excessive imbalances to be financed in the short term. To this end, it sets a minimum "acceptable" amount of funding exceeding one year in relation to the needs originating from the characteristics of liquidity and residual duration of assets and off-balance sheet exposures. In addition, the internal policy on structural liquidity also includes early warning indicators for maturities of more than 1 year, with particular attention to long-term gaps (> 5 years).

The Group Liquidity Risk Management Guidelines also establish methods for management of a potential liquidity crisis, defined as a situation of difficulty or inability of the Bank to meet its cash obligations falling due, without implementing procedures and/or employing instruments that, due to their intensity or manner of use, do not qualify as ordinary administration. By setting itself the objectives of safeguarding the Group's asset value and also guaranteeing the continuity of operations under conditions of extreme liquidity emergency, the Contingency Liquidity Plan ensures the identification of the early warning signals and their ongoing monitoring, the definition of procedures to be implemented in situations of liquidity stress, also indicating the immediate lines of action, and the intervention measures for the resolution of emergencies. Within this framework, the Group Treasury and Finance Department was officially entrusted with drawing up the Contingency Funding Plan (CFP), which contains the various lines of actions that can be activated in order to face potential stress situations, specifying the extent of the mitigating effects attainable in the short-term.

The Group's liquidity position - supported by suitable high-quality liquid assets (HQLA) and the significant contribution from retail stable funding - remained within the risk limits set out in the current Group Liquidity Policy for the entire first half of 2021: both regulatory indicators, LCR and NSFR, were well above regulatory requirements. The Liquidity Coverage Ratio (LCR) of the Intesa Sanpaolo Group, measured according to Delegated Regulation (EU) 2015/61, amounted to an average<sup>15</sup> of 174%. As at 30 June 2021, the value of unencumbered HQLA reserves was 175 billion euro. Including the other marketable reserves and/or eligible Central Bank reserves, the Group's unencumbered liquidity reserves amounted to 181 billion euro.

The NSFR also was significantly higher than 100%, supported by a solid base of stable deposits from customers, adequate wholesale medium/long-term securities funding and the TLTRO funding from the ECB. At 30 June 2021, the Group's NSFR, measured in accordance with regulatory instructions, was 124%. This indicator remains significantly higher than 100%, even excluding the positive contribution from TLTRO funding. Considering the high amounts of unencumbered liquidity reserves (liquid or eligible), also the stress tests, in a combined scenario of market and specific crises (with significant loss in customer deposits), yielded results in excess of the target threshold for the Intesa Sanpaolo Group, with a liquidity surplus capable of meeting extraordinary cash outflows for a period of more than 3 months.

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

## INFORMATION ON FINANCIAL PRODUCTS

In line with the requests for utmost transparency made by supranational and national Supervisory Authorities, the following information is provided on the fair value measurement methods adopted, structured credit products, activities performed through Special Purpose Entities (SPE), leveraged transactions, hedge fund investments and transactions in trading derivatives with customers.

## FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND LIABILITIES, INDEPENDENT PRICE VERIFICATION AND PRUDENT VALUATION

The framework of financial measurement at fair value is based on three pillars: fair value measurement according to the IFRS, independent price verification (IPV) and prudent value measurement. The latter are established by the CRR - Capital Requirement Regulation. The paragraphs below describe the methods applied by the Intesa Sanpaolo Group to implement and use those elements.

### Fair value of financial instruments

The Intesa Sanpaolo Group governs and defines the fair value measurement of financial instruments through the Group's "Guidelines/Rules for Valuation of Financial Instruments at Fair Value", prepared by the Financial and Market Risks Head Office Department and applied by the Parent Company and all consolidated subsidiaries, including the Insurance Companies. The "Rules for the Measurement of Equity Investments", drawn up by the Group M&A and Equity Investments Head Office Department, govern the fair value measurement of unlisted equities and financial instruments with unlisted equities as their underlying.

The methodologies for the fair value measurement of financial instruments, as well as any adjustments attributable to uncertainties in valuation, are governed by the Fair Value Policy of the Intesa Sanpaolo Group and are described in detail in the 2020 Annual Report, to which reference is made for more information.

IFRS 13 establishes a fair value hierarchy in which inputs to fair value measurement techniques are divided into three levels. That hierarchy assigns top priority to (unadjusted) quoted prices on active markets for identical assets or liabilities (level 1 data) and the lowest priority to unobservable inputs (level 3 data). More specifically:

- fair value level 1 applies when an instrument is measured directly on the basis of (unadjusted) quoted prices on active markets for identical assets or liabilities to which the entity has access on the measurement date;
- fair value level 2 applies when a price has not been found on an active market and the instrument is measured according to valuation techniques, on the basis of observable market parameters, or of the use of parameters that are not observable but are supported and confirmed by market evidence, such as prices, spreads or other inputs (the comparable approach);
- fair value level 3 applies when fair value is measured using various inputs, not all of which are directly drawn from observable market parameters, and which thus entail estimates and assumptions by the valuator.

If various inputs are used to measure the fair value of an asset or liability, classification in the hierarchy is determined on the basis of the lowest-level input used in measurement. When assigning a level in the fair value hierarchy, priority is given to the inputs of the valuation techniques rather than the valuation techniques themselves.

The attachment "Fair Value Hierarchy" of the Fair Value Policy defines, with regard to the respective financial instrument valuation models/inputs, the basic rules that market inputs must comply with in order to be classified as Level 2, and the significance thresholds which, when overrun, result in the assignment of Level 3.

For level 1 financial instruments, the current bid price is used for financial assets and the current ask price for financial liabilities, struck on the principal active market at the end of the reference period.

For financial instruments with a scarcely significant bid-ask spread or for financial assets and liabilities with offsetting market risks, mid-market prices are used (again referred to the last day of the reference period) instead of the bid or ask price.

The following are considered as level 1 financial instruments: contributed bonds (i.e. bonds for which the Composite

<sup>15</sup>The figure shown refers to the simple average of the last 12 months of monthly observations, as per Regulation (EU) 2021/637.

Bloomberg Bond Trader is available from the Information Provider Bloomberg, or, alternatively, a price on the EuroMTS circuit, or at least three prices available from the Information Provider Bloomberg), contributed equities (i.e., quoted on the official market of reference), contributed harmonised mutual funds (covered by EU directives), spot exchange rates, derivatives for which prices are available on an active market (for example, exchange traded futures and options) and hedge funds whose Net Asset Value (NAV) is available, according to the frequency established in the subscription contract, and in which assets classified as level 1 predominate among the assets invested in by the fund, as a percentage of the NAV, provided the level 3 instruments do not exceed a set threshold.

Conversely, all other financial instruments that do not belong to the above-described categories or that do not have the contribution level defined by the Fair Value Policy are not considered level 1 instruments.

When no listing on an active market exists or the market is not functioning regularly, that is when the market does not have a sufficient and continuous number of trades, and bid-ask spreads and volatility that are not sufficiently contained, the fair value of the financial instruments is mainly determined through the use of valuation techniques whose objective is the establishment of the price at which, in an orderly transaction, the asset is sold or the liability transferred between market participants, as at the measurement date, under current market conditions.

Such techniques include:

- the use of market values that are indirectly linked to the instrument to be measured, deriving from products with the same risk profile (level 2 inputs);
- valuations performed using – even partially – inputs not identified from parameters observed on the market, for which estimates and assumptions made by the valuator are used (level 3 inputs).

In case of level 2 inputs, the valuation is based on prices or credit spreads presumed from the official listing of instruments which are similar in terms of risk factors, using a given calculation methodology (valuation model). The use of this approach requires the identification of transactions on active markets in relation to instruments that, in terms of risk factors, are comparable with the instrument to be measured. Level 2 calculation methodologies reproduce prices of financial instruments quoted on active markets (model calibration) and do not contain discretionary parameters – parameters for which values may not be inferred from quotations of financial instruments present on active markets or fixed at levels capable of reproducing quotations on active markets – that significantly influence the final measurement.

The following are measured using level 2 input models:

- bonds without official quotations expressed by an active market and whose fair value is determined through the use of an appropriate credit spread which is estimated starting from contributed and liquid financial instruments with similar characteristics;
- loans whose fair value is determined through the use of an appropriate credit spread which is estimated starting from market data of financial instruments with similar characteristics;
- derivatives measured through specific models, fed by input parameters (such as yield, foreign exchange and volatility curves) observed on the market;
- structured credit products (including, among others, ABSs, HY CLOs, CDOs) for which significant prices are not available and whose fair value is measured using valuation techniques that consider parameters that can be gathered from the market;
- non-contributed equity instruments measured based on direct transactions, that is significant transactions on the stock registered in a time frame considered to be sufficiently short with respect to measurement date and in constant market conditions, or using the "relative" valuation models based on multipliers;
- hedge funds in which Level 2 assets predominate, as a percentage of the NAV, provided the Level 3 instruments do not exceed a set threshold.

In case of instruments classified as level 3, the calculation of the fair value is based on valuation models which consider input parameters not directly observable on the market, therefore implying estimates and assumptions on the part of the valuator. In particular, the valuation of the financial instrument uses a calculation methodology which is based on specific assumptions of:

- the development of future cash flows, which may be affected by future events that may be attributed probabilities presumed from past experience or on the basis of the assumed behaviour;
- the level of specific input parameters not quoted on active markets, for which information acquired from prices and spreads observed on the market is in any case preferred. Where this is not available, past data on the specific risk of the underlying asset or specialised reports are used (e.g. reports prepared by Rating agencies or primary market players).

The following are measured using this method:

- some transactions in derivatives, bonds, or complex structured credit instruments measured using level 3 inputs;
- hedge funds in which the level 3 assets are above a set limit;
- private equity funds and real estate funds valued at NAV, with possible discounts;
- shareholdings and other equities measured using models based on discounted cash flows or using equity methods;
- loans whose fair value is determined through the use of a credit spread that does not meet the criteria to be considered level 2;
- loans with underlying equity risk, whose fair value is calculated based on the discounting of expected contractual flows.

### Independent price verification (IPV)

Independent Price Verification (IPV) is “a process by which market prices or marking to model inputs are regularly verified for accuracy and independence” (Article 4(1.70) EU Regulation 575/2013), carried out “in addition to daily marking to market or marking to model [...] by a person or unit independent from persons or units that benefit from the trading book” (Article 105(8) EU Regulation 575/2013).

The Intesa Sanpaolo Group has structured an IPV process with 3 levels of control in line with the provisions of Bank of Italy Circular 285/2013, incorporated into the Integrated Internal Control System, which requires the risk management processes to be incorporated in the processes and methods for valuing the company activities, also for accounting purposes.

The Intesa Sanpaolo Group governs and formalises its independent price verification process through the Group’s “Guidelines/Rules for Independent Price Verification”, which are described in detail in the 2020 Annual Report and to which reference is made for further information.

### Prudent value of financial instruments

The framework of financial measurements is completed with the prudent valuation of financial instruments measured at fair value. In accordance with the provisions of Regulation (EU) 575/2013 (Capital Requirements Regulation – CRR), prudent valuation entails the calculation of specific additional valuation adjustments (AVAs) for the financial instruments measured at fair value, aimed at capturing different sources of valuation uncertainty and ensuring the achievement of a suitable level of certainty in the measurement of the positions. The total value of the AVAs is deducted from the Common Equity Tier 1 capital, without impacts on accounting fair values.

The Intesa Sanpaolo Group, in line with criteria indicated in Delegated Regulation (EU) 2016/101, is subject to the application of the core approach for the determination of AVAs both at individual and at consolidated level for all the positions measured at fair value. The prudent value corresponds to the exit price from the position with a level of certainty equal to 90%. The Group governs and formalises the measurement of the prudent value of financial instruments through the Group’s “Guidelines/Rules for Prudent Valuation of Financial Instruments at Fair Value”, which are described in detail in the 2020 Annual Report and to which reference is made for further information.

Since 1 January 2021, when the transitional provisions under Commission Delegated Regulation (EU) 2020/866 ceased to apply, the Group has used the AVAs aggregation factor established by Commission Delegated Regulation (EU) 2016/101.

### Fair value hierarchy

#### Assets and liabilities measured at fair value on a recurring basis: fair value by level

Excluding insurance companies

Assets / liabilities at fair value	30.06.2021			31.12.2020		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(millions of euro)					
1. Financial assets measured at fair value through profit or loss	31,613	25,865	3,474	22,890	31,994	3,362
a) Financial assets held for trading	30,508	24,929	283	21,861	30,900	404
of which: Equities	765	-	16	663	-	1
of which: quotas of UCI	159	2	25	169	3	31
b) Financial assets designated at fair value	-	1	3	-	1	2
c) Other financial assets mandatorily measured at fair value	1,105	935	3,188	1,029	1,093	2,956
of which: Equities	162	165	215	10	191	193
of which: quotas of UCI	943	163	1,937	1,018	227	1,740
2. Financial assets measured at fair value through other comprehensive income	58,546	8,326	391	49,681	7,747	430
of which: Equities	1,776	1,475	370	1,559	1,754	387
3. Hedging derivatives	-	1,163	12	1	1,118	15
4. Property and equipment	-	-	7,218	-	-	7,252
5. Intangible assets	-	-	-	-	-	-
<b>Total</b>	<b>90,159</b>	<b>35,354</b>	<b>11,095</b>	<b>72,572</b>	<b>40,859</b>	<b>11,059</b>
1. Financial liabilities held for trading	22,160	34,999	176	15,742	43,168	123
2. Financial liabilities designated at fair value	-	3,361	-	-	3,032	-
3. Hedging derivatives	9	5,007	3	1	7,084	3
<b>Total</b>	<b>22,169</b>	<b>43,367</b>	<b>179</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 66% as at 30 June 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 8% of the total assets measured at fair value.

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.

The level 1 assets increased compared to December 2020, mainly due to changes in Debt securities.

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.

In addition to the transfers that concerned financial assets and liabilities measured at level 3 as reported in the table “Half-yearly changes in assets measured at fair value on a recurring basis (level 3)” below, please note that the following transfers were recognised during the first half of 2021:

- from level 1 to level 2:
  - financial assets held for trading for 2 million euro (book value as at 30 June 2021);
  - other financial assets mandatorily measured at fair value for 1 million euro (book value as at 30 June 2021);
  - financial assets measured at fair value through other comprehensive income for 41 million euro (book value as at 30 June 2021);
- from level 2 to level 1:
  - financial assets held for trading for 342 million euro (book value as at 30 June 2021);
  - financial assets measured at fair value through other comprehensive income for 50 million euro (book value as at 30 June 2021);
  - financial liabilities held for trading for 201 million euro (book value as at 30 June 2021).

The transfers between fair value levels are determined by the trends in the observability of prices or market data used to measure the instruments and by the materiality of the unobservable inputs.

The transition from level 1 to level 2 is a consequence of the disappearance of an active market for that instrument assessed by analysing the reliability and the reciprocal consistency of the available prices according to the provisions of the Group’s Fair Value Policy. Conversely, securities for which a mark-to-model measurement is performed using inputs that can be observed on the market – classified, therefore, as level 2 – are transferred to level 1 when the existence of an active market is identified.



**Assets and liabilities measured at fair value on a recurring basis: fair value by level****Insurance companies**

Assets / liabilities at fair value	(millions of euro)					
	30.06.2021			31.12.2020		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	303	378	386	321	33	47
<i>of which: Equities</i>	-	-	-	-	-	-
<i>of which: quotas of UCI</i>	122	-	48	120	-	47
2. Financial assets designated at fair value through profit or loss	95,047	669	548	86,779	51	377
<i>of which: Equities</i>	3,126	-	-	2,749	-	-
<i>of which: quotas of UCI</i>	87,166	645	-	79,538	-	-
3. Financial assets available for sale	93,749	11,143	3,553	82,076	4,845	2,192
<i>of which: Equities</i>	2,057	-	53	1,713	-	43
<i>of which: quotas of UCI</i>	10,543	80	3,245	10,271	20	2,138
4. Hedging derivatives	-	362	-	-	449	-
5. Property and equipment	-	-	8	-	-	8
6. Intangible assets	-	-	-	-	-	-
<b>Total</b>	<b>189,099</b>	<b>12,552</b>	<b>4,495</b>	<b>169,176</b>	<b>5,378</b>	<b>2,624</b>
1. Financial liabilities held for trading	2	131	-	4	54	-
2. Financial liabilities designated at fair value through profit or loss	-	82,877	-	-	77,149	-
3. Hedging derivatives	-	-	-	-	-	-
<b>Total</b>	<b>2</b>	<b>83,008</b>	<b>-</b>	<b>4</b>	<b>77,203</b>	<b>-</b>

For the insurance companies, 92% 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 2% of the total assets, a slight increase compared to 31 December 2020.

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

The most significant changes compared to December 2020 are due to the new entries into the consolidation scope of Assicurazioni Vita S.p.A. (formerly Aviva Vita), Lombarda Vita S.p.A., and Cargeas Assicurazioni S.p.A. (although the changes attributable to Cargeas are less significant).

In addition to the transfers that concerned financial assets and liabilities measured at level 3 as reported in the table “Half-yearly changes in assets measured at fair value on a recurring basis (level 3)” below, please note that the following transfers were recognised during the first half of 2021:

- from level 1 to level 2:
  - financial assets measured at fair value through profit and loss for 2 million euro (book value as at 30 June 2021);
  - financial assets available for sale for 130 million euro (book value as at 30 June 2021);
- from level 2 to level 1:
  - financial assets available for sale for 62 million euro (book value as at 30 June 2021).

The transfers between fair value levels are determined by the trends in the observability of prices or market data used to measure the instruments and by the materiality of the unobservable inputs.

The transition from level 1 to level 2 is a consequence of the disappearance of an active market for that instrument assessed by analysing the reliability and the reciprocal consistency of the available prices according to the provisions of the Group’s Fair Value Policy. Conversely, securities for which a mark-to-model measurement is performed using inputs that can be observed on the market – classified, therefore, as level 2 – are transferred to level 1 when the existence of an active market is identified.

**Half-yearly changes in assets measured at fair value on a recurring basis (level 3)**  
 Excluding insurance companies

	Assets measured at fair value through profit or loss				Financial assets measured at fair value through other comprehensive income	Hedging derivatives	Property and equipment	Intangible assets
	TOTAL	of which: a) Financial assets held for trading	of which: b) Financial assets designated at fair value	of which: c) Other financial assets mandatorily measured at fair value				
	(millions of euro)							
<b>1. Initial amount</b>	<b>3,362</b>	<b>404</b>	<b>2</b>	<b>2,956</b>	<b>430</b>	<b>15</b>	<b>7,252</b>	<b>-</b>
<b>2. Increases</b>	<b>973</b>	<b>128</b>	<b>1</b>	<b>844</b>	<b>35</b>	<b>-</b>	<b>175</b>	<b>-</b>
2.1 Purchases	580	36	1	543	16	-	24	-
2.2 Gains recognised in:	85	52	-	33	5	-	-	-
2.2.1 Income statement	85	52	-	33	-	-	-	-
- of which capital gains	81	52	-	29	-	-	-	-
2.2.2 Shareholders' equity	-	X	X	X	5	-	-	-
2.3 Transfers from other levels	98	17	-	81	3	-	-	-
2.4 Other increases	210	23	-	187	11	-	151	-
<b>3. Decreases</b>	<b>-861</b>	<b>-249</b>	<b>-</b>	<b>-612</b>	<b>-74</b>	<b>-3</b>	<b>-209</b>	<b>-</b>
3.1 Sales	-440	-87	-	-353	-1	-	-14	-
3.2 Reimbursements	-1	-	-	-1	-38	-	-	-
3.3 Losses recognised in:	-143	-31	-	-112	-1	-3	-17	-
3.3.1 Income statement	-143	-31	-	-112	-	-3	-16	-
- of which capital losses	-141	-31	-	-110	-	-	-	-
3.3.2 Shareholders' equity	-	X	X	X	-1	-	-1	-
3.4 Transfers to other levels	-117	-50	-	-67	-23	-	-	-
3.5 Other decreases	-160	-81	-	-79	-11	-	-178	-
<b>4. Final amount</b>	<b>3,474</b>	<b>283</b>	<b>3</b>	<b>3,188</b>	<b>391</b>	<b>12</b>	<b>7,218</b>	<b>-</b>

**Half-yearly changes in assets measured at fair value on a recurring basis (level 3)**  
 Insurance companies

	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Financial assets available for sale	Hedging derivatives	Property and equipment	Intangible assets
	(millions of euro)					
<b>1. Initial amount</b>	<b>47</b>	<b>377</b>	<b>2,192</b>	<b>-</b>	<b>8</b>	<b>-</b>
<b>2. Increases</b>	<b>339</b>	<b>179</b>	<b>1,573</b>	<b>-</b>	<b>-</b>	<b>-</b>
2.1 Purchases	-	7	305	-	-	-
2.2 Gains recognised in:	1	-	137	-	-	-
2.2.1 Income statement	1	-	-	-	-	-
- of which capital gains	-	-	-	-	-	-
2.2.2 Shareholders' equity	X	X	137	-	-	-
2.3 Transfers from other levels	-	-	98	-	-	-
2.4 Other increases	338	172	1,033	-	-	-
<b>3. Decreases</b>	<b>-</b>	<b>-8</b>	<b>-212</b>	<b>-</b>	<b>-</b>	<b>-</b>
3.1 Sales	-	-7	-176	-	-	-
3.2 Reimbursements	-	-	-	-	-	-
3.3 Losses recognised in:	-	-1	-21	-	-	-
3.3.1 Income statement	-	-1	-1	-	-	-
- of which capital losses	-	-	-1	-	-	-
3.3.2 Shareholders' equity	X	X	-20	-	-	-
3.4 Transfers to other levels	-	-	-	-	-	-
3.5 Other decreases	-	-	-15	-	-	-
<b>4. Final amount</b>	<b>386</b>	<b>548</b>	<b>3,553</b>	<b>-</b>	<b>8</b>	<b>-</b>

The caption *Other increases* consists almost entirely of entries resulting from the *Business combinations* determined by the new entries into the scope of consolidation: Assicurazioni Vita S.p.A. (formerly Aviva Vita), Lombarda Vita S.p.A., and Cargeas Assicurazioni S.p.A. (although the changes attributable to Cargeas are less significant).

### Half-yearly changes in liabilities measured at fair value on a recurring basis (level 3)

Excluding insurance companies

	Financial liabilities held for trading	Financial liabilities designated at fair value	(millions of euro) Hedging derivatives
<b>1. Initial amount</b>	<b>123</b>	-	<b>3</b>
<b>2. Increases</b>	<b>80</b>	-	-
2.1 Issues	57	-	-
2.2 Losses recognised in:	9	-	-
2.2.1 Income statement	9	-	-
- of which capital losses	9	-	-
2.2.2 Shareholders' equity	X	-	-
2.3 Transfers from other levels	6	-	-
2.4 Other increases	8	-	-
<b>3. Decreases</b>	<b>-27</b>	-	-
3.1 Reimbursements	-	-	-
3.2 Repurchases	-	-	-
3.3 Gains recognised in:	-10	-	-
3.3.1 Income statement	-10	-	-
- of which capital gains	-10	-	-
3.3.2 Shareholders' equity	X	-	-
3.4 Transfers to other levels	-17	-	-
3.5 Other decreases	-	-	-
<b>4. Final amount</b>	<b>176</b>	-	<b>3</b>

### Half-yearly changes in liabilities measured at fair value on a recurring basis (level 3)

Insurance companies

No financial liabilities are recorded at level 3 for Insurance companies.

### Assets and liabilities not measured at fair value or measured at fair value on a non-recurring basis

Excluding insurance companies

Assets/liabilities not measured at fair value or measured at fair value on a non-recurring basis	30.06.2021		31.12.2020	
	Book value	Fair value	Book value	Fair value
1. Financial assets measured at amortised cost	656,626	667,734	615,260	631,031
2. Investment property	-	-	-	-
3. Non-current assets held for sale and discontinued operations	1,566	1,566	28,702	28,702
<b>Total</b>	<b>658,192</b>	<b>669,300</b>	<b>643,962</b>	<b>659,733</b>
1. Financial liabilities measured at amortised cost	685,622	687,832	630,146	632,495
2. Liabilities associated with non-current assets	78	78	35,676	35,676
<b>Total</b>	<b>685,700</b>	<b>687,910</b>	<b>665,822</b>	<b>668,171</b>

**Assets and liabilities not measured at fair value or measured at fair value on a non-recurring basis**
**Insurance companies**

Assets/liabilities not measured at fair value or measured at fair value on a non-recurring basis	(millions of euro)			
	30.06.2021		31.12.2020	
	Book value	Fair value	Book value	Fair value
1. Investments held to maturity	-	-	-	-
2. Due from banks	867	867	1,180	1,180
3. Loans to customers	39	39	31	31
4. Investment property	-	-	-	-
5. Non-current assets held for sale and discontinued operations	-	-	-	-
<b>Total</b>	<b>906</b>	<b>906</b>	<b>1,211</b>	<b>1,211</b>
1. Due to banks	672	677	609	609
2. Due to customers	546	546	428	428
3. Securities issued	1,311	1,311	898	898
4. Liabilities associated with non-current assets	-	-	-	-
<b>Total</b>	<b>2,529</b>	<b>2,534</b>	<b>1,935</b>	<b>1,935</b>

**Sensitivity analysis for financial assets and liabilities measured at level 3**

As required by IFRS 13, for the financial assets and liabilities measured at level 3, the following table lists the effects of a change in one or more non-observable parameters used in the valuation techniques adopted to determine the fair value.

Financial assets/liabilities	Non-observable parameters	Sensitivity (thousands of euro)	Change in non- observable parameter
FVTPL and FVTOCI securities and loans	Credit spread	-197	1 bp
FVTPL and FVTOCI securities and loans	JD parameters	1	1%
FVTPL and FVTOCI securities and loans	Correlation	-17	1%
FVTPL and FVTOCI securities	Recovery rate	-193	-1%
OTC Derivatives - Interest Rates	Correlation for spread options between swap rates	15	0.1
OTC Derivatives - Equity	Historical volatility	-2,424	10%
OTC Derivatives - Equity CPPI	Historical correlation	-62	0.1

**Information on "Day one profit/loss"**

Under IFRS 9, financial instruments shall be initially recognised at fair value. The fair value of a financial instrument at initial recognition is normally the "transaction price", i.e. the fair value of the consideration given or received in relation to, respectively, financial assets and liabilities.

The fact that, upon initial recognition, the fair value of a financial instrument coincides with the transaction price is usually intuitively verifiable in the case of transactions falling under level 1 of the fair value hierarchy.

Also in the case of level 2, which is based on quotes that can be derived indirectly from the market (Comparable Approach), the fair value and the price often coincide upon initial recognition. Any differences between the price and the fair value are usually allocated to the so-called commercial margins, which are taken to the income statement when the financial instrument is initially measured.

Conversely, with respect to level 3 instruments, which have more discretion in fair value measurement, no definite reference benchmark is available to compare the transaction price with. For the same reason, the calculation of any commercial margin to be taken to the income statement is also difficult. In this event, the instrument is always initially recognised at the transaction cost. Subsequent measurement shall not include the difference between cost and fair value identified upon initial recognition (also defined as Day-One-Profit - DOP).

This difference shall be recognised in the income statement only when it arises from changes to the factors over which market participants base their valuations when fixing prices (including the time effect). Where the instrument has a definite maturity and no model is available to monitor the changes to the factors over which prices are based, the DOP can be recognised in the income statement systematically over the life of such instrument.

When a level 3 instrument is reclassified to level 2, the residual deferred Day-One-Profits are recognised in the income statement. Similarly, in the event of "on the book" transactions falling under the Bank's activities, the Day-One-Profits earned on level 3 transactions (including in the above "on the book" management) are taken to the income statement when the Bank carries out transactions which substantially eliminate the risks of the level 3 instrument which generated the DOP.

The following table shows the changes in the DOP amount deferred in the balance sheet.

(millions of euro)

<b>1. Initial amount</b>	<b>1</b>
<b>2. Increases</b>	<b>-</b>
2.1 New transactions	-
<b>3. Decreases</b>	<b>-1</b>
3.1 Releases to the income statement	-1
<b>4. Final amount</b>	<b>-</b>

## INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure in structured credit products came to 3,224 million euro as at 30 June 2021, a net increase of 495 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 1,554 million euro, in CLOs (Collateralised Loan Obligations) of 1,596 million euro and, to a residual extent, in CDOs (Collateralised Debt Obligations) of 74 million euro, for which activity during the first half of 2021 remained marginal.

Accounting categories	30.06.2021			Total	31.12.2020		changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations		absolute	%		
Financial assets held for sale	473	529	-	1,002	849	153	18.0	
Financial assets mandatorily measured at fair value	-	3	-	3	4	-1	-25.0	
Financial assets measured at fair value through other comprehensive income	729	854	-	1,583	1,119	464	41.5	
Financial assets measured at amortised cost	394	168	74	636	757	-121	-16.0	
<b>Total</b>	<b>1,596</b>	<b>1,554</b>	<b>74</b>	<b>3,224</b>	<b>2,729</b>	<b>495</b>	<b>18.1</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.

The exposure in ABSs and CLOs measured at fair value went from 1,972 million euro in December 2020 to 2,588 million euro in June 2021, a net increase of 616 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 636 million euro in June 2021, compared with an exposure of 757 million euro in December 2020.

From a profit or loss perspective, a profit of 8 million euro was posted for the first half of 2021, a significant improvement on the loss of 26 million euro recorded in the first half of 2020.

The profit on trading – caption 80 of the income statement – amounts to 7 million euro and relates to the exposures in ABSs and CLOs, as a result of valuation effects of +4 million euro and realised gains of +3 million euro, in line with the positive performance of the market segment. As at 30 June 2020, this caption showed a loss of 29 million euro, resulting mainly from valuation effects (-34 million euro) attributable to the downturn in the markets in the period due to the COVID-19 health emergency.

The profit from financial assets mandatorily measured at fair value was 1 million euro, compared to a loss of 1 million euro in the first half 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 half of 2021 through a shareholders' equity reserve (from a reserve of -4 million euro in December 2020 to -1 million euro in June 2021); on the other hand, there was no impact from sales from the portfolio as at 30 June 2021, against an impact of +4 million euro in the first half of 2020.

No adjustments were recognised on the debt securities classified as assets measured at amortised cost in the first half of 2021, the same as in the first half of 2020.



Income statement results broken down by accounting category	(millions of euro)						
	30.06.2021			30.06.2020		changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total		absolute	%
Financial assets held for sale	2	5	-	7	-29	36	
Financial assets mandatorily measured at fair value	-	1	-	1	-1	2	
Financial assets measured at fair value through other comprehensive income	-	-	-	-	4	-4	
Financial assets measured at amortised cost	-	-	-	-	-	-	-
<b>Total</b>	<b>2</b>	<b>6</b>	<b>-</b>	<b>8</b>	<b>-26</b>	<b>34</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.

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 sponsor may be the Bank itself, which establishes a SPE to achieve one of the aims mentioned above.

As to the SPE categories identified as non-consolidated structured entities, no changes have been made to the criteria applied by the Intesa Sanpaolo Group to decide whether to include said entities in the scope of consolidation, compared to the information already provided in the 2020 Annual Report.

In the first half 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 issued, still in January: the 45th and 46th, in the amount of 1.35 billion euro each. Both are floating-rate with maturity of 15 years for the 45th series and 16 years for the 46th series; they are 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 1.5 billion euro. In February, the 14th series was issued for 1 billion euro: the security, a floating rate with 5-year maturity and listed on the Luxembourg Stock Exchange with an A2 rating from Moody's, 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.

Lastly, with regard to the former UBI Banca Group, it had a programme of Covered Bonds through the Vehicle Company UBI Finance Srl. This Programme was launched in 2008 and gave UBI Banca the right to issue bonds, to institutional investors, in the maximum amount of 15 billion euro. The programme was initially guaranteed by residential mortgage loans assigned by the Group's former network banks (later merged into UBI Banca); said banks had participated in the programme as Originator Banks and Lending Banks.

In the first half of 2021, as part of the reorganisation of the structured finance transactions following the entry of the UBI Banca Group into the Intesa Sanpaolo Group, IW Bank exited the UBI Finance Covered Bond Programme, repurchasing the entire portfolio that it had 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.

In January, the 6th series with a nominal value of 1 billion euro matured, and series no. 19 of 500 million euro and no. 32 of 1 billion euro, both held by the issuer UBI Banca, were redeemed in advance.

In June, the 30th series was partially redeemed in the amount of 200 million euro.

No new issues were carried out.

With regard to the second Covered Bond programme of the UBI Banca Group, a retained programme named UBI Finance CB 2, its early termination 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 in January 2021 with the signing of the Termination Agreement by all the parties involved.

## INFORMATION ON LEVERAGED TRANSACTIONS

In 2017, the ECB published specific Guidance on Leveraged Transactions, which applies to all the significant entities subject to direct supervision by the ECB. The stated purpose of the guidance is to strengthen company controls over "leveraged" transactions, in view of the global increase in leveraged finance activities and the highly competitive market, characterised by a prolonged period of very low interest rates and the ensuing search for yields.

The scope of 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, as well as exposures where the borrower is owned by one or more financial sponsors. Moreover, counterparties with Investment Grade ratings, private 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 transactions, are also excluded.

As at 30 June 2021, for the Intesa Sanpaolo Group, the transactions that meet the definition of Leveraged Transactions as per the ECB Guidance amounted to 29 billion euro (compared to 31 billion euro as at 31 December 2020, net of the positions classified as Leveraged Transactions and then sold in the context of the sale of branches associated with the merger of UBI Banca).

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 30 June 2021 amounted to 34 million euro in the trading book and 216 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 and pertain 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.

During the first half of 2021, the stock of these investments decreased by 66 million euro compared to 31 December 2020. Of this decrease, 61 million euro concerned the banking book (mainly due to the disposals in the period) while 5 million euro concerned the trading segment.

In terms of income effects, in the first half of 2021, a profit of 12 million euro was recorded (compared to a loss of 22 million euro in the first half of 2020). This result comprised 10 million euro attributable to the valuation component of the funds in the portfolio, and 2 million euro attributable to the realisation component.

The profits (losses) on trading – caption 80 of the income statement (trading book) – showed a loss of 4 million euro as at 30 June 2021, mainly attributable to valuation losses, compared to a loss of 22 million euro in the first half 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 portfolio) – recorded a profit of 16 million euro (compared to essentially zero in June 2020). This result is due as to 14 million euro to valuation effects and as to 2 million to realisation impacts.

### INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 30 June 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 7,470 million euro (8,934 million euro as at 31 December 2020). The notional value of these derivatives totalled 81,140 million euro (75,296 million euro as at 31 December 2020).

In particular, the notional value of plain vanilla contracts was 75,262 million euro (69,636 million euro as at 31 December 2020), while that of structured contracts was 5,878 million euro (5,660 million euro as at 31 December 2020).

The positive fair value of contracts outstanding with the 10 customers with the highest exposures was 4,843 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 1,541 million euro as at 30 June 2021 (1,460 million euro as at 31 December 2020). The notional value of these derivatives totalled 20,202 million euro (19,222 million euro as at 31 December 2020).

In particular, the notional value of plain vanilla contracts was 18,642 million euro (17,809 million euro as at 31 December 2020), while that of structured contracts was 1,560 million euro (1,413 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 30 June 2021, this led to a positive effect of 65 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 Explanatory notes.

Please note that contracts made up of combinations of more elementary derivative instruments have been 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.

### INTEREST RATE BENCHMARK REFORM

In recent years, the European benchmark rates have been undergoing extensive reform, largely due to the introduction of the European regulation on benchmarks (Benchmarks Regulation, Regulation (EU) 2016/1011), published in 2016 and in effect since January 2018. This regulation, which was partially revised at the end of 2020, establishes precise rules for contributors, users and administrators of benchmarks and also requires that the fixings for those benchmarks be determined, as far as possible, on the basis of actual transactions concluded on the relevant markets, in accordance with the recommendations from the Financial Stability Board and the IOSCO Principles, in view of the central role of the benchmark rates for the proper functioning of the global financial system.

In the specific case of the short-term benchmark rates declared critical by the European authorities, reforms relating to the following were required:

- Euribor: the revision by the EMMI (European Money Market Institute) of the method for determining fixings ("hybrid" method), using transactions concluded on the unsecured money market of up to 12 months by provider banks, where available, came into full effect from November 2019. The reform was managed in full continuity with regard to the

measurement of the market of reference, the determination and the use of fixing. As required by the Benchmark Regulation, the methodology is reviewed annually by the Administrator, who has implemented the updates from April 2021 with the aim of making it as robust as possible through a partial revision of the scope of the transactions included in the calculation;

- Eonia: from October 2019, the fixings are calculated using the new risk-free rate published by the European Central Bank (€STR rate), identified on the basis of the overnight transactions concluded by the major European banks and reported according to the rules imposed by the Money Market Statistical Reporting (EU 2014/1333). The Eonia fixing will be published until 3 January 2022 and will then be permanently replaced by €STR plus a fixed spread.

The €STR rate also constitutes the basis for the calculation of the Euribor fallback rate, to be indicated in the contracts and to be used in the event of any future permanent cessation of publication of the Euribor. To facilitate the calculation of replacement rates, since April 2021 the ECB has been publishing daily the Compounded €STR Index and compounded €STR average rates, which have been included as one of the possible alternatives in the recommendations of the Working Group on euro risk free rates published in May 2021.

Outside the Eurozone, at the beginning of March 2021, the British Financial Conduct Authority (FCA) - announced the dates for the discontinuation of Libor in the various currencies. The use of the Libor indices will remain possible until the end of 2021 with some limitations based on jurisdiction and with the progressive use of the new alternative risk free rate (RFR) indices. At the same time as the FCA's announcement, the International Swaps and Derivatives Association (ISDA) established the rules for the transition of derivative contracts between counterparties adhering to the ISDA protocol, at the same time defining the values of Credit Adjustment Spreads to be applied in the transition to RFR in the manner already established and approved for the calculation of the Libor fallbacks.

In recent years, Intesa Sanpaolo has closely monitored the developments relating to benchmarks, and in 2016 it launched a dedicated project involving the participation of all the corporate functions involved in various capacities.

The project work continued in 2021, focusing on the following aspects in particular:

- bilateral negotiations with counterparties for the migration of Credit Support Annexes (CSAs) from Eonia to €STR;
- progressive greater use of €STR derivatives;
- progressive discontinuation of the offer of products indexed to GBP Libor in the first half of the year and same plans for CHF, JPY and USD Libor products in the second half of the year to promote the transition to RFR;
- activities at all levels for the inclusion of robust fallback clauses in the outstanding contracts indexed to Libor;
- preparation of the IT structure necessary for the use of RFR in the Bank's accounting and management systems;
- constant information updates for the Group's international legal entities;
- monitoring of the ISDA developments by signing the documents that, from the beginning of the year, include the new market standards and monitoring contract updating activities also on a bilateral basis. In particular, Intesa Sanpaolo has adopted the ISDA 2020 IBOR Fallbacks Protocol and can therefore implement the IBOR Fallbacks Supplement rules for existing derivative contracts concluded before the Supplement's effective date with all counterparties that have adhered to the Protocol;
- collaboration with the Italian authorities to support the development of the new RFR rates market;
- participation in public consultations at international level, also providing input to the Italian Banking Association to produce feedback at national level;
- providing feedback on transition readiness for foreign authorities in countries where Group companies are present, and to the ECB Joint Supervisory Team for general aspects related to the Group;
- delivery of specialist training to staff via remote learning;
- provision of information to customers via dedicated pages on the Group's website on the benchmark transition process and webinars for financial area customers.

Intesa Sanpaolo has also continued to take part in various initiatives, including European working groups organised by EMMI, the European Central Bank and, recently, ESMA.

In this latter area in particular, Intesa Sanpaolo also acted in 2021 as a voting member and participant in individual project streams in the working group on euro risk free rates, in which it has also held the new role of Ambassador for Italy since 2020. The main activities of this working group include the designation of €STR as the new benchmark for the short-term money market and the publication of recommendations for the transition from Eonia to €STR and for the Euribor fallbacks.

As reported in the Chapter "Accounting Policies", in 2021, Regulation (EU) 2021/25 of 13 January 2021, adopting the document "Interest Rate Benchmark Reform – Phase 2, Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16" published by the IASB on 27 August 2020 regarding issues pertaining to the second phase of the interest rate benchmark reform project (IBOR Reform), became binding and applicable for the first time. The main amendments introduced concern the possible accounting impacts of the application of the new rates (so-called replacement issue), in particular the accounting treatment of amendments to existing contracts and to hedge accounting. No impacts on the Intesa Sanpaolo Group are foreseen for the modifications with the characteristics envisaged by the standard, in line with the objective of the amendments introduced by the IASB aimed at preventing distortions in the financial statements as a result of the reform.

Furthermore, the Intesa Sanpaolo Group has applied since the 2019 Financial Statements Regulation (EU) 34/2020 of 15 January 2020, which adopted the document issued by the IASB on "Interest Rate Benchmark Reform (amendments to IFRS 9 Financial Instruments, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures)", which introduced several amendments regarding hedge accounting designed to prevent uncertainties about the amount and timing of the cash flows arising from the rate reform from causing the discontinuation of existing hedges and difficulties in designating new hedging relationships.

In view of the regulatory measures and the actions taken by the Bank described above, no problem issues are envisaged in completing the transition within the deadlines set.

With specific regard to the hedging derivatives indexed to the Eonia, there was a downward trend in exposures compared to 31 December 2020, which is also attributable to the transition activities currently being completed.

With regard to financial instruments other than hedging derivatives, the transition activities will be implemented mainly from the second half of 2021 in compliance with the deadlines envisaged by the reform.

## OPERATIONAL RISK

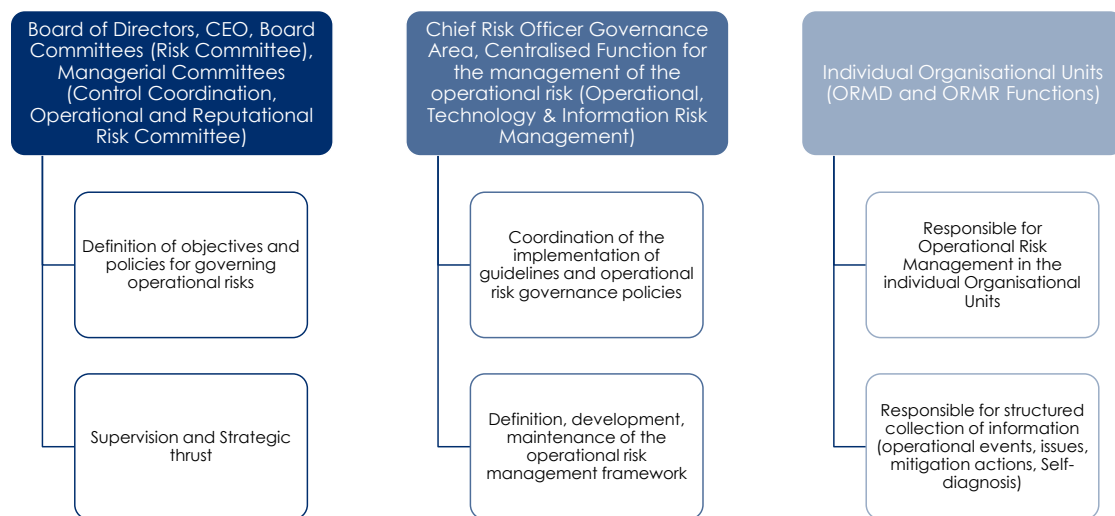
Operational risk is the risk of incurring losses resulting from inadequate or failed internal processes, people and systems or from external events<sup>16</sup>.

The Intesa Sanpaolo Group adopts an undertaking and management strategy of operational risk based on prudent management principles and aimed at guaranteeing long-term solidity and continuity for the company. In addition, the Group pays particular attention to achieving an optimal balance between growth and profitability and the resulting risks.

In line with these objectives, the Intesa Sanpaolo Group has long since established an overall operational risk governance framework, by setting up a Group policy and organisational processes for measuring, managing and controlling operational risk.

### Governance Model

An effective and efficient framework for managing operational risks must be fully integrated into decision-making processes and management of business operations. Accordingly, the Intesa Sanpaolo Group has chosen to involve the organisational units (business units, central/support structures) of the Parent Company, the Banks and Group companies with direct responsibility in the operational risk management process.



The Intesa Sanpaolo Group's operational risk governance process is divided into the following phases:

- Identification: the detection and description of potential operational risk areas (e.g., operational events, presence of issues, applicability of risk factors, significant risk scenarios);
- Measurement and assessment: determination of exposure to operational risks (e.g., self-diagnosis<sup>17</sup>, determination of economic and regulatory capital, preventive analyses of operational and ICT risks, assessment of the significance of the issues identified);
- Monitoring and control: continuous management of changes in the operational risk exposure, also to prevent the occurrence of harmful events and to promote active risk management;
- Mitigation: operational risk containment through appropriate mitigation actions and suitable risk-transfer strategies based on a risk-driven approach;
- Reporting: preparation of information flows related to operational risk management, designed to ensure adequate knowledge of the exposure to this risk.

### ICT risk

ICT (Information and Communication Technology) risk means the risk of economic, reputational or market share losses related to the use of information and communication technology. In the integrated view of corporate risk for supervisory purposes, this risk is considered, according to specific aspects, as operational, reputational and strategic risk. ICT risk includes Cyber risk and IT risk.

The Intesa Sanpaolo Group considers its information system a tool of primary importance to the achievement of its strategic, business and social responsibility objectives, including in the light of the critical nature of the company processes that depend on it. Accordingly, it undertakes to create a resilient environment and to invest in assets and infrastructure designed to minimise the potential impact of ICT events and to protect its business, image, customers and employees.

<sup>16</sup> As far as the financial losses component is concerned, the Operational risk includes: legal and compliance risk, conduct risk, IT and Cyber risk, physical security risk, business continuity risk, financial crime and financial reporting risk, third-party and model risk. Strategic risk and reputational risk are not included.

<sup>17</sup> Self-diagnosis is the annual process through which the Organisational Units identify their level of exposure to operational and ICT risk. It includes Operational Risk Assessment and ICT Risk Assessment, both of which are further broken down into Business Environment Assessment (BEA) and Scenario Analysis (SA).



The Group has therefore adopted a system of principles and rules intended to identify and measure the ICT risk to which company assets are exposed, assess the existing safeguards and identify adequate methods of managing such risks, in accordance with the operational risk management process.

#### **Internal model for the measurement of operational risk**

The Intesa Sanpaolo Group's internal model for calculating capital absorption (the "Advanced Measurement Approach" or "AMA") is designed to combine all the main sources of quantitative information (internal and external operational losses and estimates deriving from the Scenario Analysis) and qualitative information (Business Environment Evaluation - VCO).

Capital-at-risk is therefore identified as the minimum amount at Group level required to bear the maximum potential loss (worst case). It is estimated using a Loss Distribution Approach model (actuarial statistical model to calculate the value-at-risk of operational losses), applied both to quantitative data and to the results of the scenario analysis over a one-year period, with a confidence level of 99.9%. The methodology also applies a corrective factor, which derives from the qualitative analyses of the risk level of the operational environment (VCO), to take into account the effectiveness of internal controls in the various Organisational Units.

The internal model's insurance mitigation component was approved by the Competent Authority in June 2013 with immediate effect of its benefits on operations and on the capital requirements.

#### **Operational risk capital requirement**

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.

Please note that, on 30 June 2021, the Intesa Sanpaolo Group was authorised to extend its advanced model to some entities belonging to the former UBI Group, specifically to: UBI Banca (merged by incorporation into Intesa Sanpaolo on 12 April 2021), including the entities of the former Banca Marche, the former Banca Etruria, the former CariChieti, UBI Sistemi e Servizi and IW Bank Private Investments.

Consequently, the AMA approach is now being used by Intesa Sanpaolo and the main banks and companies in the Private Banking and Asset Management Divisions, as well as by VUB Banka, VUB Leasing and PBZ Banka.

The capital absorption resulting from this approach amounts to 2,110 million euro as at 30 June 2021, slightly down from 2,205 million euro as at 31 December 2020.

#### **Legal risks**

As at 30 June 2021, there were a total of about 34,900 disputes, other than tax disputes, pending at Group level (excluding those involving Risanamento S.p.A, which is not subject to management and coordination by Intesa Sanpaolo) with a total remedy<sup>18</sup> sought of around 3,973 million euro. This amount includes all outstanding disputes, for which the risk of a disbursement of financial resources resulting from a potential negative outcome has been deemed possible or probable and therefore does not include disputes for which risk has been deemed remote.

The risks associated with these disputes are thoroughly and individually analysed by the Parent Company and Group companies. Specific and appropriate provisions have been made to the Allowances for Risks and Charges in the event of disputes for which there is an estimated probability of a disbursement of more than 50% and where the amount of the disbursement may be reliably estimated (disputes with likely risk). Without prejudice to the uncertainty inherent in all litigation, the estimate of the obligations that could arise from the disputes and hence the amount of any provisions recognised are based on the forward-looking assessments of the outcome of the trial. These forward-looking assessments are, in any event, prepared on the basis of all information available at the time of the estimate.

The disputes with likely risk amount to around 25,000 with a remedy sought of 2,151 million euro and provisions of 743 million euro. The part relating to the Parent Company Intesa Sanpaolo is around 5,900 disputes with a remedy sought of 1,743 million euro and provisions of 568 million euro, the part relating to other Italian subsidiaries is around 1,000 disputes with a remedy sought of 270 million euro and provisions of 104 million euro, and the part relating to the international subsidiaries is around 18,100<sup>19</sup> disputes with a remedy sought of 138 million euro and provisions of 71 million euro.

The breakdown according to the main categories of disputes with likely risk shows the prevalence of cases related to the Group's ordinary banking and credit activities: disputes involving claims relating to banking and investment products and services or on credit positions and revocatory actions account for about 78% of the remedy sought and 71% of the provisions. The number of ongoing disputes is strongly affected by several cases of "mass" disputes present in Italy, with regard to issues relating to anatocism and other conditions of accounts/credit facilities and investment services (3,700 disputes) and, at the international level, also relating to conditions of accounts/credit facilities and loans in currencies other than the local currency (17,500 disputes).

For the main pending disputes, the significant developments in the half year are described below; see the Notes to the 2020 Annual Report for further details.

*Selari Bruno Raulet (formerly Dargent Tirmant Raulet) dispute* – Following the exchange of briefs, a hearing was held in early March 2021 to discuss the case. The judgment is expected to be issued by the summer.

<sup>18</sup> The figures for the remedy sought do not include claims of indeterminate value, i.e. those that do not contain a specific financial claim when the dispute is initiated; the value of these disputes is determined during the course of the proceedings when sufficient information emerges for the valuation.

<sup>19</sup> These include approximately 16,500 disputes (of which approximately 7,600 arising in 2021) relating to the subsidiary Banca Intesa Beograd and concerning actions brought by customers challenging the validity (1) of certain charges provided for in loan agreements and (2) of charges relating to insurance for real-estate loans (both types of dispute are common with other banks in the country). Although numerically significant, the average value of the claims is quite modest: overall, the remedy sought relating to the two types of disputes is approximately 2 million euro.



*Offering of diamonds* – With regard to the well-known criminal proceedings and in particular to the position of the Bank, which has been charged with administrative liability pursuant to Legislative Decree 231/2001 for the predicate offence of self-laundering, at the hearing of 1 July 2021, the Preliminary Investigation Judge accepted the plea bargain request which Intesa Sanpaolo had submitted solely to bring to an end the lengthy legal proceedings and which had been supported by the Public Prosecutor's Office – issuing a judgment imposing only a financial penalty of 100,000 euro, and the confiscation of only the sums constituting the profit from the offence of self-laundering, calculated at 61,434 euro.

*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 S.r.l., Conte Anna and Esposito Guido* – In 2018, Florida 2000 S.r.l., together with two directors of the company, challenged the lawfulness 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 calculated in the 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.

The Bank appealed against the ruling before the Naples Court of Appeal; the first hearing is scheduled for 5 October 2021.

*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 half-year, while there were a number of unfavourable rulings, mainly from Justices of the Peace, there were 5 judgments in favour of intermediaries. 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.

The Parliament approved an amendment inserted in the "Sostegni bis" Law Decree that provides:

- as concerns the rules on mortgage lending to consumers, removal of the reference to Article 125-sexies and insertion of a specific provision on the early redemption of this type of loan, limiting repayment to only the interest and costs due for the remaining life of the loan agreement;
- as concerns the rules on consumer credit, the amendment of Article 125-sexies, so as to implement the principles of the Lexitor ruling, indicating, however, the amortised cost criterion as the preferred criterion for calculating repayment;
- these provisions only apply to loan agreements signed after the entry into force of the law converting the decree. On the other hand, it is specified that loan agreements signed before that date continue to be governed by the law as interpreted by the Supervisory and Transparency provisions in force at the time of signing.

Intermediaries will be required to repay the upfront costs for consumer credit agreements concluded before the entry into force of the new rule, even if the agreements expired after that date, only within the limits, if any, established in the agreement itself.

As concerns the pending dispute, the adoption of the above-mentioned amendment should induce the court to accept the Bank's arguments. However, it cannot be excluded that the plaintiffs may file motions with the Constitutional Court or the Court of Justice of the European Union challenging the lawfulness of the new legislation.

*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 asking the court to declare the contract null and void due to the lack of awareness of the risks and of adequate information on the costs and structure of the instrument, and ordering the repayment of 3 million euro;
- the Municipality of Cimadolmo initiated a mediation procedure with undetermined value, which ended with a negative outcome.

In addition, the Municipality of Perugia, after initiating a mediation procedure in 2019, served a writ of summons asking the court to declare null and void four derivative contracts entered into in 2006. The first court hearing was held in May 2021.

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.

Lastly, in execution of the judgment in the plaintiff's favour delivered by the Court of Pavia on 16 September 2020, in February the amount of 10.1 million euro, taken from the specific provision, was paid to the Province of Pavia. However, this judgment is currently under appeal.

As regards the current disputes with companies owned by local authorities and Regional governments, it should be noted that, in May, a writ of summons was served by EUR S.p.A., a company held by the Ministry of the Economy and Finance and Roma Capitale. In addition to ISP, the company is also suing other credit institutions; the disputes concern derivative contracts entered into in relation to a syndicated loan. The claimant has claimed the repayment of approximately 57 million euro. Since the contracts are governed by the international ISDA rules, it is possible that the national courts lack jurisdiction. The first hearing is scheduled for 5 October 2021.

As concerns disputes with private individuals, in May the Bank was ordered to pay approximately 13 million euro as part of a dispute concerning currency options brought before the Court of Bologna. The Judge considered all the transactions null and void due to the failure to indicate the MTM and the relevant calculation formula in the contracts, and referred to the principles

set out in the aforementioned ruling of the Court of Cassation. The Bank appealed against the ruling, highlighting its errors and inconsistencies, and asked to suspend enforcement of the judgment. The Bologna Court of Appeal granted the Bank's request and provisionally suspended enforceability of the judgment. The appealed judgment not only applies the principles upheld by the Court of Cassation for contracts entered into with Public entities to derivative contracts entered into with private customers, but fully assimilates the disclosure requirements for IRS intermediaries to currency option contracts, without taking into account the difference between these two instruments.

In general, the case law on this subject remains mixed, with rulings in favour and against the banks.

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### Contingent assets

*IMI SIR dispute* – 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 the matter of 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 ordering each party to pay its own 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.

Furthermore, as concerns the proceedings on the merits of the case, in May the Bank filed an appeal with the Court of Cassation against the Rome Court of Appeal's ruling of 16 April 2020.

The appeal relates primarily to two aspects:

- the reduction in non-financial damages made by the Court of Appeal is devoid of any sound legal or logical reasoning;
- apart from the reduction in non-financial damages, the Court made a miscalculation when redetermining the total damages awarded to the Bank.

### Tax litigation

The Group's tax litigation risks are covered by adequate provisions to the allowances for risks and charges. No new cases of significant amounts arose in the first half of the year.

As at 30 June 2021, the Parent Company Intesa Sanpaolo had 733 proceedings pending (687 as at 31 December 2020) for a total amount claimed (taxes, penalties and interest) of 150 million euro (139 million euro as at 31 December 2020), considering both administrative and judicial proceedings in both the lower and higher courts.

The increase in the value of tax litigation is mainly due to the dispute concerning the former UBI Banca (7.7 million euro), which was transferred to the Parent Company following the merger, and to new disputes over municipal property tax on property lease contracts terminated without repossession of the assets (2.6 million euro).

In relation to these proceedings, the actual risks were quantified for Intesa Sanpaolo at 62 million euro as at 30 June 2021 (57 million euro as at 31 December 2020).

With regard to the pending disputes, as to the dispute with the Brazilian Tax Administration (amount in dispute of approximately 35 million euro), on income taxes and social security contributions related to the year 1995, of the company Banco Sudameris Brasil (now Banco Santander Brasil), it should be noted that the civil court of first instance issued in April its judgment which, while accepting in part some of the Bank's objections, found on the whole in favour of the Brazilian Tax Administration. The judgment was appealed on 10 May 2021, and the case is now pending in the court of second instance. According to local advisors, the likelihood of an adverse ruling in relation to the interest component (approximately 21 million euro) is remote. On the other hand, the provision for taxes and penalties (amounting to a total of 13.6 million euro of the deposit recognised within the assets in the balance sheet) has been increased prudentially from 25% as at 31 March 2021 to 50% of that amount, thus setting aside a total of 6.8 million euro in the provision for risks.

With reference to the dispute regarding registration tax on rulings ordering the Bank to return compound interest (so called *interessi anatocistici*) and maximum overdraft charges to customers - for which the Bank believes that a fixed registration tax of 200 euro is due under Article 8(1) (e) of the Tariff annexed to Presidential Decree no. 131/86 and the Note to point (b) of the same article (i.e. under the principle of alternativity VAT registration tax) - an initial judgment was issued by the Court of Cassation in June. The judgment, the grounds of which are debatable in many respects, unexpectedly upheld the principle that tax applies at the proportional rate of 3%, supporting a restrictive interpretation of Article 8(1)(e) of the Tariff and stating that said article is only applicable in cases where the entire contract, and not individual clauses, is declared invalid/voidable in judicial proceedings. As concerns the applicability of the principle of alternativity VAT registration tax, the Court of Cassation referred the matter back to the lower court for an assessment of the matter since, in this specific case, this aspect had been always subsumed in all lower court proceedings. Given the prevalence of favourable rulings in the various instances of the case, and the fact that the Court of Cassation has not yet ruled on the Bank's last objection, there are still valid reasons to continue the dispute.

With regard to the merged company Mediocredito Italiano ("MCI"), and to the Tax Audit Report served on 13 October 2020 disputing the VAT exemption under Article 8-bis of Presidential Decree 633/72 for tax year 2015, applied by the company to boat leases, the Italian Revenue Agency - Lombardy Regional Directorate - Large Taxpayers Office has served the notice of tax assessment. Discussions are currently under way with the Italian Revenue Agency to settle not only the recently notified assessment for tax year 2015, but also the amounts claimed for tax year 2014 in a previous tax dispute. To this end, the Bank and the Italian Revenue Agency jointly requested postponement of the hearing before the Milan Provincial Tax Commission scheduled for 22 June, which has been postponed to 5 October.

As to disputes settled during the period, it should be noted that a ruling by the Court of Cassation definitively annulled an earlier notice of assessment (*avviso di rettifica e liquidazione*) of registration tax on the sale in 2008 by Intesa Sanpaolo S.p.A. of a business line to Credito Piemontese S.p.A. (now Credito Valtellinese S.p.A.). The total amount of the claim is approximately 1.7 million euro and, as a result of the favourable ruling, the provisional payment made during the proceedings

will be refunded. No provision had been set aside for this case.

With regard to the Intesa Sanpaolo branches located abroad, two VAT audits on the London branch are under way, the first for the years 2016, 2017 and 2018 and the second for 2020. Three audits are also under way on the New York branch for 2015, 2016 and 2018. No claims have been made for the time being.

The audit on the Madrid branch for the year 2015 ended with a tax assessment by the tax authorities disputing the deductibility of intercompany costs of 2.2 million euro and charging 93 thousand euro of tax, plus interest of 17 thousand euro and penalties of 20 thousand euro. The branch decided to accept the tax assessment.

By notice dated April 2021, the Madrid Revenue Agency also started a tax audit for the year 2016 concerning income tax on the Madrid branch of the merged company UBI Banca, which had been closed down on 31 December 2018. In their first contact on 5 July 2021, the Spanish tax officials requested a large number of accounting and tax documents, which will be delivered by our local advisors in the coming weeks.

At the level of the Group's other Italian companies, tax disputes totalled 72 million euro as at 30 June 2021 (63 million euro as at 31 December 2020), covered by specific provisions of 10 million euro (unchanged from 31 December 2020).

The increase in disputes compared to the end of 2020 mainly relates to new disputes that arose in the first half of 2021 for Intesa Sanpaolo Private Banking S.p.A. and Cargeas Assicurazioni S.p.A., net of closed disputes of Provis S.p.A. (1 million euro) and disputes of the former UBI Banca which, as a result of the merger, are now included in the figures of the Parent Company.

As to Intesa Sanpaolo Private Banking, on 29 April 2021 notices were served for the assessment of IRES and IRAP taxes for tax year 2016. The amount deducted by the company and now disputed by the Lombardy Regional Revenue Directorate for tax year 2016 is the same amount already adjusted for 2015, of 12.1 million euro, corresponding to higher IRES of 3.3 million euro and IRAP of 0.7 million euro, plus interest, and penalties (total amount 8.2 million euro); The assessments relate to the deduction (in 2011 and the following years) of the amortisation charge for the goodwill arising from the transfers of the private banking business lines of Intesa Sanpaolo and Cassa dei Risparmi di Forlì e della Romagna in 2009, Banca di Trento e Bolzano and Cassa di Risparmio di Firenze in 2010 and Cassa di Risparmio Pistoia e Lucchesia and Cassa di Risparmio dell'Umbria in 2013, which had been realigned by the transferee in accordance with Article 15, paragraph 10, of Law Decree 185 of 29 November 2008. The dispute currently concerns the years from 2011 to 2016 and the total amount claimed by way of tax, penalties and interest is 51 million euro. According to the opinion issued on 17 June 2021 by the advisor assisting the Bank in the cases pending before the Court of Cassation, the risk of an adverse ruling is classified as "possible", since the lawfulness of realigning the tax value of the goodwill newly generated for the transferee – something which in the past was done by other Group companies without incurring in tax disputes – has been expressly acknowledged by the Italian Revenue Agency in Circular no. 8/E of 2010 and is consistent with the provisions of Article 15, paragraph 10 of Law Decree 185/2008.

Cargeas Assicurazioni S.p.A., an insurance company acquired by Intesa Sanpaolo Vita on 27 May 2021, underwent a tax audit by the Italian Revenue Agency, Lombardy Regional Directorate, Large Taxpayers Office, aimed at verifying the correct application, for the years from 2010 to 2018, of the tax rules on private insurance and life annuity contracts pursuant to Law no. 1216 of 29 October 1961.

As a result of the audit, the authorities claimed that redundancy insurance policies (which are mandatorily associated with loans secured by the assignment of one-fifth of salary and optional with other mortgages, loans and consumer credit), should not be subject to tax on insurance premiums at a rate of 2.5%, but should be classified as credit risk insurance policies, subject to a tax rate of 12.5%.

The Revenue Agency maintains that although the risk insured (on the basis of which the premium is determined with statistical/actuarial criteria) is the loss of employment, redundancy policies should be charged the 12.5% rate applicable to credit risk insurance, given that the ultimate aim of the policy is to protect the lending institution's interest in collecting its credit.

The dispute is nothing new for the insurance industry; in fact, insurance companies have been maintaining that the Agency's reasoning is unsubstantiated and biased for years now. ANIA has also recently given its opinion on the matter through circular no. 0082 of 5 March 2021 (which refers to circular no. 127 of 21 April 2005), pointing out that the Agency's position produces a series of unsystematic and abnormal consequences which certainly do not reflect the intention of the legislator in Law no. 1216, and diverge from the guidance of the financial administration itself which, on this point, had supported application of the 2.5% rate in circular no. 29/E of 2001.

After the audit, on 25 May 2021 Cargeas received an assessment notice for 2010 claiming an additional tax of 1.7 million euro, 0.6 million euro in interest and 3.4 million euro in penalties, equal to 200% of the assessed tax (minimum penalty prescribed by law), for a total of 5.6 million euro. The dispute was referred to an advisor for drafting of the appeal, which is currently being finalised. The legal advisors are studying the case to determine whether the potential charges arising from this dispute can be recovered in whole and/or in part from the seller, Cardif / BNP Paribas. Moreover, for the reasons clearly stated by ANIA, the risk of incurring a liability is considered possible. Lastly, a preliminary analysis was conducted on Cargeas to determine the potential impact of the dispute on all the years potentially subject to assessment: for the entire period 2011-2018 (the analysis is under way for the period 2019-2021) the total potential additional tax in the event of tax assessment would be 2.9 million euro and the potential penalties would amount to 5.8 million euro (plus interest).

Lastly, with regard to the same case, Intesa Sanpaolo Assicura received the following two questionnaires in April 2021: the first for 2012 and 2013 for the former Bentos Assicurazioni, merged into Intesa Sanpaolo Assicura in December 2013; the second for 2012 for Intesa Sanpaolo Assicura.

To date, the questionnaires have not been followed by any tax assessments by the Agency. According to the initial checks carried out, the potential impact of the dispute on Intesa Sanpaolo Assicura for all the years potentially subject to assessment would be of a small amount (less than one million euro).

The tax disputes involving foreign subsidiaries are of small amounts and are covered by provisions as to 75% of the risk. In particular, these are disputes having a total value of 8 million euro (9 million euro at the end of 2020) for which provisions of 6 million euro have been set aside (7 million euro at the end of 2020).

Alexbank has two pending tax audits concerning corporate income tax, referring to tax year 2018, and stamp duty, referring to

tax year 2019. At present no claims have been put forward. In addition, there is a pending dispute concerning the non-payment of stamp duty by the Bank's branches for a total value of approximately 3.3 million euro for tax periods 1984 – 2008. The potential liability has been fully covered by provision.

A tax audit on Intesa Sanpaolo Brasil S.A. - Banco Multiplo is also under way, conducted by Sao Paulo City Municipality in relation to tax years 2016 and 2017. No tax assessment notices have been issued yet, but the company's accounting and financial documents have been requested.

## 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, BancAssurance Popolari, Assicurazioni Vita - formerly Aviva Vita, Lombarda Vita and Cargeas) are made with their shareholder fund 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.

The companies Assicurazioni Vita, Lombarda Vita and Cargeas became part of the Insurance Group during the second quarter, and a project for their integration into the Insurance Group has been launched, with the objective, among others, of achieving their gradual alignment with the Insurance Group's risk management framework. The analysis provided below already includes the effect of the acquisition.

As at 30 June 2021, the investment portfolios, recorded at book value, amounted to 204,199 million euro. Of these, a part amounting to 112,942 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 91,257 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 shareholder fund.

In terms of breakdown by asset class, net of derivative financial instruments, 84.7% of assets, i.e. approximately 95,371 million euro, were bonds, whereas assets subject to equity risk represented 2.6% of the total and amounted to 2,949 million euro. The remainder (14,312 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (12.7%).

The carrying value of derivatives came to 310.4 million euro, of which -51.7 million euro relating to effective management derivatives<sup>20</sup>, and the remaining portion (362.1 million euro) is attributable to hedging derivatives.

At the end of the first six months of 2021, investments made with the shareholder fund of Intesa Sanpaolo Vita and Fideuram Vita amounted to 1,351 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of 19 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 6,704 million euro.

The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 7.6% of total investments and A bonds approximately 6.5%. Low investment grade securities (BBB) were approximately 81.4% of the total and the portion of speculative grade or unrated securities was minimal (4.5%).

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

The analysis of the exposure in terms of the issuers/counterparties produced the following results: securities issued by Governments and Central Banks made up 78.8% of the total investments, while financial companies (mostly banks) contributed 12.3% of exposure and industrial securities made up 8.9%.

At the end of the first half 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 6,776 million euro, with 5,683 million euro due to government issuers and 1.093 million euro to corporate issuers (financial institutions and industrial companies).

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<sup>20</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.