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# Risk management

## BASIC PRINCIPLES

As described in greater detail in the annual financial statements, the Intesa Sanpaolo Group's risk acceptance policies are defined by the Parent Company's Supervisory Board and Management Board. The Supervisory Board performs its activities through specific committees set up from among its members, including the Control Committee. The Management Board draws on the activities conducted by managerial committees, particularly the Group Risk Governance Committee. Both corporate bodies receive support from the Chief Risk Officer who reports directly to the Chief Executive Officer. The Chief Risk Officer is responsible for proposing the Risk Appetite Framework, setting the Group's risk management and compliance guidelines and policies in accordance with company strategies and objectives and coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, including within the various corporate departments. The Chief Risk Officer ensures management of the Group's overall risk profile by establishing methods and monitoring exposure to the various types of risk and reporting the situation periodically to the corporate bodies.

The Parent Company is in charge of overall direction, management and control of risks. Group companies that generate credit and/or financial risks are assigned autonomy limits and each has its own control structure. A service agreement governs the risk control activities performed by the Parent Company's functions on behalf of the main subsidiaries. These functions report directly to the subsidiaries' Management Bodies.

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 that could be borne by the Group over a period of one 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 under ordinary and stress conditions. The assessment of capital is included in business reporting and is submitted quarterly to the Group Risk Governance Committee, the Management Board and the Control Committee, as part of the Group's Risks Tableau de Bord. Risk hedging, given the nature, frequency and potential impact of the risk, is based on a constant balance between mitigation/hedging action, control procedures/processes and capital protection measures.

## BASEL 3 REGULATIONS AND THE INTERNAL PROJECT

With effect from 1 January 2014, the reforms of the accords by the Basel Committee ("Basel 3") were implemented in the EU legal framework. Their aim is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, improve risk management and governance, and strengthen banks' transparency and disclosures. In doing so, the Committee maintained the approach based on three Pillars, which was at the basis of the previous capital accord, known as "Basel 2", supplementing and strengthening it to increase the quantity and quality of intermediaries' available capital as well as introducing counter-cyclical regulatory instruments, provisions on liquidity risk management and financial leverage containment. Therefore, the EU implemented "Basel 3" through two legislative acts:

- Regulation (EU) No. 575/2013 of 26 June 2013 (CRR), which governs the prudential supervision requirements of Pillar 1 and public disclosure requirements (Pillar 3);
- Directive 2013/36/EU of 26 June 2013 (CRD IV), which, among other things, deals with the access to the activity of credit institutions, freedom of establishment, freedom to provide services, supervisory review process, and additional equity reserves.

EU legislation is complemented by the provisions issued by the Bank of Italy and referring to Circular no. 285 of 17 December 2013, which contains the prudential supervision regulations applicable to banks and Italian banking groups, reviewed and updated to adjust the internal regulations to the new elements of the international regulatory framework, with special reference to the new regulatory and institutional structure of banking supervision of the European Union and taking into account the needs detected while supervising banks and other intermediaries.

In order to comply with the new rules envisaged by Basel 3, the 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. Additional information on own funds, which are now calculated according to the Basel 3 rules, and on capital ratios of the Group is provided in the section on balance sheet aggregates: Own funds and capital ratios, and in the document Basel 3 Pillar 3.

With respect to credit risks, the Group received authorisation to use internal ratings-based approaches effective from the report as at 31 December 2008 on the Corporate portfolio for a scope extending to the Parent Company, network banks in the Banca dei Territori Division and the main Italian product companies.

Progressively, the scope of application has been gradually extended to include the SME Retail and Mortgage portfolios, as well as other Italian and international Group companies, as shown in the following table.

	Corporate		SME Retail	Mortgage
	FIRB	AIRB LGD	IRB LGD	IRB LGD
Intesa Sanpaolo				
Banco di Napoli				
Cassa di Risparmio del Veneto				
Cassa di Risparmio di Bologna				
Cassa di Risparmio di Venezia				
Cassa di Risparmio del Friuli Venezia Giulia	Dec - 2008	Dec - 2010	Dec - 2012	Jun - 2010
Cassa dei Risparmi di Forlì e della Romagna				
Banca dell'Adriatico				
Banca di Trento e Bolzano				
Banca di Credito Sardo				
Mediocredito Italiano				n.a.
Gruppo Cassa di Risparmio di Firenze	Dec - 2009	Dec - 2010	Dec - 2012	Jun - 2010
Cassa di risparmio dell'Umbria	n.a.	Dec - 2010	Dec - 2012	Dec - 2011
Cassa di Risparmio della Provincia di Viterbo	n.a.	Dec - 2010	Dec - 2012	Dec - 2011
Cassa di Risparmio di Rieti	n.a.	Dec - 2010	Dec - 2012	Dec - 2011
Banca Monte Parma	n.a.	Dec - 2013	Mar - 2014	Dec - 2013
Banca Prossima	n.a.	Dec - 2013	Dec - 2013	n.a.
Banca IMI	n.a.	Jun - 2012	n.a.	n.a.
Intesa Sanpaolo Bank Ireland	Mar - 2010	Dec - 2011	n.a.	n.a.
Vseobecna Uverova Banka	Dec - 2010	Jun - 2014	Jun - 2014	Jun - 2012

Dedicated rating approaches have been developed for the Banks and Public Entities Portfolio according to the type of counterparty to be assessed. This was the subject of a pre-validation inspection by the Supervisory Authority conducted in December 2013 as part of the process leading up to the application for authorisation to be submitted in the first half of 2015.

The Group is also proceeding with development of the IRB systems for the other segments and the extension of the scope of companies for their application in accordance with a plan presented to the Supervisory Authority.

With reference to the Parent Company Intesa Sanpaolo and to Banca IMI, the Bank of Italy granted the authorisation to use the internal counterparty risk model for regulatory purposes, starting from the first quarter of 2014.

With regard to Operational Risk, the Group obtained authorisation to use the Advanced Measurement Approaches (AMA – internal model) to determine the associated capital requirement for regulatory purposes, with effect from the report as at 31 December 2009. The scope of application of the advanced approaches is being progressively expanded in accordance with the roll out plan presented to the Management and to the Supervisory Authorities. For additional details see the section on operational risks.

The adequacy of the internal control system for risks is also illustrated in the annual Internal Capital Adequacy Assessment Process Report, based on the extensive use of internal approaches for the measurement of risks and for the calculation of internal capital and total capital available. The document was approved and presented to the Bank of Italy in April 2014.

As discussed in the “Executive Summary” of this document, the Intesa Sanpaolo Group was well above the thresholds required by the 2014 EU-wide Comprehensive Assessment, carried out on the balance sheets of the European banks as at 31 December 2013 and consisted of an asset quality review (AQR), as well as an exercise examining the impact of a negative macroeconomic scenario on banks’ capital (Stress Test).

As mentioned, 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 Group's strategies, powers and rules for the granting and managing of loans are aimed at:

- achieving the goal of sustainable growth 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 Intesa Sanpaolo Group has developed a set of techniques and tools for credit risk measurement and management which ensures analytical control over the quality of loans to customers and financial institutions, and loans subject to country risk.
- In particular, with respect to loans to customers, risk is measured using internal rating models which change according to the counterparty's operating segment.

### 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 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. They allow timely assessments when any anomalies arise or persist and interact with processes and procedures for loan management and for credit risk control.

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: doubtful loans, exposures to borrowers in default or in similar situations; substandard loans, exposures to borrowers in temporary difficulty, deemed likely to be settled in a reasonable period of time and exposures which satisfy the conditions objectively set by the Supervisory Authority ("objective substandard loans"), although they do not meet the requirements to be classified under doubtful loans; restructured loans, positions for which, due to the deterioration of the economic and financial position of the borrower, the bank (or pool of banks) agrees to modify the original contractual terms giving rise to a loss. Lastly, non-performing loans also include past due positions that cannot be considered mere delays in reimbursements, as established by the Bank of Italy.

	30.09.2014			31.12.2013			Changes
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Doubtful loans	37,193	-23,549	13,644	34,403	-21,504	12,899	745
Substandard loans	19,846	-4,832	15,014	17,979	-4,164	13,815	1,199
Restructured loans	2,819	-498	2,321	2,728	-413	2,315	6
Past due loans	1,892	-254	1,638	2,232	-274	1,958	-320
<b>Non-performing loans</b>	<b>61,750</b>	<b>-29,133</b>	<b>32,617</b>	<b>57,342</b>	<b>-26,355</b>	<b>30,987</b>	<b>1,630</b>
Performing loans	293,131	-2,459	290,672	300,341	-2,402	297,939	-7,267
Performing loans represented by securities	14,271	-295	13,976	15,207	-344	14,863	-887
<b>Loans to customers</b>	<b>369,152</b>	<b>-31,887</b>	<b>337,265</b>	<b>372,890</b>	<b>-29,101</b>	<b>343,789</b>	<b>-6,524</b>

(millions of euro)

Figures restated where required by international accounting standards and, where necessary, considering the changes in the scope of consolidation and discontinued operations.

The table above shows an increase for the first nine months of 2014 of non-performing loans, net of adjustments, by 1,630 million euro (+5.3%), compared to the end of the previous year. This trend led to a higher incidence of non-performing loans on total loans to customers, increasing from 9% to 9.7%. Coverage of non-performing loans came to approximately 47.2%, higher than the level at the end of 2013 (46%), and is deemed adequate to meet the expected losses, also considering the guarantees securing the positions.

In particular, as at 30 September 2014, doubtful loans, net of adjustments, reached 13.6 billion euro, up 5.8% since the beginning of the year. The incidence on total loans was 4%, with a coverage ratio of 63.3%.

Compared to 31 December 2013, substandard loans increased 8.7% to 15 billion euro. Substandard loans as a proportion of total loans to customers increased from 4% to 4.5% in the first nine months of the year, and the coverage ratio, adequate for the risk intrinsic to this portfolio, was 24.3%, slightly above the figure at the end of the prior year.

Restructured loans stood at 2,321 million euro, essentially unchanged compared to the beginning of the year, with a coverage ratio of 17.7%, up from 15.1% in the previous year.

Past due loans recorded a decrease of 320 million euro (-16.3%) to 1,638 million euro from 1,958 million euro for the previous year. This type of non-performing loans accounted for 0.5% of the total. The coverage ratio came to 13.4%, compared with 12.3% as at the end of 2013.

Performing exposures decreased, from 297.9 billion euro in the previous year to 290.7 billion euro. In this context, the cumulated collective adjustments on these loans totalled 0.8% of the gross exposure to customers, a value that is essentially in line with the figure recorded at the end of the previous year.

## MARKET RISKS

### TRADING BOOK

The quantification of trading risks is based on daily and periodic VaR of the trading portfolios of Intesa Sanpaolo and Banca IMI, which represent 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.

Other Group subsidiaries hold smaller trading portfolios with a marginal risk (around 1% of the Group's overall 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.

For some of the risk factors indicated above, the Supervisory Authority has validated the internal models for the reporting of the capital absorptions of both Intesa Sanpaolo and Banca IMI.

Effective from the report as at 30 September 2012, both banks have received authorisation from the Supervisory Authority to extend the scope of the model to specific risk on debt securities. The model was extended on the basis of the current methodological framework (a historical simulation in full evaluation), and required the integration of the Incremental Risk Charge into the calculation of the capital requirement for market risks.

Effective from June 2014, market risks are to be reported according to the internal model for capital requirements for the Parent Company's hedge fund portfolios (the full look-through approach).

The risk profiles validated are: (i) generic/specific on debt securities and on equities for Intesa Sanpaolo and Banca IMI, (ii) position risk on quotas of UCI underlying CPPI (Constant Proportion Portfolio Insurance) products for Banca IMI, (iii) position risk on dividend derivatives and (iv) position risk on commodities for Banca IMI, the only legal entity in the Group authorised to hold open positions in commodities.

The requirement for stressed VaR is included when determining capital absorption effective from 31 December 2011. 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 portfolios of Intesa Sanpaolo and Banca IMI;
- the period must allow real historical series to be used for all portfolio risk factors.

In keeping with the historical simulation approach employed to calculate VaR, the latter point is a discriminating condition in the selection of the holding period. In fact, 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 relevant to the measurement of stressed VaR had been set as 1 January to 31 December 2011 for Intesa Sanpaolo and at 1 July 2011 to 30 June 2012 for Banca IMI.

The analysis of market risk profiles relative to the trading book 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, hedge funds).

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

The following paragraphs provide the estimates and evolution of VaR, defined as the sum of VaR and of the simulation on illiquid parameters, for the trading book of Intesa Sanpaolo and Banca IMI.

In the third quarter of 2014, market risks generated by Intesa Sanpaolo and Banca IMI decreased slightly with respect to the averages for the second quarter of 2014. The average VaR for the period totalled 42.2 million euro.

## Daily VaR of the trading portfolio for Intesa Sanpaolo and Banca IMI

(millions of euro)

Var <sup>(a)</sup>	2014					2013			
	average 3 <sup>rd</sup> quarter	minimum 3 <sup>rd</sup> quarter	maximum 3 <sup>rd</sup> quarter	average 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
Intesa Sanpaolo	9.3	7.4	11.9	9.6	9.4	10.5	8.2	11.7	14.1
Banca IMI	32.9	26.9	45.4	35.0	37.0	38.6	39.3	50.8	59.0
<b>Total</b>	<b>42.2</b>	<b>36.0</b>	<b>53.7</b>	<b>44.7</b>	<b>46.5</b>	<b>49.2</b>	<b>47.6</b>	<b>62.5</b>	<b>73.2</b>

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

During the first nine months of 2014, market risks generated by Intesa Sanpaolo and Banca IMI decreased significantly with respect to the values for 2013.

(millions of euro)

Var <sup>(a)</sup>	2014			2013		
	average 30.09	minimum 30.09	maximum 30.09	average 30.09	minimum 30.09	maximum 30.09
Intesa Sanpaolo	9.4	7.3	12.0	11.3	6.4	18.1
Banca IMI	35.0	23.8	45.7	49.6	31.1	74.2
<b>Total</b>	<b>44.4</b>	<b>32.0</b>	<b>55.5</b>	<b>61.0</b>	<b>37.8</b>	<b>88.5</b>

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

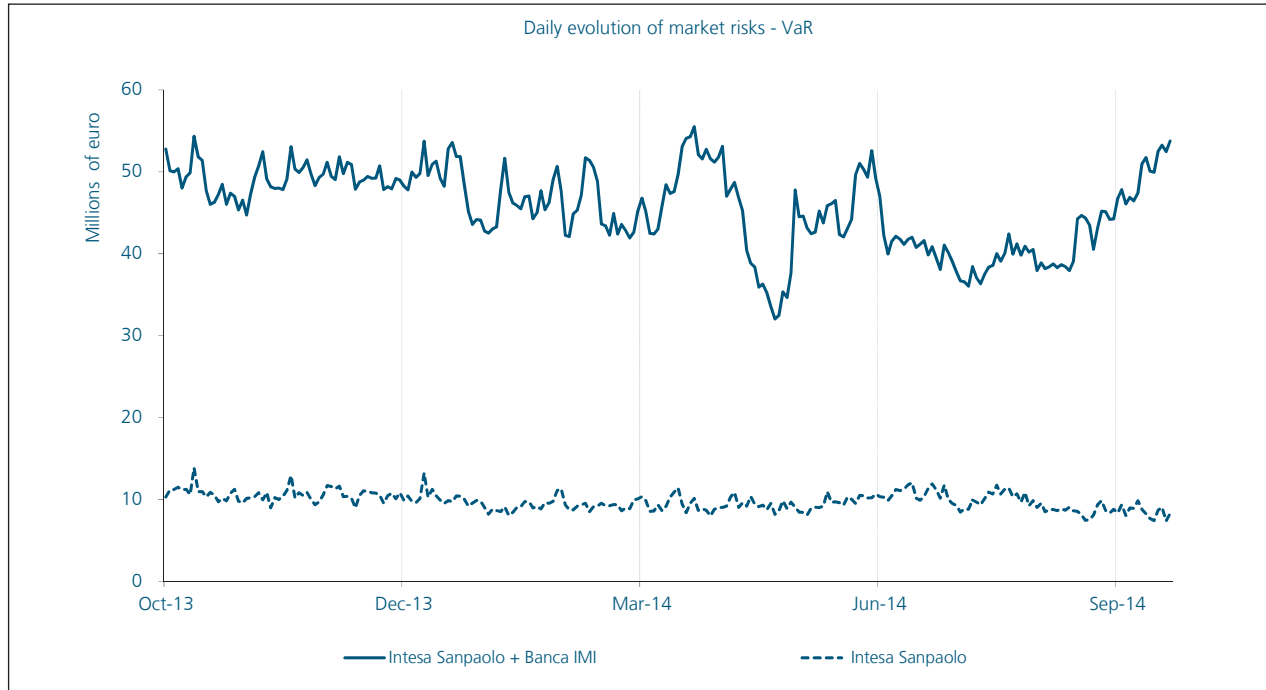
For Intesa Sanpaolo, the breakdown of risk profile in the third quarter of 2014, with regard to the various factors, shows a general prevalence of the risk generated by the equity component (invested through hedge funds), which accounted for 46% of total VaR. The percentage presented under "Hedge funds" refers solely to quotas for which full transparency is not available and whose risk is calculated according to the "illiquid parameters" method. In the case of Banca IMI, credit spread risk was predominant, at 60% of total VaR.

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

3 <sup>rd</sup> quarter 2014	Shares	Hedge funds	Rates	Credit spreads	Foreign exchange rates	Other parameters	Commodities
Intesa Sanpaolo	46%	9%	11%	25%	8%	1%	0%
Banca IMI	7%	0%	7%	60%	1%	21%	4%
<b>Total</b>	<b>16%</b>	<b>2%</b>	<b>8%</b>	<b>52%</b>	<b>3%</b>	<b>16%</b>	<b>3%</b>

<sup>(a)</sup> Each line in the table sets out the contribution of risk factors considering 100% the overall capital at risk, calculated as the average of daily estimates in the third quarter of 2013, broken down between Intesa Sanpaolo and Banca IMI and indicating the distribution of overall capital at risk.

The evolution of VaR in the last twelve months is set out below. Risk measures declined slightly on average in the first nine months of 2014. In September 2014 there was an increase in risk for Banca IMI due to the greater exposures to Italian and Spanish government bonds (assumed within the context of the limits approved by the Risk Appetite Framework).



Risk control with regard to the trading activity of Intesa Sanpaolo and Banca IMI also uses scenario analyses and stress tests. The impact on the income statement of selected scenarios relating to the evolution of stock prices, interest rates, credit spreads, foreign exchange rates and commodity prices at the end of September is summarised as follows:

- on stock market positions, a bullish scenario, that is a 5% increase in stock prices with a simultaneous 10% decrease in volatility would have led to a 20 million euro gain or to a -20 million euro loss in the opposite scenario;
- on interest rate exposures, a parallel +70 basis point shift (average) would have led to a 123 million euro loss, whereas a parallel shift in the euro curve with near zero rates would have led to potential gains of 270 million euro;
- on exposures sensitive to credit spread fluctuations, a 25 basis point widening in spreads would have led to a 226 million euro loss;
- on foreign exchange exposures, a decrease of the euro against the other currencies would have led to a loss of approximately 4 million euro;
- finally, on commodities exposures, a 50% increase in the prices of the underlying would have led to a 47 million euro loss.

(millions of euro)

	EQUITY		INTEREST RATES		CREDIT SPREADS		FOREIGN EXCHANGE RATES		COMMODITY	
	volatility +10% and prices -5%	volatility -10% and prices +5%	+70bp	lower rate	-25bp	+25bp	-10%	+10%	-50%	+50%
Total	-20	20	-123	270	228	-226	-4	-9	64	-47

**Backtesting**

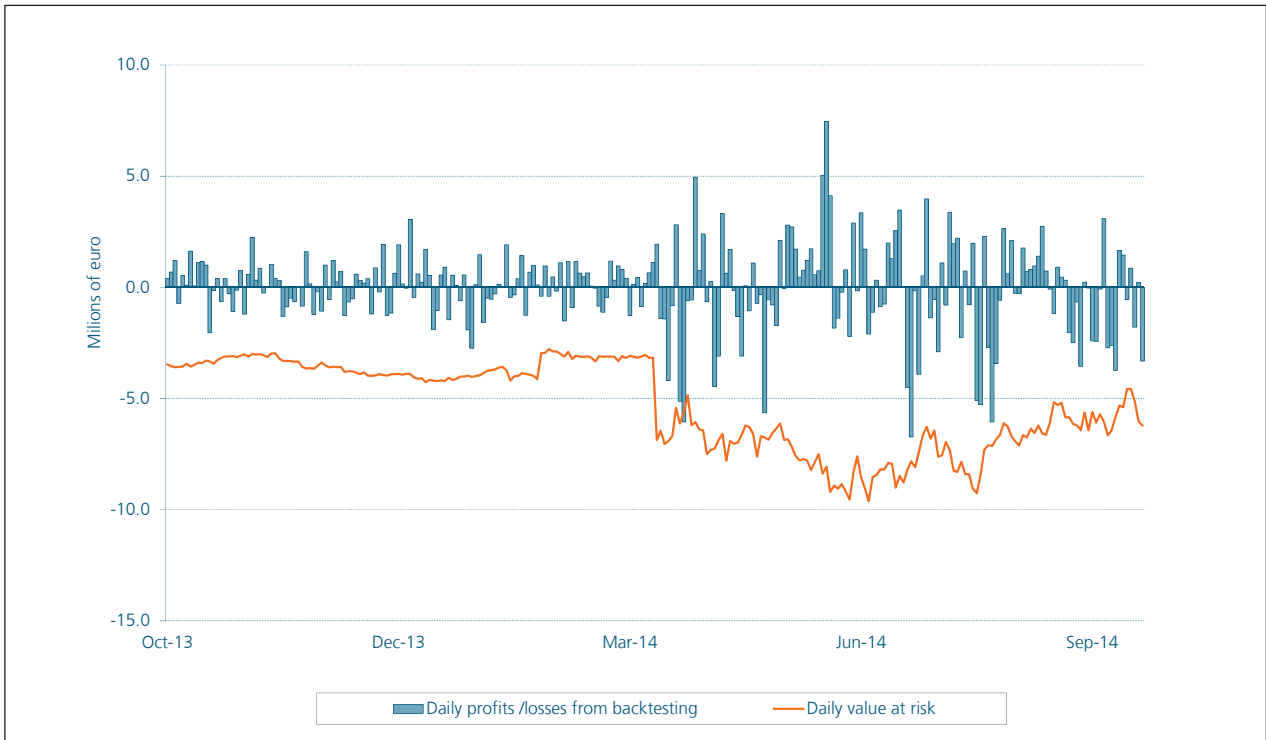
The effectiveness of the VaR calculation methods must be monitored daily via backtesting which, as concerns regulatory backtesting, compares:

- the daily estimates of value at risk;
- the daily profits/losses based on backtesting which are determined using actual daily profits and losses achieved by individual desks, net of components which are not considered in backtesting such as commissions and intraday activities.

Backtesting allows verification of the model’s capability of correctly seizing, from a statistical viewpoint, the variability in the daily valuation of trading positions, covering an observation period of one year (approximately 250 estimates). Any critical situations relative to the adequacy of the Internal Model are represented by situations in which daily profits/losses based on backtesting highlight more than three occasions, in the year of observation, in which the daily loss is higher than the value at risk estimate. Current regulations require that backtesting is performed by taking into consideration both the actual P&L series recorded and the theoretical series. The latter is based on valuation of the portfolio value through the use of pricing models adopted for the VaR measurement calculation. The number of significant backtesting exceptions is determined as the maximum between those for actual P&L and theoretical P&L.

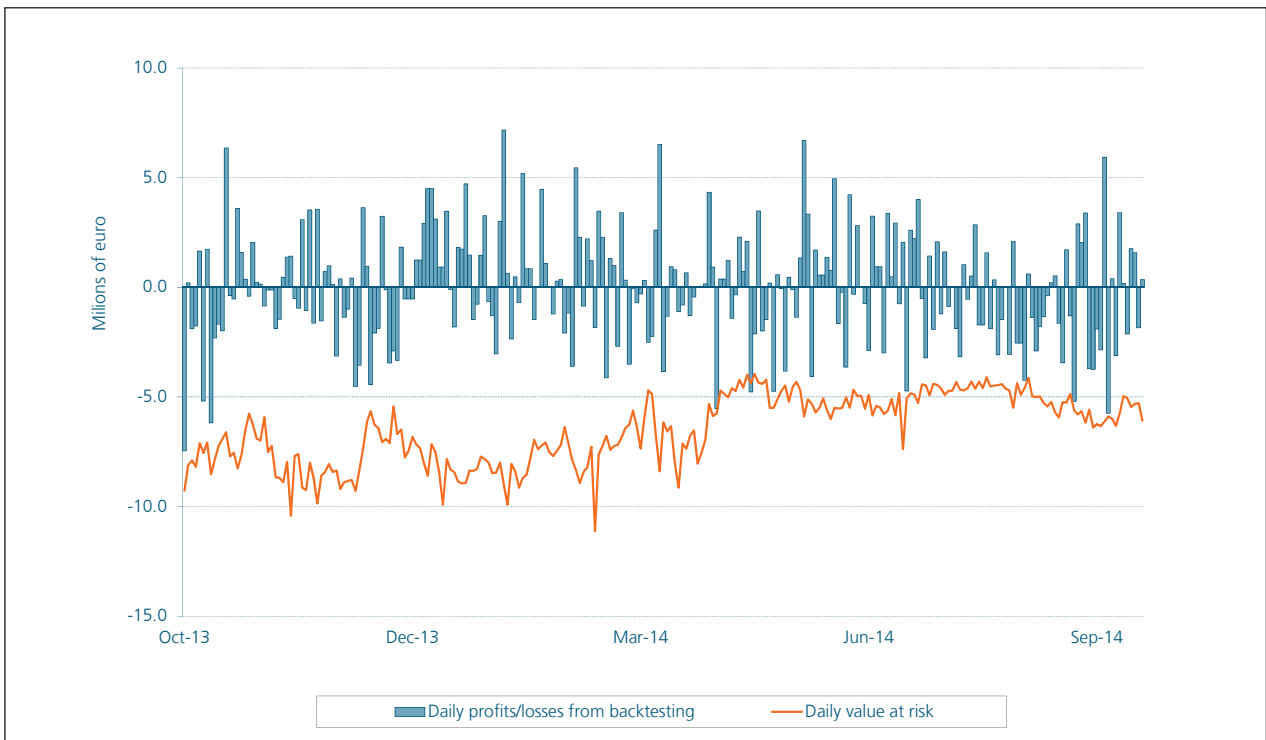
### Backtesting in Intesa Sanpaolo

There was a single exception to theoretical backtesting during the last year. The loss is to be attributed to the performance of stock prices in April 2014.



### Backtesting in Banca IMI

Banca IMI's backtesting exception refers to the actual P&L data. The loss is to be attributed to the fluctuation of Italian stock prices since early May 2014.



## BANKING BOOK

Market risk originated by the banking book arises primarily in the Parent Company and in the other main Group companies involved in retail and corporate banking. The banking book also includes exposure to market risks deriving from the equity investments in quoted companies not fully consolidated, mostly held by the Parent Company and by Equiter, IMI Investimenti and Private Equity International.

The following methods are used to measure financial risks of the Group's banking book:

- Value at Risk (VaR);
- Sensitivity Analysis.

Value at Risk is calculated as the maximum potential loss in the portfolio's market value that could be recorded over a 10-day holding period with a 99% confidence level (parametric VaR).

Shift sensitivity analysis quantifies the change in value of a financial portfolio resulting from adverse movements in the main risk factors (interest rate, foreign exchange, equity). For interest rate risk, an adverse movement is defined as a parallel and uniform shift of  $\pm 100$  basis points of the interest rate curve. The measurements include an estimate of the prepayment effect and of the risk originated by customer demand loans and deposits. Furthermore, interest margin sensitivity is measured by quantifying the impact on net interest income of a parallel and instantaneous shock in the interest rate curve of  $\pm 100$  basis points, over a period of 12 months. This measure highlights the effect of variations in interest rates on the portfolio that is being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a forecast indicator of the future levels of the interest margin.

Hedging of interest rate risk is aimed at (i) protecting the banking book from variations in the fair value of loans and deposits due to movements in the interest rate curve or (ii) reducing the volatility of future cash flows related to a particular asset/liability. The main types of derivative contracts used are interest rate swaps (IRS), overnight index swaps (OIS), cross-currency swaps (CCS) and options on interest rates stipulated with third parties or with other Group companies. The latter, in turn, cover risk in the market so that the hedging transactions meet the criteria to qualify as IAS-compliant for consolidated financial statements.

Hedging activities performed by the Intesa Sanpaolo Group are recorded using various hedge accounting methods. A first method refers to the fair value hedge of specifically identified assets or liabilities (micro-hedging), mainly consisting of bonds issued or acquired by Group companies and loans to customers. In addition, macro-hedging is carried out on the stable portion of on demand deposits and in order to hedge against fair value changes intrinsic to the instalments under accrual generated by floating rate operations. The Group is exposed to this risk from the date on which the rate is set and the interest payment date.

Another hedging method used is the cash flow hedge, which has the purpose of stabilising interest flow on both variable rate funding, to the extent that the latter finances fixed-rate investments, and on variable rate investments to cover fixed-rate funding (macro cash flow hedges).

The Risk Management Department is in charge of measuring the effectiveness of interest rate risk hedges for the purpose of hedge accounting.

In the first nine months of 2014, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity analysis, registered an average value of 123 million euro settling at 109 million euro at the end of September, almost entirely concentrated on the euro currency; this figure compares with 206 million euro at the end of 2013.

Interest margin sensitivity – assuming a 100 basis point change in interest rates – amounted to 257 million euro at the end of September 2014 (264 million euro at the end of 2013).

Interest rate risk, measured in terms of VaR, averaged 19 million euro during the first nine months of 2014 (40 million euro at the end of 2013), with a maximum value of 28 million euro and a minimum value of 9 million euro; the latter figure coincides with the value at the end of September. Price risk generated by minority stakes in listed companies, mostly held in the AFS (Available for Sale) category and measured in terms of VaR, recorded an average level of 42 million euro in the first nine months of 2014 (33 million euro at the end of 2013), with a minimum value of 30 million euro and a maximum value of 60 million euro. The VaR at the end of September amounted to 41 million euro.

Lastly, an analysis of banking book sensitivity to price risk, measuring the impact on Shareholders' Equity of a price shock on the above quoted assets recorded in the AFS category shows sensitivity to a 10% negative shock equal to 9 million euro at the end of September 2014.



## 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).

The arrangement of a suitable control and management system for that specific risk has a fundamental role in maintaining stability, not only at the level of each individual bank, but also of the market as a whole, given that imbalances within a single financial institution may have systemic repercussions. Such a system must be integrated into the overall risk management system and provide for incisive controls consistent with developments in the context of reference.

To reflect the new Basel 3 liquidity requirements, which in June 2013 were adopted by the European Union with the publication of Directive 2013/36/EU and Regulation 575/2013 (known as CRD IV and CRR), in December 2013 the Corporate Bodies of Intesa Sanpaolo updated the Liquidity Policy by replacing, starting from January 2014, the previous internal indicators with the LCR (Liquidity Coverage Ratio) and the NSFR (Net Stable Funding Ratio) metrics. 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. The key principles underpinning the Liquidity Policy of the Intesa Sanpaolo Group are:

- the existence of liquidity management guidelines approved by senior management and clearly disseminated throughout the bank;
- the existence of an operating structure that works within set limits and of a control structure that is independent from the operating structure;
- the constant availability of adequate liquidity reserves in relation to the pre-determined liquidity risk tolerance threshold;
- the assessment of the impact of various scenarios, including stress testing scenarios, on the cash inflows and outflows over time and the quantitative and qualitative adequacy of liquidity reserves;
- the adoption of an internal fund transfer pricing system that accurately incorporates the cost/benefit of liquidity, on the basis of the Intesa Sanpaolo Group's funding conditions.

From an organisational standpoint, a detailed definition is prepared of the tasks assigned to the strategic and management supervision 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.

The departments of the Parent Company that are in charge of ensuring the correct application of the Guidelines are, in particular, the Treasury Department and the Planning, Strategic ALM and Capital Management Department, responsible for liquidity management, and the Risk Management Department, directly responsible for measuring liquidity risk on a consolidated basis.

With regard to liquidity risk measurement metrics and mitigation tools, in addition to defining the methodological system for measuring short-term and structural liquidity indicators, the Group also formalises the maximum tolerance threshold (risk appetite) for liquidity risk, the criteria for defining liquidity reserves and the rules and parameters for conducting stress tests.

The short-term Liquidity Policy is aimed at ensuring an adequate, balanced level of cash inflows and outflows with certain or estimated maturities included in 12 months' time horizon, in order to face to periods of tension, including extended ones, on different funding markets, also by establishing adequate liquidity reserves in the form of assets eligible for refinancing with Central Banks or liquid securities on private markets. To that end, and in keeping with the liquidity risk appetite, the system of limits consists of two short-term indicators for holding periods of one week (cumulative projected imbalance in wholesale operations) and of one month (Liquidity Coverage Ratio).

The cumulative projected wholesale imbalances indicator measures the Bank's independence from unsecured wholesale funding in the event of a freeze of the money market and aims to ensure financial autonomy, assuming the use on the market of only the highest quality liquidity reserves. 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 a 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 the Regulations. The LCR requirement will gradually come into force, starting with a percentage of 60% from 2015.

The aim of Intesa Sanpaolo Group's structural Liquidity Policy is to adopt the structural requirement provided for by the regulatory provisions of Basel 3: Net Stable Funding Ratio. 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. NSFR's regulatory requirement, which is still subject to a period of observation, will come into force starting from 1 January 2018.

Within the Liquidity Policy it is also envisaged the time extension of the stress scenario for LCR indicator, provided by the new regulatory framework, measuring, for up to 3 months, the effect of specific acute liquidity tensions (at bank level) combined with a widespread and general market crisis. The internal management guidelines also envisage an alert threshold (Stressed soft ratio) for the LCR indicator up to 3 months, 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 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, the immediate lines of action, and the intervention measures for the resolution of emergencies. The early warning indexes, aimed at spotting the signs of a potential liquidity strain, both systematic and specific, are monitored with daily frequency by the Risk Management Department.

In the first nine months of 2014 the Group's liquidity position remained largely within the limits provided for in the Group's Liquidity Policy in force: both regulatory indicators envisaged by Basel 3 (LCR and NSFR) were met, already reaching a level above the limits under normal conditions. As at 30 September 2014, the liquidity reserves eligible with the various Central Banks came to 102 billion euro (124 billion euro at the end of December 2013), of which 81 billion euro, net of haircut, was available spot (88 billion euro at the end of December 2013) and remained unused.

Also the stress tests, when considering the high availability of liquidity reserves (liquid or eligible), yielded results in excess of the target threshold for the ISP 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 provided to company bodies and internal committees in order to ensure full awareness and manageability of the main 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 finance transactions, hedge fund investments and transactions in derivatives with customers.

## FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND LIABILITIES

### General principles

This chapter summarises the criteria used by the Group to measure the fair value of financial instruments. These criteria are unchanged with respect to those adopted for the previous year financial statements, details of which can be found in the Annual Report 2013.

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (i.e. not as part of the compulsory liquidation or a below-cost sale) as at the measurement date. Fair value is a market measurement criterion, not specifically referring to a single entity. Underlying the definition of fair value is the assumption that the company is carrying out normal operations, without any intention of liquidating its assets, significantly reducing the level of operations or carrying out transactions at unfavourable conditions.

An entity has to measure the fair value of an asset or liability by adopting the assumptions that would be used by market participants when pricing an asset or liability, presuming that they act with a view to satisfying their own economic interest in the best way possible.

The fair value of financial instruments is determined according to a hierarchy of criteria based on the origin, type and quality of the information used. In detail, this hierarchy assigns top priority to quoted prices (unadjusted) in active markets and less importance to unobservable inputs. Three different levels of input are identified:

- level 1: input represented by quoted prices (unadjusted) in active markets for identical assets or liabilities accessible by the entity as at the measurement date;
- level 2: input other than quoted prices included in level 1 that are directly or indirectly observable for the assets or liabilities to be measured;
- level 3: unobservable input for the asset or liability.

As **level 1** inputs are available for many financial assets and liabilities, some of which are traded in more than one active market, the company must pay particular attention to defining both of the following aspects:

- the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability;
- whether the company can complete a transaction involving the asset or liability at that price and in that market as at the measurement date.

The Intesa Sanpaolo Group considers the principal market of a financial asset or liability to be the market in which the Group generally operates.

A market is regarded as active if quoted prices, representing actual and regularly occurring market transactions considering a normal reference period, are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency.

In specific cases regulated by internal policies and despite being quoted on regulated markets, research is carried out in order to verify the significance of official market values.

In the event of a significant reduction in the volume or level of operations compared to normal operations for the asset or liability (or for similar assets or liabilities) highlighted by a number of indicators (number of transactions, limited significance of market prices, significant increase in implicit premiums for liquidity risk, expansion or increase of the bid-ask spread, reduction or total lack of market for new issues, limited publicly-available information), analyses of the transactions or of the quoted prices are carried out.

The following are considered as level 1 financial instruments: contributed equities, bonds quoted on the EuroMTS circuit, those for which it is possible to continuously derive from the main price contribution international platforms at least three bid and ask prices, and those for which prices are provided by the Markit platform, with at least three bid and ask prices for bonds and convertibles and at least five bid and ask prices for European ABSs, harmonised mutual funds contributed, spot exchange rates, and derivatives for which quotations are available on an active market (for example, futures and exchange traded options). Finally, level 1 instruments also include hedge funds for which the fund administrator provides the NAV (Net Asset Value) with the frequency established in the subscription contract, and the check list, which is the summary document of significant information on underlying assets of the fund, does not highlight any critical points in terms of liquidity risk or counterparty risk.

For level 1 financial instruments, the current bid price is used for financial assets and the current asking price for financial liabilities, struck on the principal active market at the close 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.

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 quotation 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);
- valuations performed using – in whole or in part but primarily – inputs not identified from parameters observed on the market, for which estimates and assumptions made by the valuator are used (level 3).

In the case of level 2 inputs, the valuation is not based on the price of the same financial instrument to be measured, but on prices or credit spreads presumed from official listing of instruments which are similar in terms of risk factors, using a given calculation methodology (pricing 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 quotes of financial instruments present on active markets or fixed at levels capable of reproducing quotes on active markets – that significantly influence the final valuation.

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;
- derivatives measured through specific pricing models, fed by input parameters (such as yield, foreign exchange and volatility curves) observed on the market;
- ABSs for which significant prices are not available and whose fair value is measured using valuation techniques that consider parameters which may be presumed from the market;
- equities 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, using, therefore, the "relative" valuation models based on multipliers;
- loans measured through the discounting of future cash flows.

The calculation of the fair value of certain types of financial instruments is based on valuation models which consider parameters not directly observable on the market, therefore implying estimates and assumptions on the part of the valuator (level 3). 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 under the Mark-to-Model Approach:

- debt securities for which at least one significant input for the purposes of calculating fair value is not observable on the market;
- debt securities and complex credit derivatives (CDOs and some ABSs) included among structured credit products and credit derivatives on index tranches;
- hedge funds not included in level 1;
- shareholding and other equities measured using models based on discounted cash flows;
- some loans, of a smaller amount, classified in the available-for-sale portfolio;
- derivative transactions relating to securitisations and equity-risk structured options;
- some OTC interest-rate derivatives relating to correlations between CMS (Constant Maturity Swap) rates;
- some commodities options;
- derivatives with counterparties in default;
- some derivatives for which the bCVA is calculated through the use of historical PD with a significant impact on the transaction's total fair value.

Regarding the valuation techniques used for financial instruments (securities, derivatives, structured products, hedge funds) classified within levels 2 and 3 of the fair value hierarchy, no changes are recorded compared to the description in the Annual Report 2013.

In particular, in valuing the derivative contracts, the Group considers the (own and counterparty) non-performance risk which is calculated through the bilateral Credit Value Adjustment method. Valuation of the "credit risk free" component of OTC derivatives determines the initial choice of the level of the fair value hierarchy, according to the level of observability of market parameters. Calculation of the component linked to the insolvency risk of the counterparty/issuer, with unobservable parameters such as historical PD, may involve reclassification to level 3 of the fair value hierarchy.

With regard to the attribution of fair value hierarchy levels, it is also underlined that, for the hedge funds managed through the Managed Account Fund (MAF) platform, the platform's characteristics make it possible to perform an analysis of the financial instruments underlying the funds and to assign the fair value hierarchy level based on the prevalence, in terms of percentage of NAV, of the weight of assets priced according to the various levels.

The Intesa Sanpaolo Group governs and defines the fair value measurement of financial instruments through the Group's Fair Value Policy, prepared by the Risk Management Department and also applied to the Parent Company and to all consolidated subsidiaries. The first part of the document, "General principles", once a favourable opinion has been given by the Group Financial Risks Committee and the Managing Director and CEO, is approved and revised at least on an annual basis by the Management Board, and specific notice thereof is given to the Control Committee and the Financial Statements Committee. The second part, "Detailed methods", is reviewed, approved and revised at least on an annual basis by the Group Financial

Risks Committee, which is specifically delegated to do so by the Management Bodies, and which also reviews material changes and updates, proposal of which falls to the Risk Management Department.

The valuation process for financial instruments (as described in the "Fair Value Policy") entails the following phases:

- identification of the sources for measurements: for each asset class, the Market Data Reference Guide establishes the processes necessary to identify market parameters and the means according to which such data must be extracted and used;
- certification and treatment of market data for measurements: this stage consists of the accurate verification of the market parameters used (verifying the integrity of data contained on the proprietary platform with respect to the source of contribution), reliability tests (consistency of each single figure with similar or comparable figures) and verification of concrete application means;
- certification of pricing models and Model Risk Assessment: this phase is aimed at verifying the consistency and the adherence of the various measurement techniques used with current market practice, at highlighting any critical aspects in the pricing models used and at determining any adjustments necessary for measurement;
- monitoring consistency of pricing models over time: periodical monitoring of the adherence to the market of the pricing model in order to discover any gaps promptly and start the necessary verifications and interventions.

### Fair value hierarchy

The table below shows financial assets and liabilities designated at fair value through profit and loss broken down by fair value hierarchy levels.

Compared to the information provided in the 2013 financial statements, the Group did not amend the guidelines based on which level changes are carried out within the fair value hierarchy.

(millions of euro)

Assets / liabilities at fair value	30.09.2014			31.12.2013		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	19,198	35,474	773	16,938	31,309	753
2. Financial assets designated at fair value through profit or loss	37,739	2,024	434	32,374	3,004	383
3. Financial assets available for sale	104,980	5,299	5,112	105,489	4,196	5,608
4. Hedging derivatives	-	8,997	-	-	7,533	1
5. Property and equipment	-	-	-	-	-	-
6. Intangible assets	-	-	-	-	-	-
<b>Total</b>	<b>161,917</b>	<b>51,794</b>	<b>6,319</b>	<b>154,801</b>	<b>46,042</b>	<b>6,745</b>
1. Financial liabilities held for trading	4,815	39,673	85	7,063	31,756	400
2. Financial liabilities designated at fair value through profit or loss	-	35,461	-	-	30,733	-
3. Hedging derivatives	-	9,374	10	-	7,577	13
<b>Total</b>	<b>4,815</b>	<b>84,508</b>	<b>95</b>	<b>7,063</b>	<b>70,066</b>	<b>413</b>

Figures restated where required by international accounting standards and, where necessary, considering the changes in the scope of consolidation and discontinued operations.

As shown in the table, level 3 instruments, which allow for more discretion in fair value measurement, still account for a limited portion of the financial instruments portfolio, with percentages reaching approximately 2.9% for financial assets and 0.1% for financial liabilities, down compared to the percentages of December 2013.

Approximately 74% of financial assets measured at fair value are determined based on market prices, and therefore without any discretion by the valuator.

The sensitivity analysis performed on level 3 structured credit products highlights a negative change in fair value, referring to complex credit derivatives, for an amount not material<sup>3</sup> when the following parameters change:

- risk-neutral probability of default derived from market spreads (10%);
- recovery rate (from 5% to 25%, based on the type of risk of the underlying product);
- correlation between the value of collaterals present in the structure (from 25% to 80%, based on the type of risk of the underlying product);
- expected residual life of the contract (one-year increase over the expected term).

<sup>3</sup> This amount is shown net of the adjustments to valuations relating to the main input parameters which were already considered to determine the fair value of financial instruments (see paragraph "Fair value measurement of financial assets and liabilities" above).

## STRUCTURED CREDIT PRODUCTS

The risk exposure to structured credit products amounted to 2,272 million euro as at 30 September 2014 with respect to funded and unfunded ABSs/CDOs, compared to 2,033 million euro as at 31 December 2013, in addition to an exposure of 26 million euro with respect to structured packages, in line with the exposure as at 31 December 2013.

The rise in the exposure (from 1,068 million euro in December 2013 to 1,562 million euro in September 2014) classified in the trading portfolio is largely attributable to higher investments in ABSs by the subsidiary Banca IMI, part of which was classified to the available-for-sale portfolio.

With regard to the exposure represented by securities classified under the loan portfolio, on the other hand, a significant decrease was recorded (from 965 million euro in December 2013 to 710 million euro in September 2014), almost entirely attributable to the Parent Company loan portfolio and for the most part due to sales. In detail, an early payment of approximately 78 million euro was recorded for one of securities classified in the funded super-senior CDO segment in the third quarter.

From an income statement perspective, structured credit products generated a net income of 35 million euro as at 30 September 2014 compared to 67 million euro at the end of 2013 and 76 million euro as at 30 September 2013.

The exposure to funded and unfunded ABSs/CDOs had an effect on "Profits (Losses) on trading – Caption 80" of 35 million euro. The profit on this segment was a result of the effects of:

- unfunded Super CDO positions for +3 million euro;
- European and US funded ABSs/CDOs (+33 million euro), entirely attributable to the subsidiary Banca IMI. The impact was the result of the profits realised on the partial disposal of the trading book (16 million euro) and of the revaluation of outstanding positions (17 million euro);
- the negative contribution of the subprime exposure for 2 million euro;
- unfunded Multisector CDO positions for 3 million euro;
- other unfunded positions for -2 million euro.

As regards the exposure to funded and unfunded ABSs/CDOs, it should be noted that the securities classified by the subsidiary Banca IMI to the available-for-sale portfolio recorded an increase in fair value of 4 million euro, accounted for in the specific shareholders' equity reserve.

The securities reclassified to the loan portfolio had a positive impact of 1 million euro on the income statement as at 30 September 2014. This result is the combination of the 7 million euro in profits realised on the sale of positions and 6 million euro in impairment losses on a number of securities included in the portfolio.

The "Monoline risk" and "Non-monoline packages" made a contribution of -1 million euro to "Profits (Losses) on trading – caption 80" as at 30 September 2014, compared to the positive result of 40 million euro recorded as at 31 December 2013. The segment trend reflects the spread volatility for the counterparty on which this exposure is concentrated.

## 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 are considered Special Purpose Entities (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 (CBs), developing and/or financing specific business initiatives, undertaking leveraged buy-out transactions, or managing credit risk inherent in an entity's portfolio).

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

For consolidation purposes, note that the implementation of the new standard IFRS 10 caused the deconsolidation of insurance SPEs (UCIs underlying insurance policies), the risk of which is borne by the insured parties rather than by the Group company.

No amendments to the consolidation criteria applied in the 2013 Financial Statements are reported for the other SPE categories.

With regard to funding SPEs, used by the Intesa Sanpaolo Group to raise funds on certain markets through the issue of financial instruments, typically guaranteed by Intesa Sanpaolo, there was an increase in the funding of the US vehicle company Intesa Funding LLC, which came to over 600 million euro at the end of September 2014 (value of funding of 300 million euro as at 31 December 2013).

This increase was tied to heightened interest by US institutional investors in securities issued by Intesa Sanpaolo, in line with a greater appetite for Italy risk on financial markets. The average duration of the securities remains very short.

There were no issues of Covered Bonds in the third quarter of 2014. For the details of transactions in the first half of 2014, reference should be made to the Half-Yearly Report.

There were no significant changes to the other categories of SPEs subject to disclosure. Accordingly, reference should be made to the 2013 Financial Statements.

## LEVERAGED FINANCE TRANSACTIONS

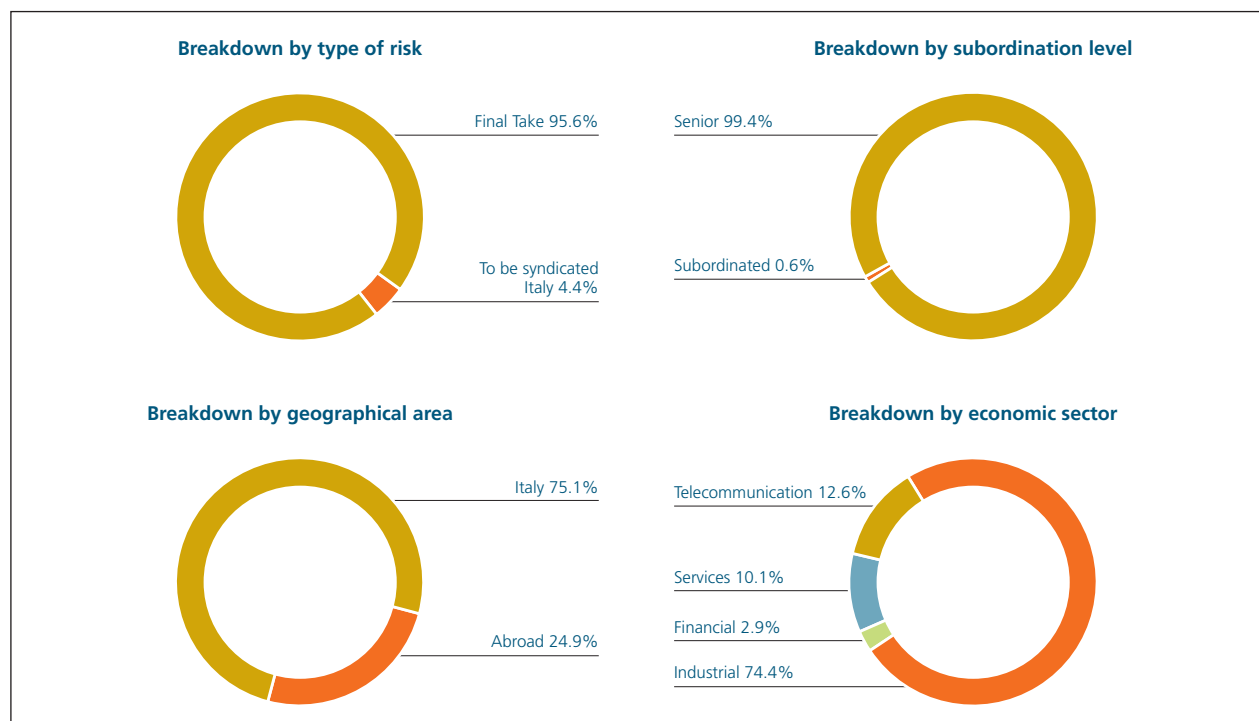
Since there is no univocal and universally agreed-upon definition of leveraged finance transactions, Intesa Sanpaolo decided to include in this category the exposures (loans granted and disbursed in relation to structured financing operations, normally medium/long term) to legal entities in which the majority of share capital is held by private equity funds.

These are mainly positions in support of Leveraged Buy Out projects (therefore with high financial leverage), i.e. linked to the full or partial acquisition of companies through recourse to SPEs created for this purpose. After acquisition of the target company's shares/quotas package, these SPEs are normally merged into the target. The target companies generally have good economic prospects, stable cash flows in the medium term and low original leverage levels. Intesa Sanpaolo has financed entities of this type, as normal borrowers, without acting as sponsor.



None of these SPEs is consolidated, since the guarantees to support the transaction are solely instrumental for the granting of the financing and are never directed to the acquisition of direct or indirect control over the vehicle.

As at 30 September 2014, 111 transactions for a total amount granted of 3,027 million euro met the above definition. These exposures are classified under the loans portfolio. They also include the portions of syndicated loans underwritten or under syndication. In line with disclosure requirements, breakdown of exposures by geographical area, economic sector and by level of subordination is set out below.



#### INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The hedge fund portfolio as at 30 September 2014 totalled 772 million euro, compared to 744 million euro recorded in December 2013. An analysis of changes in the portfolio shows distributions and redemptions during the period, which, however, were more than offset by the increase in the value in euro of the positions in US dollars due to the sharp appreciation of the foreign currency.

As at the same date, the overall result of the investments in this segment was positive for 15 million euro, compared to 35 million euro of the "Profits (Losses) on trading – caption 80" as at 30 September 2013.

The 15 million euro of net profit, recognised as at 30 September 2014 under "Profits (Losses) on trading – caption 80", included:

- 6 million euro from net valuations of positions outstanding as at the end of September 2014;
- 2 million euro representing net profit realised from the trading of fund quotas;
- 7 million euro consisting of other income attributable to profits on foreign exchange transactions.

Net capital gains on the final residual amount (6 million euro) were spread across 27 positions, 14 of which with capital gains (26 million euro) and 13 with capital losses (20 million euro).

During the third quarter of 2014, there were no noteworthy changes in the portfolio's overall strategy, which still remains prevalently directed towards benefiting from the implementation of specific corporate events, typically independent from the general market trend.

#### INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering only relations with customers, as at 30 September 2014, 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 7,360 million euro (5,542 million euro as at 31 December 2013). The notional value of such derivatives totalled 52,950 million euro (54,087 million euro as at 31 December 2013).

Please note that the positive fair value of contracts outstanding with the 10 customers with the highest exposures was 4,983 million euro (3,610 million euro as at 31 December 2013).

Conversely, negative fair value determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 1,015 million euro as at 30 September 2014 (606 million euro as at 31 December 2013).

The notional value of such derivatives totalled 18,054 million euro (17,627 million euro as at 31 December 2013).

The fair value of derivative financial instruments stipulated with customers was determined considering, as for all other OTC derivatives, the creditworthiness of the single counterparty ("Bilateral Credit Value Adjustment"). With regard to contracts outstanding as at 30 September 2014, this led to a negative effect of 49 million euro being recorded under "Profits (Losses) on trading" in the income statement.

As regards the means of calculation of the aforesaid Bilateral Credit Risk Adjustment and, in general, the various methodologies used in the determination of the fair value of financial instruments, see the specific paragraphs in this chapter.

## OPERATIONAL RISK

Operational risk is defined as the risk of suffering losses due to inadequacy or failures of processes, human resources and internal systems, or as a result of external events. Operational risk includes legal risk, that is, the risk of losses deriving from breach of laws or regulations, contractual, out-of-contract responsibilities or other disputes; strategic and reputation risks are not included.

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

With regard to Operational Risk, the Group has adopted the Advanced Measurement Approaches (AMA – internal model) to determine the associated capital requirement for regulatory purposes:

- effective from 31 December 2009, for an initial scope including the Organisational Units, Banks and Companies of the Banca dei Territori Division (excluding network banks belonging to Cassa di Risparmio di Firenze Group, but including Casse del Centro), Leasint (merged into Mediocredito, a company belonging to the Banca dei Territori Division, in 2014), Eurizon Capital and VUB Banka;
- effective from 31 December 2010, for a second set of companies within the Corporate and Investment Banking Division, in addition to Setefi, the remaining banks of the Cassa di Risparmio di Firenze Group and PBZ Banka;
- effective from 31 December 2011, for a third scope including Banca Infrastrutture Innovazione e Sviluppo. The full demerger of the Bank in favour of the Parent Company Intesa Sanpaolo and Leasint was completed in December 2012;
- effective from 30 June 2013, for a fourth scope including several companies of the Banca Fideuram group (Banca Fideuram, Fideuram Investimenti, Fideuram Gestions, Fideuram Asset Management Ireland and Sanpaolo Invest) and two international subsidiaries of VUB Banka (VUB Leasing and Consumer Finance Holding).

The remaining companies, currently using the Standardised approach (TSA), will migrate progressively to the Advanced approaches starting from the first half of 2015, based on the roll-out plan presented to the Management and Supervisory Authorities.

The control of the Group's operational risks was attributed to the Management Board, which identifies risk management policies, and to the Supervisory Board, which is in charge of their approval and verification, as well as of the guarantee of the functionality, efficiency and effectiveness of the risk management and control system.

Moreover, the tasks of Intesa Sanpaolo Group Internal Control Coordination and Operational Risk Committee include periodically reviewing the overall operational risk profile, authorising any corrective measures, coordinating and monitoring the effectiveness of the main mitigation activities and approving operational risk transfer strategies.

The Group has a centralised function within the Risk Management Department for management of the Group's operational risk. This function is responsible for the definition, implementation, and monitoring of the methodological and organisational framework, as well as for the measurement of the risk profile, the verification of mitigation effectiveness and reporting to Top Management.

In compliance with current requirements, the individual Organisational Units are responsible for identifying, assessing, managing and mitigating risks. Specific officers and departments have been identified within these business units to be responsible for Operational Risk Management (structured collection of information relative to operational events, scenario analyses and evaluation of the business environment and internal control factors).

The Integrated Self-diagnosis process, conducted on an annual basis, allows the Group to:

- identify, measure, monitor and mitigate operational risk through identification of the main operational problem issues and definition of the most appropriate mitigation actions;
- create significant synergies with the specialised functions of the Personnel and Organisation Department that supervise the planning of operational processes and business continuity issues and with control functions (Compliance, Administrative and Financial Governance and Internal Auditing) that supervise specific regulations and issues (Legislative Decree 231/01, Law 262/05) or conduct tests of the effectiveness of controls of company processes.

The Self-diagnosis process identified a good overall level of control of operational risks and contributed to enhancing the diffusion of a business culture focused on the ongoing control of these risks.

The process of collecting data on operational events (in particular operational losses, obtained from both internal and external sources) provides significant information on the exposure. It also contributes to building knowledge and understanding of the exposure to operational risk, on the one hand, and assessing the effectiveness or potential weaknesses of the internal control system, on the other hand.

The internal model for calculating capital absorption is conceived in such a way as to combine all the main sources of quantitative (operational losses) and qualitative information (Self-diagnosis).

The quantitative component is based on an analysis of historical data concerning internal events (recorded by organisational units, appropriately verified by the central function and managed by a dedicated IT system) and external events (by the Operational Riskdata eXchange Association).

The qualitative component (scenario analyses) focuses on the forward-looking assessment of the risk exposure of each unit and is based on the structured, organised collection of subjective estimates expressed directly by management (subsidiaries, Parent Company's business areas, the Corporate Centre) with the objective of assessing the potential economic impact of particularly severe operational events.

Capital-at-risk is therefore identified as the minimum amount at Group level required to bear the maximum potential loss (worst case); Capital-at-risk is estimated using a Loss Distribution Approach model (actuarial statistical model to calculate the Value-at-risk of operational losses), applied on quantitative data and the results of the scenario analysis assuming a one-year estimation period, with a confidence level of 99.90%; the methodology also applies a corrective factor, which derives from the qualitative analyses of the risk level of the business environment, to take account of the effectiveness of internal controls in the various organisational units.



Operational risks are monitored by an integrated reporting system, which provides Management with support information for the management and/or mitigation of the operational risk.

In order to support the operational risk management process on a continuous basis, a structured training programme was fully implemented for employees actively involved in this process.

In addition the Group activated a traditional operational risk transfer policy (to protect against offences such as employee disloyalty, theft and theft damage, cash and valuables in transit losses, computer fraud, forgery, earthquake and fire, and third-party liability), which contributes to mitigating exposure to operational risk. At the end of June 2013, in order to allow optimum use of the available operational risk transfer tools and to take advantage of the capital benefits, pursuant to applicable regulations the Group stipulated an insurance coverage policy named Operational Risk Insurance Programme, which offers additional coverage to traditional policies, significantly increasing the limit of liability, transferring the risk of significant operational losses to the insurance market. The internal model's insurance mitigation component was approved by the Bank of Italy in June 2013 with immediate effect of its benefits on operations and on the capital requirements.

To determine its capital requirements, the Group employs a combination of the methods allowed under applicable regulations. The capital absorption resulting from this process amounts to 1,770 million euro as at 30 September 2014, unchanged compared to 30 June 2014 and down compared to 31 December 2013 (1,819 million euro).

### Legal risks

Legal risks are thoroughly analysed by the Parent Company and Group companies. Provisions are made to the Allowances for risks and charges when there are legal obligations for which it is probable that funds will be disbursed and where the amount of the disbursement may be reliably estimated.

Reference should be made to the Notes to the 2013 Financial Statements for a detailed description of disputes regarding anatocism, investment services and other significant proceedings and litigation, as well as to the Half-Yearly Report as at 30 June 2014. The following is a description of the most significant developments in ongoing proceedings and new disputes initiated during the quarter.

*Intesa Sanpaolo (formerly Banca OPI, then Banca Infrastrutture Innovazione e Sviluppo) and Municipality of Taranto litigation* - Banca Infrastrutture Innovazione e Sviluppo (BIIS), as the successor to Banca OPI, was involved in a case pending before the Court of Taranto brought by the Municipality of Taranto in relation to the subscription in 2004 by Banca OPI of a 250 million euro bond issued by the Municipality.

In its judgement of 27 April 2009, the Court declared the invalidity of the operation, ordering the Bank to reimburse, with interest, the partial repayments of the loan made by the Municipality of Taranto. The latter was ordered to reimburse, with interest, the loan granted. The Court also ordered compensation for damages in favour of the Municipality, to be calculated by separate proceedings. The Municipality and the Bank jointly agreed not to enforce the judgement.

On 20 April 2012 the Court of Appeal, without prejudice to the findings of the separate proceedings regarding the alleged damages, partially reformulated the first instance ruling by ordering that:

- BIIS reimburse the sums paid by the Municipality of Taranto, plus legal interest;
- the Municipality of Taranto reimburse BIIS for the sums disbursed in execution of the bond loan, less amounts already paid, plus legal interest and currency appreciation;
- BIIS reimburse the Municipality for first instance legal costs, compensated against those for the appeal.

Intesa Sanpaolo, which succeeded BIIS in the proceedings following the well-known corporate operations, filed an appeal against this judgement before the Court of Cassation. The date of the hearing has not been set.

In the meantime, the insolvency procedure entity for the Municipality of Taranto informed BIIS that the Municipality's debt to the Bank for the repayment of the 250 million euro bond had been added to "the insolvency procedures' list of debts". The Bank nonetheless appealed the judgment before the Regional Administrative Court of Puglia, which found the appeal inadmissible, ruling that the dispute fell within the jurisdiction of the civil courts and – albeit on an incidental basis – the appealed judgment was devoid of dispositional content and was thus incapable of undermining the Banks' credit claims.

The Bank and the Municipality met repeatedly to assess the possibility of an amicable settlement to the pending litigation, however, such settlement could not be reached due to the intervention of the insolvency procedure entity, which claimed its own jurisdiction over managing the debt in question. In order to ascertain the illegitimacy of including the Bank's receivable in the insolvency procedures' list of debts and the lack of jurisdiction of the Extraordinary Liquidator, BIIS thus filed an extraordinary appeal to the President of the Republic, which is still pending.

The Bank has also initiated additional civil proceedings before the Court of Rome, for a ruling on its lack of liability for damages to the Municipality of Taranto.

By way of non-final ruling, the Court of Rome rejected the claims of lack of interest to sue, demurrer and estoppel, and ordered the continuation of the proceedings for the purpose of drawing up a court-appointed expert's report, not only on amount but also on the cause of the alleged damages. Moreover, the court-appointed expert's report must be limited to the documents already filed in the records, as all the preclusions pertaining to the preliminary investigation have been applied, and should be confirmed by the Bank's stance that the Municipality of Taranto suffered no damages as a result of the loan from BIIS.

These events are also connected to criminal proceedings before the Court of Taranto, against several Executives of Banca OPI and Sanpaolo IMI, among others, in which the preliminary hearing judge has ruled that the Municipality of Taranto may file an appearance as civil claimant in the criminal proceedings. The defendants are charged with indirect abuse of office, a crime which is not significant for the purposes of Legislative Decree 231/2001. In these proceedings, BIIS (now Intesa Sanpaolo) has been charged with civil liability for an amount of no less than 1 billion euro. In its ruling of 6 October 2014, the Court sentenced two Banca OPI Executives, while acquitting all of Bank's other defendants, in addition to jointly and severally sentencing the Bank and the two aforementioned Executives, to pay compensation for damages in favour of the Municipality, to be settled in separate proceedings, as well as to pay an immediately enforceable provisional award of 26,167,175 euro, almost entirely represented by the interest portion of the repayments made by the Municipality. Both the former employees found to be liable and the Bank will appeal this judgment, applying for a stay of the provisional enforcement of the civil remedies. The assessment of the compensation risk indicated that there was no need to recognise a specific provision as at 30 September 2014.

*Arbitration proceedings initiated by Acotel Group S.p.A.* - In its document initiating arbitration proceedings served on 4 November 2013, Acotel Group seeks an award ordering ISP to provide compensation for damages, quantified at a total of 150 million euro, caused by alleged breach of a complex cooperation agreement, which took the concrete form of various contracts aimed at developing and selling an innovative telephone SIM card known as "SIM Noverca" to bank customers. Acotel assumes that the failure of the commercial initiative and the resulting damages were the result solely of breach of contract by ISP due to the lack of interest shown in the promotion and distribution of the product amongst its customers, which culminated in the cancellation and termination of the commercial agreements. The Bank conducted its defence by raising a number of exceptions of a procedural nature. On the merits, it argued that the reasons for the transaction's lack of success may be found to lie in the technological inadequacy of the SIM card, which was rapidly rendered obsolete by the development of other, more attractive propositions on the market and the low level of competitiveness of the rate scheme, both of which were problems that Noverca was unable to overcome. Due to the lack of interest in proceeding with the arbitration shown by Acotel (which reserved the right to take action in the ordinary courts) and its consequent inactivity, the Chamber of Arbitration of Milan declared the proceedings closed by decision of 10 June 2014. By writ of summons served on 2 October 2014, Acotel Group S.p.A. and Noverca Italia S.r.l. resubmitted the same arguments to the Court of Turin, presenting, in the case of Acotel Group, a compensation claim of similar amount to that previously entered in the arbitration proceedings and, in the case of Noverca, a request for damages of the lesser amount of approximately 11.5 million euro by way of contractual penalties. Given the status of the proceedings, a specific provision has not been deemed necessary.

*POTROŠAČ litigation against PBZ relating to loans denominated in CHF* - In the context of historically low interest rates on assets denominated in Swiss francs (CHF), in 2004 numerous Croatian banks began to disburse retail loans in Swiss francs. This practice was immediately appreciated by customers. Therefore, in order to avoid erosion of market share, PBZ also began to offer similar products in February 2005.

Though it was following market trends, PBZ implemented procedures significantly different than those of other banks. In particular, in informing its customers of exchange rate risk, PBZ included specific clauses in its loan contracts which notified customers of the possibility that the amount of their instalments could change due to the volatility of exchange rates.

In addition to foreign currency, a fundamental characteristic of this loan portfolio is the presence of so-called "administered interest rate", which means that interest rates could be changed at the discretion of the Bank, without a clearly identified underlying index. This type of interest rate was the most common type in the Croatian banking sector along with fixed interest rates. Only with the introduction of the new law on consumer credit were administered interest rates banned for all new loans starting from January 2013. PBZ correctly complied with these law provisions by introducing index-linked interest rates.

By writ of summons served on 23 April 2012, PBZ was sued, along with seven major Croatian banks (subsidiaries of non-Croatian groups) by a consumer association (Potrošač). Extremely in brief, the association called for the banks to be sentenced for:

- not having appropriately informed customers of the risks of an exposure in a foreign currency such as the Swiss franc;
  - not having clearly set out in the contracts the rules for determining the interest rate, which the bank could unilaterally change.
- On 4 July 2013, in the first instance, the Commercial Court of Zagreb had substantially accepted the requests of the consumers association, ordering the banks to transform their receivables into Kuna at the exchange rate at the disbursement date and to a fixed interest rate equal to the interest rate applicable to loan contracts on the date of their subscription.

The execution of the first instance ruling had been suspended pending the judgment on the appeal.

On 16 July 2014, the High Commercial Court of the Republic of Croatia rendered its second instance ruling. The resulting situation appears more favourable than the first instance ruling. In particular:

- the part of the first instance ruling, which established that the banks were to denominate in HRK the principal originally lent to the borrowers of loans granted in Swiss francs, was overturned. This finding was in keeping with the expectations of PBZ, which in 2013 had not provisioned for potential extraordinary charges deriving from the recalculation of the principal;
- the first instance ruling was also overturned in the part referring to the loans granted in Swiss francs to be converted, establishing that the banks were to apply a fixed interest rate equal to that applicable to the loan agreement when granted. In this case as well, the outcome of the ruling confirmed PBZ's expectations;
- on the other hand, the court upheld the unlawful nature of the unilateral changes to interest rates on the loans by the banks. In 2013, PBZ provisioned amounts equal to approximately 10% of the maximum potential loss, calculated in the non-optimistic scenario, thereby adopting an approach that, according to the appeal ruling, may be regarded as extremely prudent.

In relation to the foregoing, it is necessary to consider that, in order to secure recognition of their right to reimbursement of the unduly paid sums, individual customers will be required to take action against their banks separately. This should be a benefit for PBZ, since it has adopted policies focusing on customer relations, for example by offering the possibility to convert principal from CHF into HRK given the strong appreciation of the Swiss currency in recent years. Moreover, PBZ discontinued the offering of loans in CHF in 2008.

The appeal ruling found PBZ partially liable, as well as the other appellant banks, with the exception of Sberbank, whose appeal was granted in full.

In light of the above, PBZ did not recognise any additional provisions, postponing any adjustments until other elements arise, such as the number of individual proceedings, if any, that are brought against PBZ.

The banks (with the exception of Sberbank) appealed to the Croatian Supreme Court, in order to obtain the review of the part of the appeal ruling in which they are found liable. The appeal to the Supreme Court does not provide a stay of the enforcement of the appeal ruling.

Finally, it should be added that Potrošač also submitted an extraordinary appeal to the Supreme Court to have the appeal ruling overturned in its favour. Furthermore, pending the extraordinary appeal, Potrošač allegedly recommended that customers of the banks refrain from bringing individual proceedings against the banks, advising them to wait for the ruling in question to become final (and thus no longer subject to appeal).

From August to the end of September 2014, PBZ received 486 reimbursement applications, 4 of which resulted in litigation before the competent authorities.

*Lawsuit brought by Fondazione Monte Paschi di Siena* - By writ served on 11 July 2014, Fondazione MPS brought a lawsuit before the Court of Siena against former members of the Foundation's administrative body, as well as all of the banks, including Intesa Sanpaolo and Banca IMI, that had participated in 2011 in a pool loan to the Foundation intended to provide the Foundation with the resources required to subscribe for a capital increase undertaken by its subsidiary, Banca Monte Paschi di Siena.

In support of its compensation claim of approximately 286 million euro, the Foundation argued that the former directors and advisor bore contractual liability for having breached the limit on the debt-to-equity ratio imposed by the articles of association, as well as that the lending banks bore tortious liability for having knowingly been complicit in the alleged breach by the directors. Even though, as regards internal dealings between the defendants, alleged liability for compensation may be allocated proportionally, the Foundation sought a finding of joint and several liability of all the defendants in the proceedings.

The compensation claim, as presented, against the banks is deemed to be unfounded on a variety of grounds that relate not only to the possibility of attributing tortious liability to the banks, but also to the existence of a causal relationship between the objectionable conduct and the harmful event, as well as to the determination of the amount of the items of the damages into which the compensation claim is divided. The first hearing has been scheduled for 14 May 2015.

*Lawsuit brought by Novembre RSA S.r.l. impresa sociale, Segno Unico S.r.l. and Novembre SGI S.r.l.* - By writ of summons served on 5 August 2014, Novembre RSA S.r.l. impresa sociale, Segno Unico S.r.l. and Novembre SGI S.r.l., which have common owners, brought a compensation claim before the Court of Turin seeking a finding of joint and several liability against Intesa Sanpaolo and Mediocredito Italiano for the payment of damages of approximately 63 million euro, for which the two banks are claimed to be liable for having failed to disburse a loan intended to finance a home for the elderly.

This litigation follows other disputes regarding allegations pertaining to anatocism and the economic conditions applied to bank accounts involving sums that have yet to be determined, but that on the basis of the accounting situations of the accounts concerned, appear far smaller than the most recent compensation claim.

The compensation claim is deemed to be unfounded in that the grounds of the failure to approve the loan are to be sought in delays in obtaining the required administrative permits and deficiencies relating to financial requirements attributable solely to the members of the companies applying for the loan.

The first hearing has been scheduled for 12 January 2015.

#### **Tax litigation**

With regard to pending tax litigation and the related risks and provisions, detailed information is provided in the Notes to the 2013 consolidated financial statements (Part E). Further information regarding developments in the first six months of the year is presented in the Half-yearly Report as at 30 June 2014.

There were no new, noteworthy tax disputes or outcomes of proceedings in the third quarter of 2014.

## INSURANCE RISKS

### Life business

The typical risks of the life insurance portfolio may be divided into three main categories: premium risks, actuarial and demographic risks and reserve risks.

Premium risks are managed initially during definition of the technical features and product pricing, and over the life of the instrument by means of periodic checks on sustainability and profitability (both at product level and at portfolio level, including liabilities).

Actuarial and demographic risks are controlled by means of systematic statistical analysis of the evolution of liabilities in its own contract portfolio, divided by risk type, and through simulations of expected profitability of the assets hedging technical reserves.

Reserve risk is guarded against through the exact calculation of mathematical reserves, with a series of detailed checks as well as overall verifications, by comparing results with the estimates produced on a monthly basis.

The mathematical reserves are calculated on almost the entire portfolio, on a contract-by-contract basis, and the methodology used to determine the reserves takes account of all the future commitments of the company.

### Non-life business

The risks of the non-life insurance portfolio are essentially premium risk and reserve risk.

Premium risks are managed initially during definition of the technical features and product pricing, and over the life of the instrument by means of periodic checks on sustainability and profitability (both at product level and at portfolio level, including liabilities).

Reserve risk is guarded against through the exact calculation of technical reserves.

### Financial risks

In line with the growing focus in the insurance sector on the issues of value, risk and capital in recent years, a series of initiatives has been launched with the objective of both strengthening risk governance and managing and controlling financial risks.

With reference to investment portfolios, set up both as coverage of obligations with the insured and in relation to free capital, the Investment Framework Resolution is the main control and monitoring instrument for market and credit risks.

The Resolution defines the goals and the operating limits that are needed to distinguish the investments in terms of eligible assets and asset allocation, breakdown by rating classes and credit risk, concentration risk by issuer and sector, market risks, in turn measured in terms of sensitivity to variations in risk factors and Value at Risk (VaR).

### Investment portfolios

The investments of the insurance companies of Intesa Sanpaolo Group (Intesa Sanpaolo Vita, Intesa Sanpaolo Assicura, Intesa Sanpaolo Life and Fideuram Vita) are made with their free capital and to cover contractual obligations with customers. These refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies.

As at 30 September 2014, the investment portfolios of Group companies, recorded at book value, amounted to 108,839 million euro. Of these, the part of 69,451 million euro relates to traditional revaluable life policies, the financial risk of which is shared with the policyholders by virtue of the mechanism whereby the returns on assets subject to segregated management are determined, non-life policies and free capital. The other component, whose risk is borne solely by the policyholders, consists of investments related to Index-linked policies, Unit-linked policies and pension funds and amounted to 39,387 million euro.

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

In terms of breakdown by asset class, net of derivative financial instruments, 92.0% of assets, i.e. approximately 64,286 million euro, were bonds, whereas assets subject to equity risk represented 1.6% of the total and amounted to 1,132 million euro. The remainder (4,452 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (6.4%).

The carrying value of derivatives came to approximately -418 million euro, almost entirely relating to effective management derivatives<sup>4</sup>. The hedging derivatives amounted to a total of approximately -8 million euro.

At the end of the first nine months of 2014, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 2,190 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 70 million euro.

The modified duration of the bond portfolio, or the synthetic financial term of assets, is approximately 5.7 years. The reserves relating to the revaluable contracts under Separate Management have an average modified duration of approximately 5.7 years. The related portfolios of assets have a modified duration of around 4.8 years.

The breakdown of the bond portfolio in terms of fair value sensitivity to interest rate changes showed that a +100 basis points parallel shift in the curve leads to a decrease of approximately 3,447 million euro. On the basis of this hypothetical scenario, the value of hedging derivatives in the portfolio undergoes an approximate 3 million euro rise which partly offsets the corresponding loss on the bonds.

The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 5.4% of total investments and A bonds approximately 3.7%. Low investment grade securities (BBB) were approximately 80.4% of the total and the portion of speculative grade or unrated was minimal (approximately 2.5%).

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

The analysis of the exposure in terms of the issuers/counterparties produced the following results: securities issued by Governments and Central banks approximately made up 73.4% of the total investments, while financial companies (mostly banks) contributed almost 13.7% of exposure and industrial securities made up approximately 4.9%.

At the end of the third quarter of 2014, the fair value sensitivity of bonds to a change in issuer credit rating, intended as a market credit spread shock of +100 basis points, was 3,560 million euro, with 3,014 million euro due to government issuers and 546 million euro to corporate issuers (financial institutions and industrial companies).

<sup>4</sup> ISVAP Regulation 36 of 31 January 2011 on investments defines "effective management derivatives" as 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.