Shareholders' equity

As at 30 September 2018, the Group's shareholders' equity, including the net income for the period, came to 52,473 million euro compared to the 53,268 million euro at the beginning of the year. The decline in equity was primarily due to the distribution of the 2017 net income.

Valuation reserves

(millions of euro)

	Reserve 01.01.2018	Change of the period	Release to Retained earnings (in case of sale)	Reserve 30.09.2018	
					incidence %
Financial assets designated at fair value through other comprehensive income (debt instruments)	120	-833	-	-713	42.6
Financial assets designated at fair value through other comprehensive income (equities)	72	34	-	106	-6.3
Property and equipment	-	-	-	-	-
Intangible assets	-	-	-	-	-
Foreign investment hedges	-	-	-	-	-
Cash flow hedges	-916	123	-	-793	47.3
Foreign exchange differences	-1,000	-20	-	-1,020	60.9
Non-current assets held for sale and discontinued operations	-	-	-	-	-
Financial liabilities designated at fair value through profit or loss (change in its creditworthiness)	-	-	-	-	-
Actuarial profits (losses) on defined benefit pension plans	-675	5	-	-670	40.0
Portion of the valuation reserves connected with investments carried at equity	-63	2	-	-61	3.6
Fair value measurement of property and equipment and legally-required revaluations	1,584	-64	-	1,520	-90.7
Valuation reserves (excluding valuation reserves pertaining to insurance companies pursuant to IAS 39)	**-878**	**-753**	**-**	**-1,631**	**97.4**
Valuation reserves pertaining to insurance companies	**417**	**-461**	**-**	**-44**	**2.6**

Valuation reserves recorded a decline of 753 million euro in the banking component and of 461 million euro in the insurance component, primarily due to the reduction in the fair value of government bonds.

Own funds and capital ratios

(millions of euro)

Own funds and capital ratios	30.09.2018 IFRS9 "Fully loaded"	30.09.2018 IFRS9 "Transitional"	31.12.2017
Own funds			
Common Equity Tier 1 capital (CET1) net of regulatory adjustments	34,219	37,189	38,051
Additional Tier 1 capital (AT1) net of regulatory adjustments	4,855	4,855	5,414
TIER 1 CAPITAL	**39,074**	**42,044**	**43,465**
Tier 2 capital net of regulatory adjustments	7,776	6,913	7,908
TOTAL OWN FUNDS	**46,850**	**48,957**	**51,373**
Risk-weighted assets			
Credit and counterparty risks	237,861	238,381	249,784
Market and settlement risk	19,120	19,120	17,833
Operational risks	17,962	17,962	18,597
Other specific risks (a)	481	481	611
RISK-WEIGHTED ASSETS	**275,424**	**275,944**	**286,825**
% Capital ratios			
Common Equity Tier 1 capital ratio	12.4%	13.5%	13.3%
Tier 1 capital ratio	14.2%	15.2%	15.2%
Total capital ratio	17.0%	17.7%	17.9%

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

Own Funds, risk-weighted assets and the capital ratios as at 30 September 2018 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 provided for the gradual introduction of the Basel 3 framework based on a transitional period, during which some elements to be fully included in or deducted from Common Equity when the framework is "fully loaded" only have a partial percent impact on Common Equity Tier 1 capital. With effect from 2018, these transitional provisions no longer apply, with the exception of the filter on valuation reserves for actuarial gains or losses (IAS 19), for which a specific transitional treatment is still in place, although it will expire after the current year. Specific transitional provisions (i.e. grandfathering) also remain in place for subordinated instruments that do not meet the Basel 3 requirements, aimed at the gradual exclusion of instruments no longer regarded as eligible from Own Funds (ending in 2022).
As already discussed in detail, application of IFRS 9 - Financial Instruments, endorsed by Regulation (EU) 2016/2067 of 22 November 2016, in replacement of the previous standard IAS 39, has become mandatory from 1 January 2018. Accordingly, first-time adoption (FTA) of the Standard took effect from the accounting date of 1 January 2018. This entailed the restatement of the financial instruments according to the new classification criteria and the recalculation of their values, where necessary, to take account of the new impairment and classification rules. The effects of this process, in respect of first-time adoption only, have been recognised through shareholders' equity.
On the subject of the introduction of IFRS 9, on 12 December 2017 the European Parliament enacted Regulation (EU) 2017/2395 updating the CRR by adding the new Article 473a "Introduction of IFRS 9", which allows banks to mitigate the impacts on own funds of the introduction of the new accounting standard.
In this regard, the Intesa Sanpaolo Group chose to adopt the "static approach" envisaged in the aforementioned Regulation. 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, on 12 January 2018, 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 2018, taking account of the transitional treatment adopted to mitigate the impact of IFRS 9, Own Funds came to 48,957 million euro, against risk-weighted assets of 275,944 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 46,850 million euro, compared to risk-weighted assets of 275,424 million euro.
Common Equity Tier 1 capital includes the net income for the first nine months of 2018, less the related dividend, calculated on the basis of the payout envisaged in the 2018-2021 Business Plan (85% for 2018) and other foreseeable charges (accrued coupon on Additional Tier 1 instruments).
With regard to the POP (Performance-based Option Plan) – a long-term incentive plan for top management, risk-takers and key managers – the effect of the exercise of the right of novation, whereby Intesa Sanpaolo attributed the obligation to deliver

the shares to the POP Counterparty, essentially representing an alternative approach to direct purchase of own shares on the market by Intesa Sanpaolo, was accounted for as a decline in equity of 160 million euro, with the ensuing reduction in Common Equity Tier 1 capital of like amount.

The events that impacted Common Equity Tier 1 Capital as at 30 September 2018 include the share capital increase with payment connected with the "LECOIP 2.0" Long-Term Investment Plan, targeted to Managers that are not Risk Takers and remaining personnel, and the mandatory conversion of savings shares, considered Additional Tier 1 instruments, into ordinary shares eligible for inclusion in Common Equity Tier 1 Capital.

On the basis of the foregoing, solvency ratios as at 30 September 2018, calculated taking account of the transitional treatment of the impact of IFRS 9 (IFRS 9 Transitional), amounted to a Common Equity ratio of 13.5%, a Tier 1 ratio of 15.2% and a total capital ratio of 17.7%. Considering the full inclusion of the impact of IFRS 9 (IFRS 9 Fully Loaded), solvency ratios as at 30 September 2018 were as follows: a Common Equity ratio of 12.4%, a Tier 1 ratio of 14.2% and a Total capital ratio of 17.0%.

You are reminded that, on 22 December 2017, Intesa Sanpaolo received the ECB's final decision regarding the capital requirements to be observed with effect from 1 January 2018, in light of the results of the Supervisory Review and Evaluation Process (SREP). The capital requirement at consolidated level in terms of Common Equity Tier 1 ratio is 8.125% under the transitional arrangements in force for 2018 and 9.32% on a fully loaded basis.

Lastly, it is noted that on 2 November 2018, the EBA published the results of its Stress Test and Supervisory Review and Evaluation Process (SREP) for the year 2018, based on the financial statement figures as at 31 December 2017, taking into account the impact of first-time adoption of IFRS 9. The Intesa Sanpaolo CET1 ratio resulting from the stress test for 2020, the final year considered in the exercise, would stand at:

- 13.04% on a phased-in basis, in accordance with the transitional arrangements for 2020 and 12.28% on a fully loaded basis, under the baseline scenario;
- 10.40% on a phased-in basis, in accordance with the transitional arrangements for 2020 and 9.66% on a fully loaded basis, under the adverse scenario;

The CET1 ratio resulting from the stress test for 2020 under the adverse scenario would be 10.99% on a phased-in basis and 10.26% on a fully loaded basis when considering the capital increase executed under the 2018-2021 LECOIP 2.0 Long-term Incentive Plan and the conversion of savings shares into ordinary shares finalised in the third quarter of 2018, other things being equal.

Reconciliation of Shareholders' equity and Common Equity Tier 1 capital

(millions of euro)

Captions	30.09.2018	31.12.2017
Group Shareholders' equity	52,473	56,205
Minority interests	344	399
Shareholders' equity as per the Balance Sheet	**52,817**	**56,604**
Adjustments for instruments eligible for inclusion in AT1 or T2 and net income for the period		
- Capital of savings shares eligible for inclusion in AT1	-	-485
- Other equity instruments eligible for inclusion in AT1	-4,121	-4,121
- Minority interests eligible for inclusion in AT1	-5	-9
- Minority interests eligible for inclusion in T2	-10	-5
- Ineligible minority interests on full phase-in	-303	-335
- Ineligible net income for the period (a)	-2,603	-3,500
- Treasury shares included under regulatory adjustments	110	86
- Other ineligible components on full phase-in	-15	-16
Common Equity Tier 1 capital (CET1) before regulatory adjustments	**45,870**	**48,219**
Regulatory adjustments (including transitional adjustments) (b)	**-8,681**	**-10,168**
Common Equity Tier 1 capital (CET1) net of regulatory adjustments	**37,189**	**38,051**

(a) Common Equity Tier 1 capital as at 30 September 2018 includes the net income for the period, less the related dividend, calculated according to the payout envisaged in the 2018-2021 Business Plan (85% for 2018) and other foreseeable charges (accrued coupon on Additional Tier 1 instruments).

(b) Adjustments for the transitional period as at 30 September 2018 take account of the prudential filter, which allows re-inclusion in Common Equity of a portion of the impact of IFRS 9 (95% in 2018) set to decrease progressively until 2022.