Part E – Information on risks and relative hedging policies

INTRODUCTION

In this Part E, the qualitative and quantitative disclosure is presented according to the order established by Bank of Italy Circular 262, which specifically regulates not only the format of the tables but also the sequence of the various topics, except for the section relating to market risks in relation to the application of internal models.

Basic principles

The Intesa Sanpaolo Group attaches great importance to risk management and control to ensure reliable and sustainable value creation in a context of controlled risk.
The risk management strategy aims to achieve a complete and consistent overview of risks, given both the macroeconomic scenario and the Group’s risk profile, by fostering a culture of risk-awareness and enhancing the transparent and accurate representation of the risk level of the Group’s portfolios.
Risk-acceptance strategies are summarised in the Group’s Risk Appetite Framework (RAF), approved by the Board of Directors. The RAF is established to ensure that risk-acceptance activities remain in line with shareholders’ expectations, taking into account the Group’s risk position and the economic situation. The framework establishes the general risk appetite principles, together with the controls for the overall risk profile and the main specific risks.
The general principles that govern the Group’s risk-acceptance strategy may be summarised as follows:

- The Intesa Sanpaolo Banking Group is focused on a commercial business model in which domestic retail activity remains the Group’s structural strength;
- the Group does not aim to eliminate risks, but rather attempts to understand and manage them so as to ensure an adequate return for the risks taken, while guaranteeing the Company’s solidity and business continuity in the long term;
- Intesa Sanpaolo has a moderate risk profile in which capital adequacy, earnings stability, a sound liquidity position and a strong reputation are the key factors to protecting its current and prospective profitability;
- Intesa Sanpaolo aims at a capitalisation level in line with its main European peers;
- Intesa Sanpaolo intends to maintain strong management of the main specific risks (not necessarily associated with macroeconomic shocks) to which the Group may be exposed;
- the Group attaches great importance to the monitoring of non-financial risks, and in particular:
  - limits are set for operational risks (including specific treatment for IT, Cyber and Legal Risk);
  - for compliance risk, the Group aims for formal and substantive compliance with rules in order to avoid penalties and maintain a solid relationship of trust with all of its stakeholders;
  - for reputational risk, the Group strives to actively manage its image and aims to prevent and contain any negative effects on said image.

The general principles apply both at Group level and business unit or company level. In the event of external growth, these general principles shall be applied, by considering the specific characteristics of the market and the competitive scenario where the growth takes place.

The Risk Appetite Framework thus represents the overall framework in which the risks assumed by the Group are managed, with the establishment of general principles of risk appetite and the resulting structuring of the management of:

- the overall risk profile; and
- the Group’s main specific risks.

Management of the overall risk profile is based on the general principles laid down in the form of a framework of limits aimed at ensuring that the Group complies with minimum solvency, liquidity and profitability levels even in case of severe stress, and also contains the non-financial risks with appropriate limits.
In detail, management of overall risk is aimed at maintaining adequate levels of:

- capitalisation, also in conditions of severe macroeconomic stress, in relation to both Pillar 1 and Pillar 2, by monitoring the Common Equity Ratio, the Total Capital Ratio, the Leverage Ratio and the Risk Bearing Capacity;
- liquidity, sufficient to respond to periods of tension, including extended periods of tension, on the various funding sourcing markets, with regard to both the short-term and structural situations, by monitoring the internal limits of the Liquidity Coverage Ratio, Net Stable Funding Ratio, Loan/Deposit Ratio and Asset Encumbrance;
- earnings stability, by monitoring the adjusted net income and the adjusted operating costs on revenues, which represent the main potential causes for their instability;
- management of operational, compliance and reputational risk, in order to minimise the potential impact of negative events that jeopardise the Group’s economic stability and image.

In compliance with the EBA guidelines (EBA/GL/2015/02) concerning the “Minimum list of quantitative and qualitative recovery plan indicators”, the Group has also included new asset quality, market-based and macroeconomic indicators as early warning indicators in the RAF, to ensure consistency with its Recovery Plan.
Management of the specific risks is implemented by establishing specific limits and mitigation measures to be taken in order to limit the impact of especially severe future scenarios on the Group. These limits and measures seek to “steer” the most significant risk concentrations such as, for example, single name concentrations, sovereign risk and the public sector.

Within the monitoring of the specific risks, the Credit Risk Appetite (CRA) Framework, a specific RAF for credit risk introduced in 2015, identifies areas of growth for loans and areas to be monitored, using an approach based on ratings and other predictive statistical indicators, to guide lending growth by optimising the management of risk and expected loss. In 2018, the CRA was extended to the Non-Banking Financial Institution, Corporate and SME Corporate Unrated portfolios and to the beneficiary groups of the Credit Ceilings. In addition, the following were introduced: i) a specific CRA limit for leveraged transactions, as defined in the guidelines issued by the ECB, ii) an Early Warning threshold to control unsecured transactions on counterparties whose lending growth is not subject to Constraints (the Green CRA). The objective of this threshold is to mitigate the effect of higher provisions due to the introduction of Calendar Provisioning.
The CRA limits are approved within the RAF and are continuously monitored by the Credit Risk Management Head Office Department.

The limits set in the RAF are divided into two categories, hard limits and soft limits, which differ in the escalation process triggered by their breach. In particular, with regard to the Group limits, the responsibility for approving the remediation plan is assigned:
- to the Board of Directors for the hard limits, typically used for the main metrics used to control overall risk (e.g. Common Equity Tier 1 ratio, Liquidity Coverage ratio, etc.);
- to the Managing Director and CEO for the soft limits, set on the metrics used to monitor the main specific risks (e.g. single name concentration, concentration towards the Italian public sector, etc.).

The limits themselves may be accompanied by the Early Warning thresholds, the exceeding of which is promptly discussed in the competent management committee[12].

Within the annual RAF update process, a number of key steps can be identified:
- Risk Assessment and RAF setting: this phase assesses the risk actually taken (Risk Profile) with respect to the maximum risk that can be taken on (Risk Capacity) and the appetite for the risk (Risk Appetite), identifying and investigating the main types of risk of the Group, including prospective risks, using both quantitative and qualitative techniques. In particular, in accordance with the principles of proportionality and materiality, the following are analysed in detail: the regulatory contexts, the situations of the reference market, the Group’s position, and the nature of the potential threats, also with the aid of specific stress tests;
- Reconciliation between the RAF, Business Plan and Budget: consistency between the RAF and the Business Plan/Budget is sought in all phases of the related preparation procedures through a process of mutual consultation and dialogue that lasts for several months, involving not only the structures of the Chief Risk Officer Governance Area and the Chief Financial Officer Governance Area but also the Business Divisions/Structures;
- Approval of the RAF: in line with the provisions of the applicable regulations, the Board of Directors sets and approves the risk objectives, the tolerance threshold (where identified) and the risk management policies.

Defining the Risk Appetite Framework is a complex process headed by the Chief Risk Officer, which involves close interaction with the Chief Financial Officer and the Heads of the various Business Units, is developed in line with the ICAAP, ILAAP and Recovery Plan processes, and represents the risk framework in which the Budget and Business Plan are developed. Consistency between the risk-acceptance strategy and policy and the Plan and Budget process is thus guaranteed.
The definition of the Risk Appetite Framework and the resulting operating limits for the main specific risks, the use of risk measurement instruments in loan management processes and controlling operational risk, the use of capital-at-risk measures for management reporting and assessment of capital adequacy within the Group represent fundamental milestones in the operational application of the risk strategy defined by the Board of Directors along the Group’s entire decision-making chain, down to the single operational units and to the single desks.
The Group sets out these general principles in policies, limits and criteria applied to the various risk categories and business areas, in a comprehensive framework of limits and procedures for governance and control.

The assessment of the total Group risk profile is conducted annually with the ICAAP, which represents the capital adequacy self-assessment process according to the Group’s internal rules, the results of which are then also discussed and analysed by the Supervisor.
In accordance with the ECB requirements, the ICAAP process incorporates two complementary perspectives, both of which are analysed from an actual perspective and, on a prospective basis, in a baseline scenario and an adverse scenario:
- Regulatory perspective, in which the regulatory metrics for the Pillar 1 risks over the short term (one year) and the medium term (four years, in line with the time-frame of the business plan) are represented for both these scenarios;
- Financial and operating perspective, in which the management measures and metrics covering all the risks, including the Pillar 2 risks, are presented, with a time horizon of one year in the adverse scenario, which is extended to four years for the baseline scenario.

The scope of analysis also includes the insurance segment to better capture the specific characteristics of the Group’s business model (financial conglomerate).

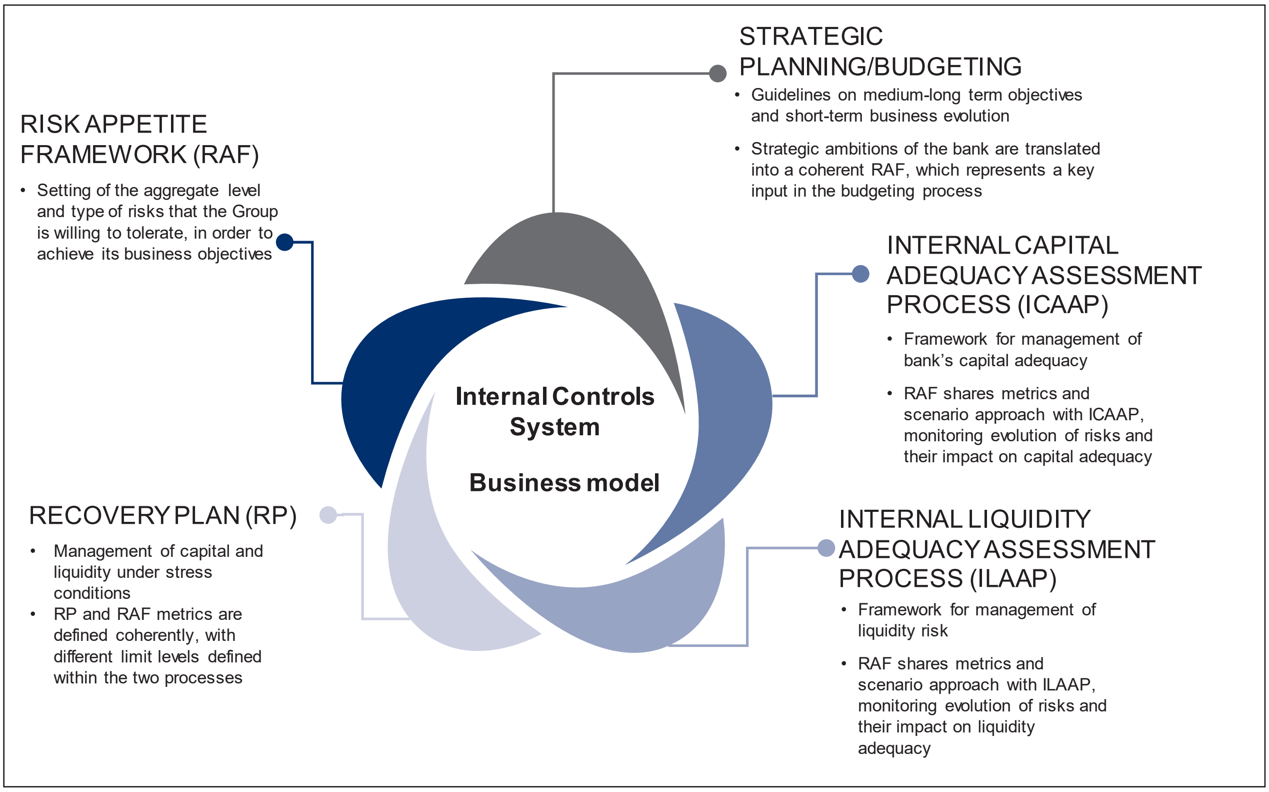
[12] The competent Management Committee varies according to the RAF metrics considered:
- for capital adequacy, credit risk and profit stability metrics, the responsibility lies with the Steering Committee;
- for liquidity and financial risk metrics, the responsibility lies with the Group Financial Risks Committee;
- for non-financial risks metrics, the responsibility lies with the Group Control Coordination, Reputational and Operational Risk Committee.

The quantitative reconciliation between regulatory requirements and management estimates of capital adequacy is set out in a specific document in the ICAAP, which reports the differences in scope and definition of risks considered in both areas, as well as the differences, where appreciable, between what is considered in the two perspectives in terms of the main parameters (e.g. confidence interval and holding period) and assumptions (such as those relating to the diversification of effects).

The Group is required to provide a Recovery Plan according to indications received by Supervisory Authorities. The process that oversees the preparation of that plan is an integral part of the regulatory response to cross-border resolution for “too-big-to-fail” banks and financial institutions. The Recovery Plan (introduced by the Bank Recovery and Resolution Directive, transposed into Italian law by Legislative Decree 180 of 16 November 2015) establishes the methods and measures to be used when an institution comes under severe stress and in an early intervention phase, in order to restore financial strength and long-term viability.
Within the annual preparation process for the Recovery Plan, the Chief Risk Officer Governance Area identifies the stress scenarios suitable of highlighting the main vulnerabilities of the Group and its business model (e.g. significant exposure to the domestic market), as well as measuring their potential impacts on the Group's risk profile. The final results showed that the Group has a high level of resilience. Following the publication of the European Banking Authority’s Final Report on Recommendation on the coverage of entities in a group recovery plan (EBA/Rec/2017/02), dated 1 November 2017, Intesa Sanpaolo has adopted specific criteria for the classification of Group companies among:
- Group-relevant;
- Locally relevant;
- Not relevant.

The application of these criteria to the Group scope has led to the Parent Company as well as Fideuram, the VUB Group, Banka Intesa Sanpaolo d.d., Intesa Sanpaolo Bank Ireland, Intesa Sanpaolo Bank Luxembourg, CIB, the Privredna Banka Zagreb Group, Banca Intesa Beograd and Intesa Sanpaolo Romania, being classified among the Group-relevant entities. The remaining companies are included in the category of not relevant entities. The above breakdown is consistent with the scope covered by the 2017 Recovery Plan.

The Intesa Sanpaolo Group ensures full consistency of the business model and internal control system with the Business Plan, the Budget, the RAF, the Recovery Plan, the ICAAP and the ILAAP, as illustrated in the diagram below.



Stress Tests

Stress tests are a fundamental risk management tool that enable banks to adopt a forward-looking perspective in their risk management, strategic planning and capital planning activities. As a fundamental element of company decision-making processes, the stress testing must be duly formalised and must have a suitable data infrastructure.

The conduct of the stress tests consists of three basic steps:
- selection and approval of scenarios;
- execution of stress tests;
- approval of results.

Intesa Sanpaolo distinguishes between the following types of stress tests:
- multi-risk exercise, based on scenario analysis, which enables the forward-looking assessment of the simultaneous impact on the Group of multiple risk factors, also taking into account the interrelationships between them and, where applicable, the top management's reaction capacity. This type of exercise, which requires the full revaluation of the impacts, is also used in the Risk Appetite Framework (RAF), Internal Capital Adequacy Assessment Process (ICAAP) / Internal Liquidity Adequacy Assessment Process (ILAAP) and Recovery Plan processes;
- regulatory multi-risk exercise, ordered and coordinated by the supervisor/regulator which defines its general assumptions and scenarios, and requires the full revaluation of the impacts;
- situational exercise, ordered by the top management or by the supervisor/regulator in order to assess the impact of particular events (relating to the geopolitical, financial, economic, competitive environment, etc.) from a forward-looking perspective. Its scope may vary from case to case;
- a single or specific risk exercise to assess the impact of scenarios (or single or more specific risk factors) on specific risk areas.

With specific regard to the regulatory multi-risk exercises, please note that in 2018 the Intesa Sanpaolo Group took part in the 2018 EU-Wide Stress Test, the exercise conducted by the European Banking Authority (EBA), in collaboration with the Bank of Italy, the European Central Bank (ECB) and the European Committee for Systemic Risk (ESRB) on the financial statements of European banks as at 31 December 2017. As usual, the exercise consisted of the estimation of the impacts on the Group's financial position and results arising from the application of two scenarios – baseline and adverse – and covered a time horizon of three years (2018-2020). The EU-Wide Stress Test is an important source of information for the purposes of the SREP as the results are useful to the competent authorities in assessing Intesa Sanpaolo's ability to comply with the related prudential requirements in stress scenarios. Intesa Sanpaolo acknowledges the results of the 2018 EU-Wide Stress Test announced by the EBA on 2 November 2018, which were extremely positive for the Group. The Common Equity Tier 1 ratio (CET1 ratio) resulting from the stress test for 2020, the final year considered in the exercise, for Intesa Sanpaolo is:
- 13.04% on a phased-in basis, in accordance with the transitional arrangements for 2020 and 12.28% on a fully-loaded basis, under the baseline scenario;
- 10.40% on a phased-in basis, in accordance with the transitional arrangements for 2020 and 9.66% on a fully-loaded basis, under the adverse scenario;

compared to the starting figure, recorded as at 31 December 2017 taking into account the impact of the first-time adoption of IFRS 9, of 13.24% on a phased-in basis and 11.85% on a fully-loaded basis. The CET1 ratio resulting from the stress test for 2020 under the adverse scenario would be 10.99% on a phased-in basis and 10.26% on a fully-loaded basis, taking into account the capital increase executed on 11 July 2018 to serve the 2018-2021 LECOIP 2.0 Long-term Incentive Plan and the conversion of savings shares into ordinary shares finalised on 7 August 2018, other things being equal.

Risk culture

The Group continues its strategic orientation towards a moderate risk profile, maintaining high levels of capital and liquidity, supported by ongoing attention to the internal control system and strengthened by operating limits and rules that favour compliance with the regulations. A culture based on widespread responsibility, balanced judgment aptitude and long-lasting sustainability of development initiatives is promoted, through extensive staff training aimed both at acquiring in-depth knowledge of the overall risk management framework (approaches, methods, internal models, rules and limits, controls) and at internalizing the Group's values (Code of Ethics, behaviour, rules of conduct and relations).
Particular attention is paid to full awareness of the principles and guidelines, by systematically updating the reference documents (Tableau de Bord, ICAAP, Risk Appetite Framework) and the information set for the exercise of activities, whose contents are clarified through structured training approaches (Risk Academy). Ongoing relations are maintained with the Chief Risk Officers of the Group companies, in order to share information on development plans and the progress of strategic projects, with the examination of the specific operational and regulatory aspects of the local markets. The survey conducted in the two-year period 2017/2018 to obtain a picture of the risk culture throughout the entire Group examined, through questionnaires and interviews, the perceptions and opinions regarding a range of dimensions, including: awareness of the risks to be addressed, clarity on sustainable risk, compliance with the rules and the limits set, level and diffusion of responsibility, timeliness of response to difficulties, ability to learn from mistakes, quality of the reporting and communication processes, orientation towards cooperation and openness to dialogue, and willingness to nurture talent and experience.
The results were compared with the data obtained from the same survey on a sample of international peers. The survey identified widespread attention to the behavioural and value aspects, together with the positive perception, felt uniformly across the Group, regarding several distinct dimensions, such as risk awareness, trust, compliance with the rules, and openness to dialogue. In 2018 initiatives were implemented aimed at strengthening cooperation and internal communications, in order to promote a wider dissemination of working approaches strongly geared towards innovation and proactive problem-solving of the issues. This involved the following in particular:
- consultation and dialogue sessions on emerging issues, aimed at developing an appropriate tone at the top;

- frequent listening sessions and communication opportunities accessible to all the staff, to ensure a level of awareness at all organisational levels;
- workshops for broad audiences across all management levels to strengthen cross collaboration and change management, in line with the evolution of the environmental situation and the competitive dynamics;
- introduction of management development tools that provide easier access (thourgh digital content), free from physical and logistical constraints, to develop individual attitudes and professional interests. Lastly, following on from the staff training programmes already carried out in previous years, a major "on-the-job mentoring" initiative was implemented to guide operational conduct, assess the quality of organisational risk management approaches, and monitor the most significant and complex change processes, with particular attention to situations of corporate evolution (acquisition of new entities) and the internal remodulation of business lines, in order to ensure full business continuity and to preserve high and uniform quality control standards across the Group.

Risk governance organisation

The policies relating to risk taking and the processes for the management of the risk that the Group is or could be exposed to are defined by the Board of Directors of Intesa Sanpaolo as the Parent Company, with the support of the Risk Committee. The Management Control Committee, which is the body with control functions, supervises the adequacy, efficiency, functionality and reliability of the risk management process and of the Risk Appetite Framework.
The Managing Director and CEO has the power to submit proposals for the adoption of resolutions concerning the risk system and implements all the resolutions of the Board of Directors, with particular reference to the implementation of the strategic guidelines, the RAF and the risk governance policies.

The Corporate Bodies also benefit from the action of some management committees on risk management. These Committees operate in compliance with the primary responsibilities of the Corporate Bodies regarding internal control system and the prerogatives of Corporate control functions, and specifically the risk control function. In particular:

- the Steering Committee, chaired by the Managing Director and CEO, is a body with a decision-making, consulting and reporting role, which, within the Group Risk Analysis Session, seeks to ensure the control and management of risks and safeguard business value at Group level, including the internal control system, in implementation of the strategic guidelines and management policies established by the Board of Directors. Its various tasks include examining the RAF proposal for the Group, for the presentation of the related proposal to the Board of Directors, the allocation, on authority from the Board of Directors, of the Group RAF limits to the Divisions and/or the Group companies, and the examination of the ICAAP and ILAAP report and of the Risks Tableau de Bord.
- The Group Financial Risk Committee is a technical body with decision-making, reporting and consulting powers, focused both on the banking business (proprietary financial risks for banking and trading books, as well as Active Value Management) and the life insurance business (result exposure to the trend in market variables). The functions of said Committee are set out in two sessions:
  - the "Risk Analysis and Assessment" session, chaired by the Chief Risk Officer, responsible for evaluating, inter alia, in advance of approval by the Board of Directors, the guidelines on undertaking and measuring financial risks and the liquidity risk and proposals for operational limits, in addition to defining, within the scope of the powers received, the distribution thereof amongst the Group's major units; in addition, the session verifies the financial risk profile and the exposure to the liquidity and interest rate risk of the Group or its main operational units;
  - the Management Guidelines and Operating Choices Session, chaired by the Chief Financial Officer, provides operational guidelines in implementation of the strategic guidelines and risk management policies laid down by the Board of Directors, in respect of management of the banking book, liquidity, interest rate and exchange risk and periodically verifies the Group's overall financial risk profile, as well as taking appropriate measures aimed at mitigating it.
- the Credit Risk and Pillar 2 Internal Models Committee is a technical body with a decision-making, reporting and advisory role. In particular, with regard to the internal risk measurement systems, the Committee acts as the competent Management Committee for:
  - the internal models for the measurement and management of credit risk;
  - the internal models for Pillar 2 risks[13].
- the Group Control Coordination, Reputational and Operational Risk Committee is divided into specific and distinct sessions:
  - the Integrated Internal Control System Session, with a reporting and advisory role, whose objective is to reinforce coordination and the interdepartmental cooperation mechanisms within the Group internal control system, thus promoting the integration of the risk management process;
  - the "Operational and Reputational Risk" session, with a decision-making, reporting and advisory role, which has the task of supervising the implementation of operational and reputational risk management guidelines and policies in accordance with indications formulated by the Board of Directors and periodically reviewing the overall operational risk profile, authorising any corrective measures, coordinating and monitoring the effectiveness of the main mitigation activities and approving, in accordance with indications of the Board of Directors, operational risk transfer strategies.

  The sessions of the Committee are attended by, among others, the Heads of Corporate control functions, as well as the Manager responsible for preparing the Company's financial reports as a permanent member. This contributes to fulfilling

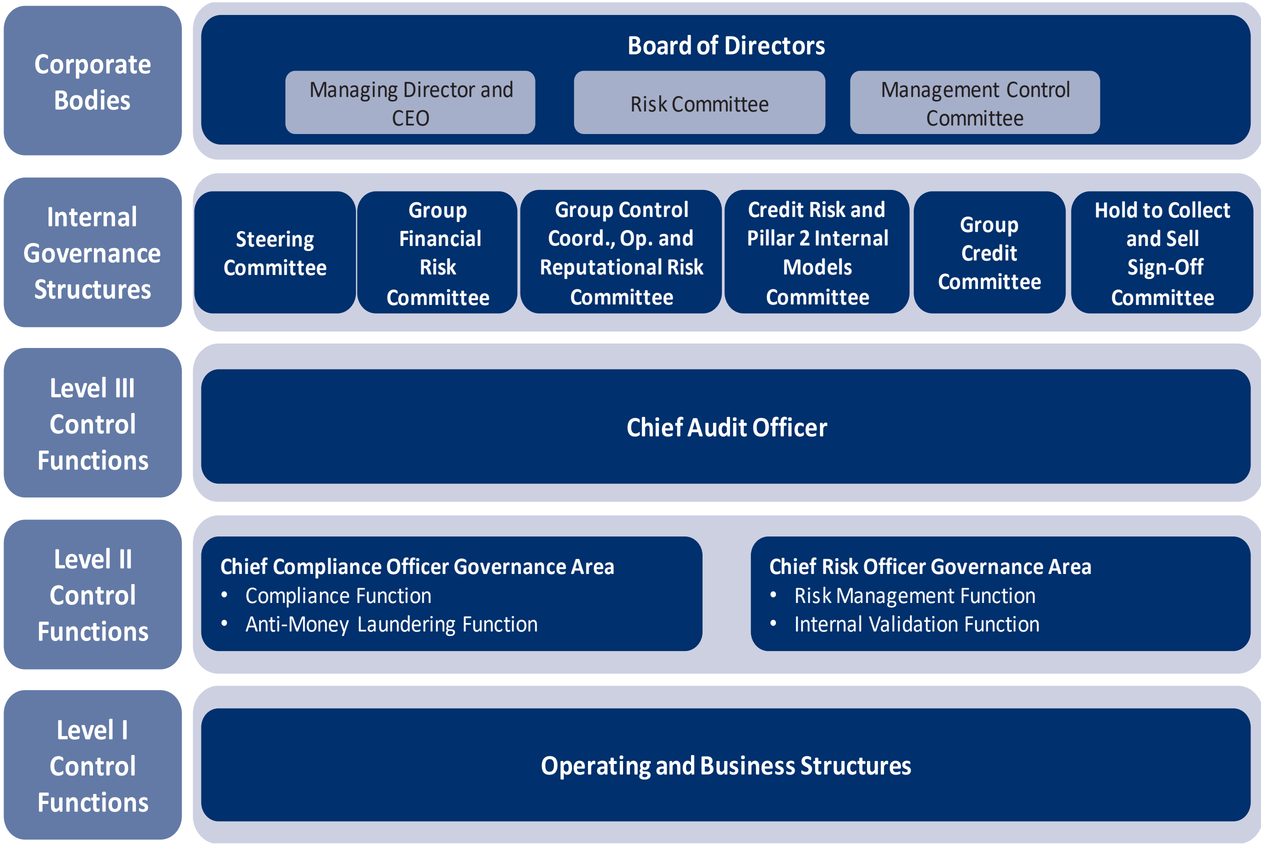
[13] The scope does not include the Pillar 2 models for the measurement and quantification of financial risks in the banking book, which already come under the scope of the Group Financial Risk Committee; however, it does include the models used for stress testing and forward-looking income statement valuations.

the assigned legal obligations and the responsibilities established in the Company Regulations on the supervision of the financial reporting process. It also enables the promotion of the inter-functional coordination and integration of control activities, within its area of responsibility.
- the Group Credit Committee is a technical body with a decision-making and advisory role that has the task of ensuring the coordinated management of issues relating to credit risk and the adoption of lending decisions and the granting of credit ceilings to the extent of its assigned powers.
- lastly, the Hold To Collect and Sell (HTCS) Sign-Off Group Committee is responsible for approving the assumption of market risks put forward by the business structures of the Corporate and Investment Banking Division on the HTCS shares required for Originate to Share transactions.

The Chief Risk Officer Governance Area, in which the risk management functions are concentrated, including the controls on the risk management and internal validation process, represents a “second line of defence” in the management of corporate risks that is separate and independent from the business supporting functions.
This Area is responsible for governing the macro process of definition, approval, control and implementation of the Group’s Risk Appetite Framework with the support of the other corporate functions involved, as well as assisting the Corporate Bodies in setting the Group’s risk management guidelines and policies, in accordance with the company’s strategies and objectives, and coordinates and verifies their implementation by the responsible units of the Group, also within the various corporate areas, in addition to ensuring the 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. It also implements the level II controls of credit and other risks, and ensures the validation of internal risk measurement systems.
To that end, the Chief Risk Officer Governance Area is broken down into the following Organisational Units:
- Credit Risk Management Department;
- Financial and Market Risks Department;
- Enterprise Risk Management Department;
- Internal Validation and Controls Department;
- Foreign Banks Risk Governance
- Coordination of Risk Management Initiatives.

The Chief Risk Officer Governance Area is responsible for operational implementation of the strategic and management guidelines along the Bank’s entire decision-making chain, down to individual operational units. The risk control functions of subsidiaries with a decentralised management model and the representatives of the Parent Company’s risk control function at subsidiaries with a centralised management model report to it.

The Chief Compliance Officer Governance Area, which reports directly to the Managing Director and CEO, in a position that is independent from operating departments and separate from internal auditing, ensures the monitoring of the Group regulatory compliance risk, including conduct risk. Within the Risk Appetite Framework, the Chief Compliance Officer Governance Area (i) proposes the statements and limits set for compliance risk, monitoring the related compliance and planning the necessary mitigation measures and (ii) collaborates with the Chief Risk Officer Governance Area in the monitoring and control of operational risks for compliance purposes, in the proposal of operating loss limits and, if these limits are exceeded, in the identification/analysis of events attributable to non-compliance with regulations and in the identification of appropriate corrective measures.



The Parent Company performs a guidance and coordination role[14] with respect to the Group companies, aimed at ensuring effective and efficient risk management at Group level, exercising responsibility in setting the guidelines and methodological rules for the risk management process, and pursuing, in particular, integrated information at Group level to the Corporate Bodies of the Parent Company, with regard to the completeness, adequacy, functioning and reliability of internal control system. For the corporate control functions in particular, there are two different types of models within the Group: (i) the centralised management model based on the centralisation of the activities at the Parent Company and (ii) the decentralised management model that involves the presence of locally established corporate control functions that conduct their activities under the direction and coordination of the same corporate control functions of the Parent Company, to which they report in functional terms.
Irrespective of the control model adopted within their company, the corporate bodies of the Group companies are aware of the choices made by the Parent Company and are responsible for the implementation, within their respective organisations, of the control strategies and policies pursued and promoting their integration within the Group controls.

The internal control system

To ensure a sound and prudent management, Intesa Sanpaolo combines business profitability with an attentive risk-acceptance activity and an operating conduct based on fairness.
Therefore, the Bank, in line with legal and supervisory regulations in force and consistently with the Corporate Governance Code for Listed Companies, has adopted an internal control system capable of identifying, measuring and continuously monitoring the risks typical of its business activities.
Intesa Sanpaolo's internal control system is built around a set of rules, functions, structures, resources, processes and procedures aimed at ensuring, in compliance with sound and prudent management, the achievement of the following objectives:

– the verification of the implementation of Company strategies and policies;
– the containment of risk within the limits indicated in the reference framework for determining the Bank’s risk appetite (Risk Appetite Framework – RAF);
– the safeguarding of asset value and protection from losses;
– the effectiveness and efficiency of the Bank processes;
– the reliability and security of Company information and IT procedures;
– the prevention of the risk that the Bank may be involved, including involuntarily involved, in illegal activities (with special regard to those relating to money-laundering, usury and financing of terrorism);
– the compliance of business continuity with the law and supervisory regulations, as well as internal policies, procedures and regulations.

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

The internal control system plays a crucial role and involves the entire corporate organisation (bodies, units, hierarchical levels, all personnel). In compliance with the provisions of Bank of Italy Circular 285/2013 (First Part, Title IV, Chapter 3) the "Integrated Internal Control System Regulation" was finalised. This aims to define the guidelines of Intesa Sanpaolo's internal control system, in its capacity as Bank and Parent Company of the Banking Group, through the adaptation of the reference principles and the definition of the responsibilities of the Bodies and of the functions with control duties, which contribute, in various ways, to the proper operation of the internal control system, as well as the identification of coordination arrangements and information flows supporting system integration. The internal control system is made up of a documentation infrastructure (regulatory framework) that provides organised and systematic access to the guidelines, procedures, organisational structures, and risks and controls present in the Company, which incorporate all the company policies and the instructions of the Supervisory Authorities, as well as the provisions of law, including the principles laid down in Legislative Decree 231/2001.
The regulatory framework consists of "Governance Documents", adopted from time to time, that oversee the operation of the Bank (Articles of Association, Code of Ethics, Group Internal Code of Conduct, Group Regulations, Group Committees Regulation, Regulation on Related Party Transactions, Integrated Internal Control System Regulations, Authorities and powers, Guidelines, Function charts of the Organisational Structures, etc.) and more strictly operational regulations that govern business processes, individual operations and the associated controls (Rules, Process Guidelines, Control Sheets, etc.).
More specifically, the corporate rules set out organisational solutions that:

- ensure sufficient separation between the operational and control functions and prevent situations of conflict of interest in the assignment of responsibilities;
- are capable of adequately identifying, measuring and monitoring the main risks assumed in the various operational segments;
- enable the recording of every operational event and, in particular, of each transaction, with an adequate level of detail, ensuring their correct allocation over time;
- guarantee reliable information systems and suitable reporting procedures for the various managerial levels assigned the control functions;
- ensure the prompt notification to the appropriate levels within the business and the swift handling of any anomalies found by the business units, the internal audit department and the other control functions;
- ensure adequate levels of business continuity.

The Company's organisational solutions also include controls at each operational level that enable the uniform and formalised identification of responsibilities, particularly in relation to the tasks of controlling and correcting the irregularities found.
In terms of Corporate Governance, Intesa Sanpaolo adopted the one-tier corporate governance system, pursuant to Articles 2409-sexiesdecies and following of the Italian Civil Code. It therefore conducts its operations through a Board of Directors, certain members of which are also members of the Management Control Committee
Based on this system:

- the Board of Directors is the body responsible for strategic supervision and performs all the tasks assigned to it by the Articles of Association, the applicable regulations and the Bank's governance documents;
- the Managing Director and CEO performs the tasks assigned by the supervisory regulations to the body responsible for management, as set out in the Bank's governance documents, approved by the Board of Directors, except for the responsibilities assigned to the Board;
- the Management Control Committee performs the control function.

The Board of Directors elects a Managing Director from its members, other than the Chairman of the Board, the members of the Management Control Committee or the minimum number of Independent Directors.
The Intesa Sanpaolo Group adopts an internal control system based on three levels, in line with the legal and regulatory provisions in force.

Such a model provides for the following types of control:

- ***Level I***: line controls which are aimed at ensuring proper performance of operations (for example, hierarchical, systematic and sample-based controls) and which, to the extent possible, are incorporated in the IT procedures. These are conducted by the same operating and business structures, also through a unit dedicated exclusively to control duties or carried out by the back office;
- ***Level II***: risk and compliance controls for the purpose of ensuring, inter alia:
  - the correct implementation of the risk management process;
  - compliance with the operating limits assigned to the various functions;
  - compliance of company operations with the rules, including self-governance rules.

  The functions assigned to such controls are separate from the ones in charge of production and contribute to the definition of the risk governance policies and the risk management process. In the Intesa Sanpaolo Group, Level II includes the following Parent Company structures and the equivalent local units of the Group companies, where established:
  - Chief Compliance Officer Governance Area, which is assigned the duties and responsibilities of the "compliance" function, as defined in the reference regulations. The Chief Compliance Officer's area also includes the Anti-money laundering Head Office Department, which is tasked with the duties and responsibilities of the "anti-money laundering function", as defined by the reference regulations;
  - Chief Risk Officer Governance Area, which is assigned the role of the risk management function, as defined by the applicable regulations. The Chief Risk Officer Governance Area also includes the Internal Validation and Controls Head Office Department, which is tasked, among other things, with the duties and responsibilities of the "validation function", as defined by the applicable regulations.
- ***Level III***: internal audit controls to identify breaches of procedures and regulations, as well as to periodically assess the completeness, adequacy, functionality (in terms of efficiency and effectiveness) and reliability of the internal control system and the IT system at Group level, at scheduled deadlines in relation to the nature and intensity of the risks. In the Intesa Sanpaolo Group, internal auditing is carried out by the Chief Audit Officer of the Parent Company and the

equivalent local units of Group companies, where established.
The internal control system is periodically reviewed and adapted in relation to business development and the reference context.
Intesa Sanpaolo has an internal control structure consistent with the indications provided by the Supervisory Authorities.

The Risk Management and Internal Validation Function

The Chief Risk Officer Governance Area is responsible for operational implementation of the strategic and management guidelines for risk along the Bank's entire decision-making chain, down to individual operational units. The tasks and functions are discussed in detail in the subsequent chapters of Part E.

Through the Internal Validation and Controls Head Office Department, the Chief Risk Officer Governance Area carries out II level controls on credit and other risks.
The purpose of the credit controls is to verify the proper classification and provisioning and the adequacy of the recovery process for individual exposures (so-called single names).
In general, the control activities development includes the credit processes assessment also to verify that suitable I level controls are in place, including proper execution and traceability. The potential areas of investigation to be examined through Single Name controls therefore also consider the results of the monitoring carried out by the I Level Control Functions within the different credit clusters.
The control of risks other than credit risk is aimed at verifying that I level controls are properly established in terms of completeness, efficiency, detection and traceability, identifying areas to be strengthened and, where necessary, requesting corrective measures.

In accordance with recent regulatory developments, the Internal Validation and Controls Head Office Department is also responsible for the development and maintenance of the framework for the identification, assessment and management of the Model Risk for the risk models (Pillar 1 and 2) and for the managerial models that are also used for accounting purposes.

The internal control system implemented by the Bank includes the validation function, which is in charge of the ongoing assessment, in accordance with the supervisory regulations for banks[15], of the compliance of internal risk measurement and management systems for the determination of the capital requirements with regulatory provisions,with company needs and with changes in the reference market. Moreover internal validation assesses the business and accounting models in application of IFRS 9. The validation function is assigned to the Internal Validation and Controls Head Office Department, which is responsible for the activity at the Group level in accordance with the requirements of supervisory regulations requesting a uniform management of the control process on internal risk measurement systems, in line with the independence requirements established by the applicable regulations.
On an annual basis a validation plan, submitted to the Board of Directors for approval, is prepared.

With respect to Pillar 1 risks, validation is a prerequisite for use of the internal systems for regulatory purposes. The validation function assesses[16] the management and measurement systems in terms of models, processes, information technology infrastructure and their compliance over time with regulatory provisions, company needs and changes in the market of reference. The level of involvement of the structure depends on the different types of validation (development/adoption of internal systems, extension of the internal systems/request for model change, ex ante notification and ongoing validation).
Both during the initial application phase and on an ongoing basis (at least annually), the results of the activities are presented to the competent functions, transmitted to the Chief Audit Officer for its related internal auditing work, as well as to the competent Management Committees and Governance Bodies for approval of the compliance of internal systems with regulatory requirements, and forwarded to the Supervisory Authorities.
With respect to Pillar 2 risks, the validation function carries out analyses on methodologies, verifying in particular that the measurement metrics adopted in quantifying significant risks are economically and statistically consistent, assessing that the methodologies adopted and the estimates produced to measure significant risks are robust and comparing alternative methodologies for measuring and aggregating individual risks. The analyses are conducted both ex-ante, when adopting/modifying the internal systems used for Pillar 2 purposes, and ex-post as part of the prudential control process. The latter are summarised in the ICAAP/ILAAP report while, for substantial or significant modifications of internal systems, the validation function produces a report to be submitted to the competent Managerial Committees and the Governance Bodies[17].
The function also manages the internal validation process at Group level, interacting with the Supervisory Authorities, the relevant Corporate Bodies and the functions responsible for the III level controls reported in regulations. It adopts a decentralised approach for companies with local validation functions[18] (several international companies), coordinating and supervising the activities of those companies, and adopting a centralised approach for the others. The adopted methodologies were developed in implementation of the principles that inspire the Supervisory Provisions for banks, EU directives and regulations, general guidelines of international committees and best practices in the area and take the form of documentary, empirical and operating practice analyses.
The function generally also provides advice and suggestions to company and Group functions on an ongoing basis, with the aim of improving the efficacy of the processes of risk management, control and governance of internal risk measurement and management systems for determining capital requirements.

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[15] Regulation (EU) 575/2013 (CRR), EBA Guidelines, EU Directive 2013/36 (CRD IV), Bank of Italy Circular 285/2013.

[16] The validation function is also responsible for calculating the default rates for the development/recalibration of the models and of the ECAF monitoring process.

[17] In the event of substantial/significant modifications, the approval process requires that the Risk Management Head Office Department submit updates to the Internal Management System, accompanied by the impact analysis on the risk metrics and the report of the validation unit, to the competent Managerial Committee for approval. Subsequently, reporting is provided on those modifications to the Board of Directors.

[18] Note that the functional reporting of local validation units to the Internal Validation and Controls Head Office Department has been formalised.

In 2018, the validation function carried out its activities, the results of which are presented in detail in the Annual report on the regulatory models and the Annual report on the management models. With regard to the transversal activities for the various risks, the main areas of investigation in which the function had a significant involvement were:

- validation of the main methodological and process implementations for compliance with IFRS 9;
- updating of the Rules for the validation of the Group internal systems (introducing the concepts of Standard and Full validation);
- involvement in the 2018 EBA stress test for its areas of responsibility;
- activities related to the requests from the Internal Audit department during the transversal audit on Internal Validation;
- involvement, as Data Owner, in the “Default Rates” process transformation within the RADAR project.

With regard to Credit Risks, the main areas of investigation in which the function had a significant involvement in 2018 are listed below:

- preparation and submission for approval of the framework for the definition of margins of conservatism as required by the EBA guidelines;
- participation in the Target Review of Internal Models (TRIM) on credit risk (SME Corporate);
- assurance activities required by the regulator on the Corporate, Institutions and Retail remediation plans;
- calculation of the default rates for the update of the central tendencies and for the Risks Tableau de Bord;
- validation of the main methodological and process implementations for the application of the new Definition of Default according to the Two Step Approach;
- validation of the substantial changes made to the LGD Corporate Defaulted Asset model;
- validation activities for ex-ante notification for the updating of the time series of all the validated models;
- validation of substantial changes to the models of the Institutions segment (PD and LGD, processes);
- establishment of the framework for the backtesting of the accounting LGD applied to doubtful positions (LGD defaulted assets), which involves verification of the conservatism of estimates, through Cohen's D statistical tes;
- involvement in the Banco Posta Mutui and Prestiti Personali projects;
- backtesting of the Static Pool portfolio.

With regard to operational risk, the validation activities in 2018 concerned, as usual, the assessment of the due maintenance of the ORM framework and monitoring of the performance of the model calculation (AMA scope). In addition, the function took part in the annual exercise, requested by the ECB, concerning the implementation of common metrics for the validation of the AMA models: the template with the summary of the information and simulations required was prepared as instructed and sent to the ECB.

In the area of market and counterparty risks, the activity focused on the definition and execution of analyses in compliance with the requests made by the Regulator following the inspections (TRIM), which ended in June 2017 and November 2017, for market and counterparty risks respectively. In this regard, it should be noted that the set of continuous analyses on the pricing models used in the risk calculation architecture has been progressively extended. With regard to market risks, the first official reporting was carried out on the analysis of hypothetical portfolios and preliminary analyses were set up to quantify the impact of the use of proxies in the internal model for market risks. With regard to counterparty risks, backtesting analyses were introduced to quantify the performance of the internal model in relation to the main types of financial instruments and a continuous analysis was also introduced to assess the adequacy of the backtesting sample used by the development function. Monitoring continued of the progress of the main projects with impacts on market and counterparty risks (e.g. Fundamental Review of Trading Book). The analyses conducted on an ongoing basis included the backtesting (issued quarterly for both risks), the review of the period for the calculation of the Stressed VaR and the stress testing of the Incremental Risk Charge model (market risk area), and the monitoring of the model’s calibration parameters and revision of the simulation drivers (counterparty risk model).

For the Pillar 2 Risks, the main areas of analysis in 2018 were:

- revision of the changes and refinements made to the models used for stress purposes within the ICAAP (related to the credit risk, strategic risk and exchange risk of the Banking Book) and more generally for the stress test framework, by participating in the drafting of the stress testing book;
- assessment of the changes made to the model for the calculation of the economic capital with respect to interest rate risk in the banking book;
- revision of behavioural models for sight items and prepayment, also in light of the refinements of the path dependent model, which seeks to dynamically measure the effect of changes in market rates on interest measures;
- assessment of changes made to the methodology for generating scenarios for calculating the economic capital with respect to insurance risk;
- assessment of the minor changes or updates to the underlying time series of the models used for other risk profiles such as country risk, pension risk, real estate risk, etc.;
- involvement in the 2018 EBA stress test through the validation of net revenue simulation models (PPNR);
- validation of the methodology used to quantify the daily liquidity risk.

In addition, structural changes to the general prudential assessment framework were evaluated, including for example:

- the increase in the confidence level used for the calculation of the economic capital (from 99.85% to 99.90%);
- extension of the time horizon for Pillar 2 baseline projections to three years in line with the Pillar 1 projections;
- introduction of stressed projections for Pillar 2 over the one-year horizon, in replacement of the Confidence Level Sensitivity on economic capital presented in the previous ICAAP exercise;
- introduction of risk diversification to provide a better representation of the absorbed capital of the entire Group risk portfolio;
- first quantification of the economic capital buffer calculated for reputational risk and model risk.

With regard to the Group’s International Subsidiaries, the activities carried out mainly concerned the areas of credit risk, operational risks and Pillar 2 risk, also covering the following transversal activities:
- validation of the main methodological and process implementations for the adoption of IFRS 9 in all the international subsidiaries;
- extension/customization of the updated “Rules for the validation of the Group internal systems” and the related Handbooks in the individual local entities;
- validation of the main methodological and process implementations for the application of the new Default Definition for the international subsidiaries included in the scope of the Two Step Approach (VUB and ISPSLO);
- validation of the framework of the EWS model that will be adopted at local level by the individual international subsidiaries.

In particular, with regard to credit risk, the following activities were carried out in 2018:
- validation of the re-estimates of the internal models (management/regulatory) adopted by the international subsidiaries of the Group, in particular with regard to the LGD Performing and Defaulted Asset models of the retail area, the Corporate and slotting model of the subsidiary PBZ, and the Corporate models and the PD Retail and Micro processes of the Hungarian subsidiary CIB;
- preparation of the documentation accompanying the ELBE application in the Mortgage segment for the subsidiary VUB;
- termination of the ECB obligations related to the application for the extension of the corporate models of the subsidiary Intesa Sanpaolo Bank Luxembourg S.A., relating to the Model Change application by the Parent Company;
- monitoring of the obligations notified by the competent Regulator to the individual international subsidiaries.

With regard to operational risks, the main activities carried out were:
- coordination of the Remote Verification process;
- revision of the annual reports prepared by the local validation functions for PBZ, VUB and CIB.

The activities carried out during the year in relation to the monitoring of Pillar 2 risks mainly concerned the coordination of the preparation of the validation reports for the ICAAP report for the two international subsidiaries PBZ and ISPSLO and the validation of the methods used for mangerial purposes. In particular, the framework for measuring the banking book interest rate risk has been aligned to the methodology adopted by the parent company (sight items and prepayment behavioural models).

Compliance

The governance of compliance risk is of strategic importance to the Intesa Sanpaolo Group, as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust.

The responsibilities and duties of the compliance function are assigned to the Chief Compliance Officer, who is independent and autonomous in relation to the operational structures, reports directly to the Corporate Bodies and has access to all activities within the Bank, as well as any significant information for the performance of his/her duties.
The Group's Compliance Model is set out in the Guidelines approved by Intesa Sanpaolo's Corporate Bodies, which indicate the responsibilities of the various company structures and macro processes to mitigate compliance risk:
- identifying and assessing compliance risk;
- proposing the functional and organisational measures for mitigation of this risk;
- conducting pre-assessments of the compliance of innovative projects, operations and new products and services;
- providing advice and assistance to the governing bodies and the business units in all areas with significant compliance risk;
- monitoring, including through the use of information provided by the other control functions, of ongoing compliance;
- disseminating a corporate culture founded on the principles of honesty, fairness and respect for the spirit and the letter of the rules.

The regulatory scope and the procedures for monitoring regulatory areas that present significant risks of non-compliance for the Group are defined in the aforementioned guidelines. The Chief Compliance Officer submits periodic reports to the Corporate Bodies on the adequacy of compliance control, with regard to all regulatory aspects applicable to the Group which show compliance risks. On an annual basis, these reports include an identification and assessment of the primary compliance risks to which the Group is exposed and a schedule of the associated management measures, and on a half-yearly basis they include a description of the activities performed, critical issues noted, and remedies identified. A specific notice is also given when events of particular significance occur.
The Compliance Guidelines call for the adoption of two distinct models in relation to direction, coordination and control of the Group. These models are organised in such a way as to account for the Group’s structure in operational and territorial terms. In particular:
- for specifically identified Italian Banks and Companies, whose operations are highly integrated with the Parent Company, the compliance supervision is centralised at the Parent Company;
- for the other Companies, that have a legal obligation or have been specifically identified based on the business conducted, as well as the International Branches, an internal compliance function is established and a local Compliance Officer is appointed, which are assigned compliance responsibilities. The local Compliance Officers of the subsidiaries functionally report to the Chief Compliance Officer structures, while those of the International Branches, except where not permitted by local regulations, hierarchically report to the Chief Compliance Officer structures.

Anti-Money Laundering

The duties and responsibilities of the Anti-money laundering Function are assigned, as required by the regulations, to the Anti-money laundering Head Office Department, which reports to the Chief Compliance Officer, and is therefore independent and autonomous in relation to the operating structures, reporting directly to the Corporate Bodies, and has access to all activities within the Bank, as well as to any significant information for the performance of its duties.

Specifically, the Anti-Money Laundering Head Office Department ensures monitoring of compliance risk in the area of money laundering, terrorist financing and embargoes, corruption (financial crime) and weapons, in addition to administrative liability of entities, by:

- laying down the general principles to be adopted within the Group for the management of compliance risk;
- conducting ongoing monitoring, with the support of the competent functions, of developments in the national and international context of reference, verifying the adequacy of company processes and procedures with respect to applicable regulations and proposing appropriate organisational and procedural changes;
- providing advice to the functions of the Parent Company and subsidiaries on a centralised basis and establishing adequate training plans;
- preparing appropriate periodic reporting for corporate bodies and top management;
- discharging the required specific obligations on behalf of the Parent Company and subsidiaries on a centralised basis, including, in particular, enhanced customer reviews, controls of proper management of the data storage Archive and the assessment and monthly submission to the Financial Intelligence Unit of data relating to aggregated anti-money laundering reports, and the assessment reports of suspicious transactions received from operating departments for the submission to the Financial Intelligence Unit of reports deemed accurate.

The Anti-money laundering Head Office Department performs its role of guidance, coordination and control of the Group according to a model similar to the one described for the Compliance function.

Internal Auditing

Internal auditing activities are assigned to the Chief Audit Officer, who reports directly to the Board of Directors (and, on its behalf, to its Chairman), functionally reporting to the Management Control Committee, without prejudice to the appropriate sharing of information with the Managing Director and CEO. The Chief Audit Officer does not have any direct responsibilities for the operational areas.
This function has a structure and a control model which is organised according to the evolution of the organisational structure of Intesa Sanpaolo and of the Group.
The Internal Auditing structures of the Group's Italian and international companies report to the Chief Audit Officer in terms of functions.
The Internal Auditing Department performs overall level 3 assessment of the internal control system, reporting possible improvements to the corporate bodies, with specific regard to the RAF, the risk management process and risk measurement and control instruments.
In particular, the Department assesses the completeness, adequacy, functionality and reliability of the components of the internal control system, the risk management process and the corporate processes, also with regard to their ability to identify and prevent errors and irregularities. In this context, amongst others, it audits the risk control and regulatory compliance corporate functions, also through participation in projects, so as to generate added value and improve the effectiveness of the control and corporate governance processes.
The audit action directly concerns Intesa Sanpaolo and the Group companies.
The Internal Auditing Department is also responsible for assessing the effectiveness of the corporate RAF definition process, the internal consistency of the overall framework and compliance of Bank operations with the RAF.
The Head of the Internal Auditing Department enjoys due autonomy and independence from the operating structures. The Department has access to all the activities conducted at both the head office departments and the local structures. If third parties are assigned significant activities for the functioning of the internal control system (e.g. data processing), the internal auditing department must also have access to the activities carried out by those parties.
The department uses personnel with the appropriate professional skills and expertise and ensures that its activities are performed in accordance with international best practices and standards for internal auditing established by the Institute of Internal Auditors (IIA).
As required by the international standards, the department is subject to an external Quality Assurance Review every five years. The last review was carried out in 2016 and assigned the department the highest assessment envisaged ("Generally Compliant"). At the end of 2018, on request from the Management Control Committee, a new assessment was conducted that will end in the first quarter 2019.
In performing its duties, the function uses structured risk assessment methods to identify existing situations of greatest interest and the main new risk factors. Based on the assessments emerging from risk assessment and the resulting priorities, as well as on any specific requests for further enquiry expressed by top management and Corporate Bodies, it prepares and submits an Annual Intervention Plan for prior examination by the Management Control Committee, and subsequent approval by the Board of Directors, on the basis of which it conducts its activities during the year, in addition to a Long-Term Plan.
The Chief Audit Officer ensures the proper conduct of the internal process for managing whistleblowing reports.
The Chief Audit Officer coordinates the "Integrated Internal Control System" session of the Group Control Coordination, Reputational and Operational Risk Committee.

Auditing was performed directly for the Parent Company, the Network Banks and other subsidiaries under an outsourcing contract. For the other Group companies having their own internal audit departments, steering and practical coordination of the local departments was performed to guarantee control consistency and adequate attention to the different types of risks,

also verifying the effectiveness and efficiency levels under both structural and operational profiles. Direct auditing and review activities, in the capacity of Parent Company, were also performed for those companies, as mentioned above.
Any weaknesses detected during control activities have been systematically notified to the company functions involved for prompt improvement actions, which are monitored by follow-up activities to verify their effectiveness.
Summary internal control system assessments from the checks have been periodically submitted to the Management Control Committee and the Board of Directors. The findings of the audits completed with a negative opinion or with the identification of major shortcomings were sent in full to the Board of Directors, the Managing Director and CEO and the Management Control Committee, as well as the Boards of Directors and Boards of Statutory Auditors of the subsidiaries concerned.
The main weaknesses detected and their development over time have been included in the Audit Tableau de Bord (TdB), with details of the mitigation actions underway, together with the related responsibilities and deadlines envisaged, so they can be systematically monitored. Lastly, the Chief Audit Officer ensured constant assessment of its own effectiveness and efficiency in line with the internal “quality assurance and improvement" plan drafted in accordance with the recommendations of international standards for professional audit practice. In this context, during 2018, a function evolution plan was launched, also in line with the strategies of the 2018-2021 Business Plan, referred to as Future Audit Solutions and Transformation (FAST).

Manager responsible for preparing the Company's financial reports

Supervision on the reliability of the Company financial reports and on the financial reporting process is carried out by Intesa Sanpaolo's Manager responsible for preparing the Company’s financial reports, in compliance with the provisions of Article 154-bis of the Consolidated Law on Finance and the related implementing provisions. This control is also ensured over the subsidiaries governed by the laws of non-EU countries, in accordance with the supervisory rules on management and accounting systems set by Article 15 of Consob Market Regulation 20249/2017 (effective from 3 January 2018, formerly Article 36 of Consob Market Regulation 16191/2007).
In order to comply with the aforesaid provisions, the Manager responsible for preparing the Company’s financial reports:
- performs a steering and coordination role in Group companies with regard to administrative matters and in the monitoring of the internal control system functional to financial reporting;
- supervises the implementation of legal requirements according to a shared approach at Group level, set out in specific internal regulations.

In particular, the Manager responsible for preparing the Company's financial reports:
- issues the instructions for the correct and uniform application of the accounting standards and measurement criteria, formalised as part of the Group Accounting Rules, which are subject to regular periodic updates;
- prepares appropriate administrative and accounting procedures for the preparation of the separate and the consolidated financial statements, and updates them to ensure compliance with the corporate disclosure requirements in force;
- verifies the adequacy of the administrative and accounting procedures and the effectiveness of the control system on the financial reporting process;
- oversees the correspondence between the corporate reporting to the market with the accounting records; to this end, it has the right to promptly obtain any information deemed necessary for the performance of his/her duties and coordinates the exchange of information with the independent auditors.

With specific regard to the financial reporting processes, the Manager responsible for preparing the Company’s financial reports:
- maintains a system of contact and information flows with the function of the Parent Company and of the Group Companies, in order to ensure the adequacy of balance sheet, income statement and financial positions and the descriptions of the main types of risks and uncertainties to which the Group may be exposed, monitoring the reliability of the of acquisition of relevant data and information;
- oversees the internal control system on the financial reporting process, drawing up audit plans to ensure the adequacy and effective application of administrative and accounting procedures over the period, also by subsidiaries subject to the laws of countries that are not part of the European Union, pursuant to art. 15 of Consob Market Regulation; periodically reports to the Board of Directors and the Management Control Committee on the scope and results of the audits;
- acquires, in relation to the effects on the financial reporting process and the reliability of the company information, the results of the activities carried out by the Corporate control functions and, in particular, by the Internal Audit Department, which is responsible for the overall assurance for the internal control system in accordance with the “Integrated Internal Control System Regulation”;
- acquires any recommendations formulated by the independent auditors at the end of the process of auditing the separate financial statements of the Parent Company and the consolidated financial statements, as well as the related feedback in terms of measures to improve the procedures that have an impact on accounting data, monitoring their implementation and effectiveness;
- shares with the Surveillance Body established pursuant to Legislative Decree 231/01, the findings of the audit plan carried out in implementation of the monitoring of the financial reporting process, focusing on preventing the criminal and administrative offences described in the “Organisation, Management and Control Model pursuant to Legislative Decree No. 231 of 8 June 2001”.

The Manager responsible for preparing the company's financial reports contributes to supervising the independence of the independent auditors, in accordance with the procedures governed by specific Company Regulations, in line with the provisions of law (Legislative Decree 39/2010 amended by Legislative Decree 135/2016, which transposed Directive 2014/56/EU into the Italian legal framework, and EU Regulation 537/2014). The above-mentioned Company Regulations assign to the Manager responsible for preparing the Company's financial reports the role of supervising, overseeing and

monitoring the accounting audit engagements and other services entrusted by the Parent Company departments and the Group companies to independent auditors, their networks and their affiliates, in addition to the task of regularly informing the Management Control Committee in this regard.
The Manager responsible for preparing the Company's financial reports also ensures periodic reporting to the Board of Directors regarding the legal and regulatory obligations assigned to the Board for the monitoring of the adequacy of powers and means granted to the Manager responsible for preparing the Company's financial reports and of the effective observance of administrative and accounting procedures. This reporting is discussed beforehand with the Management Control Committee and the other Board Committees, for the aspects under their responsibility.

Attestations as required by Art. 154-bis of the Consolidated Law on Finance

In relation to the supervisory and monitoring functions assigned, the Manager responsible for preparing the Company's financial reports:

- signs, jointly with the Managing Director and CEO, the attestations of the separate and consolidated financial statements required by the Article 154-bis, paragraph 5, of the Consolidated Law on Finance on the adequacy and actual application of administrative and accounting procedures, the compliance with the international accounting standards, the agreement of the financial statements with the supporting documentation, accounting books and records and their suitability to give a true and fair view of the financial and economic position of the Group, as well as a reliable analysis of the performance, operating result and the main risks to which the Group is exposed;

- certifies the correspondence of the documents and announcements disclosed to the market with the records, books and accounting entries, pursuant to Article 154-bis, paragraph 2, of the Italian Consolidated Law on Finance.

The monitoring of the accounting and financial reporting process is based on the review of:

- completeness and consistency of the information provided to the market through a structured reporting system originated from the functions of the Parent Company and the Companies concerning the events deemed significant for accounting/financial disclosure purposes, especially with regard to the main risks and uncertainties to which they are exposed;
- suitability of the processes and procedures used for the preparation of accounting documents and other communication of a financial nature deemed relevant pursuant to Article 154-bis of the Consolidated Law on Finance. Special attention is paid to monitoring the adequacy of the auditing approach and the proper conduct of the activities required for the financial reporting process; the focus of the controls is represented by the work stages which, within business processes, entail the recording, processing, evaluation and presentation of data and information. In addition to the adequacy of the structure of procedures and the effective application of related controls, the IT architecture and applications, operating processes and development interventions on the summary systems instrumental to financial reporting are taken into consideration.

The organisational model for the supervision of the adequacy of the administration, accounting and financial reporting procedures and the related internal control system is governed by the Company "Guidelines for Administrative and Financial Governance". In particular, the Model prescribes assessment methodologies differentiated according to, on one hand, the risk of the processes deemed significant for accounting and financial reporting purposes and, on the other, the need to realise synergies with the control activities carried out by the Internal Auditing Department and the other Corporate Control Functions. To this end, the procedures may be verified by means of in-depth analyses, conducted according to specific methodologies used to verify the correctness of the accounting and financial information, carried out by the structures that support the Manager responsible for preparing the Company's financial reports (analytical approach) and, if present, of the information collected by the Corporate control functions or by external entities such as Independent Auditors, Supervisory Authorities, etc. (synthetic approach).

Accordingly, the Model provides for the following activities:

- definition and regular update of the plan of controls and the scope of application;
- ongoing monitoring of the processes deemed significant for accounting and financial reporting purposes and the related internal control system;
- regular summary assessment of the adequacy of the procedures and internal control system for accounting and financial reporting;
- management of the system of information flows from the corporate functions of the Parent Company and the Group Companies to the Manager responsible for preparing the Company's financial reports;
- management of the system of attestation on the validity of the administrative processes and completeness of the information flows, within the respective areas of competence issued to the Manager responsible for preparing the Company's financial reports by the Managers of the Business Units, the Governance Areas and the Group Central functions, and by the Delegated Bodies of Group Companies;
- preparation of the Report concerning the financial information process;
- management of the system of reporting by the Manager responsible for preparing the Company's financial reports to the Corporate Bodies;
- procedures for the steering and coordination of subsidiaries.

For the assessment of the adequacy of the relevant processes for the financial reporting, the Manager responsible for preparing the Company's financial reports uses the results of the controls carried out by the structures reporting directly to him, by the Internal Auditing Department and the other Corporate control functions. To this end, within the scope of the Control Coordination and Operational Risk Committee provided for by the Integrated Internal Control System, the Corporate

Control Functions and the Manager responsible for preparing the Company's financial reports share annual check plans and the related outcomes. The critical issues arising from inspections conducted by external bodies (Independent Auditors, Supervisory Authorities) are also collected and assessed from the perspective of financial reporting risk.

To conclude the preparation of the Company's financial reports according to the rules and criteria set out in Part A of the Notes to the financial statements, and the supervisory activities conducted on the financial reporting processes, according to the guidelines described herein, the Managing Director and CEO and the Manager responsible for preparing the Company's financial reports sign the attestations required by Art. 154 bis, paragraph 5, of the Consolidated Law on Finance.
These attestations are included in the reporting packages for the separate financial statements of the Parent Company and the consolidated financial statements, and are provided to the public according to the model established by the Consob Regulation.

Report pursuant to Article 15 Consob Market Regulation 20249/2017 (effective from 3 January 2018, formerly Article 36 of Consob Market Regulation 16191/2007).

With regard to the protection of savings and the regulation of financial markets, the Italian Securities and Exchange Commission (Consob) has set certain conditions for the listing of parent companies incorporated and subject to the laws of non-EU member states (Article 15 of the Market Regulation cited). As a result, Intesa Sanpaolo has set up an action plan to ensure the existence of the conditions required for subsidiaries that are of material significance, identified in compliance with the criteria established in the rules of the cited Article 15:
- ensuring the public disclosure of the accounting positions of subsidiaries prepared for the purposes of drafting the consolidated financial statements;
- obtaining details from its subsidiaries of their articles of association, membership and powers of the control bodies;
- determining that the subsidiaries: i) provide the independent auditor of the parent company with the information necessary to perform annual and interim audits of the parent company; and ii) enjoy access to an administrative and accounting system appropriate for regular reporting to the management and independent auditor of the parent company of the income statement, balance sheet and cash flow data necessary for the preparation of the consolidated financial statements.

On conclusion of the activities performed and the verifications conducted, compliance is confirmed with the conditions required by Article 15 of Consob Market Regulation 20249/2017 (effective from 3 January 2018, formerly Article 36 of Consob Market Regulation 16191/2007).
The Management Control Committee and Board of Directors have been informed of compliance with those regulatory provisions governing companies incorporated in and subject to the laws of non-EU Member States, in the aforementioned "Report on the internal control system of the financial reporting process" drafted in order to illustrate the overall governance and control activities performed in accordance with the various provisions of laws and Group regulations governing the supervision of financial reporting, organically coordinated by the Manager responsible for preparing the Company's financial reports.

Scope of risks

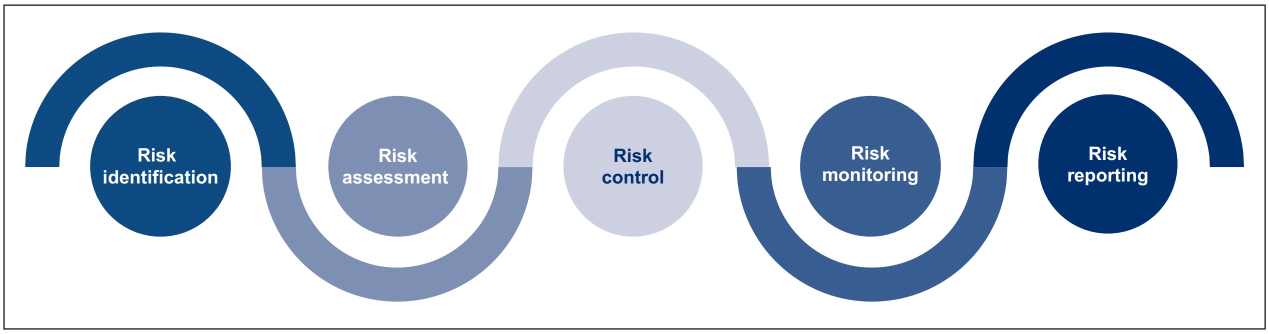
The risks identified, covered and incorporated within the Economic Capital are as follows:
- credit and counterparty risk. This category also includes concentration risk, country risk and residual risks, both from securitisations and uncertainty on credit recovery rates;
- market risk (trading book), including position, settlement and concentration risk on the trading book;
- financial risk of the banking book, mostly represented by interest rate and foreign exchange rate risk;
- operational risk, also including legal risk, compliance risk, ICT risk, model risk and financial reporting risk;
- insurance risk;
- strategic risk;
- risk on real estate assets owned for whichever purpose;
- risk on equity investments not subject to line-by-line consolidation;
- risks relating to defined-benefit pension funds.

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, including stress tests.

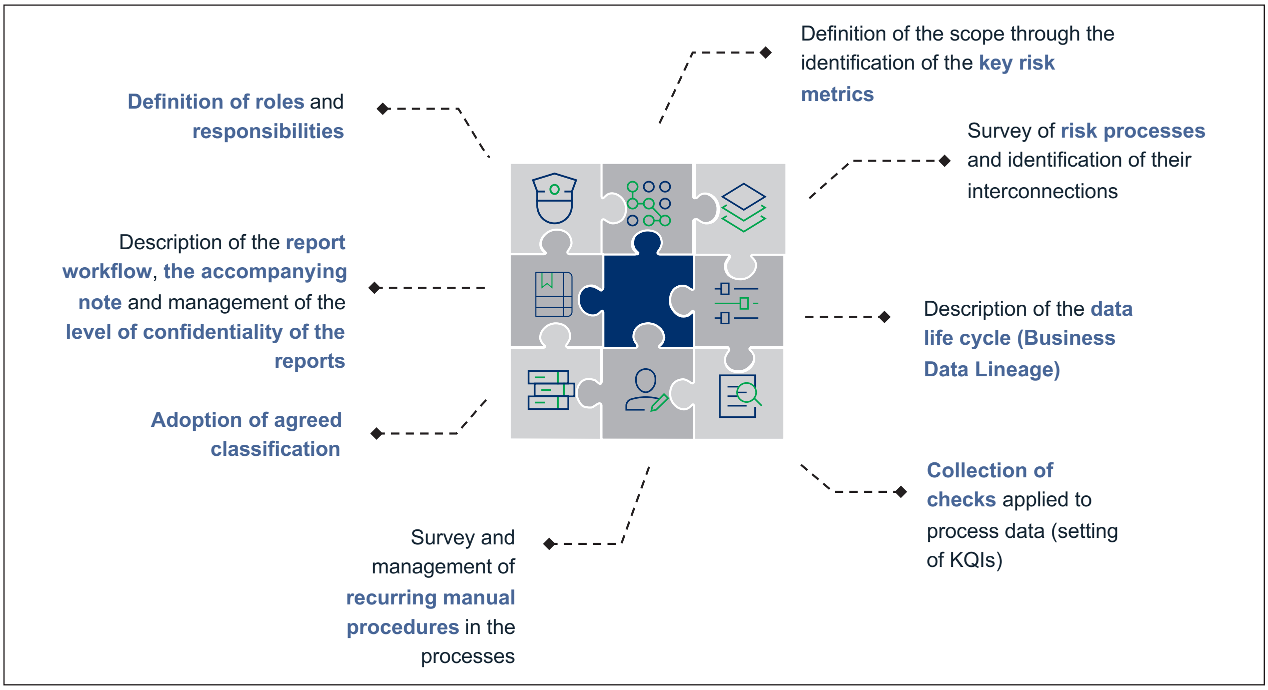
Special attention is dedicated to managing the short-term and structural liquidity position by following specific policies and procedures to ensure full compliance with the limits set at the Group level and operating sub-areas in accordance with international regulations and the risk appetite approved at the Group level.

The Group also attaches great importance to the management of reputational risk, which it pursues not only through organisational units with specific duties of promotion and protection of the company image, but also through dedicated processes for the identification and assessment of reputational risk and the creation of specific reporting flows. In addition, starting in 2018, a specific add-on for economic capital has been introduced for operational risk, determined on the basis of operational losses, to strengthen the protection against possible reputational repercussions.

Over the years, the Group has developed and implemented the necessary structural and operational improvements to support senior management with integrated risk reporting that is as complete, accurate and regular as possible.



The risk monitoring processes have undergone a progressive strengthening of the Data & Reporting Governance controls, also in compliance with the applicable regulations ("Principles for effective risk data aggregation and risk reporting - BCBS239"). The Group has planned actions in specific areas, including the adoption of agreed classifications and uniform practices for the description of the life cycle of the data within the main risk monitoring processes. More generally, actions have been taken regarding the aspects shown in the diagram below.



The Group has also strengthened its focus on data quality control, defining processes, roles and responsibilities, reference classifications (quality dimensions) and identifying the related support instruments.
The types of risk included in the scope of the Data & Reporting Governance are: credit risk, market and counterparty risk, interest rate risk of the banking book, liquidity risk, operational risks and risk integration.
Assessments of each single type of risk for the Group are integrated in a summary amount – the Economic Capital – defined as the maximum "unexpected" loss the Group might incur over a year. This is a key measure for determining the Group's financial structure and its risk tolerance, and guiding operations, ensuring the balance between risks assumed and shareholder return. It is estimated on the basis of the current situation and also as a forecast, based on the budget assumptions and projected economic scenario. The assessment of capital is included in business reporting and is submitted quarterly to the Steering Committee, the Risks Committee and the Board of Directors, as part of the Group's Risks Tableau de Bord.
In addition to managing the risks described above, Intesa Sanpaolo pays close attention to the identification and monitoring of specific areas of emerging risk, which, in the medium term, could compromise the achievement of the Group's strategic objectives or significantly influence its financial position and results.

For the purposes described above, the Intesa Sanpaolo Group uses a wide-ranging set of tools and techniques for risk assessment and management, detailed in this Part E of the Notes to the consolidated financial statements, with regard to the types of risk indicated below and in accordance with the procedures established for the qualitative disclosure in Bank of Italy Circular 262:

	FINANCIAL STATEMENTS Section/Chapter	Paragraph	PILLAR 3 Section
RISKS OF THE BANKING GROUP	PART E - SECTION 2		
- Credit risk	Chapter 1.1	*Paragraph A*	Sections 6-7-8-9-10
- Securitisations	Chapter 1.1	*Paragraph C*	Section 12
- Market risk	Chapter 1.2		Section 13
- Regulatory trading book:		*Paragraph 1.2.1*	
- Banking book		*Paragraph 1.2.2*	
- Counterparty risk	Chapter 1.3		Section 11
- Financial derivatives		*Paragraph 1.3.1*	
- Credit derivatives		*Paragraph 1.3.2*	
- Accounting hedges		*Paragraph 1.3.3*	
- Liquidity risk	Chapter 1.4		
- Operational risks	Chapter 1.5		
RISKS OF INSURANCE COMPANIES	PART E - SECTION 3		
- Insurance Risks	Chapter 3.1		
- Financial Risks	Chapter 3.2		
RISKS OF OTHER COMPANIES	PART E - SECTION 4		

The information provided in this part of the document is based on internal management data and may not necessarily coincide with that contained in Parts B and C of the Notes to the consolidated financial statements.
In addition to credit, market, trading book, banking book financial, liquidity, operational and insurance risks, discussed in detail in the following paragraphs, the Group has identified and monitors the following other risks.

Strategic risk

The Intesa Sanpaolo Group defines current or prospective strategic risk as risk associated with a potential decline in profits or capital due to changes in the operating context, misguided Company decisions, inadequate implementation of decisions, or an inability to react sufficiently to changes in the competitive scenario.
The Group's response to strategic risk is represented first and foremost by policies and procedures that call for the most important decisions to be deferred to the Board of Directors, supported by a current and forward-looking assessment of risks and capital adequacy. The high degree to which strategic decisions are made at the central level, with the involvement of the top corporate governance bodies and the support of various company functions ensures that strategic risk is mitigated.
An analysis of the definition of strategic risk leads to the observation that this risk is associated with two distinct fundamental components:
– a component associated with the possible impact of misguided Company decisions and an inability to react sufficiently to changes in the competitive scenario: this component does not require capital, but is one of the risks mitigated by the ways in which strategic decisions are reached and by their centralisation with top management, where all significant decisions are always supported by specific activities aimed at identifying and measuring the risks implicit in the initiative;
– the second component is more directly related to business risk; in other words, it is associated with the risk of a potential decline in profits as a result of the inadequate implementation of decisions and changes in the operating context. This component is handled not only by using systems for regulating Company management, but also via specific internal capital, determined according to the Variable Margin Volatility (VMV) approach, which expresses the risk arising from the business mix of the Group and its Business Units.

Strategic risk is also assessed as part of stress tests based on a multiple-factor model that describes the relations between changes in the economic scenario and the business mix resulting from planning hypotheses, with analyses to assess the impacts on both interest income and margins from the performance of net fees and commissions.

Reputational risk

The Intesa Sanpaolo Group attaches great importance to reputational risk, namely the current and prospective risk of a decrease in profits or capital due to a negative perception of the Bank's image by customers, counterparties, shareholders, investors and Supervisory Authorities.
The reputational risk governance model of Intesa Sanpaolo envisages that management and mitigation of reputational risks is pursued:
– through compliance with standards of ethics and conduct by all employees. The Code of Ethics adopted by the Group contains the core values that Intesa Sanpaolo intends to commit itself to and sets out the voluntary principles of conduct for dealings with all stakeholders (customers, employees, suppliers, shareholders, the environment and, more generally, the community) with even broader objectives than those required by current legislation. The Group has also issued voluntary conduct policies (human rights policy, environmental policy and arms industry policy) and adopted international principles (UN Global Compact, UNEP FI, Equator Principles) aimed at pursuing respect for the environment and human rights;

- systematically and independently by the structures tasked with safeguarding the company reputation, which maintain relations with stakeholders, within their respective areas of responsibility;
- across the various corporate functions, through the Reputational Risk Management processes coordinated by the Chief Risk Officer Governance Area;
- through an integrated monitoring system for primary risks, to limit exposure to those risks, and compliance with the related limits contained in the Risk Appetite Framework.

The Group aims to achieve constant improvement of reputational risk governance also through an integrated compliance risk management system, as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature are founded on trust.
In order to safeguard customers' interests and the Group's reputation, specific attention is also devoted to establishing and managing customers' risk appetite, pursued through the identification of the objective traits of each customer. The assessments of adequacy during the process of structuring products and rendering advisory services are supported by objective information, that considers the true nature of the risks borne by customers when they undertake derivative transactions or make financial investments.
More specifically, the marketing of financial products is also governed by specific advance risk assessment from the standpoint of both the Bank (along with risks, such as credit, financial and operational risks, that directly affect the owner) and the customer (portfolio risk, complexity and frequency of transactions, concentration on issuers or on foreign currency, consistency with objectives and risk tolerance profiles, and knowledge and awareness of the products and services offered).
The abovementioned Reputational Risk Management (RRM) processes are coordinated by the Chief Risk Officer Governance Area and involve control, specialist and business functions, for various purposes. These processes include:

- Reputational Risk Assessment, which seeks to identify the most significant reputational risk scenarios that the Intesa Sanpaolo Group is exposed to. This process is implemented annually and is aimed at gathering the opinion of Top Management regarding the potential impact of these scenarios on the Group's image, in order to identify appropriate communication strategies and specific mitigation actions, where necessary;
- Reputational Risk Clearing, which is aimed at the ex-ante identification and assessment of the potential reputational risks associated with the most significant business operations, the main capital budget projects and the selection of the Group's suppliers/partners;
- Reputational Risk Monitoring, aimed at monitoring the evolution of Intesa Sanpaolo's reputational positioning (on the web, for example) also with the aid of external analyses.

Risk on owned real-estate assets

The risk on owned real-estate assets may be defined as risk associated with the possibility of suffering financial losses due to an unfavourable change in the value of such assets and is thus included in the category of banking book financial risks. Real-estate management is highly centralised and represents an investment that is largely intended for use in company operations.
The degree of risk in the portfolio of owned properties is represented by calculating an economic capital based on changes observed in the past in indexes of mainly Italian real estate prices, the main type of exposure associated with the Group's real-estate portfolio, applied to the market value of the real estate portfolio at the reporting date, with an appropriate granularity of geographical location and intended use.

Risk on equity investments not subject to line-by-line consolidation

The risk in the equity investment portfolio is related to the possibility of incurring economic losses due to the adverse changes in values of investments not subject to line-by-line consolidation.
The scope considered consists of the equity instruments held in financial and non-financial companies, and includes financial investment instruments, commitments to purchase, and derivatives with underlying equity instruments and equity funds.
The model used to estimate the Economic Capital is a PD/LGD approach similar to the credit risk portfolio model and it is used for the stand-alone equity investment portfolio. The applicable LGD is the regulatory LGD, whereas the model's other parameters are the same as those used in the portfolio model for credit risk.

Risk related to defined-benefit pension funds

The risk related to defined-benefit pension funds is attributable to the possibility of having to increase the reserve that the Parent Company Intesa Sanpaolo maintains to guarantee the benefits of those pension funds, based on an adverse change in the value of the assets and/or liabilities of the pension funds concerned. This risk is fully considered within the assessment of capital adequacy, measured and controlled both with respect to Economic Capital, using an econometric model for the main macroeconomic variables, and to prospective baseline and stress scenarios.
Following the result of the offer of capitalisation of the supplementary benefits on a voluntary basis in the second half of 2018 (as described in detail in the Financial Statements – Notes to the consolidated financial statements – Part B – Information on the balance sheet - Liabilities) the guarantee to be provided on those benefits, and the associated risk of increase, have been significantly reduced.

Model risk

Model risk is defined as the risk arising from the improper use of the results of the internal models or from errors in the development and/or implementation of the internal models.
In 2018, the Internal Validation and Controls Head Office Department further developed the framework for the identification, assessment and mitigation of this risk. In particular, in order to set a specific economic capital buffer (under baseline conditions), included in the 2018-2021 ICAAP Report, the assessment was updated for the “inherent” model risk (expressed synthetically through a score) of several Pillar 1 and Pillar 2 methodologies that contribute to the aforementioned economic capital calculation.

Emerging risks

The strengthening of the overall risk management system also involves the identification, understanding and monitoring of so-called emerging risks, i.e. risks characterised by components that are partly unknown but considered significant, even though their effects are uncertain and cannot yet be fully integrated into the more consolidated risk management frameworks. These risks could have a significant impact on the Group’s financial position or business model in the medium term.
The identification of these types of risks derives primarily from the continuous analysis of the external environment and the main findings gathered by the risk management function during the identification and assessment processes, but also involves comparison with peers and with market best practices, as well as with the Bank’s other control/business functions.
In this regard, Intesa Sanpaolo pays particular attention to cyber risks and risks associated with climate change.
Technological updating, the evolution of our information system and the numerous initiatives aimed at digital transformation are a fundamental part of the Group’s development strategies, also in view of the evolution of the international competitive environment, which is seeing the entry of new types of competitors and deeply innovative solutions. Among the problems that have arisen with the digitisation and technological developments linked to the ever-increasing need to use and share data is cyber risk, which is particularly significant due to both the growth in the frequency and severity of attacks (against financial institutions or other components of their value chain) and the confidentiality of company and customer data. In view of the changes in the internal and external situation, the ISP Group has decided to make cyber risk management an integral part of its management strategy, in order to support the development and implementation of cutting-edge cybersecurity solutions, providing the tools needed to identify and deal with possible threats and risk scenarios in the various company areas (processes, technologies, personnel and organisational culture). To this end, the Group is committed to developing strategic intelligence and cyber-readiness solutions, as well as creating a resilient environment, capable of promptly restoring the normal course of processes and services and mitigating operational and reputational impacts. The Group is also establishing a framework dedicated to the management of cyber risk that enables it to implement and maintain effective control of this risk over time and to protect its business, reputation, customers and employees.
The Intesa Sanpaolo Group is aware that it has a direct impact on the environment (due, for example, to its consumption of resources) and an indirect impact (through its business activities) and has long been attentive to climate change risk, i.e. all the risks associated with climate change caused by the accumulation of greenhouse gases in the atmosphere. For example, following the signing of the Paris agreement, it is likely that reducing greenhouse gases (GHG) could have concrete financial implications on the economy of certain sectors (e.g. reduction/abandonment of fossil fuels) with which the Group has business relations.
The Group is therefore interested in monitoring the effects of climate change and has decided to support the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), committing itself to the dissemination of transparent reporting on risks and opportunities related to this change. To this end, it has set up a cross-functional working group for the implementation of the TCFD recommendations and intends to assess the repercussions of this issue within the risk management framework, also looking at the impact on its lending activities.

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In addition to the above risks, the Intesa Sanpaolo Group is carefully assessing the risks that may arise from the United Kingdom’s exit from the European Union, which are mainly linked to the regulatory and political uncertainties arising from Brexit. In order to best address these risks, the Intesa Sanpaolo Group has formulated its strategic and operational decisions, through a dedicated project, aimed at ensuring business continuity also in a Hard Brexit scenario. The Brexit plan has been defined in accordance with the external scenario and the relevant instructions from the competent Supervisory Authorities and the Regulators.
In particular, for the Corporate & Investment Banking Division, which has a presence in the United Kingdom with two branches, mitigation actions have been identified to guarantee business operations and customer coverage. In addition, particular focus has been placed on access to UK resident Central Counterparties (CCPs) for the centralised clearing of OTC derivatives.

Absorption of Economic Capital by type of risk and Business Unit

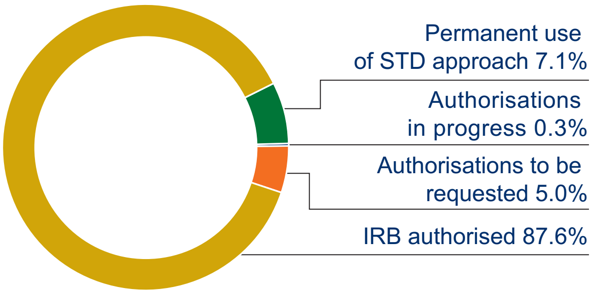
The following is an illustration of the breakdown of the Group's Economic Capital by type of risk and Business Unit.

The absorption of Economic Capital by Business Unit reflects the distribution of the Group's various activities and the specialisations of the business areas.
The majority of risk is concentrated in the "Corporate & Investment Banking" Business Unit (30.3% of the total Economic Capital): this is attributable to the type of customers served (Corporate and Financial Institutions) and Capital Market activities. This Business Unit is assigned a significant share of credit risk and trading book risk.
The "Banca dei Territori" Business Unit (17.5% of the total Economic Capital) is a significant source of absorption of Internal Capital, in line with its role as core business of the Group, serving Retail, Private and Small/Middle Corporate customers. It is assigned a sizeable portion of credit risk and operational risk.
Most of the insurance risk is assigned to the "Insurance" Business Unit (14.2% of the total Economic Capital).
The "International Subsidiary Banks" Business Unit is assigned 9.7% of the total risk, predominantly credit risk.
In addition to credit risk, the "Corporate Centre" is attributed with the risks typical of this Business Unit, namely those resulting from investments, the risks pertaining to the Capital Light Bank, the Banking Book interest rate and exchange rate risk, the risks arising from the management of the Parent Company's FVTOCI portfolio, and the residual portion of insurance risk (26.0% of the total Economic Capital).
Absorption of Economic Capital by the "Private Banking" and "Asset Management" Business Units is marginal (2.0% and 0.3%, respectively) due to the nature of their business, which is predominantly aimed at asset management activities.

The Basel 3 regulations

In view of compliance with the gradual reforms of the previous accord by the Basel Committee ("Basel 3"), the Intesa Sanpaolo Group undertakes adequate initiatives in order to continuously improve the measurement systems and the related risk management systems.
With respect to credit risks, the Group received authorisation to use internal ratings-based approaches effective from the report at 31 December 2008 on the Corporate portfolio for a scope including the Parent Company, the banks in the Banca dei Territori Division and the main Italian product companies.
Subsequently, the scope of application has been gradually extended to include the SME Retail and Retail Mortgage portfolios, as well as other Italian and international Group companies.
Compared to 31 December 2017, the authorisation was received from the ECB on 31 August 2018 for the use of the new internal rating model for the Retail segment consisting of Residential Mortgages (model change) and Other Retail (first adoption), with the extension of the model to the portfolio acquired from the former Banca Nuova. In addition, the use of the new Retail model has been extended to the former Banca Nuova portfolio and the SME Retail model has been extended to the portfolios acquired from the former Banca Popolare di Vicenza, Veneto Banca and Banca Nuova.
With regard to the progress of the roll-out plan for the internal models for credit risk, the share of exposures authorised for the IRB system is 87.6% of the loan portfolio. The pending authorisations, concerning the extension of the internal models to Banca Apulia, represent 0.3% of the portfolio, while requests to be made for the remaining portfolios of the Group's Italian and international banks represent 5% of the portfolio. For the remainder, equal to 7.1%, the permanent use of the Standardised approach has been authorised.

Roll-out plan for internal models for credit risk(*)



(*) Percentages calculated based on the full standard RWA amounts as at 31/12/18. The portfolios are considered to be covered by IRB models when the authorisation has been received, from the Supervisory Authority, for use of the internal model for at least one of the risk parameters.

With regard to counterparty risk, the Banking Group improved the measurement and monitoring of the risk, by refining the instruments required under Basel 3.
For reporting purposes, the Parent Company, the Banks of the Banca dei Territori Division and Banca IMI are authorised to use the internal models approach for the reporting of the requirement with respect to counterparty risk both for OTC derivatives and for SFTs (Securities Financing Transactions, i.e. repos and securities lending).
This authorisation was obtained for derivatives from the first quarter of 2014, and for SFTs from the report as at 31 December 2016.
The banks of the Banca dei Territori Division received the same authorisation for derivatives from the report as at 31 December 2016.
For management purposes, the advanced risk measurement approaches have been implemented for the OTC derivatives of the Parent Company and Banca IMI since 2010 and were subsequently extended in 2015 to the Banca dei Territori Division and to Securities Financing Transactions.
With regard to Operational Risk, the Group obtained authorisation to use the Advanced Measurement Approach (AMA – internal model) to determine the associated capital requirement for regulatory purposes, with effect from the report as at 31 December 2009.
The annual Internal Capital Adequacy Assessment Process Report, based on the extensive use of internal approaches for the measurement of risk, internal capital and total capital available, was approved and sent to the ECB in April 2018.
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 (www.group.intesasanpaolo.com) each quarter.

SECTION 1 – RISKS OF THE CONSOLIDATED BOOK

In this Section, information is provided regarding the companies included in the consolidated book.

QUANTITATIVE INFORMATION

A. CREDIT QUALITY

For the purposes of quantitative information about credit quality, the term "credit exposures" is understood to exclude equities and quotas of UCI.

A.1. Performing and non-performing credit exposures: amounts, adjustments, changes, and economic breakdown

A.1.1. Breakdown of financial assets by portfolio classification and credit quality (book values) - Excluding insurance companies

(millions of euro)

Portfolios/quality		Bad loans	Unlikely to pay	Non-performing past due exposures	Performing past due exposures	Other performing exposures	TOTAL
1. Financial assets measured at amortised cost		7,138	9,043	350	5,820	454,152	476,503
2. Financial assets measured at fair value through other comprehensive income		-	-	-	-	57,308	57,308
3. Financial assets designated at fair value		-	-	-	-	208	208
4. Other financial assets mandatorily measured at fair value		-	73	2	4	1,145	1,224
5. Non-current financial assets held for sale		23	886	-	11	19	939
Total	**31.12.2018**	**7,161**	**10,002**	**352**	**5,835**	**512,832**	**536,182**
Total	**31.12.2017**	**12,626**	**12,725**	**392**	**8,191**	**510,901**	**544,835**

A.1.1. Bis. Breakdown of financial assets by portfolio classification and credit quality (book values) - Insurance companies

(millions of euros)

Portfolios/quality		Bad loans	Unlikely to pay	Non-performing past due exposures	Performing past due exposures	Performing exposures	TOTAL
1. Financial assets available for sale		-	-	-	-	62,304	62,304
2. Investments held to maturity		-	-	-	-	-	-
3. Due from banks		-	-	-	-	922	922
4. Loans to customers		-	-	-	-	30	30
5. Financial assets designated at fair value		-	-	-	-	4,888	4,888
6. Non-current financial assets held for sale		-	-	-	-	-	-
TOTAL	**31.12.2018**	**-**	**-**	**-**	**-**	**68,144**	**68,144**
TOTAL	**31.12.2017**	**-**	**-**	**-**	**-**	**71,194**	**71,194**

A.1.2. Breakdown of financial assets by portfolio classification and credit quality (gross and net values) - Excluding insurance companies

(millions of euros)

Portfolios/quality	NON-PERFORMING ASSETS				PERFORMING ASSETS			TOTAL (net exposition)
	Gross exposure	Collective adjustments	Net exposure	Total partial write-offs	Gross exposure	Collective adjustments	Net exposure	
1. Financial assets measured at amortised cost	36,396	-19,865	16,531	5,306	462,242	-2,270	459,972	476,503
2. Financial assets measured at fair value through other comprehensive income	35	-35	-	-	57,355	-47	57,308	57,308
3. Financial assets designated at fair value	-	-	-	-	X	X	208	208
4. Other financial assets mandatorily measured at fair value	94	-19	75	-	X	X	1,149	1,224
5. Non-current financial assets held for sale	1,210	-301	909	8	39	-9	30	939
Total 31.12.2018	**37,735**	**-20,220**	**17,515**	**5,314**	**519,636**	**-2,326**	**518,667**	**536,182**
Total 31.12.2017	**52,424**	**-26,681**	**25,743**	**n.a.**	**520,091**	**-1,448**	**519,092**	**544,835**

(millions of euros)

Portfolios/quality	ASSETS OF EVIDENTLY LOW CREDIT QUALITY		OTHER ASSETS
	Cumulative capital losses	Net exposure	Net exposure
1. Financial assets held for trading	-38	46	37,117
2. Hedging derivatives	-	-	2,993
Total 31.12.2018	**-38**	**46**	**40,110**
Total 31.12.2017	**-46**	**309**	**41,225**

The tables above include purchased credit-impaired financial assets, mainly relating to positions included in securitisations following the integration of the former Venetian banks. The purchase price (to be understood as the initial recognition amount) of these assets was 569 million euro compared to an original gross value of 728 million euro.

A.1.2. Bis Breakdown of financial assets by portfolio classification and credit quality (gross and net values) – *Insurance companies*

(millions of euro)

Portfolios / (Figures must be filled in absolute values)	**Quality**	**Impaired assets**			**Not impaired assets**			**Total (net exposure)**
		Gross exposure	**Individual adjustments**	**Net exposure**	**Gross exposure**	**Collective adjustments**	**Net exposure**	
1. Financial assets available for sale		-	-	-	62,304	-	62,304	62,304
2. Investments held to maturity		-	-	-	-	-	-	-
3. Due from banks		-	-	-	922	-	922	922
4. Loans to customers		-	-	-	30	-	30	30
5. Financial assets designated at fair value		-	-	-	X	X	4,888	4,888
6. Non-current financial assets held for sale		-	-	-	-	-	-	-
Total	**31.12.2018**	**-**	**-**	**-**	**63,256**	**-**	**68,144**	**68,144**
Total	**31.12.2017**	**-**	**-**	**-**	**66,732**	**-**	**71,194**	**71,194**

(millions of euro)

Portfolios / Quality		**Assets of evidently low credit quality**		**Other assets**
		Cumulative capital losses	**Net exposure**	**Net exposure**
1. Financial assets held for trading		-	-	181
2. Hedging derivatives		-	-	-
Total	**31.12.2018**	**-**	**-**	**181**
Total	**31.12.2017**	**-**	**-**	**240**

B. INFORMATION ON STRUCTURED ENTITIES (OTHER THAN SECURITISATION VEHICLES)

In line with IFRS 12, the Group considers structured entities to be entities set up to achieve a narrow, well-defined objective, defined through contractual arrangements which often impose strict restrictions on decision-making powers of the entity's management bodies. In that sense, structured entities are designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, as they refer to administrative tasks, while the relevant operating activities are directed by means of contractual arrangements agreed on at the time of structuring the structured entity, which are difficult to modify. The characteristics of a structured entity include:

– limited activities;
– a narrow and well-defined objective;
– insufficient equity to permit the structured entity to finance its activities without subordinated financial support.

The structured entities through which the Group operates are mainly Special Purpose Entities (SPEs) and UCIs.

B.1. Consolidated structured entities

There are no structured entities consolidated in the accounts other than securitisation companies that fall within the scope of the Intesa Sanpaolo Banking Group.

B.2. Structured entities not consolidated in the accounts

B.2.1. Prudential consolidation of structured entities

There are no structured entities consolidated for prudential purposes other than securitisation companies that fall within the scope of the Intesa Sanpaolo Banking Group.

B.2.2. Other structured entities

Qualitative information

As indicated above, the Group's operations through structured entities are also carried out through SPEs. To that end, SPEs are understood as legal entities established to pursue a specific, well-defined and limited objective:

– to raise funds on the market by issuing specific financial instruments;
– to develop and/or finance a specific business initiative, capable of generating, through an economic activity, cash flows which permit the complete reimbursement of the debt;
– to finance the acquisition of a target company which, through its economic activity, will be capable of generating cash flows for the SPEs which permit the complete reimbursement of the debt.

For the purposes of this section, operations carried out through securitisation vehicles, that is vehicles established to acquire, sell and manage specific assets, separating them from the financial statements of the Originator, for the purpose of carrying out securitisations of assets or for acquiring funding through self-securitisations and issues of Covered Bonds (CB), shall not be relevant. For that types of vehicle companies, reference should be made to section "C. Securitisations" and section “D. Sales" of Part E of the Notes to the consolidated financial statements.

In some cases the Group sponsors the SPE by structuring the transaction to pursue specific objectives, such as raising funds, securitising its own assets also for the purposes of funding or offering financial services to customers.

In detail, the Group's operations are carried out through the following types of structured entities represented by special purpose entities (SPEs).

Project Financing SPEs

These are financing instruments for capital intensive projects, which are based on the economic or financial validity of the industrial or infrastructural project, and are independent from the standing/creditworthiness of the sponsors who developed the “entrepreneurial” idea. The financing of the initiative is based on the project’s capacity to generate positive cash flows, sufficient to reimburse loans received and guarantee an adequate risk-adjusted return on invested capital.
The Intesa Sanpaolo Group finances entities of this type, as normal borrowers, without acting as sponsor.

Asset Backed SPEs
These are transactions aimed at acquisition/construction/management of physical assets by SPEs financed by one or more entities. Their recovery prospects mostly depend upon the cash flows generated by the assets. The assets generate cash flows in their recurring operations (e.g. rentals, goods transportation contracts, etc.) or in their non-recurring operations (e.g. a real estate development or disposal plan). Generally the assets are also the collateral for the financing disbursed to the vehicle.
The Intesa Sanpaolo Group finances entities of this type, as normal borrowers, without any direct equity investments or any other interests which might lead to presume the role of sponsor. The risk undertaken is always a normal credit risk and the benefits are represented by the return on the financing granted.

Leveraged & Acquisition Finance SPEs
This category includes 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. 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. The Intesa Sanpaolo Group finances entities of this type, as normal borrowers, without acting as sponsor.

The Intesa Sanpaolo Group also has investments in/exposures to structured entities represented by UCIs.
The main cases include the Group's investments in several funds managed by IMI Fondi Chiusi SGR, which sponsors and manages closed-end private equity funds, in the form of UCIs reserved to qualified operators, specialised in investment in Small and Medium-Sized Enterprises, operating in two complementary business lines: Private Equity and Venture and Seed Capital.
In the area of Private Equity, there are several operating funds dedicated to investment in SMEs throughout the country and in specific geographical areas.
In the area of Venture and Seed Capital, the sponsored funds operate in the following areas:
- participation in new business initiatives characterised by sound technological profiles;
- participation in projects to introduce process or product innovation using digital technology;
- investments in businesses with high forecast growth rates and cutting-edge technological development, both through direct investments in Seed Capital (financing the assessment and development of a business idea prior to the start-up phase) and indirect investments in UCI units with an investment policy matching the Fund's objectives or in business incubators/accelerators.

Investments in these types of funds derive from the Group's willingness to subscribe unplaced units offered during the placement to qualified investors, to ensure that the initiatives are successful, in any event, while maintaining suitable separation of management in organisational terms.

The closed-end funds in question finance their activities exclusively using the capital that investors committed to paying in at the time of placement, without using any types of debt.

The Group made further investments in UCIs through the subsidiary Eurizon Capital SGR, in line with the financial portfolio management policies issued by the company, in agreement with the Intesa Sanpaolo Group Guidelines. In detail, the asset management company has both temporary and structural available funds deriving from company equity that is not permanently invested in equity investments or other fixed assets, and from the ordinary cash flows. Based on that set out in the guidelines for managing the financial portfolio, as part of Treasury management activities, structural and temporarily available funds linked to the trend in short-term and on demand cash flows make up the liquidity portfolio net of the amount held in current accounts or invested in term deposits. In relation to the activities carried out by the asset management company and the characteristics of the available funds in question, excess liquidity must be invested in assets with moderate risk that can be easily liquidated. That portfolio includes investments in short-term money market and bond funds, both specialising in the Eurozone, established and/or managed by Eurizon Capital SGR or by its subsidiaries. The Group's investments in UCIs managed by a subsidiary do not prejudice the operational autonomy and capacity of the asset management company to act in the exclusive interest of investors, considering the specific provisions set out in sector regulations and by the Supervisory Authorities.

The exposures to UCIs also include the investments in units of real estate funds deriving from transactions to contribute portions of the Group’s real estate portfolio.

The investments in UCIs also include the units held in the Atlante Fund and the Italian Recovery Fund, alternative investment funds managed by the asset management company Quaestio Capital Management, involved in value enhancement of Non-Performing Loans of Italian banks.

The Intesa Sanpaolo Group also invests in hedge funds. For more information, reference is made to the specific section in Part E of the Notes to the consolidated financial statements.

Quantitative information

(millions of euro)

Captions / Type of structured entity		Accounting portfolios under assets	Total assets (A)	Accounting portfolios under liabilites	Total liabilities (B)	NET BOOK VALUE (C = A-B)	Maximum exposure to risk of loss (D)	Difference between exposure to risk of loss and book value (E = D - C)
1.	**Special purpose vehicle**		**2,699**		**516**	**2,183**	**3,438**	**1,255**
		Financial assets held for trading	236	Due to customers	516			
		Other financial assets mandatorily measured at fair value	2		-			
		Assets measured at amortised cost_Loans to customers	2,461		-			
2.	**UCI**		**3,081**		**42**	**3,039**	**3,180**	**141**
		Financial assets held for trading	962	Due to customers	39			
		Financial assets designated at fair value	1,601	Financial liabilities held for trading	3			
		Assets measured at amortised cost_Loans to customers	518		-			

The maximum exposure to risk, representing the maximum exposure of the Group to losses deriving from its interests in structured entities, is generally equal to the net book value, to which, where applicable, several types of off-balance sheet exposures are added (e.g. committed credit lines or guarantees given). The net book value equals the exposure in the financial statements net of value adjustments recorded during the current and previous years.
For UCIs, the maximum risk exposure also includes the Group's commitments, not yet called up by the fund, to subscribe additional units.
The table below shows the amount and type of revenues earned over the year by structured entities. The main component of the revenues recognised consists of fees deriving from the management and placement of the UCIs sponsored and managed by the Group's asset management companies and placed with customers. The fees in question are charged by the asset management company to the funds managed and partly reversed to the distribution network for the placement service.

(millions of euro)

Type of structured entity sponsored	Interest	Fees and commissions	Dividends	Other revenue	TOTAL
UCI	3	1,882	21	4	1,910
Special-purpose vehicles	196	24	-	79	299

SECTION 2 – RISKS OF THE PRUDENTIAL CONSOLIDATION

In this section the figures are shown gross of the transactions with the other companies included in the scope of the accounting consolidation. These figures usually also include the assets and liabilities, in proportion to the interest held, of the jointly-controlled banking, financial and operational companies consolidated proportionally for reporting purposes. Where the contribution of transactions between the companies included in the prudential consolidation and the other companies in the scope of the accounting consolidation is material, the details of those transactions are provided at the foot of the disclosure concerned.

The following table contains the reconciliation of the consolidated balance sheet with the regulatory-scope balance sheet.

(millions of euro)

Assets		31.12.2018 Financial Statements	Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)	31.12.2018 Regulatory-scope balance sheet
10.	Cash and cash equivalents	10,350	-3	10,347
20.	Financial assets measured at fair value through profit or loss	42,115	555	42,670
	a) financial assets held for trading	38,806	164	38,970
	b) financial assets designated at fair value	208	-	208
	c) other financial assets mandatorily measured at fair value	3,101	391	3,492
30.	Financial assets measured at fair value through other comprehensive income	60,469	-17	60,452
35.	Financial assets pertaining to insurance companies, measured at fair value pursuant to IAS 39	149,546	-149,546	-
40.	Financial assets measured at amortised cost	476,503	3,142	479,645
	a) due from banks	69,307	-116	69,191
	b) loans to customers	407,196	3,258	410,454
45.	Financial assets pertaining to insurance companies measured at amortised cost pursuant to IAS 39	952	-952	-
50.	Hedging derivatives	2,993	-	2,993
60.	Fair value change of financial assets in hedged portfolios (+/-)	124	-	124
70.	Investments in associates and companies subject to joint control	943	5,343	6,286
80.	Technical insurance reserves reassured with third parties	20	-20	-
90.	Property and equipment	7,372	-773	6,599
100.	Intangible assets	9,077	-1,743	7,334
	of which:	-	-	-
	- goodwill	4,163	-602	3,561
110.	Tax assets	17,253	-631	16,622
	a) current	3,320	-47	3,273
	b) deferred	13,933	-584	13,349
120.	Non-current assets held for sale and discontinued operations	1,297	-278	1,019
130.	Other assets	8,707	-3,731	4,976
Total Assets		**787,721**	**-148,654**	**639,067**

Liabilities and Shareholders' Equity		31.12.2018 Financial Statements	Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)	31.12.2018 Regulatory-scope balance sheet
10.	Financial liabilities measured at amortised cost	513,775	4,173	517,948
	a) due to banks	107,815	-1,352	106,463
	b) due to customers	323,900	3,197	327,097
	c) securities issued	82,060	2,328	84,388
15.	Financial liabilities pertaining to insurance companies measured at amortised cost pursuant to IAS 39	810	-810	-
20.	Financial liabilities held for trading	41,895	156	42,051
30.	Financial liabilities designated at fair value	4	-	4
35.	Financial liabilities pertaining to insurance companies measured at fair value pursuant to IAS 39	67,800	-67,800	-
40.	Hedging derivatives	7,221	-331	6,890
50.	Fair value change of financial liabilities in hedged portfolios (+/-)	398	-	398
60.	Tax liabilities	2,433	-596	1,837
	a) current	163	-35	128
	b) deferred	2,270	-561	1,709
70.	Liabilities associated with non-current assets held for sale and discontinued operations	258	-258	-
80.	Other liabilities	11,645	-2,012	9,633
90.	Employee termination indemnities	1,190	-9	1,181
100.	Allowances for risks and charges	5,064	-192	4,872
	a) commitments and guarantees given	510	-63	447
	b) post-employment benefits	261	-1	260
	c) other allowances for risks and charges	4,293	-128	4,165
110.	Technical reserves	80,797	-80,797	-
120.	Valuation reserves	-913	-	-913
125.	Valuation reserves pertaining to insurance companies	9	-	9
130.	Redeemable shares	-	-	-
140.	Equity instruments	4,103	-	4,103
150.	Reserves	13,006	-	13,006
160.	Share premium reserve	24,768	-	24,768
170.	Share capital	9,085	-	9,085
180.	Treasury shares (-)	-84	-	-84
190.	Minority interests (+/-)	407	-178	229
200.	Net income (loss) (+/-)	4,050	-	4,050
Total Liabilities and Shareholders' Equity		**787,721**	**-148,654**	**639,067**

(*) The effects are attributable to :
- deconsolidation of companies that are not part of the Banking Group;
- proportional consolidation of the jointly controlled companies that are consolidated at equity in the financial statements.