
Risk management

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 companies¹⁷, 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 Tableau de Bord of the Group Risks. 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.

¹⁷ In this regard, it is specified that Intesa Sanpaolo does not exercise management and coordination over Risanamento S.p.A. and Autostrade Lombarde S.p.A. and their subsidiaries pursuant to Article 2497 et seq. of the Italian Civil Code.

THE 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 of the decision both 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) continued in accordance with the Regulatory Roadmap agreed with the Supervisory Authorities.

The situation as at 30 June 2020 is shown in the following table:

Portfolio	PD - Model Type	LGD - Model Type	EAD - Model Type	Status
Sovereign	Shadow model based on agency rating	Model based on recovery rates estimated by rating agencies	Regulatory parameters	Used for management purposes only; Standardised approach for reporting purposes
Institutions	Default model (Banks) ⁽⁴⁾	Market model (Banks)	Regulatory parameters (Banks)	AIRB authorised since June 2017
	Default model (Municipalities and Provinces) Shadow model (Regions) ⁽⁴⁾	Workout model (Municipalities, Provinces, Regions)	Regulatory parameters (Municipalities, Provinces, Regions)	AIRB authorised since June 2017
Corporate	Default model (Corporate)	Workout model (Corporate)	CCF/K factor model (Corporate)	FIRB authorised since December 2008, AIRB LGD authorised since December 2010, EAD authorised since September 2017 ⁽¹⁾
	Simulation models (Specialised Lending)	Simulation models (Specialised Lending)	Regulatory parameters (Specialised Lending)	AIRB authorised since June 2012
	Expert-Based Model (Non-Banking Fin. Inst.)	Regulatory parameters (Non-Banking Fin. Inst.)	Regulatory parameters (Non-Banking Fin. Inst.)	Used for management purposes only; Standardised approach for reporting purposes
Retail	Default model (Retail)	Workout model (Retail)	CCF/K factor model (Retail)	IRB Retail since September 2018 ⁽²⁾
	Default model (Retail SME)	Workout model (Retail SME)	Regulatory parameters (Retail SME)	AIRB authorised since December 2012 ⁽³⁾

- 1) ISP authorised for FIRB from December 2008, for LGD AIRB from December 2010 and for EAD from 2017, Banca IMI (2012), ISP Ireland (2010), VUB (2010), Intesa Sanpaolo Bank (2017), and ISP Luxembourg (2017). From 2017, the Corporate model has also been used to calculate the risk on the Banking book equity portfolio with LGD 65%/90%
- 2) VUB authorised from June 2012 for PD and LGD of Retail Mortgage models
- 3) VUB authorised from June 2014
- 4) ISP and Banca IMI authorised from 2017

With regard to counterparty risk on OTC derivatives and SFTs, the Group has improved the measurement and monitoring, by refining the instruments required under Basel 3. For reporting purposes, Intesa Sanpaolo and Banca IMI have been authorised to use internal models (both for the determination of Exposure at default for replacement risk and for the CVA capital charge for migration risk).

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

The annual Internal Capital Adequacy Assessment Process (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.

CREDIT RISK

The Intesa Sanpaolo Group's strategies, powers and rules for credit granting and management are aimed at:

- achieving the goal of sustainable growth consistent with the Group's risk appetite and value creation objectives, whilst guaranteeing and improving the quality of its lending operations;
- diversifying the portfolio, limiting the concentration of exposures to counterparties/groups, economic sectors or geographical areas;
- efficiently selecting economic groups and individual borrowers through a thorough analysis of their creditworthiness aimed at limiting the risk of insolvency and mitigating potentially associated losses;
- given the current economic climate, favouring lending business aimed at supporting the real economy and production system and at developing relationships with customers;
- constantly monitoring relationships and the related exposures, through the use of both IT procedures and systematic surveillance of positions that show irregularities with the aim of detecting any symptoms of deterioration in a timely manner.

The 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.

There were no changes relating to the authorisations for the models to be applied to the specific portfolios with respect to 31 December 2019.

Credit quality

Constant monitoring of the quality of the loan portfolio is also pursued through specific operating checks for all the phases of loan management.

The overall watch-list and non-performing loan portfolio is subject to a specific management process which, inter alia, entails accurate monitoring through a control system and periodic managerial reporting. In particular, this activity is performed using measurement methods and performance controls that allow the production of synthetic risk indicators. The quality of the loan portfolio is pursued through specific operating checks for all the phases of loan management, through the use of both IT procedures and systematic supervision of positions with the aim of detecting any symptoms of difficulty and promote corrective measures to prevent possible deterioration of credit risk.

Positions are detected and automatically entered in the credit management processes by way of daily and monthly checks using objective risk indicators that allow timely assessments when any anomalies arise or persist and interact with processes and procedures for loan management and monitoring.

Within the Group, in accordance with pre-set rules, positions which are attributed a persistent high-risk rating are intercepted (manually or automatically) and classified to the following categories based on their risk profile, in accordance with the regulatory provisions on credit quality:

- Bad loans: the set of "on-" and "off-balance sheet" exposures towards borrowers in default or similar situations;
- Unlikely to pay: "on-" and "off-balance sheet" exposures which the bank, based on its opinion, does not deem likely to be completely (as principal and/or interest) repaid by the borrowers without the implementation of actions such as enforcement of guarantees. This assessment is irrespective of the presence of any amounts (or instalments) due and unpaid.

The category of non-performing loans also includes past due positions that cannot be considered mere delays in reimbursements, as established by the Bank of Italy.

Lastly, non-performing exposures also include the individual forbore exposures which comply with the definition of "Non performing exposures with forbearance measures" envisaged by the EBA ITS (European Banking Authority - Implementing Technical Standards), which are not a separate category of non-performing assets, but rather a sub-category. Similarly, exposures characterised by "forbearance measures" are also included among performing loans.

The management process for such exposures, in close accordance with regulatory provisions concerning classification times and methods, is assisted by automatic mechanisms that ensure pre-established, autonomous and independent management procedures.

Captions	30.06.2019		31.12.2019		(millions of euro)		
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Change Net exposure
Bad loans	17,585	-11,186	6,399	19,418	-12,678	6,740	-341
Unlikely to pay	11,092	-4,457	6,635	10,995	-4,257	6,738	-103
Past due loans	1,177	-200	977	886	-142	744	233
Non-Performing Loans	29,854	-15,843	14,011	31,299	-17,077	14,222	-211
<i>Non-performing loans in Stage 3 (subject to impairment)</i>	29,809	-15,827	13,982	31,257	-17,062	14,195	-213
<i>Non-performing loans designated at fair value through profit or loss</i>	45	-16	29	42	-15	27	2
Performing loans	385,349	-2,191	383,158	376,839	-1,697	375,142	8,016
<i>Stage 2</i>	62,959	-1,442	61,517	41,146	-1,068	40,078	21,439
<i>Stage 1</i>	321,554	-749	320,805	334,973	-629	334,344	-13,539
<i>Performing loans designated at fair value through profit or loss</i>	836	-	836	720	-	720	116
Performing loans represented by securities	6,173	-27	6,146	5,875	-34	5,841	305
<i>Stage 2</i>	2,809	-21	2,788	2,972	-30	2,942	-154
<i>Stage 1</i>	3,364	-6	3,358	2,903	-4	2,899	459
Loans held for trading	22	-	22	24	-	24	-2
Total loans to customers	421,398	-18,061	403,337	414,037	-18,808	395,229	8,108
<i>of which forbore performing</i>	6,106	-236	5,870	5,918	-255	5,663	207
<i>of which forbore non-performing</i>	6,777	-2,869	3,908	7,157	-3,119	4,038	-130
Loans to customers classified as discontinued operations (*)	168	-11	157	475	-93	382	-225

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

(*) As at 30 June 2020, this caption included the portfolio of unlikely-to-pay loans and performing loans soon to be sold (gross exposure of 168 million euro, total adjustments of 11 million euro, net exposure of 157 million).

As at 30 June 2020, the Group's net non-performing loans amounted to 14 billion euro, down by 1.5% compared with the beginning of the year, continuing the progressive decline that marked 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 (53.1%).

In further detail, at the end of June 2020 bad loans came to 6.4 billion euro net of adjustments (down by -341 million euro on the beginning of the year, or -5.1%), and represented 1.6% of total loans. During the same period, the coverage ratio came to 63.6%. 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 40.2%. Past due loans amounted to 977 million euro (+31.3%), with a coverage ratio of 17%. Within the non-performing loan category, forbore 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 42.3%, while forbore exposures in the performing loans category amounted to 5.9 billion euro.

The coverage ratio for performing loans rose to 0.6% as a result of 730 million euro of prudential provisions due to the revision of the scenario. These were in addition to approximately 150 million euro of adjustments to non-performing loans, bringing the total provisions due to the revision of the scenario following the COVID-19 pandemic to approximately 880 million euro.

Counterparty risk

Counterparty risk is a particular type of credit risk, relating to OTC (over the counter) and ETD (exchange-traded derivatives) derivatives and SFTs (Securities Financing Transactions), which refers to the possible default of the counterparty before the expiry of a contract that has a positive market value.

The Group uses techniques to mitigate counterparty risk through bilateral netting arrangements which enable the netting off of credit and debit positions in the event of counterparty default.

This is achieved by entering into ISDA (International Swaps and Derivatives Association) agreements, for OTC derivatives, which also reduce the absorption of regulatory capital in accordance with supervisory provisions.

In addition, the Bank establishes collateral arrangements, where possible, typically calling for daily margins, to hedge bilateral OTC derivatives (credit support annexes - CSAs) and SFTs (Global Master Repurchase Agreements - GMRA e General Market Securities Lending Agreements - GMSLAs).

For reporting purposes, Intesa Sanpaolo and Banca IMI are authorised to use the internal models approach to calculate the counterparty risk requirement for OTC and ETD derivatives and SFTs.

These advanced risk measurement methods are also used at operational level to perform the “use test”: the Financial and Market Risks Head Office Department calculates, validates and sends the metrics to the credit monitoring systems on a daily basis to measure the use of the credit lines for OTC and ETD derivatives and SFTs.

The Group’s banks which are not included in the roll-out plan for the internal models nevertheless apply the advanced metrics in a simplified manner at operational level.

To perform the use test of the model, the Group has implemented the processes required by the “Basel 3” regulations. In particular, stress tests are carried out to measure the impacts on risk measures under extreme market conditions. Backtesting is also conducted to ensure the robustness of the model.

In addition, to complete the risk analysis process, the following corporate processes have been activated:

- definition and periodic analysis of Wrong-Way Risk, i.e. the risk of a positive correlation between the future exposure to a counterparty and that counterparty’s probability of default;
- definition and monitoring of management limits;
- contribution of collateral inflow/outflow risk measures, calculated on the basis of the internal counterparty risk model, for margined OTC derivatives and SFTs;
- periodic reporting to management of the measures calculated using the current and future internal exposure model, analysis of portfolio composition by type of counterparty/division/segment/country, underlying type per SFT capital requirement, level of use of management limits, and results of stress tests and Wrong-Way Risk analyses.

MARKET RISKS

TRADING BOOK

The quantification of trading risks (managerial calculation scope) is based on daily and periodic analysis of the trading portfolios of Intesa Sanpaolo and Banca IMI, which represent the main portion of the Group’s market risks, to adverse market movements of the following risk factors:

- interest rates;
- equities and market indexes;
- investment funds;
- foreign exchange rates;
- implied volatilities;
- spreads in credit default swaps (CDSs);
- spreads in bond issues;
- correlation instruments;
- dividend derivatives;
- asset-backed securities (ABSs);
- commodities.

Some Group subsidiaries hold smaller trading portfolios with a marginal risk (approximately less than 1% of the Group’s overall management risk). In particular, the risk factors of the international subsidiaries’ trading books are local government bonds, positions in interest rates, and foreign exchange rates relating to linear pay-offs.

Managerial VaR

The analysis of market risk profiles relative to the trading book (managerial scope) uses various quantitative indicators and VaR is the most important. Since VaR is a synthetic indicator which does not fully identify all types of potential loss, risk management has been enriched with other measures, in particular simulation measures for the quantification of risks from illiquid parameters (dividends, correlation, ABS, hedge funds).

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

In line with what has been approved by the BoD, with regard to the VaR limits for legal entities, the managerial VaR of the held-for-trading component includes the HTCS portfolio for Banca IMI

Sensitivity and greeks

Sensitivity measures make risk profiling more accurate, especially in the presence of option components. These measure the risk attributable to a change in the value of a financial position to predefined changes in valuation parameters including a one basis point increase in interest rates.

Level measures

Level measures are risk indicators which are based on the assumption of a direct relationship between the size of a financial position and the risk profile. These are used to monitor issuer/sector/country risk exposures for concentration analysis, through the identification of notional value, market value or conversion of the position in one or more benchmark instruments (so-called equivalent position).

Stress tests

Stress tests measure the value changes of instruments or portfolios due to changes in risk factors of unexpected intensity and correlation, or extreme events, as well as changes representative of expectations of the future evolution of market variables. Stress tests for management purposes are applied periodically to market risk exposures, typically adopting scenarios based on historical trends recorded by risk factors, for the purpose of identifying past worst-case scenarios, or defining variation grids of risk factors to highlight the direction and non-linearity of trading strategies.

Internal model validation

For some of the risk factors included in the managerial VaR measurements, with regard to the regulatory trading book, the Supervisory Authority has validated the internal models for the reporting of the capital requirement of both Intesa Sanpaolo and Banca IMI.

More specifically, concerning market risk, the risk profiles validated are: (i) generic/specific on debt securities and on equities for Intesa Sanpaolo and Banca IMI, (ii) position risk on quotas of UCI underlying CPPI (Constant Proportion Portfolio Insurance) products for Banca IMI and the hedge fund portfolios of the Parent Company (look through approach), (iii) position risk on dividend derivatives and (iv) commodity risk for Banca IMI, the only legal entity in the Group authorised to hold open positions in commodities.

Stressed VaR

Capital absorption includes the requirement for stressed VaR. The requirement derives from the determination of the VaR associated with a market stress period. This period was identified considering the following guidelines, on the basis of the indications presented in the Basel document "Revision to the Basel 2 market risk framework":

- the period must represent a stress scenario for the portfolio;
- the period must have a significant impact on the main risk factors for the portfolios of Intesa Sanpaolo and Banca IMI;
- the period must allow real time series to be used for all portfolio risk factors.

While using the historical simulation approach for VaR calculation, the latter point is a discriminating condition in the selection of the holding period. Actually, in order to ensure that the scenario adopted is effectively consistent and to avoid the use of driver or comparable factors, the historical period must ensure the effective availability of market data.

As at the date of preparation of this document, the period for the measurement of Stressed VaR was from 11 October 2011 to 28 September 2012 for both Intesa Sanpaolo and Banca IMI.

Incremental Risk Charge (IRC)

The Incremental Risk Charge (IRC) is the maximum potential loss in the credit trading book resulting from an upgrade/downgrade or bankruptcy of the issuers, over a 1-year period, with a 99.9% confidence level. This measure is additional to VaR and enables the correct representation of the specific risk on debt securities and credit derivatives because, in addition to idiosyncratic risk, it also captures event and default risk.

Details are provided below of the estimates and evolution of managerial VaR, defined as the sum of VaR and of the simulation on illiquid parameters, for the trading book of Intesa Sanpaolo and Banca IMI.

Daily managerial VaR of the trading book for Intesa Sanpaolo and Banca IMI ^(a)

During the second quarter of 2020, managerial market risks (inclusive of the HTCS portfolio for Banca IMI) generated by Intesa Sanpaolo and Banca IMI increased compared to the average values of the first quarter of 2020. The Group's average managerial VaR for the period was 363.5 million euro compared to 174.8 million euro in the previous quarter. The Group's average VaR for the period on the trading component only was 85.6 million euro, an increase on the previous quarter. The increase in managerial VaR – mainly determined by Banca IMI – derives from an increase in the risk measures, mainly attributable to the health emergency caused by the COVID-19 pandemic.

(millions of euro)

	2020				2019			
	average 2 nd quarter	minimum 2 nd quarter	maximum 2 nd quarter	average 1 st quarter	average 4 th quarter	average 3 rd quarter	average 2 nd quarter	average 1 st quarter
Intesa Sanpaolo Trading	37.9	34.2	42.6	15.0	13.1	16.8	15.0	16.9
Banca IMI Trading & HTCS	325.6	301.5	356.3	159.8	107.2	128.5	149.0	160.1
<i>of which Trading Book IMI</i>	47.7	29.7	57.0	26.1	27.8	28.4	27.9	34.2
Total	363.5	337.7	394.9	174.8	120.2	145.3	164.0	177.0
<i>of which Group Trading Book (a)</i>	85.6	66.6	97.4	41.1	40.8	45.2	42.9	51.1

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

(a) The Group Trading Book figure has been calculated as the sum of the managerial VaR of Intesa Sanpaolo and the managerial VaR of Banca IMI (trading book scope).

Managerial market risks for the first half of 2020 (equal to 269.9 million euro) were up at Group level compared to the first half of 2019 (170.4 million euro); at the level of the trading component only (63.5 million euro), there was an increase in the Group's total risks. The performance of this indicator – mainly determined by Banca IMI – once again derives from an increase in the risk measures, mainly attributable to the health emergency caused by the COVID-19 pandemic.

(millions of euro)

	2020			2019		
	average 1 st half	minimum 1 st half	maximum 1 st half	average 1 st half	minimum 1 st half	maximum 1 st half
Intesa Sanpaolo Trading	26.5	10.1	42.6	16.0	13.4	19.0
Banca IMI Trading & HTCS	243.3	85.0	356.3	154.4	102.5	192.3
of which Trading Book IMI	37.0	20.7	57.0	31.0	24.6	38.4
Total	269.9	95.6	394.9	170.4	116.6	208.8
of which Group Trading Book (a)	63.5	31.0	97.4	47.0	40.0	57.1

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

(a) The Group Trading Book figure has been calculated as the sum of the managerial VaR of Intesa Sanpaolo and the managerial VaR of Banca IMI (trading book scope).

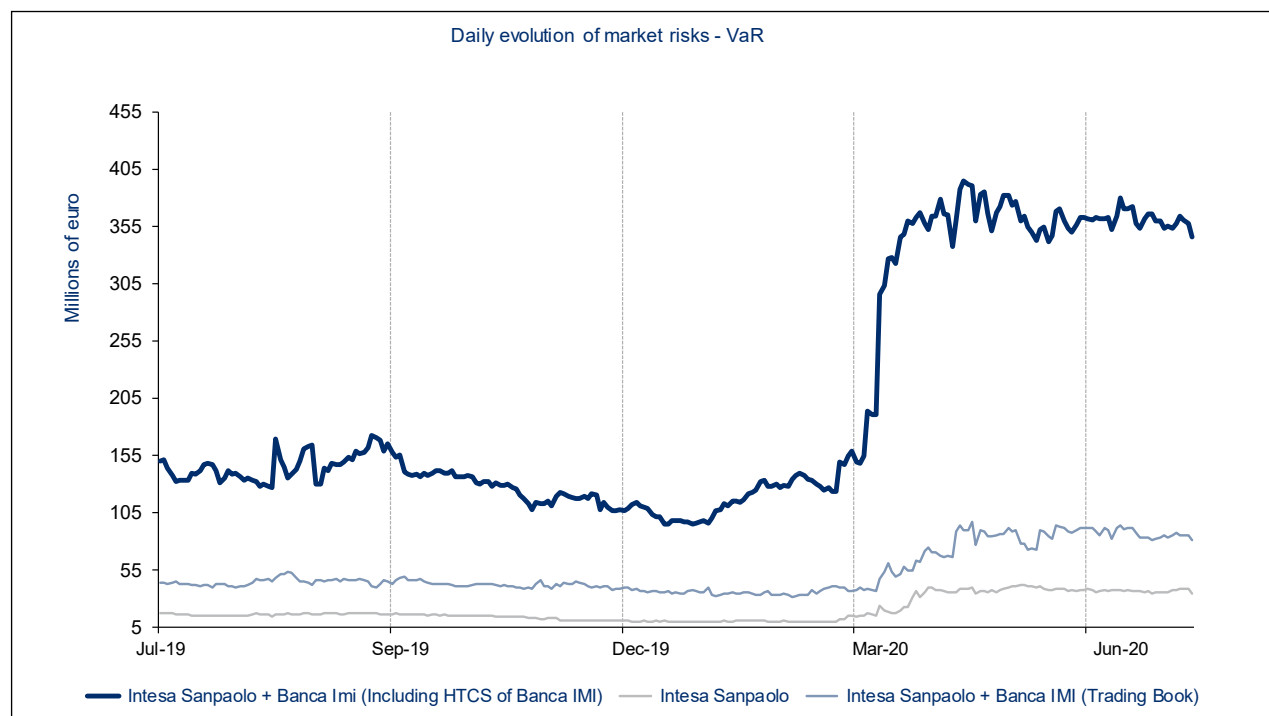
The breakdown of the risk profile in the second quarter of 2020 with regard to the different factors shows the prevalence of the risk generated by the credit spread, which accounted for 81% of the total managerial VaR for the Group (67% for the trading component only), 70% for Intesa Sanpaolo and 82% for Banca IMI.

Contribution of risk factors to total managerial VaR^(a)

2nd quarter 2020	Shares	Hedge funds	Interest rates	Credit spreads	Foreign exchange	Other parameters	Commodities
Intesa Sanpaolo	1%	1%	11%	70%	17%	1%	0%
Banca IMI	3%	0%	12%	82%	1%	2%	0%
Total	2%	0%	12%	81%	2%	2%	0%

(a) Each line in the table sets out the contribution of risk factors considering 100% the overall VaR, calculated as the average of daily estimates in the second quarter of 2020, broken down between Intesa Sanpaolo and Banca IMI and indicating the distribution of overall VaR.

The VaR trend in the first half of 2020 is primarily attributable to Banca IMI. In January risks increased by approximately 37% overall, owing 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). Finally, the measure was generally stable in the last quarter: in further detail, given the reduced financial market volatility observed in the second quarter, the stability of the managerial VaR figure may be attributed to both an overall stable portfolio and to the absence of new scenarios in the tail end of the distribution (managerial VaR is calculated using a weighted historical simulation with a 99% confidence interval and a time horizon of 1 day). Lastly, it should be noted that following the aforementioned revision of the Risk Appetite Framework within the environment resulting from the COVID-19 epidemic, the managerial VaR figure remained constantly within the pre-established limits.



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 June 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	1	-3	-211	115	898	-858	22	-5	-	-2
<i>of which HTCS of Banca Imi</i>	-	-	-205	124	786	-750	-	-	-	-

In particular:

- for stock market positions, there would be a loss of 3 million euro in the event of a sharp rise in equity prices and a decrease in volatility;
- for positions in interest rates, there would be a loss of -211 million euro in the event of an increase in rate curves of 40 bps (of which -205 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 858 million euro (of which -750 million euro attributable to Banca IMI's HTCS portfolio);
- for positions in exchange rates, there would be a loss of 5 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:

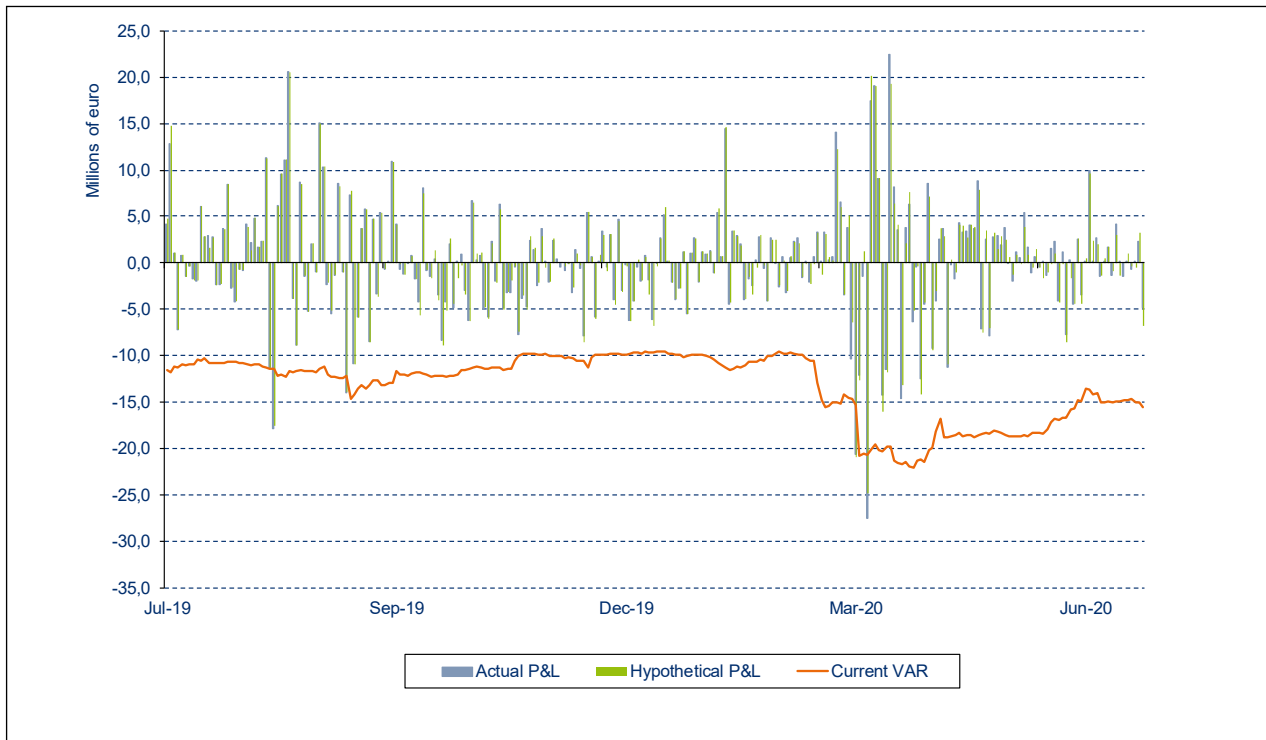
- the daily estimates of value at risk;
- the daily profits/losses based on backtesting which are determined using actual daily profits and losses achieved by individual desks, net of components which are not considered in backtesting: these include for example fees and financial costs of managing the positions that are regularly reported within the managerial area.

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.

As at 30 June 2020, the ISP Group did not benefit from the exclusion of overshootings from the calculation of the backtesting addend in view of the COVID-19 pandemic (Reg. 2020/873, Art. 500c). The exceptions set out below are the only cases recorded by the legal entities over the last twelve months.

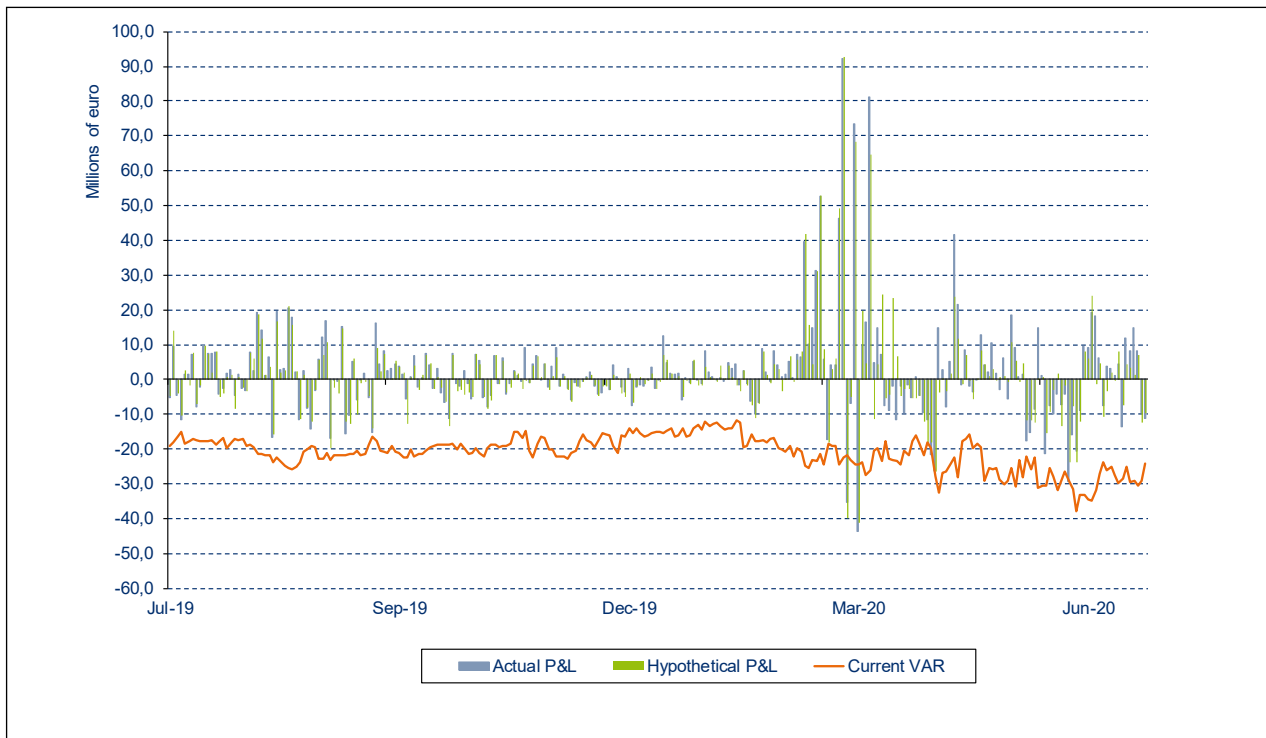
Backtesting in Intesa Sanpaolo

Four backtesting exceptions have been recorded during the last year. As for the exceptions in the third quarter of 2019, the most recent exceptions, 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 three effective P&L backtesting exceptions have been recorded (two hypothetical P&L exceptions). In addition to interest rate volatility, the largest losses are to be attributed to the credit spread variability of financial sector.



BANKING BOOK

Market risk originated by the banking book arises primarily from the exposure to assets, liabilities and off-balance sheet transactions sensitive to interest rates (interest rate risk) assumed by the Parent Company and the other main Group companies involved in credit activity (retail and corporate banking). The banking book also includes exposure to market risks deriving from the equity investments in listed companies not fully consolidated, mainly held by the Parent Company.

The internal system for measuring interest rate risk assesses and describes the effect of changes in interest rates on the economic value and the net interest income and identifies all significant sources of risk that affect the banking book:

- repricing risk: risk arising from maturity mismatches (for fixed-rate positions) and interest rate revision date mismatches (for floating-rate positions) of financial items due to parallel movements in the yield curve;
- yield curve risk: risk arising from maturity mismatches and interest rate revision date mismatches due to changes in the inclination and shape of the yield curve;
- basis risk: risk arising from imperfect correlation in the adjustment of lending and deposit rates of floating-rate instruments which may differ according to indexing parameters, rate revision method, indexing algorithm, etc. This risk arises as a result of non-parallel changes in market rates;
- option risk: risk due to the presence of automatic options or options that depend on the behaviour of the counterparty to the assets, liabilities and off-balance sheet instruments of the Group.

Interest rate risk is managed by setting limits and an early warning level for the exposure, approved within the Risk Appetite Framework (RAF). In particular, the early warning level allows exposure to the risk of bends in the curve. The Financial and Market Risks Head Office Department performs monthly checks that the limits and early warning level approved in the Risk Appetite Framework (RAF) are observed at the consolidated and individual level.

In addition, the Group has adopted a specific internal policy document regarding interest rate risk (the IRRBB Guidelines) subject to approval by the BoD, which governs the Group's entire interest rate risk management framework and in particular the aspects of governance, methods of use and formulation of scenarios.

The following metrics are used to measure the interest rate risk generated by the banking book:

1. with regard to economic value:
 - o fair value shift sensitivity (Δ EVE);
 - o fair value basis risk (BR);
 - o value at risk (VaR).
2. with regard to net interest income:
 - o net interest income sensitivity (Δ NII);
 - o net interest income basis risk.

The shift sensitivity of the economic value (or shift sensitivity of the fair value) measures the change in the economic value of the banking book and is calculated at individual cash flow level for each financial instrument, based on different instantaneous rate shocks. It reflects the changes in the present value of the cash flows of the positions already in the balance sheet for the entire remaining duration until maturity (run-off balance sheet). The cash flows used to determine the present value are developed at the contractual rate, FTP (internal fund transfer price) or risk-free rate (Euribor/Libor) and discounted according to risk-free discount curves. When calculating the present value of loans, the expected loss component is considered; it represents the amount of cash flow that the bank does not expect to recover on a given exposure and that thus reduces the value of the loan. The present value of the loan adjusted for credit risk is calculated for this purpose by deducting the corresponding level of expected loss from expected cash flows according to the "cash flow adjustment" ("CFA") method.

To control the exposure and monitor the limits, the calculation involves determining the algebraic sum of the equivalent in euro of the shift sensitivities of the positions in the various currencies by applying a parallel shock of +100 bps to the interest rate curves in the various currencies. The calculation for non-parallel shocks for the purposes of controlling the exposure and monitoring the early warning level is performed similarly. The sensitivity of the relevant currencies is then corrected, according to a "currency aggregation" management technique, to take account of the imperfect correlation with the rates of the main currency (the euro).

The fair value basis risk (BR) is a risk measure designed to capture the effect on the floating-rate banking book caused by the imperfect correlation of changes in market indices. The method of estimating fair value basis risk is based on applying shocks, diversified by the curve of reference of the main risk factors. The specific shock level is calculated as a change in the base of each reference rate compared to a designated pivot rate in the same currency.

Value at Risk (VaR) measures the maximum loss that could occur within a given time horizon (holding period) and with a given confidence level. VaR is determined by adopting a 99% confidence level and a holding period of ten days. VaR is estimated using a method based on the historical simulation of the risk factors, represented by the risk-free market interest rate curves, in which the bank's exposure is revalued (full evaluation) on the basis of the curves observed over the last 250 days prior to the evaluation date.

The sensitivity of net interest income quantifies the impact on interest income of shock to the interest rate curve. For managerial monitoring of the limits, the sensitivity of net income is measured over a short-term horizon (12 months), excluding potential effects due to new transactions and future changes in the mix of assets and liabilities, by applying parallel, instantaneous interest rate shocks. The method implicitly assumes that the principal amounts of transactions upon reaching maturity or repricing are reinvested or refinanced through transactions with the same financial characteristics as those that have reached maturity (constant balance sheet assumption), within 12 months of the date of the analysis (date of the end-of-month situation). In addition, for the purposes of prospective simulation of interest income, dynamic analyses are performed, involving a change in the composition and volumes of assets and liabilities, by also applying non-parallel, non-instantaneous shocks, over medium-term time horizons (up to 3 years).

In calculating the above risk measures, Intesa Sanpaolo adopts behavioural models for representing capital items based on their contractual profile, except for categories of instruments whose risk profiles are different from those contractually envisaged. In this respect, therefore, the choice was made to use a behavioural representation to calculate the risk measures. More specifically:

- for mortgages, statistical techniques are used to determine the probability of prepayment, in order to reduce the Group's exposure to interest rate risk (overhedging) and to liquidity risk (overfunding). The method developed estimates prepayment coefficients diversified according to the type of customer, financial characteristics of the transaction, such as the loan rate type (fixed or floating), the original term of the loan and the seasoning, understood as the age of the loan on the date of the prepayment event. The analysis refers to partial repayments, full repayments and refinancing. The prepayment model also examines the reasons that lead customers to make prepayments. With regard to this aspect, the phenomenon may be divided into a structural component ("Core Prepayment") and a scenario component ("Coupon Incentive"), primarily linked to market variations. Prepayment phenomena are monitored monthly and the prepayment coefficients to be applied to the model are re-estimated at least annually, in accordance with the specific model change document;
- for core deposits, a financial representation model is adopted aimed at reflecting the behavioural features of stability of deposits and partial and delayed reaction to market interest rate fluctuations, in order to stabilise the value and net interest income both in absolute terms and in terms of variability over time.

In addition, within the framework of the dynamic simulation of net interest income, an additional behavioural model is adopted to simulate the effects of potential renegotiations of the contractual conditions of medium-/long-term assets. In terms of risks, renegotiations modify the duration of the portfolio of medium-/long-term loans and entail a decline in net interest income due to the revision of the contractual rates/spreads to include conditions more advantageous to customers. Specific models have been estimated to ensure a proper representation of the renegotiations phenomenon in terms of the percentages of mortgage loans renegotiated and their financial characteristics.

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

Hedging activities performed by the Intesa Sanpaolo Group are recorded using various hedge accounting methods.

A first method refers to the fair value hedge of specifically identified assets and liabilities (microhedging), mainly consisting of bonds issued or acquired by Group companies and loans to customers. In addition, in order to preserve the economic value of a portion of the HTCS portfolio, by protecting the price of the securities against adverse market movements, the Group negotiates forward sales of the debt securities held in portfolio on a fair value hedging basis. Finally, on the basis of the carved-out version of IAS 39, fair-value hedging is also applied for the macrohedging of the stable portion of demand deposits (core deposits) and on the already fixed portion of variable-rate loans and on a portion of fixed-rate loans. For this last type, an open-portfolio macrohedging model has been adopted according to a bottom-layer approach that, in accordance with the interest rate risk measurement method involving modelling of the prepayment phenomenon, is more closely correlated with risk management activity and asset dynamics.

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

The Financial and Market Risks Head Office Department of the Parent Company is in charge of measuring the effectiveness of interest rate risk hedges for the purpose of hedge accounting, in compliance with the IAS/IFRS.

The table below shows the changes in the main interest rate risk measures during the first half of 2020.

	1st half 2020			30.06.2020	(millions of euro) 31.12.2019
	average	minimum	maximum		
Shift Sensitivity of the Economic Value +100 bp	-554	-1,400	297	-1,400	394
Shift Sensitivity of Net Interest Income -50bp	-925	-999	-847	-847	-1,037
Shift Sensitivity of Net Interest Income +50bp	930	847	1,122	1,122	939
Shift Sensitivity of Net Interest Income +100bp	1,802	1,664	2,182	2,182	1,837
Value at Risk - Interest Rate	579	271	814	814	227

With regard to the fair value shift sensitivity, the change in the exposure compared to 31 December 2019 was due to banking book management measures to mitigate the potential negative impacts of COVID-19.

Price risk related to the FVOCI minority equity portfolio: impact on Shareholders' Equity

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 $\pm 10\%$ for the quoted assets recorded in the HTCS category.

		1st quarter 2020 impact on shareholders' equity at 31.03.2020	2nd quarter 2020 impact on shareholders' equity at 30.06.2020	Impact on shareholders' equity at 31.12.2019
Price shock	10%	49	141	50
Price shock	-10%	-49	-141	-50

During 2020, no hedging activities have been performed to cover the price risk of the banking book.

LIQUIDITY RISK

Liquidity risk is defined as the risk that the Bank may not be able to meet its payment obligations due to the inability to obtain funds on the market (funding liquidity risk) or liquidate its assets (market liquidity risk).

Intesa Sanpaolo's internal control and management system for liquidity risk is implemented within the Group Risk Appetite Framework and in compliance with the tolerance thresholds for liquidity risk approved in the system, which establish that the Group must maintain an adequate liquidity position in order to cope with periods of strain, including prolonged periods, on the various funding supply markets, also by establishing adequate liquidity reserves consisting of marketable securities and refinancing at Central Banks. To this end, a balance needs to be maintained between incoming and outgoing funds, both in the short and medium-long term. This goal is implemented by the Group Liquidity Risk Management Guidelines approved by the Corporate Bodies of Intesa Sanpaolo, in implementation of the most recent applicable regulatory provisions.

These Guidelines illustrate the tasks of the various company functions, the rules and the set of control and management processes aimed at ensuring prudent monitoring of liquidity risk, thereby preventing the emergence of crisis situations. To this end, they include procedures for identifying risk factors, measuring risk exposure and verifying observance of limits, conducting stress tests, identifying appropriate risk mitigation initiatives, drawing up emergency plans and submitting informational reports to company bodies.

In particular, a detailed definition is prepared of the tasks assigned to the Corporate Bodies and reports are presented to the senior management concerning certain important formalities such as the approval of measurement methods, the definition of the main assumptions underlying stress scenarios and the composition of early warning indicators used to activate emergency plans.

In order to pursue an integrated, consistent risk management policy, strategic decisions regarding liquidity risk monitoring and management at the Group level fall to the Parent Company's Corporate Bodies. From this standpoint, the Parent Company performs its functions of monitoring and managing liquidity not only in reference to its own organisation, but also by assessing the Group's overall transactions and the liquidity risk to which it is exposed.

The departments of the Parent Company that are in charge of ensuring the correct application of the Guidelines are, in particular, the Group Treasury and Finance Head Office Department, responsible for liquidity management, and the Financial and Market Risks Head Office Department, directly responsible for measuring liquidity risk on a consolidated basis.

The Chief Audit Officer assesses the functioning of the overall structure of the control system monitoring the process for measuring, managing and controlling the Group's exposure to liquidity risk and verifies the adequacy and compliance of the process with the requirements established by the regulations. The results of the controls carried out are submitted to the Corporate Bodies, at least once a year.

The liquidity risk measurement metrics and mitigation tools are formalised by the Group Liquidity Risk Management Guidelines which establish the methodology used for both the short-term and structural liquidity indicators.

The short-term liquidity is aimed at providing an adequate, balanced level of cash inflows and outflows the timing of which is certain or estimated to fall within a period of 12 months, while ensuring a sufficient liquidity buffer, available for use as the main mitigation tool for liquidity risk. To that end, and in keeping with the liquidity risk appetite, the system of limits consists of specific short-term indicators, both of a regulatory nature with a holding a period of one month (Liquidity Coverage Ratio - LCR) and internally defined (Survival Period indicators) with a holding period of up to 12 months.

The LCR, the minimum regulatory threshold for which is 100% after 1 January 2018, is aimed at strengthening the short-term liquidity risk profile, ensuring the holding of sufficient unencumbered high-quality liquid assets (HQLA) that can be easily and immediately converted into cash on the private markets to satisfy the short-term liquidity requirements (30 days) in an acute liquidity stress scenario, as defined by Delegated Regulation (EU) 2015/61.

The Survival Period is an internal indicator designed to measure the first day on which the net liquidity position (calculated as the difference between available liquidity reserves and net outflows) becomes negative, i.e. when additional liquidity is no longer available to cover simulated net outflows up to 12 months. To this end, two different scenario hypotheses are considered, baseline and stressed, designed to measure, respectively: (i) the Group's independence from interbank funding on the financial markets and (ii) the survival period in the event of further tensions of a market and idiosyncratic nature, of medium-high severity, managed without envisaging restrictions on credit activity involving customers. For the Survival Period indicator, in stress conditions it is established that a minimum survival period must be maintained with the purpose of establishing an overall level of reserves covering greater cash outflows during a period of time that is adequate to implement the required operating measures to restore the Group to balanced conditions.

The aim of the Intesa Sanpaolo Group's structural Liquidity Policy is to adopt the structural requirement provided for by the regulatory provisions - the Net Stable Funding Ratio (NSFR). This indicator is aimed at promoting the increased use of stable funding, to prevent medium/long-term operations from giving rise to excessive imbalances to be financed in the short term. To this end, it sets a minimum "acceptable" amount of funding exceeding one year in relation to the needs originating from the characteristics of liquidity and residual duration of assets and off-balance sheet exposures. In addition, the internal policy on structural liquidity also includes early warning indicators for maturities of more than 1 year, with particular attention to long-

term gaps (> 5 years). The entry into force of the net stable funding ratio (100%) is, instead, planned for June 2021, following publication in the Official Journal in May 2019 of the package of banking reforms containing the new EU Directive 2019/878 (CRD V) and the new Regulation 219/876 (CRR2).

The Group Liquidity Risk Management Guidelines also establish methods for management of a potential liquidity crisis, defined as a situation of difficulty or inability of the Bank to meet its cash obligations falling due, without implementing procedures and/or employing instruments that, due to their intensity or manner of use, do not qualify as ordinary administration. By setting itself the objectives of safeguarding the Group's asset value and also guaranteeing the continuity of operations under conditions of extreme liquidity emergency, the Contingency Liquidity Plan ensures the identification of the early warning signals and their ongoing monitoring, the definition of procedures to be implemented in situations of liquidity stress, also indicating the immediate lines of action, and the intervention measures for the resolution of emergencies. Within this framework, the Group Treasury and Finance Department was officially entrusted with drawing up the Contingency Funding Plan (CFP), which contains the various lines of actions that can be activated in order to face potential stress situations, specifying the extent of the mitigating effects attainable in the short-term.

The Group's liquidity position - supported by suitable high-quality liquid assets (HQLA) and the significant contribution from retail stable funding - remained within the risk limits set out in the current Group Liquidity Policy in the first six months of 2020: both regulatory indicators, LCR and NSFR, were well above 100%. The Liquidity Coverage Ratio (LCR) of the Intesa Sanpaolo Group, measured according to Delegated Regulation (EU) no. 2015/61, amounted to an average¹⁸ of 150%. As at 30 June 2020, the value of unencumbered HQLA reserves was 119 billion euro, more than 28% comprised of cash and deposits held with Central Banks. Including the other marketable reserves and/or eligible Central Bank reserves, the Group's unencumbered liquidity reserves amounted to 127 billion euro.

In view of the high stock of available liquidity reserves (liquid or eligible), the period of independence from wholesale funding, measured by the Survival Period indicator (baseline scenario), identifies a financial independence in situations of freeze of the money market for more than 12 months. The additional stress tests, measured by the Survival Period indicator in a combined scenario of severe market and specific crises (with significant loss in customer deposits), also yielded results in excess of the target threshold for the Intesa Sanpaolo Group, with a liquidity surplus capable of meeting extraordinary cash outflows for a period of more than 3 months.

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

¹⁸ The figure presented refers to the simple average of the last 12 monthly observations, per the EBA guidelines, "Guidelines on LCR disclosure to complement the disclosure of liquidity risk management under Article 435 of Regulation (EU) 575/2013", June 2017.

INFORMATION ON FINANCIAL PRODUCTS

In line with the requests for utmost transparency made by supranational and national Supervisory Authorities, the following information is provided on the fair value measurement methods adopted, structured credit products, activities performed through Special Purpose Entities (SPE), leveraged transactions, hedge fund investments and transactions in trading derivatives with customers.

FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND LIABILITIES, INDEPENDENT PRICE VERIFICATION AND PRUDENT VALUATION

The framework of financial measurement at fair value is based on three pillars: fair value measurement according to the IFRS, independent price verification (IPV) and prudent value measurement. The latter are established by the CRR - Capital Requirement Regulation. The paragraphs below describe the methods applied by the Intesa Sanpaolo Group to implement and use those elements.

Fair value of financial instruments

The Intesa Sanpaolo Group governs and defines the fair value measurement of financial instruments through the Group's Fair Value Policy, prepared by the Financial and Market Risks Head Office Department and applied by the Parent Company and all consolidated subsidiaries, including the Insurance Companies.

The "Rules for the Measurement of Equity Investments", drawn up by the Group M&A and Equity Investments Head Office Department, govern the fair value measurement of unlisted equities and financial instruments with unlisted equities as their underlying.

The methodologies for the fair value measurement of financial instruments, as well as any adjustments attributable to uncertainties in valuation, are governed by the Fair Value Policy of the Intesa Sanpaolo Group and are described in detail in the 2019 Annual Report, to which reference is made for more information.

IFRS 13 establishes a fair value hierarchy in which inputs to fair value measurement techniques are divided into three levels. That hierarchy assigns top priority to (unadjusted) quoted prices on active markets for identical assets or liabilities (level 1 data) and the lowest priority to unobservable inputs (level 3 data). In particular:

- Fair value level 1 applies when an instrument is measured directly on the basis of (unadjusted) quoted prices on active markets for identical assets or liabilities to which the entity has access on the measurement date.
- Fair value level 2 applies when a price has not been found on an active market and the instrument is measured according to valuation techniques, on the basis of observable market parameters, or of the use of parameters that are not observable but are supported and confirmed by market evidence, such as prices, spreads or other inputs (the comparable approach).
- Fair value level 3 applies when fair value is measured using various inputs, not all of which are directly drawn from observable market parameters, and which thus entail estimates and assumptions by the valuator.

If various inputs are used to measure the fair value of an asset or liability, classification in the hierarchy is determined on the basis of the lowest-level input used in measurement. When assigning a level in the fair value hierarchy, priority is given to the inputs of the valuation techniques rather than the valuation techniques themselves.

The attachment "Fair Value Hierarchy" of the Fair Value Policy defines, with regard to the respective financial instrument valuation models/inputs, the basic rules that market inputs must comply with in order to be classified as Level 2, and the significance thresholds which, when overrun, result in the assignment of Level 3.

For level 1 financial instruments, the current bid price is used for financial assets and the current ask price for financial liabilities, struck on the principal active market at the end of the reference period.

For financial instruments with a scarcely significant bid-ask spread or for financial assets and liabilities with offsetting market risks, mid-market prices are used (again referred to the last day of the reference period) instead of the bid or ask price.

The following are considered as level 1 financial instruments: contributed bonds (i.e. bonds for which the Composite Bloomberg Bond Trader is available from the Information Provider Bloomberg, or, alternatively, a price on the EuroMTS circuit, or at least three prices available from the Information Provider Bloomberg), contributed equities (i.e., quoted on the official market of reference), contributed harmonised mutual funds (covered by EU directives), spot exchange rates, derivatives for which prices are available on an active market (for example, exchange traded futures and options) and hedge funds whose Net Asset Value (NAV) is available, according to the frequency established in the subscription contract, and in which assets classified as level 1 predominate among the assets invested in by the fund, as a percentage of the NAV, provided the level 3 instruments do not exceed a set threshold.

Conversely, all other financial instruments that do not belong to the above-described categories or that do not have the contribution level defined by the Fair Value Policy are not considered level 1 instruments.

When no listing on an active market exists or the market is not functioning regularly, that is when the market does not have a sufficient and continuous number of trades, and bid-ask spreads and volatility that are not sufficiently contained, the fair value of the financial instruments is mainly determined through the use of valuation techniques whose objective is the establishment of the price at which, in an orderly transaction, the asset is sold or the liability transferred between market participants, as at the measurement date, under current market conditions.

Such techniques include:

- the use of market values that are indirectly linked to the instrument to be measured, deriving from products with the same risk profile (level 2 inputs);
- valuations performed using – even partially – inputs not identified from parameters observed on the market, for which

estimates and assumptions made by the valuator are used (level 3 inputs).

In case of level 2 inputs, the valuation is based on prices or credit spreads presumed from the official listing of instruments which are similar in terms of risk factors, using a given calculation methodology (valuation model). The use of this approach requires the identification of transactions on active markets in relation to instruments that, in terms of risk factors, are comparable with the instrument to be measured. Level 2 calculation methodologies reproduce prices of financial instruments quoted on active markets (model calibration) and do not contain discretionary parameters – parameters for which values may not be inferred from quotations of financial instruments present on active markets or fixed at levels capable of reproducing quotations on active markets – that significantly influence the final measurement.

The following are measured using level 2 input models:

- bonds without official quotations expressed by an active market and whose fair value is determined through the use of an appropriate credit spread which is estimated starting from contributed and liquid financial instruments with similar characteristics;
- loans whose fair value is determined through the use of an appropriate credit spread which is estimated starting from market data of financial instruments with similar characteristics;
- derivatives measured through specific models, fed by input parameters (such as yield, foreign exchange and volatility curves) observed on the market;
- structured credit products (ABSs, HY CLOs, CDOs, etc.) for which significant prices are not available and whose fair value is measured using valuation techniques that consider parameters that can be gathered from the market;
- non-contributed equity instruments measured based on direct transactions, that is significant transactions on the stock registered in a time frame considered to be sufficiently short with respect to measurement date and in constant market conditions, or using the "relative" valuation models based on multipliers;
- hedge funds in which Level 2 assets predominate, as a percentage of the NAV, provided the Level 3 instruments do not exceed a set threshold.

In case of instruments classified as level 3, the calculation of the fair value is based on valuation models which consider input parameters not directly observable on the market, therefore implying estimates and assumptions on the part of the valuator. In particular, the valuation of the financial instrument uses a calculation methodology which is based on specific assumptions of:

- the development of future cash flows, which may be affected by future events that may be attributed probabilities presumed from past experience or on the basis of the assumed behaviour;
- the level of specific input parameters not quoted on active markets, for which information acquired from prices and spreads observed on the market is in any case preferred. Where this is not available, past data on the specific risk of the underlying asset or specialised reports are used (e.g. reports prepared by Rating agencies or primary market players).

The following are measured using this method:

- some transactions in derivatives, bonds, or complex structured credit instruments measured using level 3 inputs;
- hedge funds in which the level 3 assets are above a set limit;
- private equity funds and real estate funds valued at NAV, with possible discounts;
- shareholdings and other equities measured using models based on discounted cash flows or using equity methods;
- loans whose fair value is determined through the use of a credit spread that does not meet the criteria to be considered level 2;
- loans with underlying equity risk, whose fair value is calculated based on the discounting of expected contractual flows.

Independent price verification (IPV)

Independent Price Verification (IPV) is "a process by which market prices or marking to model inputs are regularly verified for accuracy and independence" (Article 4(1.70) EU Regulation 575/2013), carried out "in addition to daily marking to market or marking to model [...] by a person or unit independent from persons or units that benefit from the trading book" (Article 105(8) EU Regulation 575/2013).

The Intesa Sanpaolo Group has structured an IPV process with 3 levels of control in line with the provisions of Bank of Italy Circular 285/2013, incorporated into the Integrated Internal Control System, which requires the risk management processes to be incorporated in the processes and methods for valuing the company activities, also for accounting purposes.

The Intesa Sanpaolo Group governs and formalises its independent price verification process through the Group Independent Price Verification Policy, which is described in detail in the 2019 Annual Report and to which reference is made for further information.

Prudent value of financial instruments

The framework of financial measurements is completed with the prudent valuation of financial instruments measured at fair value, which involves the calculation of additional valuation adjustments for prudential purposes, without impacts on the fair value calculated for accounting purposes in accordance with the IFRS. The prudent value corresponds to the exit price from the position with a level of certainty equal to 90%.

Regulation (EU) 2016/101 specifies an aggregation approach for calculating total Additional Valuation Adjustments (AVAs) at the category level based on the individual AVAs, which takes account of the overlap between the individual AVAs that occurs in the aggregation of these AVA categories. Commission Delegated Regulation (EU) 866/2020, published in the Official Journal on 25 June 2020, established that entities must apply a 66% aggregation factor from 30 June 2020 to 31 December 2020 in order to better manage the extreme volatility of market prices and the systemic shock tied to the COVID-19 pandemic.

The Intesa Sanpaolo Group governs and formalises the measurement of the prudent value of financial instruments through the Group Prudent Value Policy, which is described in detail in the 2019 Annual Report and to which reference is made for further information.

Fair value hierarchy

Assets and liabilities measured at fair value on a recurring basis: fair value by level

Excluding insurance companies

Assets / liabilities at fair value	30.06.2020			31.12.2019		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
(millions of euro)						
1. Financial assets measured at fair value through profit or loss	24,281	33,392	3,165	17,934	28,658	2,822
a) Financial assets held for trading	23,250	32,545	477	17,161	27,622	369
of which: Equities	556	-	1	713	-	1
of which: quotas of UCI	444	2	21	661	2	24
b) Financial assets designated at fair value	-	51	-	-	195	-
c) Other financial assets mandatorily measured at fair value	1,031	796	2,688	773	841	2,453
of which: Equities	1	116	181	2	95	179
of which: quotas of UCI	1,030	129	1,463	771	127	1,410
2. Financial assets measured at fair value through other comprehensive income	64,456	8,867	455	63,815	8,173	422
of which: Equities	1,446	1,760	391	611	2,048	400
3. Hedging derivatives	-	4,195	15	8	3,008	13
4. Property and equipment	-	-	5,685	-	-	5,748
5. Intangible assets	-	-	-	-	-	-
Total	88,737	46,454	9,320	81,757	39,839	9,005
1. Financial liabilities held for trading	13,110	41,911	111	18,422	26,704	100
2. Financial liabilities designated at fair value	38	2,022	-	-	4	-
3. Hedging derivatives	17	12,605	3	-	9,284	4
Total	13,165	56,538	114	18,422	35,992	104

Excluding insurance companies, level 3 instruments, which allow for more discretion in fair value measurement, account for a limited portion of the financial assets portfolio equal to 6.5%.

As far as liabilities are concerned, level 3 instruments account for less than 1% of total liabilities.

Over 61% of financial assets measured at fair value (excluding the insurance segment) are determined based on market prices, and therefore without any discretion by the valuator.

In addition to the transfers relating to financial assets and liabilities measured at level 3 as detailed below, please note that the following transfers were made during the first half of 2020:

- from level 1 to level 2:
 - o financial assets held for trading for 460 million euro (book value as at 30 June 2020);
 - o other financial assets mandatorily measured at fair value for 4 million euro (book value as at 30 June 2020);
 - o financial assets measured at fair value through other comprehensive income for 485 million euro (book value as at 30 June 2020);
 - o financial liabilities held for trading for 9,504 million euro (book value as at 30 June 2020), including Certificates, whose market dynamics are described in the paragraph "The first half of 2020";
- from level 2 to level 1:
 - o financial assets held for trading for 81 million euro (book value as at 30 June 2020);
 - o financial assets measured at fair value through other comprehensive income for 13 million euro (book value as at 30 June 2020);
 - o financial liabilities held for trading for 165 million euro (book value as at 30 June 2020).

The transfers between fair value levels are determined by the trends in the observability of prices or market data used to measure the instruments and by the materiality of the unobservable inputs.

The transition from level 1 to level 2 is a consequence of the disappearance of an active market for that instrument assessed by analysing the reliability and the reciprocal consistency of the available prices according to the provisions of the Group's Fair Value Policy. Conversely, securities for which a mark-to-model measurement is performed using inputs that can be

observed on the market – classified, therefore, as level 2 – are transferred to level 1 when the existence of an active market is identified.

Assets and liabilities measured at fair value on a recurring basis: fair value by level
Insurance companies

Assets / liabilities at fair value	30.06.2020			31.12.2019		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
(millions of euro)						
1. Financial assets held for trading	347	14	44	284	22	46
of which: Equities	-	-	-	-	-	-
of which: quotas of UCI	116	-	44	119	-	46
2. Financial assets designated at fair value through profit or loss	81,171	161	279	83,816	141	308
of which: Equities	2,310	-	-	2,315	-	-
of which: quotas of UCI	73,691	117	-	76,521	99	-
3. Financial assets available for sale	78,288	2,766	2,029	79,315	2,162	1,902
of which: Equities	1,583	-	24	1,480	-	-
of which: quotas of UCI	9,468	-	1,994	9,917	-	1,902
4. Hedging derivatives	-	243	-	-	206	-
5. Property and equipment	-	-	3	-	-	-
6. Intangible assets	-	-	-	-	-	-
Total	159,806	3,184	2,355	163,415	2,531	2,256
1. Financial liabilities held for trading	7	52	-	-	45	-
2. Financial liabilities designated at fair value through profit or loss	-	72,800	-	-	75,886	-
3. Hedging derivatives	-	1	-	-	4	-
Total	7	72,853	-	-	75,935	-

Having regard to insurance companies, as shown in the table, level 3 instruments, which allow for more discretion in fair value measurement, account for a limited portion of the financial assets portfolio equal to 1%.

As far as liabilities are concerned, level 3 instruments account for less than 1% of total liabilities.

Around 97% of financial assets measured at fair value in the insurance segment are determined based on market prices, and therefore without any discretion by the valuator.

In addition to the transfers relating to financial assets and liabilities in the insurance segment measured at level 3 as detailed below, please note that the following transfers were made during the first half of 2019:

- from level 1 to level 2:
 - o financial assets measured at fair value through profit and loss for 3 million euro (book value as at 30 June 2020);
 - o financial assets available for sale for 798 million euro (book value as at 30 June 2020);
- from level 2 to level 1:
 - o financial assets measured at fair value through profit and loss for 7 million euro (book value as at 30 June 2020);
 - o financial assets available for sale for 63 million euro (book value as at 30 June 2020);

The transfers between fair value levels are determined by the trends in the observability of prices or market data used to measure the instruments and by the materiality of the unobservable inputs.

The transition from level 1 to level 2 is a consequence of the disappearance of an active market for that instrument assessed by analysing the reliability and the reciprocal consistency of the available prices according to the provisions of the Group's Fair Value Policy. Conversely, securities for which a mark-to-model measurement is performed using inputs that can be observed on the market – classified, therefore, as level 2 – are transferred to level 1 when the existence of an active market is identified.

Half-yearly changes in assets measured at fair value on a recurring basis (level 3)
Excluding insurance companies

	Assets measured at fair value through profit or loss				Financial assets measured at fair value through other comprehensive income	Hedging derivatives	Property and equipment	Intangible assets
	TOTAL	of which: a) Financial assets held for trading	of which: b) Financial assets designated at fair value	of which: c) Other financial assets mandatorily measured at fair value				
	(millions of euro)							
1. Initial amount	2,822	369	-	2,453	422	13	5,748	-
2. Increases	787	280	-	507	140	2	6	-
2.1 Purchases	313	128	-	185	7	-	2	-
2.2 Gains recognised in:	101	57	-	44	10	2	-	-
2.2.1 Income statement	101	57	-	44	-	2	-	-
- of which capital gains	90	54	-	36	-	2	-	-
2.2.2 Shareholders' equity	-	X	X	X	10	-	-	-
2.3 Transfers from other levels	214	89	-	125	34	-	-	-
2.4 Other increases	159	6	-	153	89	-	4	-
3. Decreases	-444	-172	-	-272	-107	-	-69	-
3.1 Sales	-134	-106	-	-28	-7	-	-2	-
3.2 Reimbursements	-45	-1	-	-44	-6	-	-	-
3.3 Losses recognized in:	-106	-47	-	-59	-6	-	-4	-
3.3.1 Income statement	-106	-47	-	-59	-1	-	-3	-
- of which capital losses	-103	-46	-	-57	-	-	-	-
3.3.2 Shareholders' equity	-	X	X	X	-5	-	-1	-
3.4 Transfers to other levels	-89	-15	-	-74	-15	-	-	-
3.5 Other decreases	-70	-3	-	-67	-73	-	-63	-
4. Final amount	3,165	477	-	2,688	455	15	5,685	-

Half-yearly changes in assets measured at fair value on a recurring basis (level 3)
Insurance companies

	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Financial assets available for sale	Hedging derivatives	Property and equipment	Intangible assets
1. Initial amount	46	308	1,902	-	-	-
2. Increases	-	1	427	-	3	-
2.1 Purchases	-	-	304	-	-	-
2.2 Gains recognized in:	-	-	17	-	-	-
2.2.1 Income statement	-	-	3	-	-	-
- of which capital gains	-	-	-	-	-	-
2.2.2 Shareholders' equity	X	X	14	-	-	-
2.3 Transfers from other levels	-	1	35	-	-	-
2.4 Other increases	-	-	71	-	3	-
3. Decreases	-2	-30	-300	-	-	-
3.1 Sales	-	-1	-149	-	-	-
3.2 Reimbursements	-	-	-	-	-	-
3.3 Losses recognized in:	-2	-	-82	-	-	-
3.3.1 Income statement	-2	-	-2	-	-	-
- of which capital losses	-2	-	-2	-	-	-
3.3.2 Shareholders' equity	X	X	-80	-	-	-
3.4 Transfers to other levels	-	-	-	-	-	-
3.5 Other decreases	-	-29	-69	-	-	-
4. Final amount	44	279	2,029	-	3	-

Half-yearly changes in liabilities measured at fair value on a recurring basis (level 3)
Excluding insurance companies

	(millions of euro)		
	Financial liabilities held for trading	Financial liabilities designated at fair value	Hedging derivatives
1. Initial amount	100	-	4
2. Increases	37	-	-
2.1 Issues	-	-	-
2.2 Losses recognised in:	29	-	-
2.2.1 Income statement	29	-	-
- of which capital losses	29	-	-
2.2.2 Shareholders' equity	X	-	-
2.3 Transfers from other levels	8	-	-
2.4 Other increases	-	-	-
3. Decreases	-26	-	-1
3.1 Reimbursements	-	-	-
3.2 Repurchases	-	-	-
3.3 Gains recognised in:	-11	-	-1
3.3.1 Income statement	-11	-	-1
- of which capital gains	-9	-	-1
3.3.2 Shareholders' equity	X	-	-
3.4 Transfers to other levels	-5	-	-
3.5 Other decreases	-10	-	-
4. Final amount	111	-	3

Half-yearly changes in liabilities measured at fair value on a recurring basis (level 3)
Insurance companies

No financial liabilities are recorded at level 3 for Insurance companies.

Assets and liabilities not measured at fair value or measured at fair value on a non-recurring basis
 Excluding insurance companies

Assets/liabilities not measured at fair value or measured at fair value on a non-recurring basis	(millions of euro)			
	30.06.2020		31.12.2019	
	Book value	Fair value	Book value	Fair value
1. Financial assets measured at amortised cost	497,653	508,366	467,815	477,020
2. Investment property	-	-	-	-
3. Non-current assets held for sale and discontinued operations	2,593	2,593	494	494
Total	500,246	510,959	468,309	477,514
1. Financial liabilities measured at amortised cost	536,565	536,464	519,382	521,242
2. Liabilities associated with non-current assets	2,381	2,381	41	41
Total	538,946	538,845	519,423	521,283

Assets and liabilities not measured at fair value or measured at fair value on a non-recurring basis
 Insurance companies

Assets/liabilities not measured at fair value or measured at fair value on a non-recurring basis	(millions of euro)			
	30.06.2020		31.12.2019	
	Book value	Fair value	Book value	Fair value
1. Investments held to maturity	-	-	-	-
2. Due from banks	705	705	581	580
3. Loans to customers	30	31	31	32
4. Investment property	-	-	-	-
5. Non-current assets held for sale and discontinued operations	-	-	-	-
Total	735	736	612	612
1. Due to banks	618	618	2	2
2. Due to customers	394	393	77	76
3. Securities issued	767	767	747	747
4. Liabilities associated with non-current assets	-	-	-	-
Total	1,779	1,778	826	825

Sensitivity analysis for financial assets and liabilities measured at level 3

As required by IFRS 13, for the financial assets and liabilities measured at level 3, the following table lists the effects of a change in one or more non-observable parameters used in the valuation techniques adopted to determine the fair value.

Financial assets/liabilities	Non-observable parameters	Sensitivity (thousands of euro)	Change in non- observable parameter
FVTPL and FVTOCI securities and loans	Credit spread	-348	1 bp
FVTPL and FVTOCI securities and loans	JD parameters	389	1%
FVTPL and FVTOCI securities and loans	Correlation	-28	1%
FVTPL and FVTOCI securities	Recovery rate	-214	-1%
OTC Derivatives - Interest Rates	Correlation for spread options between swap rates	-70	10%
OTC Derivatives - Equity	Correlation between underlying equity baskets	-75	10%
OTC Derivatives - Equity	Historical volatility	-1,902	10%
OTC Derivatives - Equity CPPI	Historical correlation	-168	10%

Information on “Day one profit/loss”

Under IFRS 9, financial instruments shall be initially recognised at fair value. The fair value of a financial instrument at initial recognition is normally the “transaction price”, i.e. the fair value of the consideration given or received in relation to, respectively, financial assets and liabilities.

The fact that, upon initial recognition, the fair value of a financial instrument coincides with the transaction price is always intuitively verifiable in the case of transactions falling under level 1 of the fair value hierarchy. Also in the case of level 2, which is based on quotes that can be derived indirectly from the market (Comparable Approach), the fair value and the price often coincide upon initial recognition. Any differences between the price and the fair value are usually allocated to the so-called commercial margins, which are taken to the income statement when the financial instrument is initially measured.

Conversely, with respect to level 3 instruments, which have more discretion in fair value measurement, no definite reference benchmark is available to compare the transaction price with. For the same reason, the calculation of any commercial margin to be taken to the income statement is also difficult. In this event, the instrument is always initially recognised at the transaction cost. Subsequent measurement shall not include the difference between cost and fair value identified upon initial recognition (also defined as Day-One-Profit - DOP).

This difference shall be recognised in the income statement only when it arises from changes to the factors over which market participants base their valuations when fixing prices (including the time effect). Where the instrument has a definite maturity and no model is available to monitor the changes to the factors over which prices are based, the DOP can be recognised in the income statement systematically over the life of such instrument.

When a level 3 instrument is reclassified to level 2, the residual deferred Day-One-Profits are recognised in the income statement. Similarly, in the event of “on-the-book” transactions falling under the Bank’s investing activities, the Day-One-Profits earned on level 3 transactions (including in the above “on-the-book” management) are taken to the income statement when the Group entity (the investment bank) carries out transactions which substantially eliminate the risks of the level 3 instrument which generated the DOP.

The above regulation applies only to those instruments which fall in one of the classes which can be recognised at fair value through profit and loss (Fair Value Option and Trading Book). Indeed, only for the latter, the difference between the transaction price and the fair value would be taken to the income statement upon initial recognition.

The following table shows the changes in the DOP amount deferred in the balance sheet.

	(millions of euro)
1. Initial amount	1
2. Increases	-
2.1 New transactions	-
3. Decreases	-
3.1 Releases to the income statement	-
4. Final amount	1

Finally, in the context of the transaction that involved the transfer to Nexi of the business line consisting of the acquiring activities, on 30 June 2020 Intesa Sanpaolo purchased 9.9% of Nexi SpA from Mercury UK HoldCo Limited, the company’s reference shareholder, for a pre-determined price of 10.5 euro per share, corresponding to a cash outlay of 653 million euro; since the Nexi SpA shares are listed on Borsa Italiana, and thus have a fair value level of 1, the difference of 315 million euro between the amount paid and the corresponding value on the basis of market capitalisation at the effective date of the purchase was accounted for as profit in the income statement.

INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure in structured credit products, which amounted to 3,794 million euro as at 31 December 2019, came to 2,985 million euro as at 30 June 2020, showing a net decrease of 809 million euro. The exposure includes investments in ABSs (asset-backed securities) of 1,565 million euro, in CLOs (collateralised loan obligations) of 1,345 million euro and, for a residual amount, in CDOs (collateralised debt obligations) of 75 million euro, for which there were essentially no additional transactions during the period.

Accounting categories	30.06.2020			31.12.2019		(millions of euro) changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total		absolute	%
Financial assets held for sale	395	561	-	956	1,514	-558	-36.9
Financial assets mandatorily measured at fair value	-	4	-	4	20	-16	-80.0
Financial assets measured at fair value through other comprehensive income	563	660	-	1,223	1,485	-262	-17.6
Financial assets measured at amortised cost	387	340	75	802	775	27	3.5
Total	1,345	1,565	75	2,985	3,794	-809	-21.3

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, also 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 2,183 million euro in June 2020, a net decrease of 836 million euro, attributable to investments, which were significantly 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 primarily in the financial assets held for trading portfolio. The investments made by Banca IMI in the portfolio of assets held for trading and, to a lesser extent, in the portfolio of assets measured at fair value through other comprehensive income refer to CLOs with mainly AAA ratings and, to a lesser extent, ABSs with underlying residential mortgages.

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 802 million euro in June 2020.

From profit or loss perspective, a loss of -26 million euro was posted for 2020, compared to +24 million euro for the first six months of 2019.

This loss from trading activities – caption 80 of the income statement – of -29 million euro (compared to a profit of +8 million euro in the first half of 2019) was due to exposures in ABSs amounting to -14 million euro and to exposures in CLOs amounting to -15 million euro, and is to be attributed to net profits on disposals of +5 million euro, offset by net unrealised losses of -34 million euro, attributable to the downturn in the markets during the period as a result of the COVID-19 health emergency.

The loss from financial assets mandatorily measured at fair value was -1 million euro, compared to a profit of +14 million euro in the first half of 2019.

The exposures to ABSs and CLOs of debt securities classified as assets measured at fair value through other comprehensive income, essentially attributable to the subsidiary Banca IMI, recorded a decrease in fair value of -19 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 -17 million euro in June 2020); there was also an impact of +4 million euro from sales during the period (+1 million euro in the first six months of 2019).

Adjustments recognised on the debt securities classified as assets measured at amortised cost amounted to less than 1 million euro in the first half of 2020, compared to adjustments of +1 million euro in the first half 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 at the end of the first half of 2020.

Income statement results broken down by accounting category	30.06.2020				30.06.2019		(millions of euro) changes	
	Collateralized Loan Obligations	Asset Backed Securities	Collateralized Debt Obligations	Total		absolute	%	
Financial assets held for sale	-15	-14	-	-29	8	-37		
Financial assets mandatorily measured at fair value	-	-1	-	-1	14	-15		
Financial assets measured at fair value through other comprehensive income	-	4	-	4	1	3		
Financial assets measured at amortised cost	-	-	-	-	1	-1		
Total	-15	-11	-	-26	24	-50		

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 half 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 then issued for an amount of 1.8 billion euro. The securities are floating rate with a maturity of 13 years for the 38th series and 14 years for the 39th and 40th series, respectively. Subsequently, the securities for the 41st and 42nd series were issued in April, each amounting to 2.4 billion euro, floating rate, with a maturity of 15 years. Finally, two additional series, the 43rd and 44th, were then issued in June, each amounting to 1.35 billion euro, floating rate, with maturities of 8 and 16 years, respectively. All securities in the series issued are listed on the Luxembourg Stock Exchange and rated A (High) by DBRS, were fully subscribed by the Parent Company and are eligible with the Eurosystem.

With regard to the covered bond issue programme guaranteed by ISP CB Pubblico, the 10th series was partially redeemed (for an amount of 550 million euro) in January, 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. The security, with an Aa3 rating from Moody's, is a floating rate, 11-year security listed on the Luxembourg Stock Exchange, was fully subscribed by the Parent Company and is eligible for the Eurosystem.

A new securitisation on a portfolio of consumer credit loans was completed in June by the special purpose vehicle company Clara Sec., which issued two classes of notes for a total of 7.2 billion euro, subscribed by Intesa Sanpaolo. Only the senior class, amounting to 6.35 billion euro, with an A (High) rating from DBRS and A1 from Moody's, is eligible with the Eurosystem.

INFORMATION ON LEVERAGED TRANSACTIONS

In 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, financial institutions and 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 and object financing) and certain other types of credit, such as trade finance operations, are also excluded.

As at 30 June 2020, for the Intesa Sanpaolo Group, the transactions that meet the definition of Leveraged Transactions in the ECB Guidance amounted to 21 billion euro, relating to approximately 1,800 credit lines (as at 31 December 2019 the amount was 20.8 billion euro, 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 30 June 2020 amounted to 34 million euro in the trading book and 194 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 consist of funds that adopt 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 half of 2020, disposals of positions were made for 80 million euro in the trading books, which occurred in the first three months of the year as an action to reduce 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 stable, with no major investments or disposals made during the half-year.

In terms of profit or loss effect, the profits (losses) on trading – caption 80 of the income statement (trading book) – showed a loss of 22 million euro for the first six months of 2020 compared to a profit of 2 million euro in the first six months of 2019. The result for the period included valuation losses of 6 million euro and losses on disposals of 16 million euro, the latter relating to the de-risking strategy, which resulted in a reduction of the trading book.

The net profit (loss) on financial assets mandatorily measured at fair value – caption 110 of the income statement (banking book) – recorded an overall loss of approximately 0.5 million euro during the period (compared to a profit of 3 million euro in the first six months of 2019), attributable to valuation components, nonetheless marking a recovery from the valuations recorded for the first three months of the year.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 30 June 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 8,763 million euro (7,694 million euro as at 31 December 2019). The notional value of these derivatives totalled 64,309 million euro (62,528 million euro as at 31 December 2019). In particular, the notional value of plain vanilla contracts was 58,933 million euro (58,403 million euro as at 31 December 2019), while that of structured contracts was 5,376 million euro (4,125 million euro as at 31 December 2019). Please note that the positive fair value of contracts outstanding with the 10 customers with the highest exposures at the end of the first half of the year came to 5,817 million euro (5,269 million euro as at 31 December 2019), of which 519 million euro (476 million euro as at 31 December 2019) referred to structured contracts.

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 1,907 million euro as at 30 June 2020 (1,410 million euro as at 31 December 2019). The notional value of these derivatives totalled 20,486 million euro (20,334 million euro as at 31 December 2019). In particular, the notional value of plain vanilla contracts was 18,204 million euro (17,392 million euro as at 31 December 2019), while that of structured contracts was 2,282 million euro (2,942 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 30 June 2020, this led to a negative effect of 76 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. Please note that contracts made up of combinations of more elementary derivative instruments have been considered "structured" and that the aforesaid figures do not include fair value of derivatives embedded in structured bond issues as well as the relative hedges agreed by the Group.

OPERATIONAL RISK

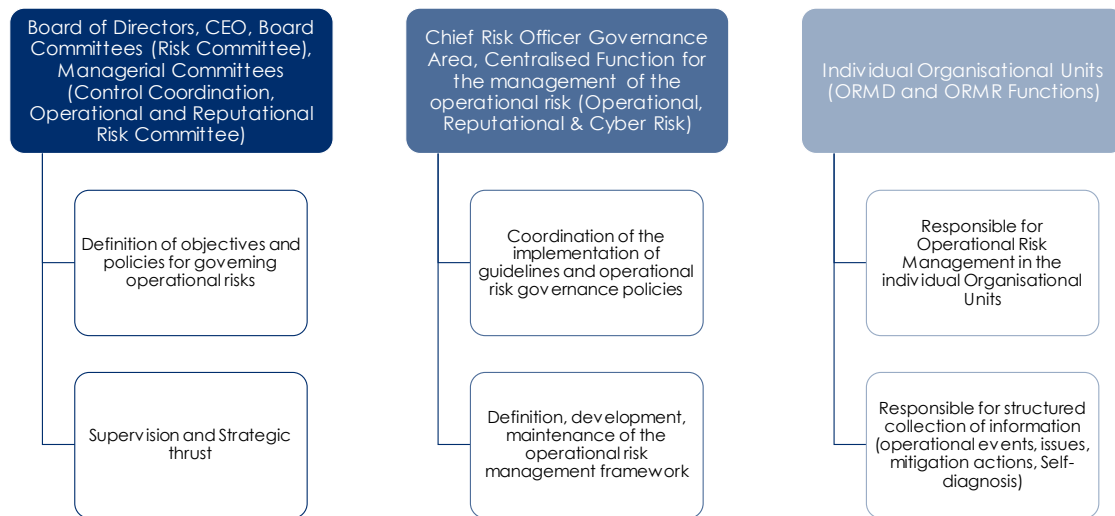
Operational risk is the risk of incurring losses resulting from inadequate or failed internal processes, people and systems or from external events. As far as the financial losses component is concerned, the Operational risk includes: legal and compliance risk, conduct risk, IT and Cyber risk, physical security risk, business continuity risk, financial crime and financial reporting risk, third party and model risk. Strategic and reputational risk are not included.

The Intesa Sanpaolo Group adopts an undertaking and management strategy of operational risk based on prudent management principles and aimed at guaranteeing long-term solidity and continuity for the company. In addition, the Group pays particular attention to achieving an optimal balance between growth and profitability and the resulting risks.

In line with these objectives, the Intesa Sanpaolo Group has long since established an overall operational risk governance framework, by setting up a Group policy and organisational processes for measuring, managing and controlling operational risk.

Governance Model

The monitoring of the operational risks (including IT and cyber risks) involves Bodies, Committees and units that interact with different responsibilities and roles in order to create an effective governance system that is closely integrated into the decision-making processes and the management of company operations.



The Intesa Sanpaolo Group's operational risk governance process is divided into the following phases:

- Identification: the detection and description of potential operational risk areas (e.g. operational events, presence of issues, applicability of risk factors, significant risk scenarios);
- Assessment and measurement: determination of operational risk exposure;
- Monitoring and control: continuous management of changes in the operational risk exposure, also to prevent the occurrence of harmful events and to promote active risk management;
- Mitigation: operational risk containment through appropriate mitigation actions and suitable risk transfer strategies, based on a risk-driven approach;
- Reporting: preparation of information flows related to operational risk management, designed to ensure adequate knowledge of the exposure to this risk.

IT and cyber risk

The Intesa Sanpaolo Group considers its information system a tool of primary importance to the achievement of its strategic, business and social responsibility objectives, including in the light of the critical nature of the company processes that depend on it, and undertakes to create a resilient environment and to invest in assets and infrastructure designed to minimise the potential impact of ICT events and to protect its business, image, customers and employees.

The Group has therefore adopted a system of principles and rules intended to identify and measure the ICT risk to which company assets are exposed, assess the existing safeguards and identify adequate methods of managing such risks, planning appropriate mitigation measures to reduce their levels to within the pre-established limits, where necessary.

Internal model for the measurement of operational risk

The Intesa Sanpaolo Group's internal model for calculating capital absorption (the "Advanced Measurement Approach" or "AMA") is designed to combine all the main sources of quantitative information (internal and external operational losses and estimates deriving from the Scenario Analysis) and qualitative information (Business Environment Evaluation - VCO).

Capital-at-risk is therefore identified as the minimum amount at Group level required to bear the maximum potential loss (worst case). It is estimated using a Loss Distribution Approach model (actuarial statistical model to calculate the Value-at-risk of operational losses), applied to both operational losses and the results of the scenario analysis assuming a one-year estimation period, with a confidence level of 99.90% (equivalent to facing the worst 1,000 year annual loss). The methodology

also applies a corrective factor, which derives from the qualitative analyses of the risk level of the operational environment (VCO), to take into account the effectiveness of internal controls in the various Organisational Units.

The internal model's insurance mitigation component was approved by the Competent Authority in June 2013 with immediate effect of its benefits on operations and on the capital requirements.

Operational risk capital requirement

For regulatory purposes, the Group adopts the Advanced Measurement Approach, in partial use with the standardised (TSA) and basic approaches (BIA), to determine the capital requirement.

The AMA approach is adopted by Intesa Sanpaolo S.p.A. and the main banks and companies in the Corporate and Investment Banking, Private Banking and Asset Management Divisions, as well as by VUB Banka, VUB Leasing and PBZ Banka.

The capital absorption resulting from this approach amounts to 1,781 million euro as at 30 June 2020, up modestly from 1,697 million euro as at 31 December 2019.

Legal risks

As at 30 June 2020, there were a total of about 26,000 disputes pending, other than tax disputes, (excluding those involving Risanamento S.p.A. and Autostrade Lombarde S.p.A., which are not subject to management and coordination by Intesa Sanpaolo) with a total remedy sought of 5,622 million euro¹⁹. This amount includes all outstanding disputes, regardless of the estimated risk of a disbursement of financial resources resulting from a potential negative outcome and therefore also includes disputes with a remote risk.

The risks associated with the above disputes have been thoroughly analysed by the Parent Company and Group companies involved. Specific and appropriate provisions have been made to the Allowances for Risks and Charges in the event of disputes for which there is an estimated probability of a disbursement of more than 50% and where the amount of the disbursement may be reliably estimated (disputes with likely risk). These disputes amount to around 11,600 with a remedy sought of 1,815 million euro and provisions of 589 million euro. The part relating to the Parent Company Intesa Sanpaolo is around 5,100 disputes with a remedy sought of 1,451 million euro and provisions of 441 million euro, the part relating to other Italian subsidiaries is around 500 disputes with a remedy sought of 254 million euro and provisions of 93 million euro, and the part relating to the international subsidiaries is around 6,000 disputes with a remedy sought of 110 million euro and provisions of 55 million euro.

There were no new significant legal disputes during the half-year.

For the main pending disputes, the significant developments in the first half of the year are described below; see the Notes to the 2019 Annual Report for further details.

Private banker (Sanpaolo Invest) – In relation to the serious violations committed by a private banker of Sanpaolo Invest, at the end of June the subsidiary had received a total of 272 complaints with a total remedy sought of approximately 54 million euro. Of these, 61 complaints relate to misappropriations (with a remedy sought of approximately 17 million euro, for which the checks conducted determined the lesser amount of 13 million euro) and other types of damages (10 million euro). A further 211 claims for a total remedy of around 27 million euro relate to false accounting and unauthorised transactions, as well as requests for reimbursement of fees.

During the half-year, the subsidiary accepted and reimbursed more than 4 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 residual risk of disbursement resulting from the illegal acts committed by the private banker is covered by a provision of approximately 9 million euro. 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 discovery orders issued and the coverage provided by the insurance policy, which the Company promptly triggered in accordance with the policy conditions.

Selarl Bruno Raulet (formerly Dargent Tirmant Raulet) Dispute - During the first quarter of 2020, 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. Subsequently, in the second quarter, the bankruptcy trustee informed that the dispute would have been referred to the Court of Appeal of Metz; the related brief shall be filed by August.

ENPAM Lawsuit - Following the filing of the court-appointed expert's report, at the hearing of 4 June 2020 the judge presented a settlement proposal to the parties. After negotiations between the parties, the Chairman of ENPAM's Board of Directors informed JP Morgan Chase, BNP Paribas and Intesa Sanpaolo that he was willing to settle the dispute for an amount slightly lower than that proposed by the judge. This solution was accepted by the three banks; Intesa Sanpaolo's share was limited to the amount that had been provisioned the previous year precisely in view of a possible settlement.

As a consequence, the judge adjourned the case until 21 October 2020 to allow the settlement agreement to be finalised.

Disputes relating to loans in CHF against the Croatian subsidiary Privredna Banka Zagreb Dd - 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

¹⁹ The figures for the remedy sought do not include claims of indeterminate value, i.e. those that do not contain a specific financial claim when the dispute is initiated; the value of these disputes is determined during the course of the proceedings when sufficient information emerges for the valuation.

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.

A petition for the correction of a material error contained in the judgment of the Court of Appeal of Rome was filed by the Bank in the second quarter. The hearing for discussion has been set for 17 September 2020.

Tax litigation

The Group's tax litigation risks are covered by adequate provisions to the allowances for risks and charges.

No new cases of significant amounts arose in the first half of the year. In addition, the suspension of trial time limits until 11 May was established, first by the so-called "Cura Italia" Law Decree no. 18 of 17 March 2020, and then by Law Decree no. 23 of 8 April 2020. Furthermore, Law Decree no. 34 of 19 May 2020 provides that notices of assessment, settlement, claims, penalties and recovery of tax credits, for which the time limits are set to expire between 9 March and 31 December 2020, may be issued until 31 December 2020 and validly served on the taxpayer during the period from 1 January to 31 December 2021. Finally, the time limits for conducting administrative proceedings on the petition of a party or on an ex officio basis that were pending on 23 February 2020 or commenced after that date have been suspended until 15 May 2020.

As at 30 June 2020, Intesa Sanpaolo had 668 pending litigation proceedings (612 as at 31 December 2019) for a total amount claimed (taxes, penalties and interest) of 141 million euro (146 million euro as at 31 December 2019, including the former Banco Sudameris Brasil dispute with a value of 35 million euro at the current exchange rate), considering both administrative and judicial proceedings at various instances.

In relation to these proceedings, the actual risks were quantified for Intesa Sanpaolo at 52 million euro as at 30 June 2020 (54 million euro as at 31 December 2019).

The dispute with the Provincial Department of Florence on the VAT applied in 2014 by Infogroup Informatica e Servizi Telematici S.c.p.A., a consortium company wholly represented by Intesa Sanpaolo Group companies and sold to Engineering - Ingegneria Informatica S.p.A. on 28 December 2017, was resolved during the period. In 2019, a settlement agreement had been reached for the year 2014 (approximately 2 million euro), whereas in the first half of 2020 the IRES, IRAP and VAT findings for the years 2015, 2016 and 2017 were settled by filing an amended return and paying a total of 7.7 million euro, of which 0.6 million euro contractually borne by Engineering, already set aside in the 2019 Financial Statements. The total settlement cost was 7.1 million euro, considering the positive effect of 2 million euro arising from the deduction of the VAT paid for the settlement, recovered from ISP, for the purposes of IRES and IRAP.

With regard to the disputes still pending, in June the Attorney General filed an appeal before the Court of Cassation against the judgment of the court of second instance, favourable to the Bank, in the matter of registration tax, assessed by the Italian Revenue Agency of Milan in the amount of 6.7 million euro, in addition to interest (no penalty was levied). The Agency reclassified the overall transaction whereby Manzoni s.r.l. transferred a private equity business line that it had acquired through two different contributions of business lines by the Bank and the former IMI Investimenti S.p.A. to Melville S.r.l. through a partial, non-proportional demerger as the sale of a business line, levying registration tax on the transaction at 3% of the economic value declared in the de-merger deed. The Bank retained a major law firm to represent it at trial.

Mention should also be made of the filing by the Regional Tax Commission of Piedmont of judgment no. 125/4/2020, unfavourable to the Bank, regarding the lawfulness of a payment notice of 1.7 million euro. This notice, served in 2016, follows the unfavourable judgment of the Court of Cassation no. 25463/2015 regarding solely the penalties for tax periods

1986 and 1988 on IRPEG and ILOR findings not cancelled in the various instances of the trial on the merits, which concluded a complex, lengthy trial, arising from the merger of Istituto Bancario Sanpaolo di Torino with Banca Popolare dell'Agricoltura. In addition, another set of proceedings had unfolded in parallel, regarding the amnesty pursuant to Law 413/1991, in which the Istituto had participated for the years in dispute, also disputed by the tax authorities, which had yielded a favourable outcome for the Bank in the first and second instances. Given the complexity of the matters at issue in the trial and the legal questions on the merits, it is currently being evaluated whether an appeal of the aforementioned unfavourable judgment before the Court of Cassation would be tenable. The amount of the notice was already paid in full in the course of the trial on a provisional basis; if this claim becomes definitive, there will be no impact on the income statement, since the tax authorities' claim is fully covered by the allowance for tax litigation.

With regard to the merged company Banca Nuova (formerly a member of the Banca Popolare di Vicenza Group), on 20 December 2019 the Italian Revenue Agency served Intesa Sanpaolo, as the surviving company, with a tax audit report regarding tax period 2015 containing findings for a total of 1.6 million euro of taxable profit and IRES and IRAP taxes for a total of 0.46 million euro, in addition to penalties and interest. The alleged violations relate to: i) unlawful deduction of contingent losses on receivables due for invoices to be issued; ii) unlawful deduction due to decreases in the allowance for credit losses arising from the write-off of loans; and iii) unlawful off-balance sheet deduction of the "super-depreciation". As the party responsible for making decisions regarding the findings formulated in the tax audit report by the Italian Revenue Agency, ISP conducted all document research and follow-up activities, on the basis of which it prepared defence briefs that are in the process of being filed. The dispute will be reported to Banca Popolare di Vicenza in compulsory administrative liquidation - and to the Ministry of the Economy and Finance for their consideration and in view of the guarantees provided under Art. 2, paragraph c), of Ministerial Decree 187 of 25 June 2017, in accordance with Art. 4, paragraph 1, letter c), of Decree-Law 99 of 25 June 2017 - which has the obligation to indemnify ISP against any liability, pursuant to Article 11 of the contract entered into on 26 June 2017, for the acquisition of certain assets, liabilities and legal relationships.

With regard to the Intesa Sanpaolo branches located outside Italy, see the disclosures provided in the 2019 financial statements on ongoing audits. In addition, a general audit by the German tax authority will be launched at the Frankfurt branch in August with regard to the following areas relating to the tax periods from 2016 to 2018: i) income taxes; ii) VAT; iii) withholding taxes; iv) tax losses carried forward; v) transfer pricing; and vi) German trade tax.

At the Group's other Italian companies, tax disputes totalled 53 million euro as at 30 June 2020, unchanged compared to 31 December 2019, covered by specific provisions of 1 million euro (1 million euro in the 2019 financial statements).

Of these 53 million euro: i) 9.3 million euro refers to claims involving Fideuram concerning the failure to withhold 27% of the interest accrued in 2009, 2010 and 2011 on foreign bank accounts held at Fideuram Bank (Luxembourg) by two "historic" Luxembourg mutual funds (Fonditalia and Interfund SICAV), for which in the years assessed Fideuram was only the placement bank and correspondent bank. The risk has been deemed not probable; ii) 42.2 million euro is attributable to the IRES and IRAP disputes involving Intesa Sanpaolo Private Banking, relating to the deduction (in 2011 and the following years) of the amortisation charge for the goodwill arising from the transfers of the private banking business lines of Intesa Sanpaolo and Cassa di Risparmio di Forlì e della Romagna in 2009, Banca di Trento e Bolzano and Cassa di Risparmio di Firenze in 2010 and Cassa di Risparmio Pistoia e Lucchesia and Cassa di Risparmio dell'Umbria in 2013, realigned by the transferee in accordance with Article 15, paragraph 10, of Law Decree no. 185 of 29 November 2008. The risk of incurring liabilities is considered to be remote.

The amount of tax disputes involving international subsidiaries is limited and almost entirely provisioned. These consisted of claims for a total value of 9 million euro (11 million euro at the end of 2019) covered by provisions of 7 million euro (7 million euro at the end of 2019).

The decrease in the claimed amount was mainly due to a dispute involving Intesa Sanpaolo Bank Albania, settled without any impact on the income statement in 2020 (total remedy sought of 0.5 million euro), and the reduction in the value of the lawsuit involving Intesa Sanpaolo Brasil S.A., regarding direct taxes for the years 2015 and 2016, due to the negative performance of the Brazilian currency (-0.6 million euro).

The dispute in which the most significant amount is at issue relates to the Egypt-based Alexbank and concerns the non-payment of stamp duty by the branches of the Egyptian bank amounting to approximately 4.8 million euro for the tax periods from 1984 to 2006. The potential liability arising from the litigation has been provisioned.

In addition, in March Exelia was subject to a VAT audit by the Romanian tax authority (ANAF) with regard to tax periods 2014 - 2019. This audit has been concluded and ANAF has determined that the services rendered by Exelia may be classified as services of a financial nature for VAT purposes and are thus exempt, resulting in the full non-deductibility of the VAT on purchases of goods and services. The revenue authority thus claimed non-payment of VAT for 369 thousand euro, in addition to penalties of 146 thousand euro, for the tax periods subject to audit, but the company could have the penalties cancelled in full.

Finally, the tax audit on IMI SEC is still underway for the years 2015 and 2016, for which the US tax authorities are contesting the composition of the company's revenues, which have a high level of income originating from outside the State of New York and subject to lower tax. In 2019 the audit was also extended to 2017. 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, Fideuram Vita and Intesa Sanpaolo RBM Salute) are made with their free capital and to cover contractual obligations with customers. These refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies.

As at 30 June 2020, the investment portfolios of Group companies, recorded at book value, amounted to 167,199 million euro. Of these, a part amounting to 85,781 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 81,418 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, 84.2% of assets, i.e. 72,003 million euro, were bonds, whereas equity instruments represented 1.9% of the total and amounted to 1,608 million euro. The remainder (11,901 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (13.9%).

The carrying value of derivatives came to approximately 269 million euro, of which 242 million euro relating to effective management derivatives²⁰, and the remaining portion (27 million euro) is attributable to hedging derivatives.

At the end of the first six months of 2020, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 419 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10 day holding period) of approximately 14 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 4,250 million euro.

The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 5.1% of total investments and A bonds approximately 6.4%. Low investment grade securities (BBB) were approximately 85.9% of the total and the portion of speculative grade or unrated was minimal (approximately 2.6%).

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 80.1% of the total investments, while financial companies (mostly banks) contributed approximately 11.1% of exposure and industrial securities made up approximately 8.8%.

At the end of the first half 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 4,266 million euro, with 3,625 million euro due to government issuers and 641 million euro to corporate issuers (financial institutions and industrial companies).

OTHER RISK FACTORS

In addition to the risks described above, the Intesa Sanpaolo Group is carefully assessing the following risk factors.

Brexit

On 31 January 2020, the United Kingdom (UK) officially left the European Union (EU) on the basis of the Withdrawal Agreement reached by the UK and EU in October 2019 and ratified by both parties in early 2020.

An 11-month transition period began on 1 February 2020, during which:

- Community legislation will continue to apply in the United Kingdom;
- the EU and UK will be required to negotiate the terms of their future relations.

Although a departure with a withdrawal agreement with effect from 31 January 2020 has emerged, there continues to be uncertainty regarding the regulatory framework that will enter into effect, in particular with regard to financial services, at the end of the transition period.

In March 2020, negotiations relating future relations began; however, due in part to the COVID-19 emergency, in the first half of 2020 no particular progress was made; the deadline by which the United Kingdom and European Union were to have agreed the extension of the transition period expired on 30 June 2020, and the said transition period is thus set to expire on 31 December 2020. In July 2020, negotiations are expected to intensify, ideally culminating in an agreement by October at the latest, to allow the parties to conclude their respective ratification procedures by the end of the year.

In addition, the deadline by which, according to the Political Declaration, the United Kingdom and the European Union had pledged, albeit on a "best effort" basis, to conclude their respective assessments of the equivalence frameworks, expired on 30 June 2020.

Considering, therefore, that in the coming weeks the United Kingdom and the European Union will have to confront very complex, delicate issues and reach an agreement of unprecedented scope, the period available to negotiate an agreement on all aspects of European-British relations and equivalence decisions might not be sufficient.

The Intesa Sanpaolo Group - present in the UK through its IMI Corporate and Investment Banking, Asset Management and Private Banking Divisions - which through a dedicated interfunctional project had long been prepared, from a prudential perspective, for a withdrawal of the United Kingdom from the EU without a Withdrawal Agreement (a "hard Brexit"), is now preparing for a worst case scenario in which by 31 December 2020 the UK and EU are unable to agree the terms of their future relations, including with regard to financial services; this would be a "no-deal" scenario with the resulting "cliff-edge"

²⁰ 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.

effects that could only be mitigated after the fact by individual equivalence decisions by the United Kingdom and EU. In this case, the effects of a deferred hard Brexit would most likely result.

In this respect, the project is completing the implementation of a “Brexit Strategy” to ensure coverage of risks relating to Brexit and operating and business continuity through the formulation of contingency plans. In particular, it is managing the following main risks by planning and overseeing the appropriate mitigation measures:

- a) *Loss of the European financial services passporting regime*
After obtaining the necessary authorisations from the European supervisor, the Group is working on preparing a new application to be submitted by 2020 to the UK supervisor for authorisation of the single branch in the UK resulting from the merger of ISP and BIMl (effective date of 20 July 2020). If the authorisation procedure with the UK supervisor were not to be concluded by the end of the transitional period, enrolment in the Temporary Permission Regime (TPR) granted by the British authorities would permit Group entities present in the UK to continue to operate in the United Kingdom for a maximum of three years, pending formal approval of their applications.
The Group has also prepared a contingency plan to ensure business continuity for operations and assets that, in the absence of passporting, could no longer be managed by branches in the UK.
- b) *Limitations on the access to central counterparties (CCPs) located in UK by EU branches*
The Group has taken measures to extend its membership in European CCPs for IRDs, CDSs, ETDs, bonds and repos in order to ensure business continuity.
In addition, with regard to positions held with UK CCPs, a risk neutralisation strategy has been implemented, resulting in a significant reduction in regulatory capital.
- c) *Contract discontinuity risk*
The Group is carrying out a repapering process with counterparties to OTC derivatives contracts not cleared through a CCP and entered into with counterparties based in the United Kingdom, as well as to other types of contracts (supply, outsourcing, etc.) and has established adequate safeguards for the transfer of personal data pursuant to Regulation (EU) No 2016/679 (GDPR). It has also prepared IT and organisational solutions to block operations for any contracts not renegotiated by the end of the transition period.
- d) *Risk of non-compliance with UK legislation (SMR and regulatory reporting)*
The Group is in the process of achieving compliance with United Kingdom legislation. In particular, the Group's compliance efforts are focusing on the Senior Managers and Certification Regime (SM&CR), which provides for the appointment, subject to approval by the UK supervisor, of several top management personnel (“Senior Managers”) with precise areas of responsibility for branches operating in the United Kingdom as third-country branches. In addition, the Group has begun the process of complying with reporting obligations applicable to third-country branches present in the United Kingdom.
- e) *Risk of disruption of operations with market counterparties based in the UK*
With regard to the risk of disruption of operations with market counterparties based in the UK, the Intesa Sanpaolo Group has begun the onboarding process for EU-based counterparties / brokers (OTFs included) to which UK-based entities have decided to migrate all or part of their operations in a no-deal scenario.

In the second half of 2020, the Intesa Sanpaolo Group will finalise the implementation phase and authorisation procedure in the UK, while also monitoring the status and outcomes of the negotiations, with particular regard to the regulatory framework that could be established for financial services and that could therefore have an impact on the contingency plans defined thus far.

Interest Rate Benchmark Reform

As is common knowledge, European benchmark rates are currently undergoing extensive reform, deriving in large part from the introduction of the European regulation on benchmarks (the Benchmarks Regulation, Regulation (EU) 2016/1011), published in 2016 and in effect since January 2018. This regulation, which establishes precise rules for contributors, users and administrators of benchmarks, also requires that they be determined on the basis, insofar as possible, of actual transactions concluded on the relevant markets, in accordance with instructions from the Financial Stability Board, in view of the central role of the relevant rates to the proper functioning of the global financial system.

In the specific case of the short-term benchmark rates declared critical by the European authorities, reforms relating to the following were required:

- Euribor: revision in 2019 by the EMMI (European Money Market Institute) of the method for determining fixings (“hybrid” method), using, where available, transactions concluded on the unsecured money market of up to 12 months by provider banks, in full continuity with the measurement of the market of reference, determination and use of fixing.
- Eonia: with effect from October 2019, determination of fixings by calculating them on the basis of the new risk-free rate published by the European Central Bank (€STR rate), according to the overnight transactions concluded by major European banks and reported according to the rules imposed by Money Market Statistical Reporting (EU 2014/1333).
The Eonia fixing will be published until the end of 2021 and then permanently replaced by €STR.

Beyond European borders, the British authorities have already announced that the publication of the Libor will be discontinued at the end of 2021 and there are already alternative risk-free rates available in the individual nations, which will gradually replace the Libor.

In recent years, Intesa Sanpaolo has closely monitored the developments relating to benchmarks, and in 2016 it launched a dedicated project involving the participation of all the corporate functions involved in various capacities.

Intesa Sanpaolo also participated in various initiatives, including working groups at the European level organised by EMMI and the European Central Bank. In particular, in this latter venue, the Bank participates as a voting member in the *Working Group on Risk-Free Rates*, whose main activities included the designation of €STR as the new benchmark for the short-term money market and the publication of recommendations for the transition from Eonia to €STR.

Project activities continued in the first half of 2020. Following the completion of the activities relating to the new hybrid contribution to the Euribor and release of the €STR rate for full use, the focus of the project shifted to the activities that remain ongoing, and more specifically:

- Discounting switch from Eonia to €STR for transactions subject to clearing, according to the timescales dictated by European and U.S. clearing houses;
- Progressive greater use of derivatives in respect of the €STR rate for hedging needs;
- Preparation of activities at all levels to ensure the progressive transition from the Libor to the new risk-free rates, including through reinforcement of the governance of the Libor project and the benchmark users project to cover regulatory and business aspects, with support from specialist functions. Participation in the work by the international hub branches as users of foreign currency rate benchmarks was also reinforced;
- Active, constant participation in international working groups and collaboration with the Italian authorities in support of the development of the new risk-free rates market;
- Progressive analysis of the documentation being produced from time to time at the international level, including public consultations, in order to complete the final significant milestones in 2021.

As stated in the "Accounting policies" chapter of this Report, the Intesa Sanpaolo Group elected to apply Regulation 34/2020 of 15 January 2020 in advance in its 2019 Financial Statements. This regulation adopted the document issued by the IASB on "Interest Rate Benchmark Reform (amendments to IFRS 9 Financial Instruments, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures)", which introduced several amendments regarding hedges (hedge accounting) designed to prevent uncertainties about the amount and timing of the cash flows arising from the rate reform from resulting in the discontinuation of existing hedges and difficulties in designating new hedging relationships.