Risk management

MAIN RISKS AND UNCERTAINTIES

Specific information regarding the situation following the COVID-19 pandemic and the specific actions taken has been provided in the Executive Summary. It also provides information about the impact on the valuation of financial assets and credit risk, as well as the impairment testing of the intangible assets in the situation resulting from the COVID-19 pandemic.
Group liquidity remains high: as at 31 March 2020, both the regulatory indicators LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio), also adopted as internal liquidity risk measurement metrics, were well above the fully phased-in regulatory requirements. At the end of March 2020, the amount of unencumbered HQLA reserves, consisting of cash and deposits held with Central Banks, totalled 91 billion euro (96 billion euro in December 2019); adding in other marketable reserves and/or eligible Central Bank reserves, including retained self-securitisations, the Group's unencumbered liquidity reserves totalled 96 billion euro (118 billion euro in December 2019).
The loan to deposit ratio at the end of March 2020, calculated as the ratio of loans to customers to direct deposits from banking business, came to 93%.
In terms of funding, the widespread branch network remains a stable, reliable source: 78% of direct deposits from banking business come from retail operations (338 billion euro). In addition, GBP 350 million of unsecured senior bonds and 1.5 billion euro of Additional Tier 1 instruments were placed during the quarter.
Refinancing operations with the ECB at the end of March 2020 amounted to 68.4 billion euro (of which 53.9 billion euro relating to TLTROs, 7 billion euro relating to LTROs, and 7.5 billion euro relating to US dollar refinancing operations).
The Intesa Sanpaolo Group's leverage ratio was 6.6% as at 31 March 2020.
The Bank's already high level of capital strength was further enhanced following the approval at the Shareholders' Meeting of 27 April 2020 of the proposal to suspend the distribution of dividends to shareholders and to allocate the profit for the 2019 financial year to reserves, made by the Board of Directors on 31 March 2020, in compliance with the European Central Bank recommendation of 27 March 2020, concerning dividend policies through to 1 October 2020, as a result of the situation resulting from the COVID-19 epidemic, after the assignment of 12.5 million euro to the Allowance for charitable, social and cultural contributions.
Own funds, risk-weighted assets and the capital ratios as at 31 March 2020 have been calculated in accordance with the harmonised rules and regulations for banks and investment companies contained in Directive 2013/36/EU (CRD IV) and in Regulation (EU) 575/2013 (CRR) of 26 June 2013, which have transposed the banking supervision standards laid down by the Basel Committee (the Basel 3 Framework) into European Union legislation, and in accordance with the related Bank of Italy Circulars.
At the end of March, Own Funds – taking account of the transitional treatment adopted to mitigate the impact of IFRS 9 – came to 54,971 million euro, against risk-weighted assets of 297,119 million euro, which primarily reflected credit and counterparty risk and, to a lesser extent, market and operational risk.
The Total Capital Ratio stood at 18.5%, while the ratio of the Group's Tier 1 capital to its total risk-weighted assets (Tier 1 ratio) was 16.1%. The ratio of Common Equity Tier 1 capital (CET1) to risk-weighted assets (the Common Equity Tier 1 ratio) was 14.2%.
Having met the regulatory requirements for its inclusion pursuant to article 26(2) of the CRR, the Common Equity Tier 1 Capital as at 31 March 2020 took account of the figure of 25% of the net income for the period (net of foreseeable costs), in accordance with the dividend policy set out in the 2018-2021 Business Plan, which envisages a payout ratio of 75% for 2020, subject to the recommendations that will be provided by the ECB regarding dividend distributions after 1 October this year, the end date in the recommendation issued on 27 March.
The Group's risk profile remained within the limits approved by the Risk Appetite Framework, consistent with the intention to continue to privilege commercial banking operations. In relation to market risk, the Group's average risk profile (inclusive of the HTCS portfolio for Banca IMI) in terms of managerial VaR during the first three months of 2020 was approximately 175 million euro, in line – in average terms – with 177 million euro in the same period of 2019. The Group's average VaR for the period on the trading component only was 41 million euro (with a peak of 75 million euro), lower than in the same quarter of 2019, when it was 51 million euro. The trend in the first quarter of 2020 showed a sharp increase in the managerial VaR (mainly to be attributed to Banca IMI's HTCS portfolio) entirely attributable to the health emergency generated by the COVID-19 pandemic, which caused an exceptional increase in volatility and correlations in various segments of the financial markets.

THE BASIC PRINCIPLES OF RISK MANAGEMENT

The policies relating to risk taking and the processes for the management of the risks to which the Group is or could be exposed are approved by the Board of Directors of Intesa Sanpaolo as the Parent Company, with the support of the Risk Committee. The Management Control Committee, which is the body with control functions, supervises the adequacy, efficiency, functionality and reliability of the risk management process and of the Risk Appetite Framework.
The Managing Director and CEO has the power to submit proposals for the adoption of resolutions concerning the risk system and implements all the resolutions of the Board of Directors, with particular reference to the implementation of the strategic guidelines, the RAF and the risk governance policies.
The Corporate Bodies also benefit from the action of some Management Committees on risk management. These committees, which include the Steering Committee, operate in compliance with the primary responsibilities of the Corporate Bodies regarding internal control system and the prerogatives of corporate control functions, and in particular the risk control function.

Subject to the powers of the Corporate Bodies, the Chief Risk Officer Governance Area – reporting directly to the Managing Director and CEO – is responsible for: (i) governing the macro-process of definition, approval, control and implementation of the Group's Risk Appetite Framework with the support of the other corporate functions involved; (ii) cooperating with the Corporate Bodies in setting the Group's risk management guidelines and policies in accordance with the company strategies and objectives; (iii) coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, also within the various corporate departments; (iv) ensuring the management of the Group's overall risk profile by establishing methods and monitoring exposures to the various types of risk and reporting the situation periodically to the Corporate Bodies; and (v) carrying out level 2 controls on credit and other risks and ensuring the validation of internal risk measurement systems.

The Parent Company performs a guidance and coordination role with respect to the Group companies[10], aimed at ensuring effective and efficient risk management at Group level, exercising responsibility in setting the guidelines and methodological rules for the risk management process, and pursuing, in particular, integrated information at Group level to the Bodies of the Parent Company, with regard to the completeness, adequacy, functioning and reliability of internal control system. For the corporate control functions in particular, there are two different types of models within the Group: (i) the centralised management model based on the centralisation of the activities at the Parent Company and (ii) the decentralised management model that involves the presence of locally established corporate control functions that conduct their activities under the direction and coordination of the same corporate control functions of the Parent Company, to which they report in functional terms.

Irrespective of the control model adopted within their company, the corporate bodies of the Group companies are aware of the choices made by the Parent Company and are responsible for the implementation, within their respective organisations, of the control strategies and policies pursued and promoting their integration within the Group controls.

The risk measurement and management tools contribute to defining a risk-monitoring framework at Group level, capable of assessing the risks assumed by the Group from a regulatory and economic point of view. The level of absorption of economic capital, defined as the maximum "unexpected" loss the Group might incur over a year, is a key measure for determining the Group's financial structure, risk appetite and for guiding operations, ensuring a balance between risks assumed and shareholder returns. It is estimated on the basis of the current situation and also as a forecast, based on the budget assumptions and projected economic scenario. The assessment of capital is included in business reporting and is submitted quarterly to the Steering Committee, the Risk Committee and the Board of Directors, as part of the Group's Risks Tableau de Bord. Risk hedging, given the nature, frequency and potential impact of the risk, is based on a constant balance between mitigation/hedging action, control procedures/processes and capital protection measures.

THE BASEL 3 REGULATIONS

In view of compliance with the reforms of the previous accord by the Basel Committee ("Basel 3"), the Intesa Sanpaolo Group has undertaken adequate project initiatives, expanding the objectives of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.

The Bank, in agreement with the Supervisory Authorities, is currently assessing the impacts both of the recent decision of the Basel Committee (27 March 2020) to postpone the implementation of the Basel III standards by one year (to 1 January 2023), and of the other regulatory measures, some of which are still being defined, designed to provide banks and Supervisory Authorities additional capacity to rapidly and effectively respond to the impact of Covid-19.

With regard to credit risk, there were no changes with respect to the situation as at 31 December 2019. The periodic updating and alignment to changes in regulations governing IRB systems and their roll-out to international subsidiaries (according to the Group's roll-out plan) continue in accordance with the Regulatory Roadmap agreed with the Supervisory Authorities.

There were no changes in the scope of application of the internal models concerning counterparty risk for OTC derivatives and Securities Financing Transactions (SFTs) or operational risks compared to 31 December 2019.

The annual Internal Capital Adequacy Assessment Process (ICAAP) Report, based on the extensive use of internal approaches for the measurement of risk, internal capital and total capital available, was approved and sent to the ECB in April 2020.

As part of its adoption of Basel 3, the Group publishes information concerning capital adequacy, exposure to risks and the general characteristics of the systems aimed at identifying, monitoring and managing them in a document entitled "Basel 3 - Pillar 3" or simply "Pillar 3".

The document is published on the website (group.intesasanpaolo.com) on a quarterly basis.

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

CREDIT RISK

The Intesa Sanpaolo Group has developed a set of techniques and tools for credit risk measurement and management which ensures analytical control over the quality of loans to customers and financial institutions, and loans subject to country risk.
In particular, with regard to loans to customers, risk measurement is performed by means of different internal rating models according to borrower segment (Corporate, Retail SME, Retail, Sovereigns, Italian Public Sector Entities and Banks). These models make it possible to summarise the counterparty's credit quality in a value, the rating, which reflects the probability of default over a period of one year, adjusted on the basis of the average level of the economic cycle. These ratings are then made comparable with those awarded by rating agencies, by means of a consistent scale of reference.
Ratings and credit-risk mitigating factors (guarantees, loan types and covenants) play a key role in the loan granting and managing process.

Credit quality

(millions of euro)

Captions	31.03.2020			31.12.2019			Change
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Bad loans	18,399	-11,841	6,558	19,418	-12,678	6,740	-182
Unlikely to pay	10,823	-4,184	6,639	10,995	-4,257	6,738	-99
Past due loans	956	-152	804	886	-142	744	60
Non-Performing Loans	**30,178**	**-16,177**	**14,001**	**31,299**	**-17,077**	**14,222**	**-221**
Non-performing loans in Stage 3 (subject to impairment)	*30,134*	*-16,162*	*13,972*	*31,257*	*-17,062*	*14,195*	*-223*
Non-performing loans designated at fair value through profit or loss	*44*	*-15*	*29*	*42*	*-15*	*27*	*2*
Performing loans	**386,414**	**-1,592**	**384,822**	**376,839**	**-1,697**	**375,142**	**9,680**
Stage 2	*43,126*	*-982*	*42,144*	*41,146*	*-1,068*	*40,078*	*2,066*
Stage 1	*342,479*	*-610*	*341,869*	*334,973*	*-629*	*334,344*	*7,525*
Performing loans designated at fair value through profit or loss	*809*	*-*	*809*	*720*	*-*	*720*	*89*
Performing loans represented by securities	**6,084**	**-30**	**6,054**	**5,875**	**-34**	**5,841**	**213**
Stage 2	*3,122*	*-26*	*3,096*	*2,972*	*-30*	*2,942*	*154*
Stage 1	*2,962*	*-4*	*2,958*	*2,903*	*-4*	*2,899*	*59*
Loans held for trading	**23**	**-**	**23**	**24**	**-**	**24**	**-1**
Total loans to customers	**422,699**	**-17,799**	**404,900**	**414,037**	**-18,808**	**395,229**	**9,671**
of which forborne performing	***5,622***	***-190***	***5,432***	***5,918***	***-255***	***5,663***	***-231***
of which forborne non-performing	***6,704***	***-2,819***	***3,885***	***7,157***	***-3,119***	***4,038***	***-153***
Loans to customers classified as discontinued operations (*)	**797**	**-148**	**649**	**475**	**-93**	**382**	**267**

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

(*) As at 31 March 2020, this caption included the portfolio of bad loans/unlikely-to-pay loans and performing loans soon to be sold (gross exposure of 470 million euro, total adjustments of 102 million euro, net exposure of 368 million euro) and the so-called "high-risk" loans originating from the Aggregate Set of Banca Popolare di Vicenza and Veneto Banca, reclassified as bad loans and/or unlikely-to-pay loans, for which the sale contract provides the option to transfer them to the Banks in compulsory administrative liquidation (gross exposure of 327 million euro, total adjustments of 46 million euro, net exposure of 281 million euro).

As at 31 March 2020, the Group's net non-performing loans amounted to 14 billion euro, down by 1.6% compared with the beginning of the year, continuing the progressive decline already seen in the previous year. Non-performing assets also decreased as a percentage of total net loans to customers, down to 3.5%, in line with the de-risking strategy set out in the Business Plan, while the coverage ratio for non-performing loans remained high (53.6%).

In further detail, at the end of March 2020 bad loans came to 6.6 billion euro net of adjustments (down by -182 million euro on the beginning of the year, or -2.7%), and represented 1.6% of total loans. During the same period, the coverage ratio came to 64.4%. Loans included in the unlikely-to-pay category amounted to 6.6 billion euro, down by 1.5%, accounting for 1.7% of total loans to customers, with a coverage ratio of 38.7%. Past due loans amounted to 804 million euro (+8.1%), with a coverage ratio of 15.9%. Within the non-performing loan category, forborne exposures, generated by forbearance measures for borrowers experiencing difficulty in meeting their financial obligations, amounted to 3.9 billion euro, with a coverage ratio of 42%, while forborne exposures in the performing loans category amounted to 5.4 billion euro.
Overall, the coverage ratio of performing loans amounted to 0.4%.
For further information on the provision for the COVID-19 epidemic, refer to the discussion provided in the Executive Summary.

MARKET RISKS

TRADING BOOK

During the first quarter of 2020, managerial market risk measures (inclusive of the HTCS portfolio for Banca IMI) generated by Intesa Sanpaolo and Banca IMI increased compared to the average values of the fourth quarter of 2019. The Group's average managerial VaR for the period was equal to 175 million euro compared to 120 million euro in the previous quarter. The maximum value for the quarter was approximately 367 million euro.
The average figure for the first three months of 2020 was slightly lower than in the first quarter of 2019, when it amounted to 177 million euro.

The Group's average VaR for the period on the trading component only was 41 million euro (with a peak of 75 million euro), stable compared to the previous quarter. The average figure for the first three months of 2020 was lower than in the first quarter of 2019, when it amounted to 51 million euro.

The breakdown of the Group's risk profile in the first quarter of 2020 with regard to the different risk factors shows the prevalence of credit spread risk, which accounted for 73% of the Group's total managerial VaR, of which respectively 54% for Intesa Sanpaolo and 74% for Banca IMI(55% for the trading component only).

The VaR trend in the first quarter of 2020 is primarily attributable to Banca IMI. In January risks increased overall by approximately 37%, due to transactions in government bonds, in accordance with the 2020 RAF. In March there was a sharp increase in managerial VaR (mainly due to the government bonds in Banca IMI's HTCS portfolio), entirely attributable to the health emergency generated by the COVID-19 pandemic, which caused an exceptional increase in volatility and correlations in various segments of the financial markets (e.g. equities and fixed income).
Financial markets are characterised by "market dislocation" that has severely compromised their functioning.

Risk control with regard to the trading activity of Intesa Sanpaolo and Banca IMI also uses scenario analyses and stress tests. The impact of selected scenarios relating to the evolution of stock prices, interest rates, credit spreads, foreign exchange rates and commodity prices within the managerial scope defined above at the end of March is summarised in the following table:

(millions of euro)

	EQUITY		INTEREST RATES		CREDIT SPREADS		FOREIGN EXCHANGE RATES		COMMODITIES	
	Crash	Bullish	+40bp	lower rate	-25bp	+25bp	-5%	+5%	Crash	Bullish
Total	-8	-14	-207	118	817	-794	11	-17	2	-2
of which HTCS of Banca Imi	*0*	*0*	*-158*	*97*	*725*	*-701*	-	-	-	-

In particular:
– for stock market positions, there would be losses in both crash and bullish stock market scenarios, given the portfolio non-linearity;
– for positions in interest rates, there would be a loss of 207 million euro in the event of an increase in rate curves of 40 bps (of which 158 million euro attributable to Banca IMI's HTCS portfolio);
– for positions in credit spreads, a widening of credit spreads of 25 bps would entail a loss of 794 million euro (of which 701 million euro attributable to Banca IMI's HTCS portfolio);
– for positions in exchange rates, there would be a loss of 17 million euro in the event of a 5% appreciation in the Euro;
– finally, for positions in commodities, there would be a loss of 2 million euro in the event of an increase in commodity prices other than precious metals and the consequent decline in volatility.

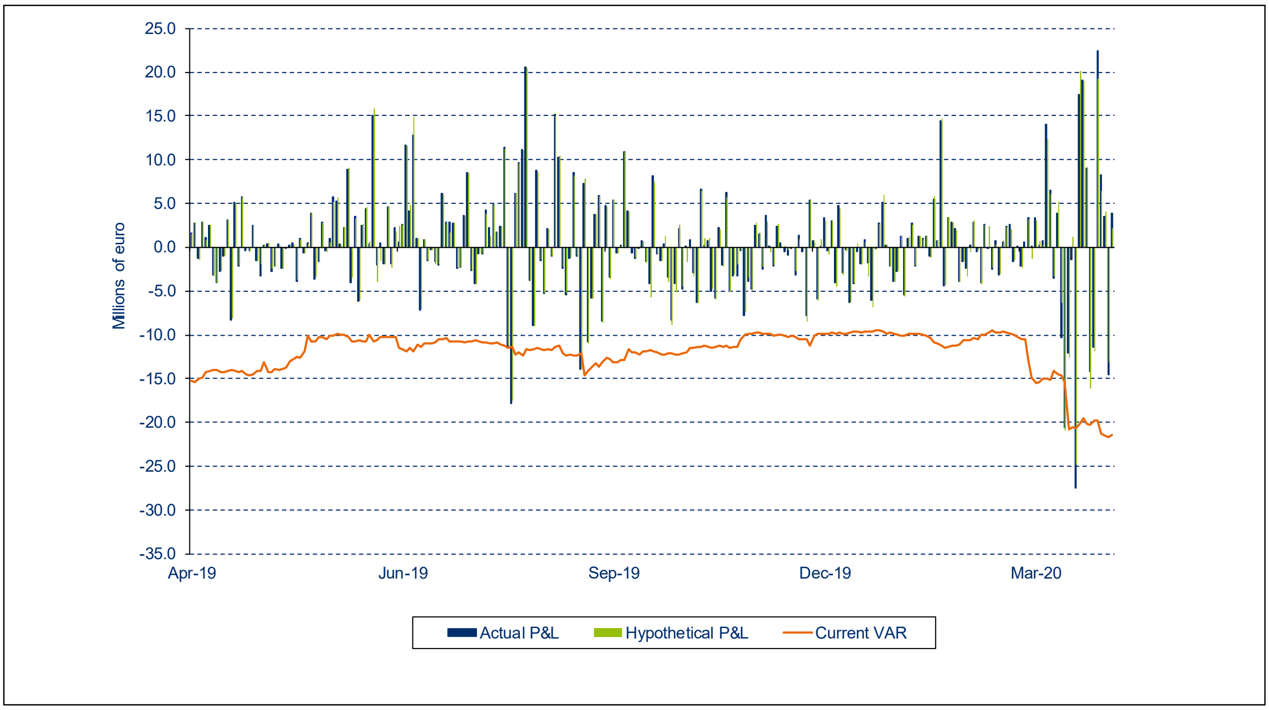
Backtesting

The soundness of the VaR calculation methods must be monitored daily via backtesting which, for the regulatory backtesting, compares:
– the daily estimates of value at risk;
– the daily profits/losses based on backtesting which are determined using actual daily profits and losses achieved by individual desks, net of components which are not considered in backtesting: these include, for example, fees and financial costs of managing the positions that are regularly reported for management purposes.

Backtesting allows verification of the model's capability of correctly seizing, from a statistical viewpoint, the variability in the daily valuation of trading positions, covering an observation period of one year (approximately 250 estimates). Any critical situations relative to the adequacy of the internal model are represented by situations in which daily profits/losses based on backtesting highlight more than four occasions, in the year of observation, in which the daily loss is higher than the value at risk estimate. Current regulations require that backtesting is performed by taking into consideration both the actual and hypothetical P&L series.

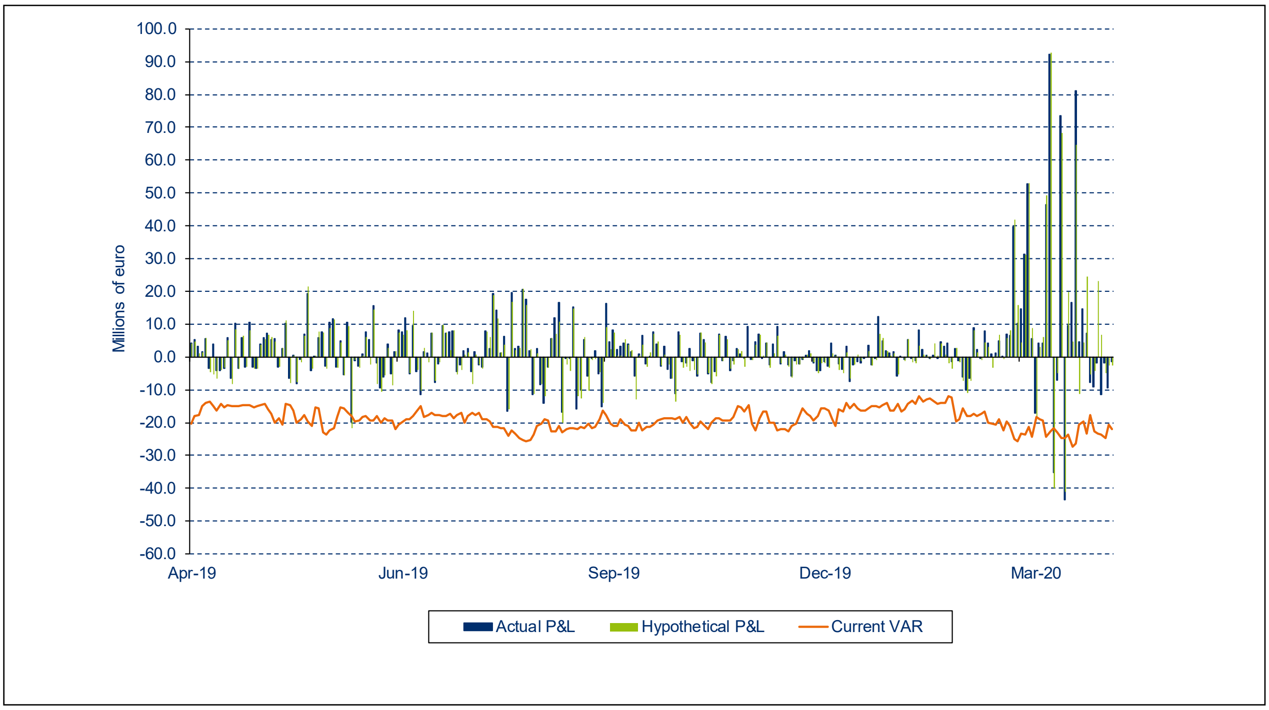
Backtesting in Intesa Sanpaolo

Four backtesting exceptions have been recorded during the last year. As for the exceptions in the third quarter of 2019, the most recent cases, recorded in March, are also primarily due to the interest rate component within the trading book.



Backtesting in Banca IMI

Over the last twelve months there have been three backtesting exceptions. In addition to interest rate volatility, the largest losses are related to the variability of financial sector credit spreads.



BANKING BOOK

In the first three months of 2020, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity of value, averaged 58 million euro, with a maximum value of 297 million euro and a minimum value of -272 million euro, a figure that coincides with that at the end of March 2020 (394 million euro at the end of 2019), almost entirely concentrated on the US dollar and euro currencies.

The sensitivity of net interest income – assuming a +50, -50 and +100 basis point change in interest rates – amounted to 869 million euro, -908 million euro and 1,681 million euro, respectively, at the end of March 2020. The last of these figures was down on the 1,837 million euro recorded at the end of 2019.

Interest rate risk, measured in terms of VaR, recorded an average of 404 million euro in the first three months of 2020, with a minimum value of 271 million euro and a maximum value of 579 million euro; the latter figure is the same as the value at the end of March 2020 (227 million euro at the end of 2019).
Foreign exchange risk expressed by equity investments in foreign currency (banking book) and measured in terms of VaR averaged 51 million euro in the first three months of 2020, with a minimum value of 35 million euro and a maximum value of 82 million euro, with the latter coinciding with the value at the end of March 2020 (35 million euro at the end of 2019).
Price risk generated by minority stakes in listed companies, mostly held in the HTCS (former AFS) category recorded an average level of 73 million euro in the first three months of 2020, with a minimum value of 45 million euro and a maximum value of 119 million euro; the latter figure coincides with the value at the end of March 2020 (43 million euro at the end of 2019).

The value at risk figures were up on the end of December 2019 due to a general increase in volatility recorded in March 2020.

The table below shows the changes in the main risk measures during the first quarter of 2020.

(millions of euro)

	1st quarter 2020			31.03.2020	31.12.2019
	average	minimum	maximum		
Shift Sensitivity of the Economic Value +100 bp	58	-272	297	-272	394
Shift Sensitivity of Net Interest Income -50bp	-964	-908	-999	-908	-1,037
Shift Sensitivity of Net Interest Income +50bp	917	869	945	869	939
Shift Sensitivity of Net Interest Income +100bp	1,778	1,681	1,827	1,681	1,837
Value at Risk - Interest Rate	404	271	579	579	227
Value at Risk Exchange	51	35	82	82	35
Value at Risk - Equity investments in listed companies	73	45	119	119	43

Lastly, the table below shows a sensitivity analysis of the banking book to price risk, measuring the impact on Shareholders' Equity of a price shock of ±10% for the abovementioned quoted assets recorded in the HTCS category.

Price risk: impact on Shareholders' Equity

(millions of euro)

		1st quarter 2020 impact on shareholders' equity at 31.03.2020	Impact on shareholders' equity at 31.12.2019
Price shock	10%	49	50
Price shock	-10%	-49	-50

LIQUIDITY RISK

In the first three months of 2020, the Group's liquidity position remained within the risk limits provided for in the Group's Liquidity Policy: both the LCR and NSFR indicators were largely respected, as they reached levels well above the phased-in requirements of the Regulation. Over the last 12 months, the Liquidity Coverage Ratio (LCR) of the Intesa Sanpaolo Group, measured according to Delegated Regulation (EU) no. 2015/61, has amounted to an average of 152.8%.

At the end of March 2020, the amount of unencumbered HQLA reserves, consisting of cash and deposits held with Central Banks, totalled 91 billion euro (96 billion euro in December 2019). With the other marketable reserves and/or eligible Central Bank reserves, including retained self-securitisations, added in, the Group's unencumbered liquidity reserves totalled 96 billion euro (118 billion euro in December 2019).

The stress tests, in view of the high availability of liquidity reserves, yielded results in excess of the maximum threshold for the Intesa Sanpaolo Group, with a liquidity surplus capable of meeting extraordinary cash outflows for a period longer than 3 months.

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

FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND LIABILITIES

Fair value hierarchy – Excluding insurance companies

(millions of euro)

Assets / liabilities at fair value	31.03.2020			31.12.2019		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets designated at fair value through profit or loss	19,930	33,139	3,229	17,934	28,658	2,822
a) Financial assets held for trading	18,905	32,218	534	17,161	27,622	369
of which: Equities	*488*	*-*	*1*	*713*	*-*	*1*
of which: quotas of UCI	*557*	*2*	*20*	*661*	*2*	*24*
b) Financial assets designated at fair value	-	180	-	-	195	-
c) Other financial assets mandatorily designated at fair value	1,025	741	2,695	773	841	2,453
of which: Equities	*1*	*77*	*196*	*2*	*95*	*179*
of which: quotas of UCI	*1,024*	*104*	*1,447*	*771*	*127*	*1,410*
2. Financial assets designated at fair value through other comprehensive income	62,495	9,230	554	63,815	8,173	422
of which: Equities	*486*	*1,780*	*396*	*611*	*2,048*	*400*
3. Hedging derivatives	-	4,006	14	8	3,008	13
4. Property and equipment	-	-	5,716	-	-	5,748
5. Intangible assets	-	-	-	-	-	-
Total	**82,425**	**46,375**	**9,513**	**81,757**	**39,839**	**9,005**
1. Financial liabilities held for trading	14,723	39,450	203	18,422	26,704	100
2. Financial liabilities designated at fair value	-	762	-	-	4	-
3. Hedging derivatives	-	11,655	3	-	9,284	4
Total	**14,723**	**51,867**	**206**	**18,422**	**35,992**	**104**

The Group's assets designated at fair value (excluding the insurance companies) primarily comprise level 1 instruments (approximately 60% as at 31 March 2020, over 62% at the end of 2019), measured based on market prices, without any discretion by the valuator. Level 3 assets, which are subject to greater discretion in determining fair value, make up approximately 7% of total assets measured at fair value; they have not undergone significant change and are over 60% composed of property and equipment. The increase in Level 2 assets on 31 December 2019 was affected by the increase in exposures to OTC derivatives contracts, which also had an analogous effect on liabilities.

As far as liabilities are concerned, level 3 instruments remain at essentially insignificant levels (well below 1% of total liabilities), whereas level 2 instruments, mostly OTC derivatives, continue to prevail. In March 2020, level 2 liabilities also included certificates issued that had been classified as level 1 at the end of December 2019, on the basis of assessments made regarding the reduction at the end of March compared with the previous months in the number and value of daily trades on the markets of reference (EuroTLX and SeDeX), as described in further detail in the specific paragraph of the Executive Summary provided in this Report.
As at 31 March 2020, liabilities designated at fair value included the newly issued capital protected certificates.

Fair value hierarchy – Insurance companies

(millions of euro)

Assets / liabilities at fair value	31.03.2020			31.12.2019		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	470	39	45	284	22	46
of which: Equities	*-*	*-*	*-*	*-*	*-*	*-*
of which: quotas of UCI	*110*	*-*	*45*	*119*	*-*	*46*
2. Financial assets designated at fair value through profit or loss	76,248	141	425	83,816	141	308
of which: Equities	*1,879*	*-*	*-*	*2,315*	*-*	*-*
of which: quotas of UCI	*67,885*	*104*	*-*	*76,521*	*99*	*-*
3. Financial assets available for sale	75,249	3,820	2,044	79,315	2,162	1,902
of which: Equities	*1,338*	*-*	*-*	*1,480*	*-*	*-*
of which: quotas of UCI	*9,653*	*-*	*2,032*	*9,917*	*-*	*1,902*
4. Hedging derivatives	-	175	-	-	206	-
5. Property and equipment	-	-	-	-	-	-
6. Intangible assets	-	-	-	-	-	-
Total	**151,967**	**4,175**	**2,514**	**163,415**	**2,531**	**2,256**
1. Financial liabilities held for trading	51	66	-	-	45	-
2. Financial liabilities designated at fair value through profit or loss	-	68,699	-	-	75,886	-
3. Hedging derivatives	-	6	-	-	4	-
Total	**51**	**68,771**	**-**	**-**	**75,935**	**-**

For the insurance companies, over 95% of financial assets designated at fair value are determined based on market prices, without any discretion by the valuator.
Level 3 instruments, which are subject to greater discretion in determining fair value, are essentially stable and continue to account for less than 2% of assets measured at fair value.

All liabilities measured at fair value are level 2.

INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure in structured credit products, came to 3,028 million euro as at 31 March 2020, showing a net decrease of 766 million euro compared to 3,794 million euro as at 31 December 2019. The exposure includes investments in ABSs (asset-backed securities) of 1,640 million euro, in CLOs (collateralised loan obligations) of 1,311 million euro and, to a residual extent, in CDOs (collateralised debt obligations) of 77 million euro, for which there were essentially no additional transactions during the period.

(millions of euro)

Accounting categories	31.03.2020				31.12.2019	changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total		absolute	%
Financial assets held for sale	383	559	-	**942**	**1,514**	-572	-37.8
Financial assets mandatorily measured at fair value	-	18	-	**18**	**20**	-2	-10.0
Financial assets measured at fair value through other comprehensive income	540	714	-	**1,254**	**1,485**	-231	-15.6
Financial assets measured at amortised cost	388	349	77	**814**	**775**	39	5.0
Total	**1,311**	**1,640**	**77**	**3,028**	**3,794**	**-766**	**-20.2**

In this disclosure, structured credit products include debt securities held by the Group divided into tranches upon issue consisting of various degrees of subordination and not issued within the framework of transactions originated by entities of the Intesa Sanpaolo Group or by public entities, in addition to transactions whereby the Group finances its corporate and financial institution customers (operations implemented by the Group through the subsidiary Duomo Funding Plc).

The strategy for transactions in structured credit products involved investments aimed at exploiting market opportunities, on the one hand, and continuous disposals of the portfolio, mainly referring to positions which at the time were affected by the financial crisis, on the other hand.
The exposure in ABSs and CLOs measured at fair value went from 3,019 million euro in December 2019 to 2,214 million euro in March 2020, a net decrease of 805 million euro, attributable to investments, which were much lower than disposals, mainly made by Banca IMI in the financial assets held for trading portfolio and, to a lesser extent, in the assets measured at fair value through other comprehensive income portfolio, in addition to the investments made by the Parent Company in the financial assets held for trading portfolio.
The exposure to debt securities classified as assets measured at amortised cost amounted to 775 million euro in December 2019, compared with an exposure of 814 million euro in March 2020, and was substantially stable with little significant change.
The investments, primarily made by Banca IMI, mainly consisted of CLOs, most of which with AAA ratings and, to a lesser extent, of ABSs with underlying residential mortgages, essentially relating to the trading book.
From profit or loss perspective, a loss of -39 million euro was posted for 2020, compared to +16 million euro for the first three months of 2019.
This result, which was mainly attributable to trading activities – caption 80 of the income statement – and to exposures in ABSs amounting to -13 million euro and exposures in CLOs amounting to -26 million euro, was solely due to valuation effects, attributable to the downturn in the markets during the period as a result of the COVID-19 health emergency (the result for the first quarter of 2019 was a profit of 4 million euro).
The profits (losses) from financial assets mandatorily measured at fair value was nil, compared to a profit of 12 million euro in the first quarter of 2019.
The exposures to ABSs and CLOs of debt securities classified as assets measured at fair value through other comprehensive income, which related primarily to the subsidiary Banca IMI, recorded a net decrease in fair value of -33 million euro in 2020 through a shareholders' equity reserve (from a positive reserve of 2 million euro in December 2019 to a negative reserve of -31 million euro in March 2020); there was also an impact of +1 million euro from sales during the period (nil figure for the first three months of 2019).
Adjustments of 1 million euro were recognised on the debt securities classified as assets measured at amortised cost in 2020, compared to a nil result for the first quarter of 2019.
With regard to the monoline and non-monoline packages, in line with the situation as at the end of 2019, there were no positions held in 2020.

(millions of euro)

Income statement results broken down by accounting category	**31.03.2020**				**31.03.2019**	**changes**	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	**Total**		**absolute**	**%**
Financial assets held for sale	-26	-13	-	**-39**	**4**	-43	
Financial assets mandatorily measured at fair value	-	-	-	**-**	**12**	-12	
Financial assets measured at fair value through other comprehensive income	-	1	-	**1**	**-**	1	-
Financial assets measured at amortised cost	-	-1	-	**-1**	**-**	1	-
Total	**-26**	**-13**	**-**	**-39**	**16**	**-53**	

INFORMATION ON ACTIVITIES PERFORMED THROUGH SPECIAL PURPOSE ENTITIES (SPES)

For the purpose of this analysis, legal entities established to pursue a specific, clearly defined and limited objective (raising funds on the market, acquiring/selling/managing assets both for asset securitisations, acquisition of funding through self-securitisations and the issue of covered bonds, developing and/or financing specific business initiatives, undertaking leveraged buy-out transactions, or managing credit risk inherent in an entity's portfolio) are considered Special Purpose Entities.
The sponsor of the transaction is normally an entity which requests the structuring of a transaction that involves the SPE for the purpose of achieving certain objectives. In some cases the Bank is the sponsor and establishes a SPE to achieve one of the objectives cited above.
For the SPE categories identified as not consolidated structured entities, no amendments are recorded to the criteria based on which the Intesa Sanpaolo Group decides on whether to include the companies in the scope of consolidation, compared to the information already provided in the 2019 financial statements.
In the first quarter of 2020, under the programme guaranteed by ISP OBG, the securities of the 6th, 15th and 16th series were redeemed in advance in February for a total of 3.484 billion euro and two new series, the 38th and 39th, were issued for an amount of 1.750 billion euro each. In March, the 40th series was issued for an amount of 1.8 billion euro.
The securities, which have a DBRS A High rating, are both floating rate with a maturity of 13 years for the 38th series and 14 years for the 39th and 40th series. The securities, which are listed on the Luxembourg Stock Exchange, were fully subscribed by the Parent Company and are eligible for the Eurosystem.
With regard to the covered bond issue programme guaranteed by ISP CB Pubblico, in January the 10th series was partially redeemed (for an amount of 550 million euro), bringing the nominal amount to 550 million euro.
Under the covered bond issue programme guaranteed by ISP CB Ipotecario, the 27th series was issued in January for an amount of 750 million euro. This security has a Moody's Aa3 rating and is a floating-rate bond with a maturity of 11 years. The

security, which is listed on the Luxembourg Stock Exchange, was fully subscribed by the Parent Company and is eligible for the Eurosystem.

INFORMATION ON LEVERAGED FINANCE TRANSACTIONS

In May 2017, the ECB published specific Guidance on Leveraged Transactions, which applies to all significant entities subject to direct supervision by the ECB. The declared purpose of the regulations is to strengthen company controls over “leveraged” transactions, where such transactions increase globally and in the context of a highly competitive market, marked by a long period of low interest rates and the resulting search for yields.
The scope identified in the ECB Guidance includes exposures in which the borrower’s level of leverage, measured as the ratio of total financial debt to EBITDA, is greater than 4, in addition to exposures to parties whose majority of capital is held by one or more financial sponsors. Moreover, counterparties with Investment Grade ratings, individuals, credit institutions, companies in the financial sector in general, public entities, non-profit entities, as well as counterparties with credit facilities below a certain materiality threshold (5 million euro), Retail SME counterparties and Corporate SME counterparties if not owned by financial sponsors, are explicitly excluded from the scope of Leveraged Transactions. Specialised lending transactions (project finance, real estate, object financing and commodities financing) and certain other types of credit, such as trade finance operations, are also excluded.
As at 31 March 2020, for the Intesa Sanpaolo Group, the transactions that meet the definition of Leveraged Transactions in the ECB Guidance amounted to 23.4 billion euro, relating to approximately 1,900 credit lines (as at 31 December 2019 the amount was 20.8 billion euro, also relating to around 1,900 credit lines).
In accordance with the requirements of the ECB Guidance, a specific limit for the outstanding stock of leveraged transactions was submitted for approval to the Board of Directors, within the framework of the 2020 Credit Risk Appetite.

INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The Hedge Fund portfolio as at 31 March 2020 amounted to 35 million euro in the trading book and 187 million euro in the banking book, compared to 115 million euro and 194 million euro respectively in December 2019.
The investments allocated to the banking book are recognised under financial assets mandatorily measured at fair value and relate to investments made in funds that have medium/long-term investment strategies and redemption times that are longer than those of UCITS (Undertakings for Collective Investment in Transferable Securities) funds.
During the first quarter of 2020, disposals of positions were made for 80 million euro in the trading books aimed at reducing the intrinsic risk of this portfolio in a situation of extreme volatility and downturn in the markets, resulting from the COVID-19 health emergency, by using the greater dynamism allowed for trading books.
The banking book was substantially stable, with no major investments or disposals made during the quarter.
In terms of profit or loss effect, the profits (losses) on trading – caption 80 of the income statement – showed a loss of 22 million euro for the first three months of 2020 compared to a substantially nil result in March 2019. The result for the period included valuation losses of 6 million euro and losses on disposals of 16 million euro.
The net profit (loss) on financial assets mandatorily measured at fair value – caption 110 of the income statement – recorded an overall loss of 8 million euro during the period, attributable to valuation components, compared to a profit of 2 million euro in the first three months of 2019.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 31 March 2020, the Intesa Sanpaolo Group, in relation to derivatives trading with retail customers, non-financial companies and public entities (therefore excluding banks, financial and insurance companies), presented a positive fair value, not having applied netting agreements, of 8,755 million euro (7,694 million euro as at 31 December 2019). The notional value of these derivatives totalled 64,051 million euro (62,528 million euro as at 31 December 2019).
The positive fair value of contracts outstanding with the 10 customers with the highest exposures was 5,759 million euro (5,269 million euro as at 31 December 2019).
Conversely, the negative fair value referring to total contracts outstanding, determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 2,331 million euro as at 31 March 2020 (1,410 million euro as at 31 December 2019). The notional value of these derivatives totalled 21,192 million euro (20,334 million euro as at 31 December 2019).
The fair value of derivative financial instruments entered into with customers was determined considering, as for all other OTC derivatives, the creditworthiness of the single counterparty ("Bilateral Credit Value Adjustment"). With regard to contracts outstanding as at 31 March 2020, this led to a negative effect of 90 million euro being recorded under “Profits (Losses) on trading” in the income statement.
As regards the methodologies used in determining the fair value of financial instruments, see the specific paragraphs of the section on accounting policies in the Notes to the consolidated financial statements.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk and compliance risk, model risk, ICT risk and financial reporting risk; strategic and reputational risk are not included.
The Intesa Sanpaolo Group has for some time defined the overall operational risk management framework by setting up a Group policy and organisational processes for measuring, managing and controlling operational risk.
To determine its capital requirements, the Group uses a combination of the methods allowed under applicable regulations. The capital absorption resulting from this process amounted to 1,697 million euro as at 31 March 2020, unchanged compared to 31 December 2019.

Legal risks

Legal risks are thoroughly analysed by the Parent Company and Group companies. Provisions are made to the allowances for risks and charges in the event of disputes for which it is probable that funds will be disbursed and where the amount of the disbursement may be reliably estimated.
There were no new significant legal disputes during the quarter. With regard to the main pending disputes, details are provided below of the significant developments in the first quarter of 2020; a summary description of these disputes can be found in the Notes prepared for the 2019 Annual Report and for the previous quarters of 2019.

Private banker (Sanpaolo Invest) – In relation to the serious violations committed by a private banker of Sanpaolo Invest, at the end of March the subsidiary received a total of 60 complaints for misappropriations with a total remedy sought of approximately 24 million euro, of which 17 million euro relating solely to the misappropriations and the rest to further damages. The checks conducted by the Internal Audit Function and the Legal function determined total misappropriated amounts of 13 million euro. The company also received another 208 claims for around 20 million euro (195 claims for 18 million euro in December) relating to false accounting and unauthorised transactions, as well as requests for reimbursement of fees for the advanced advisory service.
During the quarter, the subsidiary accepted and reimbursed more than 3 million euro in claims, in addition to the amount of around 1 million euro already paid in 2019. At the same time, the company continued the out-of-court and legal actions against the unlawful beneficiaries for the recovery of the amounts misappropriated.
The risk of disbursement resulting from the illegal acts committed by the private banker is covered by a provision of 10 million euro (of which 2.4 million euro allocated in the first quarter of 2020). This provision was determined on the basis of an assessment of the claims for the confirmed appropriations and the claims relating to incorrect reports and unauthorised transactions, without considering the recovery actions already initiated, the discovery orders issued, and the coverage provided by the insurance policy, which the company promptly triggered in accordance with the policy conditions.

Dargent Lawsuit - During the first quarter of this year, the Bank obtained the refund of the around 23 million euro paid according to the ruling of the Court of Appeal of Colmar in 2018, which was annulled and quashed by the French Court of Cassation in January this year.

Disputes relating to loans in CHF – In March 2020 the Croatian Supreme Court, within a model case proceedings (a Supreme Court proceedings with obligatory effect on lower instance courts with the aim of unifying/harmonising case law), ruled that the conversion agreements concluded between banks and borrowers under the Croatian Conversion Law of 2015 produce legal effects and are valid even in the case when the provisions of the underlying loan agreements on variable interest rate and currency clause are null and void. Such decision is binding on all Croatian courts and will positively impact the individual proceedings related to converted loans in Swiss francs (or indexed to that currency), which should be settled, then, in favour of the Croatian subsidiary.

Disputes arising from the acquisition of certain assets, liabilities and legal relationships of Banca Popolare di Vicenza S.p.A. in compulsory administrative liquidation and Veneto Banca S.p.A. in compulsory administrative liquidation – In June 2019, Intesa Sanpaolo sent the Banks in compulsory administrative liquidation a number of letters containing claims for compensation of already incurred or potential damages, which Intesa Sanpaolo is entitled to under the sale agreement (compensation obligation secured by government guarantee).
To enable the Banks in compulsory administrative liquidation to perform a more thorough examination of the claims made, Intesa Sanpaolo, in the letters sent in June 2019, granted an extension of the contractual deadline to 22 November 2019 for contesting the claims made. Subsequently, upon request from the Banks in compulsory administrative liquidation, Intesa Sanpaolo granted a further extension of this initial deadline up to 31 March 2020 and then to 30 November 2020.

IMI/SIR Dispute – You are reminded that following the final judgement establishing the criminal liability of the corrupt judge Metta (and his accomplices Rovelli, Acampora, Pacifico, and Previti), the defendants were ordered to pay compensation for damages, with the determination of those damages referred to the civil courts. Intesa Sanpaolo then brought a case before the Court of Rome to obtain an order of compensation for damages from those responsible.
In its ruling of May 2015, the Court of Rome quantified the financial and non-financial damages for Intesa Sanpaolo and ordered Acampora and Metta – the latter also jointly liable with the Prime Minister's Office (pursuant to Law no. 117/1988 on the accountability of the judiciary) – to pay Intesa Sanpaolo 173 million euro net of tax, plus legal interest accruing from 1 February 2015 to the date of final payment, plus legal expenses. The amount ordered took account of the amounts received in the meantime by the Bank as part of the settlements with the Rovelli family and with the counterparties Previti and Pacifico.
In July 2016, the Rome Court of Appeal stayed the enforcement of the judgment of first instance with respect to the amount in excess of 130 million euro, in addition to ancillary charges and expenses, and adjourned the hearing of the final pleadings to June 2018. As a result of this decision, in December 2016 the Office of the President of the Council of Ministers credited Intesa Sanpaolo with the sum of 131,173,551.58 euro (corresponding to the 130 million euro of the order, in addition to legal

interest and reimbursement of expenses). To avoid dispute, only the exact amount of the order, without applying the gross-up, was demanded and collected.
On 16 April 2020, the ruling of the Court of Appeal of Rome was filed, which essentially upheld the Court's ruling, while reducing the amount of non-financial damages to 8 million euro (compared to 77 million euro that had been quantified by the court of first instance), and set the amount to be paid at 108 million euro, to be considered net of tax, plus legal interest and expenses.
The legal actions to safeguard the Bank's claims are currently being assessed.

Tax litigation

The Group's tax litigation risks are covered by adequate provisions to the allowances for risks and charges.
There was a marginal increase in disputes at the Parent Company during the quarter, mainly due to the municipal property tax assessments on property leases discussed below (+122 new cases with a total value of 4.7 million euro and a related provision of 1.4 million euro for interest and penalties).
Law Decree no. 18/2020 (referred to as the "Cure Italy Decree") suspended the deadline for appeals and proceedings in tax disputes from 9 March to 15 April 2020 (later extended to 11 May by Law Decree no. 23/2020, referred to as the "Liquidity Decree"). The deadlines for the activities of the tax authorities relating to settlement, control, assessment, and collection were also suspended from 8 March to 31 May 2020.
The merged company Mediocredito Italiano ("MCI") has municipal property tax disputes outstanding regarding properties where the leases have terminated but it has not yet taken repossession of the properties. The disputes relate to the identification of the liability for municipal property tax for properties owned by the leasing company (now Intesa Sanpaolo) leased out to third parties, where the lease was terminated early due to default by the lessee, or as a result of insolvency proceedings involving the lessee, but without the lessee having returned the property. The subject of dispute is whether the lessee is liable for the municipal property tax rather than the leasing company in the period between the date of termination (or dissolution) of the lease and the date of return of the property to the lessor or the date when the lessor physically takes repossession of the property. The position adopted by Intesa Sanpaolo, namely that the party liable for the tax continues to be the former occupying lessee, is in line with that of all the other Italian leasing companies and the recommendations from the ASSILEA (Italian association of leasing companies). In recent months, there have been a number of Court of Cassation rulings on the subject, mostly unfavourable to banks and leasing companies, but not all unequivocal. Pending firm guidance from the courts of judicial review, the Bank is currently assessing the future conduct to be adopted, both in relation to the next payment deadlines for the municipal property tax and to the existing disputes.
With regard to the cases settled during the period, there was a favourable ruling by the Court of Cassation concerning the former Cassa di Risparmio di Piacenza e Vigevano regarding the registration tax on the capital increase based on the subsidies under the Amato Law amounting to around 0.8 million euro. In addition, the Court of Cassation ruled against the notice of payment of registration tax issued against the merged company Centro Leasing in relation to the sale of a leased property in Rome, in Via Tuscolana. The total claim for tax, penalties and interest was around 2 million euro, already fully provisioned and paid on a provisional basis pending a ruling.
With regard to the Intesa Sanpaolo branches located abroad, there were no changes during the period. Accordingly, we confirm what was reported as at 31 December 2019, namely that tax audits by the Tax Authorities are underway in relation to: i) VAT on the London branch for the years 2016, 2017 and 2018; and ii) federal direct taxes at the New York branch for the tax periods 2015, 2016 and 2017. No claims have been made for the time being.
There were no reports of significant disputes during the first quarter of 2020 at the other Italian Group Companies included in the scope of consolidation and for the international Group Companies.
Internationally, a VAT tax audit was initiated on 2 March 2020 on the Romanian service company Exelia for the periods from 1 December 2014 to 31 December 2019 by the ANAF (Romanian Tax Administration) of Brasov. For the year 2014, the company had already been audited up to 30 November 2014. No claims have been made for the time being.

INSURANCE RISKS

Investment portfolios

The investments of the insurance companies of the Intesa Sanpaolo Group (Intesa Sanpaolo Vita, Intesa Sanpaolo Assicura, Intesa Sanpaolo Life and Fideuram Vita) are made with their free capital and to cover contractual obligations with customers. These refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies.
As at 31 March 2020, the investment portfolios of Group companies, recorded at book value, amounted to 160,661 million euro. Of these, a part amounting to 84,018 million euro relates to traditional revaluable life policies (the financial risk of which is shared with the policyholders by virtue of the mechanism whereby the returns on assets subject to segregated management are determined), non-life policies and free capital. The other component, whose risk is borne solely by the policyholders, consists of investments related to Unit-linked policies and pension funds and amounted to 76,643 million euro.
Considering the various types of risks, the analysis of investment portfolios, described below, concentrates on the assets held to cover traditional revaluable life policies, non-life policies and free capital.
In terms of breakdown by asset class, net of derivative financial instruments, 83.7% of assets, i.e. 70,063 million euro, were bonds, whereas equity instruments represented 1.8% of the total and amounted to 1,535 million euro. The remainder (12,127 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (14.5%).
The carrying value of derivatives came to approximately 294 million euro, of which 125 million euro relating to effective management derivatives[11], and the remaining portion (169 million euro) is attributable to hedging derivatives.
At the end of the first three months of 2020, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 624 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 9 million euro.
The breakdown of the bond portfolio in terms of fair value sensitivity to interest rate changes showed that a +100 basis points parallel shift in the curve leads to a decrease of approximately 4,089 million euro.
The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 5.8% of total investments and A bonds approximately 6.1%. Low investment grade securities (BBB) were approximately 85.9% of the total and the portion of speculative grade or unrated was minimal (2.2%).
A considerable portion of the BBB area is made up of securities issued by the Italian Republic.
The analysis of the exposure in terms of the issuers/counterparties produced the following results: securities issued by Governments and Central Banks approximately made up 81.5% of the total investments, while financial companies (mostly banks) contributed approximately 10% of exposure and industrial securities made up approximately 8.5%.
At the end of the first quarter of 2020, the fair value sensitivity of bonds to a change in issuer credit rating, intended as a market credit spread shock of +100 basis points, was 4,066 million euro, with 3,474 million euro due to government issuers and 592 million euro to corporate issuers (financial institutions and industrial companies).

[11] ISVAP Regulation 36 of 31 January 2011 on investments defines as "effective management derivatives" all derivatives aimed at achieving pre-established investment objectives in a faster, easier, more economical or more flexible manner than would have been possible acting on the underlying assets.