SHAREHOLDERS’ EQUITY

As at 30 September 2020, the Group’s shareholders’ equity, including the net income for the period, came to 68,364 million euro, of which 64,636 net of the UBI Group's contribution, compared to the 55,968 million euro at the beginning of the year. The increase is to be attributed to the contribution of the net income earned in the first nine months (6,376 million euro, of which 3,303 attributable to the acquisition of the UBI Group, including the effect of negative goodwill) and the capital instruments issued (+2.9 billion euro net of UBI).
As previously reported, in compliance with the European Central Bank communication of 27 March 2020 concerning the dividend policy in the situation resulting from the COVID-19 epidemic, the Bank has decided to suspend the proposed cash distribution to shareholders of around 3.4 billion euro and assigned the net income for 2019 to reserves, after attributing 12.5 million euro to the Allowance for charitable, social and cultural contributions.

Valuation reserves

(millions of euro)

	Reserve 31.12.2019	Change of the period	Reserve 30.09.2020
Financial assets designated at fair value through other comprehensive income (debt instruments)	57	-340	-283
Financial assets designated at fair value through other comprehensive income (equities)	172	-165	7
Property and equipment	1,526	-9	1,517
Cash flow hedges	-882	28	-854
Foreign exchange differences	-956	-203	-1,159
Non-current assets held for sale and discontinued operations	-	-	-
Financial liabilities designated at fair value through profit or loss (change in its creditworthiness)	-	-62	-62
Actuarial profits (losses) on defined benefit pension plans	-410	3	-407
Portion of the valuation reserves connected with investments carried at equity	28	-15	13
Legally-required revaluations	308	-	308
Valuation reserves (excluding valuation reserves pertaining to insurance companies)	**-157**	**-763**	**-920**
Valuation reserves pertaining to insurance companies	**504**	**91**	**595**

Banking valuation reserves were negative (-920 million euro), up compared to 31 December 2019, mainly due to the performance of the spread on government bonds, which entailed a decrease in the value of the assets in portfolio. Negative reserves for foreign exchange differences also increased, whereas positive reserves on equity instruments were reduced almost to zero. Reserves on liabilities designated at fair value (-62 million euro) relating to certificates issued with capital protection were also recognised during the year.
The valuation reserves of the insurance companies amounted to 596 million euro, compared with 504 million euro at the end of 2019.

OWN FUNDS AND CAPITAL RATIOS

(millions of euro)

Own funds and capital ratios	30.09.2020		31.12.2019
	IFRS9 "Fully loaded"	IFRS9 "Transitional"	IFRS9 "Transitional"
Own funds			
Common Equity Tier 1 capital (CET1) net of regulatory adjustments	48,193	50,325	41,542
Additional Tier 1 capital (AT1) net of regulatory adjustments	7,496	7,496	4,096
TIER 1 CAPITAL	**55,689**	**57,821**	**45,638**
Tier 2 capital net of regulatory adjustments	10,149	9,276	7,057
TOTAL OWN FUNDS	**65,838**	**67,097**	**52,695**
Risk-weighted assets			
Credit and counterparty risks	298,935	297,436	258,187
Market and settlement risk	18,226	18,226	18,829
Operational risks	26,282	26,282	21,212
Other specific risks (a)	307	307	296
RISK-WEIGHTED ASSETS	**343,750**	**342,251**	**298,524**
% Capital ratios			
Common Equity Tier 1 capital ratio	14.0%	14.7%	13.9%
Tier 1 capital ratio	16.2%	16.9%	15.3%
Total capital ratio	19.2%	19.6%	17.7%

(a) The caption includes all other elements not contemplated in the foregoing captions that are considered when calculating total capital requirements.

The figures as at 30 September 2020 include assets and liabilities in relation to the UBI Group.

Own Funds, risk-weighted assets and the capital ratios as at 30 September 2020 were calculated according to the harmonised rules and regulations for banks and investment companies contained in Directive 2013/36/EU (CRD IV) and in (EU) Regulation 575/2013 (CRR) of 26 June 2013, which transpose the banking supervision standards defined by the Basel Committee (the Basel 3 Framework) to European Union laws, and on the basis of the related Bank of Italy Circulars.
The regulations governing own funds, which provided for the gradual introduction of the Basel 3 framework, are now in full effect, following the conclusion in 2018 of the specific transitional period during which some elements to be fully included in or deducted from Common Equity when the framework is “fully loaded” only had a partial percent impact on Common Equity Tier 1 capital. The Intesa Sanpaolo Group chose to take the "static approach" to adopting IFRS 9 envisaged in Regulation (EU) 2017/2395. This approach permits the re-inclusion in Common Equity of a gradually decreasing amount, ending in 2022 (95% in 2018, 85% in 2019, 70% in 2020, 50% in 2021 and 25% in 2022), of the impact of IFRS 9, calculated net of the tax effect, based on the comparison of the IAS 39 adjustments as at 31 December 2017 and the IFRS 9 adjustments as at 1 January 2018, excluding the reclassification of financial instruments, and after eliminating the shortfall as at 31 December 2017.
Regulation (EU) 2017/2395 also lays down the reporting obligations that entities are required to publish, while charging the EBA with issuing specific guidelines on this subject. In implementation of the Regulation, the EBA issued specific guidelines according to which banks that adopt a transitional treatment of the impact of IFRS 9 (such as the static approach mentioned above) are required to publish, with quarterly frequency, the fully loaded consolidated figures (as if the transitional treatment had not been applied) and the transitional consolidated figures for Common Equity Tier 1 (CET1) capital, Tier 1 capital, total capital, total risk-weighted assets, capital ratios and the leverage ratio.
As at 30 September 2020, taking account of the transitional treatment adopted to mitigate the impact of IFRS 9, Own Funds came to 67,097 million euro, against risk-weighted assets of 342,251 million euro, resulting primarily from credit and counterparty risk and, to a lesser extent, operational and market risk. As at that same date, considering the full inclusion of the impact of IFRS 9, Own Funds stood at 65,838 million euro, compared to risk-weighted assets of 343,750 million euro.
Own funds calculated considering the full impact of IFRS 9 (i.e., on a “fully-loaded” basis) take account of the provisions of the 2019 Budget Act calling for the adjustments upon first-time adoption of the Standard to be applied in instalments for tax purposes, with the recognition of the resulting DTAs. These DTAs have been considered at 30% of their book value for the purposes of calculating transitional own funds, in accordance with Article 473bis of the CRR with regard to the application of the static approach, whereas they have been fully included among deductible elements in fully-loaded own funds. The impact of such DTAs on fully-loaded own funds is nonetheless temporary since they will be phased out by 2028.
In addition, the Group has not adopted so far the new IFRS 9 transitional rules relating to adjustments to loans after 31 December 2019 or the reintroduction of the prudential filter for exposures to central governments classified to the FVTOCI category, both introduced by the European Commission in Regulation No 2020/873 of 24 June 2020.
Capital adequacy ratios as at 31 December 2019 had been calculated considering the income for 2019 net of the component that the Issuer’s Board of Directors, during its session of 25 February 2020, had proposed be allocated to dividends for a total of 3,362 million euro; following the ECB’s Recommendation of 27 March 2020 regarding dividend policies in the situation resulting from the COVID-19 epidemic, on 31 March 2020 Intesa Sanpaolo’s Board of Directors amended the proposal to the Shareholders’ Meeting for the allocation of the net income reported in the Financial Statements as at 31 December 2019,

adopting the European Central Bank’s Recommendation not to distribute dividends in view of the economic environment created by the epidemic, and instead proposing that the share of the net income allocated to dividends in the previous resolution dated 25 February 2020 be assigned to reserves. On 27 April 2020, the Shareholders' Meeting approved the assignment of the net income for 2019 to reserves. Accordingly, Common Equity Tier 1 capital as at 30 September 2020 includes, among reserves, the entire net income for 2019, less the foreseeable other charges (accrued coupon on Additional Tier 1 instruments and charitable giving). On 27 July 2020, the ECB extended its recommendation that dividends not be distributed until 1 January 2021, from the previous date of 1 October 2020 indicated in the recommendation dated 27 March 2020.

Capital ratios as at 30 September 2020 include the effects of the consolidation of the UBI Group, the impacts of which are primarily attributable to the capital increase in service of the Public Purchase and Exchange Offer, the calculation of the negative goodwill recognised as at 30 September 2020 - although it is entirely provisional since the purchase price allocation process for the acquisition cost under IFRS 3 will be concluded for the 2020 Financial Statements - and the consideration of the UBI Group's risk-weighted assets. It should be noted that risk-weighted assets take account of the contribution attributable to the branches that will be sold to BPER in 2021, although the estimated capital loss on the sale of these branches has already been recognised during the period ended 30 September 2020.

Account has also been taken of the net income for the first nine months of 2020, less the related dividend (and other foreseeable charges), calculated on the basis of the 75% payout ratio envisaged for 2020, excluding the contribution of the provisional negative goodwill. The 75% pay-out ratio is based on Intesa Sanpaolo’s intention to confirm for 2020 the dividend policy set out in the 2018-2021 Business Plan, subject to the recommendations that will be provided by the ECB in the fourth quarter of 2020 regarding dividend distributions after 1 January 2021 and not to distribute the definitive negative goodwill, as resulting from the finalisation of the purchase price allocation process for the business combination and net of charges for integration and the reduction of the risk profile.

Common Equity Tier 1 Capital and risk-weighted assets as at 30 September 2020 take account of the impact of the application of the “Danish Compromise” (Art. 49.1 of Regulation (EU) No 575/2013), as per the specific authorisation received from the ECB in 2019, according to which insurance investments, excluding those attributable to the UBI Group, for which an extension of the "Danish Compromise" has not been requested, are treated as risk-weighted assets instead of being deducted from capital.

On the basis of the foregoing, solvency ratios as at 30 September 2020, calculated taking account of the transitional treatment of the impact of IFRS 9 (IFRS 9 Transitional), amounted to a Common Equity ratio of 14.7%, a Tier 1 ratio of 16.9% and a total capital ratio of 19.6%. Considering the full inclusion of the impact of IFRS 9 (IFRS 9 Fully Loaded), solvency ratios as at 30 September 2020 were as follows: a Common Equity ratio of 14.0%, a Tier 1 ratio of 16.2% and a Total capital ratio of 19.2%.

Finally, it should be noted that on 26 November 2019 Intesa Sanpaolo disclosed that it had received the ECB’s final decision concerning the capital requirement that the Bank has to meet, on a consolidated basis, as of 1 January 2020, following the results of the Supervisory Review and Evaluation Process (SREP). The overall capital requirement the Bank has to meet in terms of Common Equity Tier 1 ratio is 8.44% under the transitional arrangements for 2020 and 8.63% on a fully loaded basis.

As previously disclosed, it bears reiterating that the positive effect of 3,264 million euro associated with the negative goodwill relating to the acquisition of UBI Banca and included in Common Equity Tier 1 capital as at 30 September 2020 is to be considered absolutely provisional, and will be redetermined at the time of preparation of the 2020 financial statements following the outcome of the PPA (Purchase Price Allocation) procedure through the exact calculation, as at the date of acquisition, of the fair value of identifiable assets acquired and liabilities assumed of the UBI Group.

Moreover, the 2020 Financial Statements will recognise the charges currently being determined, related to the integration and improvement of the operating efficiency and to the de-risking.

It also bears reiterating that the above amount of negative goodwill, as already stated, takes account of not only the provisional effects of the acquisition, but also the capital loss on the sale of UBI Banca and Intesa Sanpaolo branches, for which the corresponding risk-weighted assets continue to be included in the consolidated figures, since they have not yet been eliminated from the scope of consolidation.

Reconciliation of Shareholders’ equity and Common Equity Tier 1 capital

(millions of euro)

Captions	30.09.2020	31.12.2019
Group Shareholders' equity	68,364	55,968
Minority interests	277	554
Shareholders' equity as per the Balance Sheet	**68,641**	**56,522**
Adjustments for instruments eligible for inclusion in AT1 or T2 and net income for the period		
- Other equity instruments eligible for inclusion in AT1	-7,490	-4,091
- Minority interests eligible for inclusion in AT1	-6	-5
- Minority interests eligible for inclusion in T2	-3	-3
- Ineligible minority interests on full phase-in	-237	-511
- Ineligible net income for the period (a)	-2,389	-3,451
- Treasury shares included under regulatory adjustments	244	230
- Other ineligible components on full phase-in	-	-
Common Equity Tier 1 capital (CET1) before regulatory adjustments	**58,760**	**48,691**
Regulatory adjustments (including transitional adjustments) (b)	**-8,435**	**-7,149**
Common Equity Tier 1 capital (CET1) net of regulatory adjustments	**50,325**	**41,542**

(a) Common Equity Tier 1 capital as at 30 September 2020 includes the income for the first nine months of 2020, less the related dividend (and other foreseeable charges), calculated by applying the pay-out ratio of 75% envisaged for 2020, excluding the contribution of provisional negative goodwill deriving from the acquisition of the UBI Group.

(b) Adjustments for the transitional period as at 30 September 2019 take account of the prudential filter, which allows re-inclusion in Common Equity of a portion of the impact of IFRS 9 (70% in 2020) set to decrease progressively until 2022.

The figures as at 30 September 2020 include assets and liabilities in relation to the UBI Group.