

## SECTION 3 – RISKS OF INSURANCE COMPANIES

### 3.1 INSURANCE RISKS

#### QUALITATIVE AND QUANTITATIVE INFORMATION

##### Life business

The typical risks of the life insurance portfolio (managed by Intesa Sanpaolo Vita, Intesa Sanpaolo Life and Fideuram Vita) 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). During the definition of a product, profit testing is used, aimed at measuring profitability and identifying any weaknesses beforehand, by means of specific sensitivity analyses.

Actuarial and demographic risks arise when an unfavourable trend is recorded in the actual loss ratio compared with the trend estimated when the rate was calculated, and these risks are reflected in the level of “reserves”. The loss ratio refers not only to actuarial loss, but also to financial loss (guaranteed interest rate risk). The Company guards against these risks 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 (for example, checking that all the variables required for the calculation such as yields, quotations, technical foundations, parameters for the supplementary reserves, and recalculation of the value of single contracts are correctly saved in the system) as well as overall verifications, by comparing results with the estimates produced on a monthly basis. Specific attention is paid to checking the correct assumption of contracts, by checking the relative portfolio against the reconstruction of movements during the period, divided by purpose, and checking the consistency of the amounts settled compared with the movements of reserves.

The tables below show the structure of the mathematical reserves by expiry date, excluding reserves for amounts to be paid and before intercompany netting, and the structure of the guaranteed minimum yield as at 31 December 2019.

Breakdown of mathematical reserves of life branch: maturity	Mathematical reserve	(millions of euro)
		%
up to 1 year	2,865	3.52
1 to 5 years	4,041	4.97
6 to 10 years	1,302	1.60
11 to 20 years	2,244	2.76
over 20 years	70,927	87.15
<b>TOTAL</b>	<b>81,379</b>	<b>100.00</b>

Breakdown of risk concentration by type of guarantee	Total Reserves	(millions of euro)
		%
<b>Insurance and investment products with guaranteed annual yield</b>		
0% - 1%	25,736	29.51
from 1% to 3%	41,459	47.54
from 3% to 5%	6,143	7.04
<b>Insurance products</b>	<b>8,041</b>	<b>9.22</b>
<b>Shadow reserve</b>	<b>5,821</b>	<b>6.69</b>
<b>TOTAL</b>	<b>87,200</b>	<b>100.00</b>

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.

The following table shows a breakdown by maturity of financial liabilities, before intercompany netting, represented by assets covering commitments arising under unit- and index-linked policies and subordinated liabilities.

Breakdown of financial liabilities by maturity	(millions of euro)			
	Within 12 months	Over 12 months	Total as at 31.12.2019	Total as at 31.12.2018
Unit linked	127	76,038	76,165	67,990
Index linked	-	-	-	-
Subordinated liabilities	-	1,536	1,536	1,535
<b>Total</b>	<b>127</b>	<b>77,574</b>	<b>77,701</b>	<b>69,525</b>

### Non-life business

The typical risks of the non-life insurance portfolio (managed through Intesa Sanpaolo Assicura and Intesa Sanpaolo Vita) mainly relate to premium 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).

Reserve risk is monitored through the exact calculation of technical reserves. More specifically, for companies with non-life business the technical reserves may be broken down into: premium reserves, claims reserves, profit sharing and reversal reserves, other technical reserves and the equalisation reserve.

With regard to risk assumption, policies are checked when acquired through an automatic system aimed at detecting the underwriting parameters associated with the applicable tariff. The check is thus not only formal, but also substantive, and in particular allows the identification of exposures in terms of capital and limits of liability, in order to verify that the portfolio matches the technical and tariff scheme agreed upon with the sales network.

Subsequently, statistical checks are carried out to verify potentially anomalous situations (such as concentration by area or by type of risk) and to keep under control accumulation at the level of individual persons (with particular reference to policies that provide cover in the accident and health branches). This is also carried out in order to provide the Financial Reporting Actuarial Analysis and Reinsurance Unit with suitable indications of the portfolio characteristics in order to prepare the annual reinsurance plan.

The following table presents the development of claims by year of generation, broken down into the major business lines of operation, as at 31 December 2019.

Development of Claims Reserves	(millions of euro)					TOTAL
	YEAR OF GENERATION/EVENT					
	2015	2016	2017	2018	2019	
<b>Reserve amount:</b>						
as at 31/12 generation year N	122	128	132	151	222	
as at 31/12 year N+1	99	108	111	139		
as at 31/12 year N+2	97	106	108			
as at 31/12 year N+3	94	104				
as at 31/12 year N+4	92					
<b>Total claims paid</b>	<b>88</b>	<b>95</b>	<b>89</b>	<b>97</b>	<b>66</b>	<b>435</b>
<b>Claims reserve booked as at 31.12.2019</b>	<b>4</b>	<b>10</b>	<b>20</b>	<b>43</b>	<b>157</b>	<b>234</b>
<b>Final claims reserve for previous years</b>						<b>18</b>
<b>Total claims reserve booked as at 31.12.2019</b>						<b>252</b>

## 3.2 FINANCIAL RISKS

### QUALITATIVE AND QUANTITATIVE INFORMATION

#### Financial Risks

These risks derive from the level or volatility of market prices of financial instruments that impact the book value of both assets and liabilities. The risk factors identified by the company are as follows:

- Interest rate risk: impacts assets and liabilities whose value is sensitive to changes in the forward structure of interest rates or the volatility of interest rates;
- Equity price risk: derives from the level or volatility of market prices of equities and impacts assets and liabilities whose value is sensitive to changes in equity prices;
- Property risk: derives from the level or volatility of market prices of real estate property and impacts assets and liabilities sensitive to said changes;
- Foreign exchange risk: derives from changes in the level or volatility of foreign exchange rates;
- Spread risk: impacts assets and liabilities whose value is sensitive to adverse changes in credit spreads;
- Concentration risk: reflects the risk of holding high percentages of financial assets of the same counterparty.

#### Investment portfolios

The investments of the insurance companies of the Intesa Sanpaolo Group (Intesa Sanpaolo Vita, Intesa Sanpaolo Assicura, Intesa Sanpaolo Life and Fideuram Vita) are made with their free capital and to cover contractual obligations with customers. These refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies. As at 31 December 2019, the investment portfolios of Group companies, recorded at book value, amounted to 170,555 million euro. Of these, a part amounting to 86,360 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 84,195 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.

#### Financial assets under segregated funds and free capital

In terms of breakdown by asset class, net of derivative financial instruments, 84% of assets, i.e. approximately 72,410 million euro, were bonds, whereas assets subject to equity risk represented 1.7% of the total and amounted to 1,485 million euro. The remainder (12,271 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (14.3%). The carrying value of derivatives came to approximately 189 million euro, almost entirely relating to hedging derivatives while the portion of effective management derivatives<sup>35</sup> amounts to approximately 169 million euro.

At the end of 2019, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 838 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 7 million euro.

#### Interest rate risk exposure

The breakdown by maturity of bonds showed 16.72% short-term (under 1 year), 33.17% medium-term and 50.11% long-term (over five years).

Financial assets	Book value	%	(millions of euro)
			Duration
<b>Fixed-rate bonds</b>	<b>67,374</b>	<b>78.18</b>	<b>5.65</b>
up to 1 year	10,986	12.75	
1 to 5 years	22,891	26.56	
over 5 years	33,497	38.87	
<b>Floating rate/indexed bonds</b>	<b>5,036</b>	<b>5.85</b>	<b>3.20</b>
up to 1 year	1,118	1.30	
1 to 5 years	1,127	1.31	
over 5 years	2,791	3.24	
<b>TOTAL</b>	<b>72,410</b>	<b>84.03</b>	<b>-</b>
<b>Equities or similar capital securities</b>	<b>1,485</b>	<b>1.72</b>	
<b>UCI, Private Equity, Hedge Fund</b>	<b>12,276</b>	<b>14.25</b>	
<b>TOTAL AS AT 31.12.2019</b>	<b>86,171</b>	<b>100.00</b>	

<sup>35</sup> ISVAP Regulation 36 of 31 January 2011 on investments defines as “effective management derivatives” all derivatives aimed at achieving pre-established investment objectives in a faster, easier, more economical or more flexible manner than would have been possible acting on the underlying assets.

The sensitivity of the fair value of the portfolio of financial assets to interest rate movements, summarised in the table below, highlights the exposure of the portfolio: for example, a parallel shift in the yield curve of +100 basis points leads to a negative fair value change in the bond portfolios of 3,863 million euro.

	Book value	%	(millions of euro)	
			Fair value changes due to interest rate fluctuations	
			+100 bps	-100 bps
Fixed-rate bonds	67,374	93.05	-3,731	4,182
Floating rate/indexed bonds	5,036	6.95	-132	134
Interest rate risk hedging effect	-	-	-	-
<b>TOTAL</b>	<b>72,410</b>	<b>100.00</b>	<b>-3,863</b>	<b>4,316</b>

### Credit risk exposure

The table below sets forth the distribution of the bond portfolio by rating class: AAA/AA bonds represented 7.23% of total investments and A bonds approximately 6.02%. Low investment grade securities (BBB) were 84.82% of the total, while the portion of speculative grade or unrated was minimal (1.93%).

With regard to exposure to BBB rated securities, the majority of the exposure related to bonds issued by the Republic of Italy.

Breakdown of financial assets by issuer rating	(millions of euro)	
	Book value	%
<b>Bonds</b>	<b>72,410</b>	<b>84.03</b>
AAA	1,852	2.15
AA	3,380	3.92
A	4,360	5.06
BBB	61,420	71.28
Speculative grade	1,369	1.59
Unrated	29	0.03
<b>Equities or similar capital securities</b>	<b>1,485</b>	<b>1.72</b>
<b>UCI, Private Equity, Hedge Fund</b>	<b>12,276</b>	<b>14.25</b>
<b>TOTAL</b>	<b>86,171</b>	<b>100.00</b>

The analysis of the exposure in terms of the issuers/counterparties produced the following results: securities issued by governments, central banks and other public entities made up 80.41% of the total investments, whereas the securities of corporate issuers contributed around 19.59%.

The sensitivity values of the fair value of the bonds with respect to a variation in the creditworthiness of the issuers, namely a market credit spread shock of  $\pm 100$  basis points, as at end of 2019, are shown in the table below.

	Book value	%	(millions of euro)	
			Fair value changes due to credit spread fluctuations	
			+100 bps	-100 bps
Government bonds	58,221	80.40	-3,345	3,783
Corporate bonds	14,189	19.60	-611	621
<b>TOTAL</b>	<b>72,410</b>	<b>100.00</b>	<b>-3,956</b>	<b>4,404</b>

**Equity risk exposure**

The sensitivity of the equity portfolio to a hypothetical deterioration in equity prices of 10% amounts to 149 million euro, as shown in the table below.

	Book value	%	(millions of euro) Fair value changes due to stock price fluctuations -10%
Equities - Financial institutions	165	11.11	-17
Equities - Non-financial companies and other counterparties	1,320	88.89	-132
<b>TOTAL</b>	<b>1,485</b>	<b>100.00</b>	<b>-149</b>

**Foreign exchange risk exposure**

Approximately 97% of investments is made up of assets denominated in the EU currency. The residual exposure to foreign exchange risk was hedged by positions in derivative financial instruments, particularly domestic currency swaps, in the same currency.

**Derivative financial instruments**

Financial derivative instruments are used to hedge the financial risks of the investment portfolio or for effective management. The table below shows the book values of the financial derivative instruments as at 31 December 2019.

Type of underlying	DEBT SECURITIES/ INTEREST RATES		EQUITIES, EQUITY INDICES, COMMODITIES, EXCHANGE RATES		(millions of euro) TOTAL	
	Quoted	Unquoted	Quoted	Unquoted	Quoted	Unquoted
	Hedging derivatives	-	201	-	-	-
Effective management derivatives	-	-43	28	3	28	-40
<b>TOTAL</b>	<b>-</b>	<b>158</b>	<b>28</b>	<b>3</b>	<b>28</b>	<b>161</b>