Part E – Information on risks and relative hedging policies

INTRODUCTION

The table below shows the mapping of risk disclosure regarding the financial statements and Pillar 3.

	FINANCIAL STATEMENTS		PILLAR 3
	Section/Chapter	Paragraph	Section
RISKS OF THE BANKING GROUP	PART E - SECTION 1		
- Credit risk	Chapter 1.1		Sections 5-6-7-8
- Securitisations		*Paragraph C*	*Section 10*
- Counterparty risk	Chapter 1.1 - Chapter 1.2		Section 9
- Market risk	Chapter 1.2		
- Regulatory trading book		*Paragraph 1.2.1*	*Section 11*
- Banking book		*Paragraph 1.2.2*	*Sections 13-14*
- Sovereign risk	Chapter 1.3		
- Liquidity risk	Chapter 1.3		
- Operational risk	Chapter 1.4		Section 12
- Legal risk	Chapter 1.4		
RISKS OF INSURANCE COMPANIES	PART E - SECTION 2		
- Insurance risks	Chapter 2.1		
- Financial risks	Chapter 2.2		
RISKS OF OTHER COMPANIES	PART E - SECTION 3		

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 Management Board and Supervisory Board. The RAF, introduced in 2011 to ensure that risk-acceptance activities remain in line with shareholders' expectations, is established by taking account of the Intesa Sanpaolo Group's risk position and the economic situation.
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 level of capital 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 compliance and reputational risks: 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 Intesa Sanpaolo Group strives to actively manage its image in the eyes of all stakeholders and aims to prevent and contain any negative effects on said image.

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 under the conditions of severe stress. In addition, it aims to ensure the desired reputational and compliance risk profiles.
In detail, management of overall risk is aimed at maintaining adequate levels of:

– capital, even under conditions of severe macroeconomic stress, with respect to both Pillar 1 and Pillar 2. In further detail, capital adequacy is assessed by monitoring:
  o Common Equity and the Total Capital Ratio, for Pillar 1; and
  o the Leverage Ratio and Risk-Bearing Capacity, for Pillar 2;

- liquidity, so as 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; the Liquidity Coverage Ratio, the Net Stable Funding Ratio and the Funding/Lending Gap;
- earnings stability, so as to ensure profitability even in stress scenarios through an adequate mix of business;
- management of operational, compliance and reputational risk so as to minimise the risk 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 included new indicators in its 2015 Recovery Plan (mainly asset quality indicators, market-based indicators and macroeconomic indicators) and has agreed with the regulator to also include them in the RAF as early warning thresholds on updating the framework for 2016.
Management of the main specific risks is aimed at determining the risk appetite that the Group intends to assume with regard to exposures that may represent especially significant concentrations. Such management is implemented by establishing ad hoc limits, management processes and mitigation measures to be taken in order to limit the impact of especially severe scenarios on the Group. Such risks are assessed on the basis of stress scenarios, are subject to periodic monitoring within the framework of Risk Management systems and constitute early warning indicators, especially as regards capital adequacy.
In detail, the main specific risks monitored are:

- especially significant risk concentrations (e.g., concentration on individual counterparties, sovereign risk or commercial real estate);
- the individual risks that make up the Group's overall risk profile and whose operating limits, as envisaged in specific policies, complete the Risk Appetite Framework.

In light of the Italian macroeconomic context and its extreme uncertainty, in 2015 credit risk was identified as a priority area for analysis, also considering its significant amount for the Group. At the time of the annual update of the RAF, in line with the European peer competitors' standards, it was decided to develop a specific credit risk framework to identify suitable limits both for governing credit risk from the centre (by standardising and codifying the approach and use of analytical instruments) and identifying areas for growth in commitments with equivalent/lower risk for the Bank and areas to be kept under control.

In compliance with the recent instructions from the Bank of Italy, the Group Risk Appetite is organised (both in terms of the total risk and in terms of the main specific risks) on the subsidiaries that contribute significantly to risks and/or specific local characteristics: Banca IMI, Banca Fideuram, Intesa Sanpaolo Vita, Fideuram Vita and the international subsidiaries. Overall risk management is implemented by monitoring key aspects (capital adequacy, liquidity and reputation) according to an approach similar to that followed at the Group level.
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. In accordance with regulatory constraints and in a manner consistent with the risk profile assumed by the Group, the Chief Financial Officer area lays down the strategic profitability, capital adequacy and liquidity objectives that the Group intends to pursue. These objectives then form the basis for identifying the assets and financial resources to be allocated to the individual business units, including the insurance segment, through a process that involves an assessment of their attractiveness, financial independence, growth potential and ability to create value.
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 Supervisory Board and the Management Board 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 with specific risk tolerance sub-thresholds, in a comprehensive framework of governance and control limits and procedures.

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.
Since 2013, the Group has been drawing up a Recovery Plan according to indications from the Supervisory Authorities. The process governing the preparation of that plan is an integral part of the regulatory response agreed with the G20 heads of State to the problem of the cross-border resolution of the "too-big-to-fail" banks and financial institutions, brought to light after the Lehman Brothers' default and the consequences on the financial system at a global level. The Recovery Plan (governed by the Bank Recovery and Resolution Directive, transposed into Italian law by Legislative Decree no. 180 of 16 November 2015) establishes the methods and measures to be used to take action in the early stage to restore the long-term economic stability of an institution in the event of serious deterioration of its financial situation.

A culture of risk-awareness

The utmost attention is devoted to spreading and sharing a culture of risk-awareness through both periodic updates to the documents prepared (Tableau de Bord, ICAAP and Risk Appetite Framework) and initiatives undertaken with the aim of dealing with specific issues raised from time to time.
In addition, the Group guarantees the spread of a culture of risk-awareness through extensive training efforts aimed at ensuring the proper application of the internal risk management models.
The measures taken in pursuit of this goal are established with a coordinated approach to risk management and are compliant with supervisory regulations, as well as ongoing support from the Parent Company for the local development of risk assessment and monitoring systems within the international subsidiaries.
To that end, in 2015 the CRO Forum was set up, consisting of quarterly meetings of the Chief Risk Officers of the Group's international subsidiary banks with the corresponding structures of the Parent Company. These meetings aim to favour the discussion of common issues and problems, best leverage the specific experiences of all Group structures in charge of risk governance, and improve the understanding of the specific characteristics of all local markets where the Group operates (including

regulatory aspects). The CRO Forums are also the most appropriate venue for sharing strategic projects on risk governance conducted at Group level.
The Risk Academy initiative, mainly addressed to the international subsidiaries, is another strategic project that pursues the goal of improving management of Risk Governance at Banking Group level.
The risk management approach aims to achieve increasingly integrated and consistent risk management, considering both the macroeconomic scenario and the Group's risk profile, by fostering a culture of risk-awareness through a transparent, thorough representation of the risk level of portfolios. The efforts made in recent years with the Basel 2 and 3 Project in order to obtain authorisation from the Supervisory Authorities for the use of internal ratings to calculate credit risk requirements and in order to secure validation of internal models for operational and market risks should be seen in this context.

Risk governance organisation

Risk-acceptance policies are defined by the Parent Company's Supervisory Board and Management Board. The Supervisory Board carries out its activity through specific internal committees, among which mention should be made of the Internal Control Committee and the Risk Committee. The Management Board relies on the action of managerial committees, among which mention should be made of the Group Risk Governance Committee. Both corporate bodies receive support from the Chief Risk Officer, who is a member of the Management Board and reports directly to the Chief Executive Officer.
The Chief Risk Officer, to whom the Governance Area in charge of the risk management functions as well as the controls on the risk management and internal validation process reports, represents a "second line of defence" in the management of corporate risks that is separate and independent from the business functions.
These functions are performed by the Group Risk Manager, a position established in 2015, who monitors the risk management and control functions, and by the Internal Validation Service.
The Chief Risk Officer is responsible for proposing the Risk Appetite Framework, setting the Group's risk management guidelines and policies in accordance with company strategies and objectives and coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, including within the various corporate departments. The Chief Risk Officer ensures management of the Group's overall risk profile by establishing methods and monitoring exposure to the various types of risk and reporting the situation periodically to the corporate bodies. The CRO implements level II monitoring and controls of credit and other risks, and ensures the validation of internal risk measurement systems.
In 2015, the Chief Compliance Officer was established, directly reporting to the Managing Director and CEO, in a position that is independent from operating departments and separate from internal auditing, which ensures the management of Group compliance risk, both in the operating and reputational risk component, including the risk of sanctions, losses or damage arising from improper conduct towards customers or such as to jeopardise the integrity and orderly functioning of the markets (so-called conduct risk). Furthermore, in line with corporate strategies and objectives, the CCO defines guidelines and policies, including statements and limits for the Risk Appetite Framework, and works with the corporate control functions to effectively integrate the risk management process.

The Group Risk Governance Committee, chaired by the Managing Director and CEO, is a body with decision-making, consultative and reporting powers. It was established with the aim of ensuring the monitoring and management of risks and the safeguarding of corporate value at Group level, including internal control systems, in implementation of the strategic guidelines and management policies defined by the corporate bodies. The Committee is also responsible for Basel 2 and 3 project governance and supervising the projects and measures necessary to guarantee compliance.
The Group Financial Risks Committee is a technical body with decision-making and reporting 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, in the life assurance sector (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, is responsible for evaluating, in advance of approval by the Corporate Bodies, the methodological and measurement guidelines for financial risks and proposals for operational limits, in addition to defining the distribution thereof amongst the Group's major units; in addition, the session verifies the financial risk profile of the Group and 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 Corporate Bodies 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 appropriate measures aimed at mitigating it.

The Group Internal Control Coordination and Operational Risk Committee is a technical body that operates with the aim of stepping up coordination and interdepartmental cooperation mechanisms:
– as part of the Group internal control system, facilitating the integration of the risk management process;
– in relation to operational risk, including ICT risk, facilitating its effective management.

The Committee operates within the scope of the guidelines set by the corporate bodies, based on the operational and functional powers delegated by the Management Board of the Parent Company. The Functions of the Group Internal Control Coordination and Operational Risk Committee are organised into specific, separate sessions:
– Integrated Internal Control System Session, for reporting and consulting purposes;
– Operational Risk session, with decision-making, reporting and consulting purposes (in this context, the Committee's duties include periodically reviewing the overall operational risk profile, authorising any corrective measures, coordinating and monitoring the effectiveness of the main mitigation activities and approving operational risk transfer strategies).

The Parent Company is in charge of overall direction, management and control of risks. Group companies that generate credit and/or financial risks are assigned autonomy limits and each has its own control structure. For the main Group subsidiaries, these functions are performed, based on an outsourcing contract, by the Parent Company's risk control functions, which periodically report to the management bodies of the subsidiary.

Within the Chief Risk Officer Governance Area, the Group Risk Manager is in charge of the operational implementation of management and strategic guidelines along the decision-making process, down to individual operational units.
The Group Risk Manager performs the following functions:
- It measures and controls the Group's current and future exposure to the various types of risk, particularly market, counterparty, credit, country, interest rate, liquidity, operational and insurance risk, reporting the overall situation to the corporate governance bodies;
- it monitors capital absorption (capital requirements), supporting the Planning and Active Value Management Head Office Department in actively managing capital;
- it proposes the annual update of the RAF to the Chief Risk Officer;
- it proposes to the top management, along with the other competent corporate bodies, the definition of the structure of operating limits, including the rights to grant and manage credit, in line with the RAF and the allocated capital;
- it oversees regulatory developments and ensures that statutory reports are sent to the Supervisory Bodies with regard to internal models;
- it develops and maintains risk measurement, management and control systems in line with current regulations and international best practices, interacting, for such purposes, with the functions in charge of said corporate processes;
- it adopts capital-at-risk measurements for management reporting and assessment of the Group's Economic Capital adequacy;
- as part of the Tableau de Bord and on a quarterly basis, it reports to the corporate bodies on the situation of the Group's overall risk profile; it compares that situation with the Risk Appetite Framework, highlighting any situations that require action by the boards;
- it draws up the annual update of the criteria for identifying significant transactions and provides a prior opinion on such transactions.
- it ensures oversight of level II risk monitoring and controls, as well as contributing to designing level I controls, ensuring verification that they are effectively applied;
- it carries out level II monitoring and controls of credit quality, composition and the evolution of the various loan portfolios and for the purpose of correctly classifying and assessing single names;
- it also monitors and analyses the structure of level II controls for monitoring risks other than credit risk, in order to verify the completeness and continuity of level I controls;
- it identifies any critical issues based on its control/monitoring activities and the results of level I controls, requesting and monitoring the implementation of specific mitigation actions, ensuring prompt reporting to the corporate bodies in the event of breaches or significant shortcomings.

To that end, the Group Risk Manager structure is broken down into the following Departments:
- Credit Risk Management Department;
- Financial and Market Risks Department;
- Enterprise Risk Management Department;
- Controls Department.

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, ICT risk and model risk;
- strategic risk;
- risk on equity investments not subject to line by line consolidation;
- risk on real estate assets owned for whichever purpose;
- insurance risk.

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 in the form of stress tests.
Particular 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 and actively manages its image in the eyes of all stakeholders, aiming to prevent and contain any negative effects on its image, including through robust, sustainable growth capable of creating value for all stakeholders. Reputational risk management is pursued not only through organisational structures with specific duties on reputation monitoring, but also through *ex-ante* risk management processes, defining prevention and mitigation tools and measures in advance and implementing specific, dedicated reporting flows.
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 under ordinary and stress conditions.

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.
The information provided in this part of the document is based on internal management data and does not necessarily coincide with that contained in Parts B and C.

Other risks

In addition to credit, market, operational and insurance risks, discussed in detail in the following paragraphs, the Group has also 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 Management Board and the Supervisory Board, 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 analysis 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 Group actively manages its image in the eyes of all stakeholders and aims to prevent and contain any negative effects on its image, including through robust, sustainable growth capable of creating value for all stakeholders, while also minimising possible adverse events through rigorous, stringent governance, control and guidance of the activity performed at the various service and function levels.

The reputational risk governance model of Intesa Sanpaolo envisages that management and mitigation of reputational risks is pursued:

- systematically and independently by the corporate structures with specific tasks aimed at preserving corporate reputation, through a structured system of organisational monitoring measures;
- across the various corporate functions, through the Reputational Risk Management process governed by specific Guidelines.

The 'systematic monitoring of reputational risk envisages:

- specific organisational structures which, each for its purview, monitor the Bank's reputation and manage the relationships with the various stakeholders;
- an integrated monitoring system for primary risks, to limit exposure to them;
- compliance with standards of ethics and conduct;
- establishing and managing customers' risk appetite, through the identification of their various risk tolerance profiles according to subjective and objective traits of each customer.

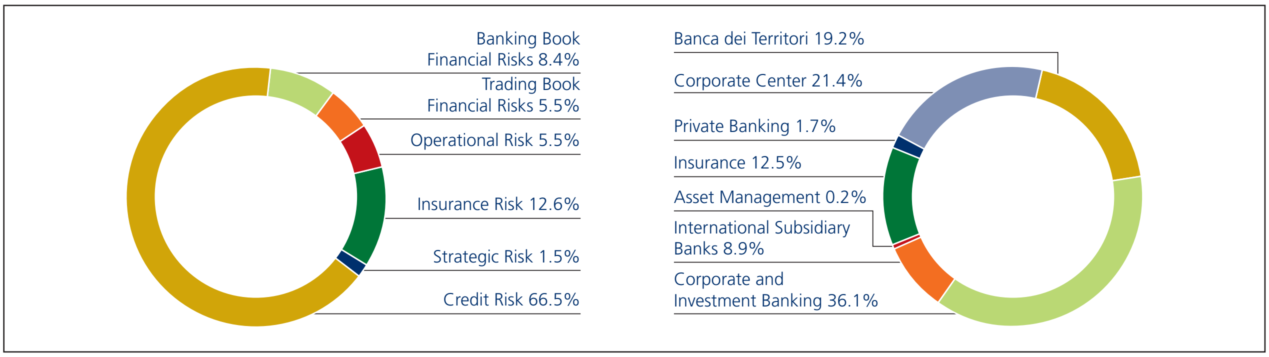
A fundamental tool for reputational risk monitoring is the Code of Ethics adopted by the Group. This contains the basic values to which the Group intends to commit itself and enunciates the voluntary principles of conduct for dealings with all stakeholders (customers, employees, suppliers, shareholders, the environment and, more generally, the community) with broader objectives than those required by mere compliance with the law. The Group has also issued voluntary conduct policies (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.
In order to safeguard customers' interests and the Group's reputation, specific attention is also devoted to establishing and managing customers' risk tolerance, through the identification of their various risk appetite profiles according to subjective and objective traits of each customer. The assessments of adequacy during the process of structuring produces and providing advisory services are supported by objective assessments that contemplate 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 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 is founded on trust.

The "cross-function" monitoring of reputational risk is entrusted to the Reputational Risk Management (RRM) process, conducted yearly and aimed at integrating and consolidating the main findings provided by the organisational structures more directly involved in monitoring the company's reputation. The objective of that process is to identify and mitigate the most significant reputational risk scenarios to which the Intesa Sanpaolo Group is exposed through:
– the identification of the main risk scenarios to which the Group is exposed, by the Enterprise Risk Management Department, along with the Governance and Controls Compliance Department as regards the compliance risks and with the cooperation of the other relevant corporate functions;
– the assessment of said scenarios by the Top Management;
– the definition and monitoring of adequate communication strategies and specific mitigation measures.

The Intesa Sanpaolo Group carefully considers all the risks associated with climate change that may result in additional costs for the Bank or its customers. Specifically, with regard to changes in national and international regulations which could have significant financial effects on its customers, through the subsidiary Mediocredito Italiano, Intesa Sanpaolo has set up an Energy Desk specialising in supporting customer companies in energy efficiency projects and advanced advisory services on legal developments and how to suitably prepare for compliance with such regulations.
Furthermore, with regard to the risk of extreme weather events or emergencies due to climate changes, to meet the needs of customers that have incurred damages, following such events Intesa Sanpaolo shall suspend payment of mortgage loans and instalments of loans for retail customers and businesses in areas seriously impacted by weather events.

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 using a VaR-type model based on indexes of mainly Italian real estate prices, which is the main type of exposure associated with the Group's real-estate portfolio.

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 (36.1% 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 (19.2% of the total Economic Capital) is the second 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 (12.5% of the total Economic Capital).
The "International Subsidiary Banks" Business Unit is assigned 8.9% 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, and the residual portion of insurance risk (21.4% of the total Economic Capital).
Absorption of Economic Capital by the "Private Banking" and "Asset Management" Business Units is marginal (1.7% and 0.2%, respectively) due to the nature of their businesses, which are predominantly aimed at asset management activities.

Basel 3 regulations and the Internal Project

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

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

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

In order to comply with the new rules envisaged by Basel 3, the Group has undertaken adequate project initiatives, expanding the objectives of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.
Additional information on own funds, which are now calculated according to the Basel 3 rules, and on capital ratios of the Group is provided in the section on balance sheet aggregates: Own funds and capital ratios, and in the document Basel 3 - Pillar 3.

With respect to credit risks, the Group received authorisation to use internal ratings-based approaches effective from the report as at 31 December 2008 on the Corporate portfolio for a scope extending to the Parent Company, network banks in the Banca dei Territori Division and the main Italian product companies.
Progressively, the scope of application has been gradually extended to include the SME Retail and Retail Mortgage portfolios, as well as other Italian and international Group companies, as shown in the following table.

<table>
<tr><th>Company</th><th>Corporate
FIRB</th><th>Corporate
AIRB LGD</th><th>SME Retail
IRB LGD</th><th>Mortgage
IRB LGD</th></tr>
<tr><td>Intesa Sanpaolo</td><td rowspan="8">Dec - 2008</td><td rowspan="8">Dec - 2010</td><td rowspan="8">Dec - 2012</td><td rowspan="7">Jun - 2010</td></tr>
<tr><td>Banco di Napoli</td></tr>
<tr><td>Cassa di Risparmio del Veneto</td></tr>
<tr><td>Cassa di Risparmio in Bologna</td></tr>
<tr><td>Cassa di Risparmio del Friuli Venezia Giulia</td></tr>
<tr><td>Cassa dei Risparmi di Forlì e della Romagna</td></tr>
<tr><td>Banca dell'Adriatico</td></tr>
<tr><td>Mediocredito Italiano</td><td>n.a.</td></tr>
<tr><td>Gruppo Cassa di Risparmio di Firenze</td><td>Dec - 2009</td><td>Dec - 2010</td><td>Dec - 2012</td><td>Jun - 2010</td></tr>
<tr><td>Cassa di Risparmio dell'Umbria</td><td>n.a.</td><td>Dec - 2010</td><td>Dec - 2012</td><td>Dec - 2011</td></tr>
<tr><td>Banca Prossima</td><td>n.a.</td><td>Dec - 2013</td><td>Dec - 2013</td><td>n.a.</td></tr>
<tr><td>Banca IMI</td><td>n.a.</td><td>Jun - 2012</td><td>n.a.</td><td>n.a.</td></tr>
<tr><td>Intesa Sanpaolo Bank Ireland</td><td>Mar - 2010</td><td>Dec - 2011</td><td>n.a.</td><td>n.a.</td></tr>
<tr><td>Vseobecna Uverova Banka</td><td>Dec - 2010</td><td>Jun - 2014</td><td>Jun - 2014</td><td>Jun - 2012</td></tr>
</table>

Changes compared to the situation as at 31 December 2014 include the mergers by incorporation of Banca di Trento e Bolzano, Banca Monte Parma, Cassa di Risparmio di Rieti, Cassa di Risparmio della Provincia di Viterbo and Cassa di Risparmio di Civitavecchia (CRF Group) into the Parent Company Intesa Sanpaolo S.p.A.

Dedicated rating approaches have been developed for the Banks and Public Entities Portfolio according to the type of counterparty to be assessed. This was the subject of a pre-validation inspection by the Supervisory Authority conducted in December 2013, followed by an additional validation visit in March 2015. In the same month an AIRB authorisation request was presented to the Supervisory Authority for this portfolio.
The Group is also proceeding with development of the IRB systems for the other segments and the extension of the scope of companies for their application in accordance with a plan presented to the Supervisory Authority.
For OTC derivatives, with reference to the Parent Company Intesa Sanpaolo and to Banca IMI, the Bank of Italy granted the authorisation to use the internal counterparty risk model for regulatory purposes, starting from the first quarter of 2014. For the Banks in the Banca dei Territori Division, an application for authorisation to use the internal model for regulatory purposes was submitted to the Supervisory Authority in 2015, while for management purposes, the advanced risk estimate measures were implemented in November 2014.
In 2015 an application for authorisation to use internal models for regulatory purposes was also submitted for Securities Financing Transactions (SFT - Repos and securities lending) products. For management purposes, the advanced risk measurement methods were implemented for SFT in May 2015.

With regard to Operational Risk, the Group obtained authorisation to use the Advanced Measurement Approaches (AMA – internal model) to determine the associated capital requirement for regulatory purposes, with effect from the report as at 31 December 2009.

The adequacy of the internal control system for risks is also illustrated in the annual Internal Capital Adequacy Assessment Process Report, based on the extensive use of internal approaches for the measurement of risks and for the calculation of internal capital and total capital available. The document was approved and sent to the Supervisor in April 2015.

In 2016, the Intesa Sanpaolo Group will once again be involved in an EU-wide stress test conducted by the European Central Bank and the European Banking Authority on the financial statements of European banks as at 31 December 2015. As opposed to the previous year, the test will not involve an asset quality review (AQR), but only a simulation of the impact of negative macroeconomic scenarios on capital soundness (Stress Test).

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.

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 transactions with the law and supervisory regulations, as well as internal policies, procedures and regulations.

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 no. 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 structure of internal controls is also outlined by the entire set of company documentation (regulatory framework) that provides organised and systematic access to the guidelines, procedures, organisational structures, and risks and controls in force, incorporating all the Company policies, the instructions of the Supervisory Authorities, and provisions of law, including the principles laid down in Legislative Decree 231/2001 and Law 262/2005.
The regulatory framework consists of "Governance Documents" that oversee the operation of the Bank (Articles of Association, Code of Ethics, Group Regulations, Authorities and powers, Policies, Guidelines, Function charts of the Organisational Structures, Organisational Models, etc.) and of more strictly operational regulations that govern business processes, individual operations and the associated controls.
More specifically, the Company 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, with an adequate level of detail, of every operational event and, in particular, of every transaction, ensuring their correct allocation over time;
- guarantee reliable information systems and suitable reporting procedures for the various managerial levels assigned the functions of governance and control;
- allow the prompt notification to the appropriate levels within the Company and the swift handling of any anomalies found by the business units and the control functions;
- ensure adequate levels of business continuity.

The Company's organisational solutions also enable the uniform and formalised identification of responsibilities, particularly in relation to the tasks of controlling and correcting the irregularities found.
At Corporate Governance level, Intesa Sanpaolo has adopted a dual corporate governance system, in which the functions of control and strategic management, performed by the Supervisory Board, are separated from the management of the Company, which is exercised by the Management Board in accordance with the provisions of art. 2409-octies et seq. of the Italian Civil Code and art. 147-ter et seq. of the Consolidated Law on Finance. The competent authorities have issued the required authorisation for the amendments to the Articles of Associations relating to the planned adoption - effective from the date of renewal of the corporate bodies currently in office - of the one-tier governance system, which will be submitted for the approval of the Shareholders' Meeting called for 26 February 2016.
The Supervisory Board established an Internal Control Committee within the Board (which replaced the Control Committee on 19 December 2014) which proposes, advises and enquires on matters regarding the internal control system.
The Committee also performs the duties and tasks of a Surveillance Body pursuant to Legislative Decree 231/2001 on the administrative liability of companies, supervising operations and compliance with the Organisational, Management and Control Model adopted by the Bank.
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:

  - o Chief Compliance Officer, who 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 Department, which is tasked with the duties and responsibilities of the “anti-money laundering function”, as defined by the reference regulations;
  - o as part of the Chief Risk Officer Governance Area, the Group Risk Manager and the Internal Validation Service, which, to the extent of their responsibilities, duly carry out the “risk management function” and the “validation function”, respectively, as defined in the reference 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 organisational structure of the other components 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 Internal Auditing Department 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.

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 36 of the Consob Market Regulation.

In order to comply with the aforesaid provisions, the Manager responsible for preparing the Company’s financial reports plays 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. The Manager responsible for preparing the Company’s financial reports oversees the fulfilment of the obligations according to a shared approach at Group level, approved by the Management Board, with the favourable opinion of the Supervisory Board. To this end, 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, subject to regular periodic updates;
- prepares appropriate administrative and accounting procedures regulating the preparation of the financial statements and the consolidated financial statements, taking care of their adaptation in relation to the corporate disclosure requirements applicable from time to time;
- 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;
- submits public disclosures to the Management Board and certifies the compliance of financial documents and reports in accordance with the provisions of Article 154-bis of the Consolidated Law on Finance.

With specific regard to the financial reporting process, the Manager responsible for preparing the Company’s financial reports:

- maintains a system of information reports and flows with the Parent Company and the Group company functions, in order to ensure the adequacy of balance sheet, income statement and financial positions and the descriptions of the main risks and uncertainties to which the Group may be exposed, monitoring the reliability of the data acquisition process and the process of disclosure of the relevant information;
- oversees the internal control system on the financial reporting process, drawing up audit plans to ensure the adequacy and effective application of management and accounting procedures over the period, also by subsidiaries subject to the laws of countries that are not European Union Member States, in accordance with the provisions laid down by Article 36 of the Consob Market Regulation; periodically reports to the Management Board and the Internal Control Committee on the scope and results of the audits;
- acquires any recommendations formulated by the independent auditors at the end of the process of auditing the Parent Company’s financial statements and the consolidated financial statements, as well as the related feedback in terms of measures to improve the procedures that influence accounting data, monitoring their implementation and effectiveness;
- shares with the Supervisory Board, pursuant to Law 231/01 the findings of the audit plan carried out in implementation of the monitoring of the financial reporting process, with specific focus 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, monitoring the assignments granted to said auditors and regularly informing the Internal Control Committee, in line with the provisions of law (Legislative Decree 39/2010) and in accordance with the methods governed by the specific corporate Regulation for the granting of assignments to independent auditors.

The Manager responsible for preparing the Company’s financial reports ensures periodic reporting to the Management Board 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. These reports are also submitted to the Internal Control Committee, which reports to the Supervisory Board in order for it to perform its supervisory task of monitoring the financial reporting system, as required by law and the Articles of Association.

Certification as required by art. 154-bis of the Consolidated Law on Finance

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

- signs, jointly with the Managing Director and CEO, the certifications of the Parent Company's and consolidated financial statements pursuant to Article 154-bis, paragraph 5, of the Consolidated Law on Finance on the adequacy and actual application of administrative and accounting procedures, compliance with the international accounting standards, the compliance of the financial statement documents with the records, books and accounts and their capacity to give a true and fair view of the Group's financial position and results, as well as a reliable analysis of the performance, results of operations and the main risks to which the Group is exposed;
- certifies correspondence of the deeds and communications circulated to the public with the accounting documents, books and records, pursuant to Article 154-bis, paragraph 2, of the Consolidated Law on Finance.

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

- the completeness and consistency of the information disclosed to the market through a structured system of information flows coming from the functions of the Parent Company and from the Group companies on the significant events for the purposes of accounting and financial reporting;
- the suitability of sensitive processes for drawing up corporate accounting documents. The focus of the activities is represented by the work stages which, within the various 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 of supervision of the administrative and accounting procedures and of the effectiveness of the control system on the financial reporting process is governed by the Company "Guidelines for Administrative and Financial Governance", and entails:

- the determination of the existence and compliance of the internal control system at corporate level, through the examination, conducted by the internal audit Function, of the governance systems, the presence and dissemination of standards of conduct inspired by ethics and integrity, the consistency of the organisational structures and transparent attribution of powers and responsibilities, the effectiveness of risk policies, the soundness of fraud prevention systems and the impact of codes of conduct and personnel disciplinary systems;
- the formalisation of relevant business processes for financial reporting purposes, with special focus on the risks and controls that define the stages of recording, processing, evaluation and presentation of data and information conducive to the preparation of Company financial reports and financial market disclosures; in addition to financial reporting processes (e.g. accounting, budget, reporting, management control, risk control) business processes (e.g.: credit, finance, asset management, insurance etc.) are also included, with reference to the assessment and reporting of assets and liabilities recorded in the accounting books and presented in corporate documents and operations processes in support of transactional and administrative data;
- the performance of an annual audit plan to certify the adequacy of the procedures and the effectiveness of the controls in place, by verifying the methodologies that govern the management of transactions within the scope of business processes and the forms of monitoring of the stages associated with the recording, evaluation and presentation of accounting data and financial information;
- the conduct of an annual audit plan to certify the application of IT architecture governance rules with reference to the processing steps instrumental to the preparation of accounting and financial reports;
- the periodic preparation, for each significant Group company, of an "Report on the internal control system of the financial reporting process" which sets out the scope of the controls implemented during the year and the results of the audits conducted, providing proof of the shortcomings found and the measures adopted to resolve them;
- the formulation of an opinion on the internal control system of the financial reporting process, upon the outcome of the monitoring over the correct implementation of the regulations, the audits conducted on the scope of companies and the performance of the evaluation process according to standard opinion-forming criteria, considering the material nature of the shortcomings found in relation to the consolidated financial statements;
- the management of the communication processes between the Manager responsible for preparing the Company's financial reports and the Control Bodies, the corporate Control Functions and Internal Auditing function, in accordance with the provisions set out in the Regulations on the integrated internal control system;
- the management of the communication processes between the Manager responsible for preparing the Company's financial reports and the corporate bodies and independent auditors pertaining to legal and regulatory obligations.

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 process, according to the guidelines described herein, the Managing Director and CEO and the Manager responsible for preparing the Company's financial reports sign the certifications required by Art. 154 bis, paragraph 5, of the Consolidated Law on Finance.

These certifications are included in the Parent Company's financial statements and the consolidated financial statements, and are provided to the public according to the model established by Consob Regulation no. 11971/99 (pursuant to Article 81 ter and its Annex 3c-ter of the Issuers' Regulation).

Report pursuant to Art.36 of the Market Regulation

Consob (the Italian Securities and Exchange Commission), in accordance with Law 262/2005 governing the protection of savings and the regulation of financial markets, has set certain conditions for the listing of companies that control companies incorporated and subject to the laws of non-EU member states (art. 36 of the Market Regulation). As a result, Intesa Sanpaolo has set up an action plan to ensure the existence of the conditions required for companies that are of material significance, identified in compliance with the criteria established in the rules:

– determining that the companies' administrative and accounting systems are suited to regularly providing the competent department within the Parent Company and its Independent Auditors with the income statement, balance sheet and cash flow data required for the preparation of the consolidated financial statements and auditing;
– regularly obtaining the company information required by the rules (Articles of Association, powers and composition of corporate bodies) and ensuring that the public is provided access to the accounting positions prepared by the companies for the purposes of drafting the consolidated financial statements.

On conclusion of the activities performed and the verifications conducted, compliance with the conditions required by Article 36 of the Market Regulation is confirmed.

The Internal Control Committee and Management Board 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.

Group Risk Manager

The Group Risk Manager's 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 Controls Department, the Group Risk Manager's area carries out level II monitoring and controls over credit and other risks. The activities conducted on credit consider the quality, composition and evolution of the various loan portfolios, also through risk-based controls for the purpose of correctly classifying and assessing single names. It also carries out monitoring and control of the rating allocation and update processes.
In general, the development of the audit activities includes an examination of the individual credit processes also in order to verify that suitable level I controls are in place, including implementation and traceability methods.

Internal Validation

The internal control system implemented by the Bank includes the validation function, the purpose of which is ongoing evaluation, in accordance with the New Supervisory Regulations for banks[9], of the compliance of internal risk measurement and management systems over time as regards determination of the capital requirements with regulatory provisions, Company needs and changes in the market of reference. The validation function is entrusted to Internal Validation, which is responsible for the activity at the Group level in accordance with the requirements of supervisory regulations governing uniform management of the control process on internal risk measurement systems. The Internal Validation Service reports directly to the Chief Risk Officer and is independent of the units that manage internal system development activities and the internal auditing department. It ensures that internal models, whether already operational or in the development stages, are validated with regard to all risk profiles covered by Pillars 1 and 2 of the Basel Accord, in accordance with the independence requirements established by the reference regulations.

The validation process is mainly driven by Intesa Sanpaolo's roll-out plan and any requests coming from the Regulator. On an annual basis, the Internal Validation Service prepares a validation plan that is submitted to the Management Board and the Supervisory Board for approval.

With respect to Pillar 1 risks, validation is a prerequisite for use of the internal systems for regulatory purposes. The validation function conducts assessments of risk 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, application for adoption/extension of internal systems, application for model change and ongoing validation).
Both during the initial application phase and on an ongoing basis (at least annually), the results of the Internal Validation Service's activities are presented to the competent functions, transmitted to the Internal Auditing Department for its related internal auditing work, as well as to the competent Managerial Committees and Governance Bodies for approval of the certification of compliance of internal systems with regulatory requirements, and forwarded to the Supervisory Authorities.

With respect to Pillar 2 risks, the Internal Validation Service conducts analyses of methodologies, verifying in particular that the measurement or assessment metrics adopted in quantifying significant risks are economically and statistically consistent, the methodologies adopted and estimates produced to measure and assess significant risks are robust and comparing alternative methodologies for measuring and aggregating individual risks. The analyses are conducted both in advance, 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 report while, for substantial or significant modifications of internal systems, the Internal Validation Service produces a report to be submitted to the competent Managerial Committees and the Governance Bodies[10].
The function also manages the internal validation process at the Group level, interacting with the Supervisory Authorities, the Corporate Bodies of reference and the functions responsible for the level III controls provided for in regulations. The Internal Validation Service adopts a decentralised approach for companies with local validation functions[11] (certain international companies), coordinating and supervising the activities of such companies, and a centralised approach for the others. The adopted methodologies were developed in implementation of the principles that inspire the Supervisory Provisions for banks, UE directives

[9] EU Regulation no. 575/2013 (CRR), EBA Guidelines, EU Directive no. 2013/36 (CRD IV), Bank of Italy Circular no. 285/2013.

[10] In the event of substantial/significant modifications, the approval process requires that the Group Risk Manager 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 drawn up on those modifications to the Management Board and the Supervisory Board.

[11] Note that the functional reporting of local validation units to the Internal Validation Service has been formalised.

and regulations, general orientations 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.

Finally, the Internal Validation Service is responsible for the validation of the internal systems used for management purposes and contributes to the risk model development process[12] for both Pillar 1 and Pillar 2 risks.

In 2015, the main validation activities in the area of credit risks pertained to analyses for the submission of the following applications:
- adoption of the AIRB internal system for the Institutions segment (Banks and Public-sector Entities);
- adoption of internal estimates of PD for the Banking Book Equity portfolio;
- extension of the AIRB internal system to the subsidiary Provis;
- model change of the AIRB internal system for the Regulatory Corporate segment;

The following ongoing analyses were also conducted, and their results were summarised in the annual validation report:
- half-yearly backtesting analyses of regulatory segments authorised to use internal systems (residential mortgages for individuals, Corporate and Retail SME segments);
- half-yearly analyses on guarantees used to mitigate credit risk (mortgage, personal and financial guarantees).
- yearly quantitative and qualitative analyses (performance analyses and empirical analyses of use tests) for regulatory segments authorised to use internal systems.

In the cases of the international subsidiaries, Internal Validation conducted its own assessments in collaboration with the local validation functions, where present. In detail, analyses of the adequacy of internal credit risk measurement systems were conducted for the following subsidiaries:
- VUB (Slovakia): validation report for application for model change on residential mortgages to individuals and for extending the IRB approach to non-residential mortgages. Reports for the operational adoption of the Retail Unsecured model. Support for the model change for the Large Corporate segment (former IALC);
- PBZ (Croatia): validation report for the application of the FIRB approach for the Corporate segment and the IRB approach for Mortgages;
- CIB (Hungary): reports for the operational adoption of the Micro and Individual and Private Entrepreneur models and support to the local validation function for the tests regarding the PD and LGD Corporate models;
- BIB (Serbia): reports for the operational adoption of the Small Business Double & Single Entry model and the Specialized Lending slotting model;
- Banka Koper (Slovenia): validation report for the application of the FIRB approach for the Corporate segment;
- Intesa Sanpaolo Luxembourg (former SEB): validation report for the application for model change for the Large Corporate segment.

Validation activities for operational risk conducted in 2015 took the form of:
- verification of the strength of the model in the event of updating of the loss data during 2014 (internal and external data);
- ongoing validation analyses for the purpose of drawing up the annual report including the activity of replicating and verifying the database used by the calculation engine to quantify capital requirements. To that end, the information drawn from documentary and empirical analyses was supplemented by:
  - onsite inspections on the Corporate and Investment Banking Division and the international subsidiary banks included in the AMA scope (Advanced Measurement Approach - with the support of the local validation functions), to verify the actual application of the process of operational risk monitoring and management and methodological analyses. A specific onsite inspection was also conducted at the subsidiary CIB for the purpose of the AMA application planned for 2015 and then postponed to the first half of 2016. An onsite inspection was also conducted at Banca IMI, which will be formally reported on in the first quarter of 2016;
  - Remote Verification Process on the Organisational Units/Legal Entities within the AMA scope, completed in the first half of 2015.

The activity of the Internal Validation Service relating to the market risk component focused on the following areas:
- periodic quantitative and qualitative analysis as part of the ongoing valuation activity (in particular, backtesting of the Value at Risk (VaR) model and stress testing of the Incremental Risk Charge (IRC) model);
- monitoring of the existing model for calculating stressed VaR, which entails a half-yearly revision of the adequacy of the historical stress period to be used in the calculation;
- verifications conducted to support the request to revise the add-ons defined by the Bank of Italy, to calculate the capital requirement for market risk using the internal model, in relation to the completion of the corrective measures requested.

In addition, the Internal Validation Service carries out ongoing activities concerning pricing issues (for example, verification of the consistency of non-contributed bonds pricing among the end of quarter measurements carried out by the Financial and Market Risks Department, and operational pricing, monitored by Product Control of Banca IMI). With regard to the MAF (Managed Account Funds) portfolio, the Internal Validation Service produced detailed backtesting analyses, both for individual funds and for individual strategies.

In relation to counterparty risk, the Internal Validation Service periodically monitors the progress of corrective measures implemented for the findings reported in the authorisation letter and conducts periodic quantitative and qualitative analyses, whose results were summarised in the annual validation report.

[12] Model risk is intended as the risk that the model could become unsuitable or could be used incorrectly to describe - in a simplified but accurate manner - the real phenomenon for which it was developed.

In 2015, the main validation activities pertained to analyses for the submission of the following applications:
- model change, only in relation to quantitative aspects, for the EPE internal model of Banca IMI and Intesa Sanpaolo;
- extension of the EPE advanced approach to OTC derivatives of the Banks of the Banca dei Territori Division and the companies within this scope (Banca Prossima, Mediocredito and Intesa Sanpaolo Private Banking);
- extension of the EPE advanced approach to SFT instruments of Banca IMI and Intesa Sanpaolo.

With regard to Pillar 2 risks, in 2015 the following analyses were conducted to assess the methods to be used to calculate economic capital:
- impact analysis on the use of reporting metrics in the portfolio model following the comparison and reconciliation of reporting and operational measures carried out by the development function;
- analysis of economic capital calculated for Pillar 2 credit risk (i.e., including the additional components compared to Pillar 1, for example, the concentration component) for International banks and comparison with the economic capital used for local ICAAP (Internal Capital Adequacy Assessment Process) reporting;
- in the area of interest rate risk in the banking book, behavioural model analyses of prepayment (changed during 2015) and model analyses of demand items for the international subsidiaries CIB and VUB. In the last quarter of 2015, analyses were also initiated on the IRRBB framework (Interest Rate Risk in the Banking Book) to quantify the economic capital[13];
- assessment of the changes in approach adopted during the last ICAAP report compared to the previous year (for example, change in the confidence interval, change in the holding period for market risk, elimination of the risk integration mechanism);
- assessments of the changes to the default loans model[14];
- assessment of the corrective measures implemented or under way on findings of the Internal Valuation Service during the previous ICAAP report.

Moreover, in 2015, the development function conducted the annual valuation of the stability of the parameters of the model for demand deposits to quantify shift sensitivity.

Lastly, in line with the regulatory requirements implemented by the Group in the "Guidelines for the adoption, management and control of internal risk measurement systems used for management purposes", in June 2015, the annual report on internal systems used for management (non-regulatory) purposes was drawn up. Specifically, the following were analysed:
- pricing models for credit products and calculation of EVA;
- behavioural models to quantify banking book interest rate risk (prepayment and demand deposits);
- market risk models;
- counterparty risk 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 Governing 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 Management Board and Supervisory Board, 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;
- assessing the consistency of the company's bonus system;
- 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;
- promoting 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 Group Compliance Guidelines. The Chief Compliance Officer submits periodic reports to corporate bodies on the adequacy of compliance control, with regard to all regulatory aspects applicable to the Bank 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 and control of the Group. These models are organised in such a way as to account for the Intesa Sanpaolo Group's structure in operational and territorial terms. In particular:
- compliance supervision activities for specifically identified Network Banks and Italian Companies whose operations show a high degree of integration with the Parent Company are centralised with the Chief Compliance Officer structures;
- for the other Companies, specifically identified on the basis of the existence of a legal obligation or due to the importance of their material size and/or risk, as well as for 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

[13] The outcome of these analyses will be formally recorded in the 2015/2016 ICAAP year.

[14] Note that the model for quantifying economic capital of default loans was used under Pillar 1 to calculate the downturn component for LGD on re-estimating the Corporate model.

where not permitted by local regulations, hierarchically report to the Chief Compliance Officer structures.

The activities carried out during the year concentrated on the regulatory areas are considered to be the most significant in terms of compliance risk, including the most significant ongoing projects that are part of the Company Business Plan, as well as the measures to comply with regulations enacted at an international level. In particular:
- with regard to investment services, monitoring of the procedural organisational structure in support of the service model adopted by the Bank continued, also in light of the Consob Communication on the distribution of Complex Financial Products to retail customers, and the new European rules on the resolution of banking crises (BRRD) and the related obligations of adequacy assessment and disclosure to customers. A project of adjustment to new European regulations (MiFID 2 and MiFIR, MAD 2 and MAR), which entail significant changes to the current regulations, was also launched. Work also continued in the areas of monitoring personal transactions, controlling customer operations in order to prevent market abuse, managing conflicts of interest and the circulation of insider information;
- as regards banking products and services, the IT systems were integrated to implement the prohibition of bank anatocism, pending the expected CICR resolution to complete the new approach, and the adjustment to the European sector rules was begun (Mortgage Credit Directive on credit agreements for consumers relating to residential immovable property, Payment Accounts Directive, Regulation on card-based payment transactions);
- with regard to insurance and pension-related intermediation, the reinforcement of compliance risk monitoring continued in relation to the distribution of policies that can be associated with loans, based on the indications issued by the Bank of Italy and IVASS;
- compliance controls were defined and implemented for new services (Real Estate and e-commerce) and channels (out-of-branch and remote offerings) which enhance the content and methods of offerings to customers;
- the organisational, management and control model pursuant to Italian Legislative Decree 231/2001 was overseen by verifying its compliance with the company regulations and coordinating verification of its proper implementation;
- among "non-core" regulations, specific focus was placed on the Tax and ICT areas.

Additional activities were aimed at reinforcing management and coordination activity for Italian and international subsidiaries and international branches, with the aim of implementing a supervisory model comparable to that adopted by the Parent Company.
Lastly, considerable importance was attached to personnel training programmes, involving the implementation, in collaboration with the competent Company functions, of initiatives aimed at pre-defined targets in order to maximise their effectiveness.

Anti-Money Laundering

The duties and responsibilities of the Anti-Money Laundering Function, as envisaged by regulations, are assigned to the Anti-Money Laundering Department, which, following the reorganisation implemented in July 2015, reports directly to the Chief Compliance Officer.
Specifically, the Anti-Money Laundering Department ensures monitoring of compliance risk in the area of money laundering, combating financing of terrorism and embargo management 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 Single Electronic Archive and the assessment and monthly submission to the Financial Reporting 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 Reporting Unit of reports deemed accurate.

During 2015 the Anti-Money Laundering function devoted the utmost attention to projects aimed at reinforcing coverage of the Group's Italian and international companies, also in light of the new indications from the Supervisory Authorities, with a view to organisational, regulatory and procedural compliance to the standards of the Parent Company. The strict monitoring of cash transactions continued, including those routed through payment cards, and customised measures were implemented to mitigate the typical risks of transactions of parties operating in specific sectors (for ex. "gold buying" and "gaming").

Internal Auditing

Internal auditing activities are performed by the Internal Auditing Department, which reports directly to the Chairman of the Management Board and the Chairman of the Supervisory Board. It also functionally reports to the Internal Control Committee and has no direct operating responsibilities.
The Department has a structure and a control model which is organised consistently with the evolution of the organisational model of Intesa Sanpaolo and of the Group.
The Internal Auditing structures of the Group's Italian and international companies report to the Internal Auditing Department 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 plans 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 departments. The Department has free access to the activities, data and documents of all company functions.
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).
The Department has earned the maximum rating ("Generally Compliant") in the external Quality Assurance Review envisaged by the international standards.
In performing its duties, the Department 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 executive positions and corporate bodies, it prepares and submits an Annual Intervention Plan for prior examination by the Internal Control Committee, and subsequent approval by the Supervisory Board, on the basis of which it conducts its activities during the year, as well as a Multi-Year Plan with the hedging commitments.
During 2015, auditing was performed directly for the Parent Company, Intesa Sanpaolo, the Network Banks and other subsidiaries under an outsourcing contract. For the other Group companies with their own internal audit departments, controls were conducted (indirect surveillance).
Audits were primarily aimed at monitoring the evolution of the risks associated with credit quality, internal capital adequacy estimation criteria and international activities. Particular attention was also devoted to the themes of compliance with money laundering prevention regulations.
Control activity was generally oriented towards the processes carried out by company functions with the aim of assessing:
- the functionality of line and second-level controls;
- the reliability of operating departments and delegation mechanisms;
- the accuracy of the information available in the various activities and the adequate use of the same.

Direct surveillance, both on-site and remote, was carried out in particular through supervision of processes relating to:
- credit granting, management and classification, verifying its adequacy with respect to the risk control system and the functioning of measurement mechanisms in place;
- measurement, management and control of the Group's exposure to various market, counterparty, liquidity, interest rate, operational and credit risks. Particular attention was dedicated to the adequacy of the processes and criteria for estimating internal capital with respect to the Risk Appetite Framework as well as in accordance with the Prudential Supervisory regulations;
- controls carried out by compliance risks governance functions and operating functions, in particular on provisions of law concerning money laundering, investment services, transactions with related parties and the administrative liability of entities pursuant to Legislative Decree 231/01;
- IT system development and management, to ensure their reliability, security and functionality;
- management of financial operations with the aim of verifying the adequacy of related risk control systems;
- management of operations.

Control activity was then completed through:
- measures affecting Italian product company subsidiaries, with a priority focus on credit quality and processes, as well as on money laundering prevention and embargo processes;
- verification of the operations performed by international banks, companies and branches, with interventions by both local internal auditors and internal auditors from the Parent Company;
- control of the governance activity performed by the Parent Company for the International Subsidiary Banks;
- timely performance of the assessments requested by the Supervisory Authorities in specific areas such as management remuneration and incentive systems, the Parent Company's management and coordination powers over asset management companies, obligations under new authorisations, privacy, business continuity and provisioning for doubtful loans.

Indirect audit was conducted via the steering and practical coordination of the auditing departments of Italian and international subsidiary banks and companies, 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, was 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 Internal Control Committee, Management Board and Supervisory Board. The main weaknesses detected and their development over time have been included in the Audit Tableau de Bord (TdB) so that they may be systematically monitored. The reports relating to the actions completed with a negative opinion or which highlight major shortcomings were submitted in full to the Supervisory Board and the Management Board of the Parent Company as well as to the Boards of Directors and Statutory Auditors of the subsidiaries concerned.
Lastly, the Internal Auditing Department 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 regard, during 2015 it pursued an evolutionary path with the aim of strengthening the audit model in line with the new European supervisory standards laid down by the EBA (SREP framework).

SECTION 1 – RISKS OF THE BANKING GROUP

As required by the instructions provided by the Bank of Italy, the information in this section - Risks of the Banking Group - is provided solely with respect to the Banking Group, as defined in the Supervisory Instructions, except when it is expressly indicated to the contrary that all companies within the scope of consolidation are considered.
The tables that refer to the Banking Group alone include the share proportional to the interest held of the assets and liabilities of jointly controlled banking, financial and instrumental companies consolidated proportionally for regulatory purposes. Amounts are stated gross of transactions with other companies within the scope of consolidation.
Where the contribution of transactions between the Banking Group and the other companies in the scope of consolidation is material, the details of such transactions are provided.

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

(millions of euro)

Assets		31.12.2015 Financial Statements	Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)	31.12.2015 Regulatory-scope balance sheet
10.	Cash and cash equivalents	9,344	17	9,361
20.	Financial assets held for trading	51,597	-695	50,902
30.	Financial assets designated at fair value through profit and loss	53,663	-52,289	1,374
40.	Financial assets available for sale	131,402	-75,858	55,544
50.	Investments held to maturity	1,386	-	1,386
60.	Due from banks	34,445	-573	33,872
70.	Loans to customers	350,010	3,606	353,616
80.	Hedging derivatives	7,059	-	7,059
90.	Fair value change of financial assets in hedged portfolios (+/-)	110	-	110
100.	Investments in associates and companies subject to joint control	1,727	5,223	6,950
110.	Technical insurance reserves reassured with third parties	22	-22	-
120.	Property and equipment	5,367	-374	4,993
130.	Intangible assets	7,195	-695	6,500
	of which: goodwill	*3,914*	*-470*	*3,444*
140.	Tax assets	15,021	-548	14,473
150.	Non-current assets held for sale and discontinued operations	27	-5	22
160.	Other assets	8,121	-2,955	5,166
Total Assets		**676,496**	**-125,168**	**551,328**

Liabilities and Shareholders' Equity		31.12.2015 Financial Statements	Effects of the deconsolidation and consolidation of counterparties other than those in the banking group	31.12.2015 Regulatory-scope balance sheet
10.	Due to banks	59,327	-356	58,971
20.	Due to customers	255,258	6,231	261,489
30.	Securities issued	110,144	3,453	113,597
40.	Financial liabilities held for trading	43,522	-42	43,480
50.	Financial liabilities designated at fair value through profit and loss	47,022	-47,022	-
60.	Hedging derivatives	8,234	-4	8,230
70.	Fair value change of financial liabilities in hedged portfolios (+/-)	1,014	-	1,014
80.	Tax liabilities	2,367	-850	1,517
	a) current	*508*	*-20*	*488*
	b) deferred	*1,859*	*-830*	*1,029*
90.	Liabilities associated with non-current assets held for sale and discontinued operations	-	-	-
100.	Other liabilities	11,566	-1,405	10,161
110.	Employee termination indemnities	1,353	-6	1,347
120.	Allowances for risks and charges	3,480	-132	3,348
	a) post employment benefits	*859*	*-1*	*858*
	b) other allowances	*2,621*	*-131*	*2,490*
130.	Technical reserves	84,616	-84,616	-
140.	Valuation reserves	-1,018	-	-1,018
150.	Redeemable shares	-	-	-
160.	Equity instruments	877	-	877
170.	Reserves	9,167	-	9,167
180.	Share premium reserve	27,349	-	27,349
190.	Share capital	8,732	-	8,732
200.	Treasury shares (-)	-70	-	-70
210.	Minority interests (+/-)	817	-419	398
220.	Net income (loss)	2,739	-	2,739
Total Liabilities and Shareholders' Equity		**676,496**	**-125,168**	**551,328**

(*) 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.