Risk management

BASIC PRINCIPLES

Intesa Sanpaolo Group policies relating to risk acceptance are defined by the Parent Company's Supervisory Board and Management Board with support from specific Committees, particularly the Control Committee and the Lending and Risks Commission, and with the aid of the Group Risk Governance Committee and the Chief Risk Officer, who reports directly to the Chief Executive Officer.
The Parent Company is in charge of overall direction, management and control of risks. Group companies that generate credit and/or financial risks are assigned autonomy limits and each has its own control structure. A service agreement governs the risk control activities performed by the Parent Company's functions on behalf of the main subsidiaries. These functions report directly to the subsidiaries' Management Bodies.
The risk measurement and management tools contribute to define 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 that could be borne by the Group over a period of one 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 under ordinary and stress conditions. The assessment of capital is included in business reporting and is submitted quarterly to the Group Risk Governance Committee, the Management Board and the Control Committee, as part of the Group's Risks Tableau de Bord. Risk hedging, given the nature, frequency and potential impact of the risk, is based on a constant balance between mitigation/hedging action, control procedures/processes and capital protection measures.

BASEL 2 REGULATIONS AND THE INTERNAL PROJECT

The goal of the Basel 2 Project is the adoption of advanced approaches for credit and operational risks by the main Group companies.
The credit risk situation differs by portfolio:

– for the Corporate segment, authorisation has been obtained from the Supervisory Authority for the use of the AIRB approach on a scope that extends to the Parent Company, the network banks, Banca Infrastrutture Innovazione e Sviluppo and Mediocredito Italiano (effective 31 December 2010; the FIRB approach had been in use since December 2008) and the foreign company Intesa Sanpaolo Bank Ireland Plc. (effective reporting as at 31 December 2011). The foreign bank VUB Banka obtained permission to use the FIRB approach effective from the report as at 31 December 2010.
  With effect from June 2012 permission was obtained to extend the AIRB approach to the subsidiary Banca IMI and for the adoption of rating models for the hedging of Specialised Lending exposures at Group level, together with the use of internal LGD estimates for the Corporate segment in relation to the product companies Leasing and Mediofactoring (the FIRB approach had been in use since December 2008);
– for the Retail Mortgage segment, permission was granted for the use of the IRB approach effective June 2010, extended to the former Casse del Centro network banks effective the report as at 31 December 2011 and to VUB Banka with effect from the report as at 30 June 2012;
– an application for authorisation of transition to the IRB approach for the SME Retail segment is expected to be submitted in the second half of 2012.

The Group is also proceeding with development of the IRB systems for the other segments and the extension of the scope of companies for their application in accordance with a plan presented to the Supervisory Authority.
With regard to Operational Risk, the Group obtained authorisation to use the Advanced Measurement Approaches (AMA – internal model) to determine the associated capital requirement for regulatory purposes, with effect from the report as at 31 December 2009. The scope of application of the advanced approaches is being progressively expanded in accordance with the roll out plan presented to the Management and to the Supervisory Authorities. For additional details see the section on operational risk.
In April 2012 the Group presented its Annual Internal Capital Adequacy Assessment Process Report as a "class 1" banking group, according to Bank of Italy classification, based on the extensive use of internal approaches for the measurement of risk, internal capital and total capital available.
As part of its adoption of Basel 2, 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 2 - Pillar 3" or simply "Pillar 3".
The document is published on the website (group.intesasanpaolo.com) each quarter, inasmuch as Intesa Sanpaolo is among the groups that have adopted validated internal approaches for credit, market and operational risk.

CREDIT RISK

The Group's strategies, powers and rules for the granting and managing of loans 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;

– 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 Intesa Sanpaolo Group has developed a set of techniques and tools for credit risk measurement and management which ensures analytical control over the quality of loans to customers and financial institutions, and loans subject to country risk.
In particular, with respect to loans to customers, risk is measured using internal rating models which change according to the counterparty's operating segment.

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 non-performing loan portfolio is subject to a specific management process which, inter alia, entails accurate monitoring through a predetermined 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. They allow timely assessments when any anomalies arise or persist and interact with processes and procedures for loan management and for credit risk control.
Within the Group, in accordance with preset rules, positions which are attributed a persistent high-risk rating are intercepted (manually or automatically) and included in a unique operational category based on their risk profile. In accordance with the Supervisory Authority instructions, they are classified in the following categories: doubtful loans, exposures to borrowers in default or in similar situations; substandard loans, exposures to borrowers in temporary difficulty, deemed likely to be settled in a reasonable period of time and exposures which satisfy the conditions objectively set by the Supervisory Authority ("objective substandard loans"), although they do not meet the requirements to be classified under doubtful loans; restructured loans, positions for which, due to the deterioration of the economic and financial position of the borrower, the bank (or pool of banks) agrees to modify the original contractual terms giving rise to a loss. Lastly, non-performing loans also include past due positions that cannot be considered mere delays in reimbursements, as established by the Bank of Italy.
With specific reference to "non-performing" past due positions, from 2012 and with effect from the first indications provided by the Supervisory Authority, later adopted in prudential regulations, for identification of these positions the Group applies the 90-day limit to all regulatory portfolios, regardless of the respective exposure classes and related credit risk measurement approaches.

(millions of euro)

	30.06.2012			31.12.2011			Changes
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Doubtful loans	25,462	-15,862	9,600	24,961	-15,963	8,998	602
Substandard loans	13,132	-2,672	10,460	11,486	-2,360	9,126	1,334
Restructured loans	3,982	-663	3,319	4,032	-607	3,425	-106
Past due loans	3,005	-282	2,723	1,319	-172	1,147	1,576
Non-performing loans	**45,581**	**-19,479**	**26,102**	**41,798**	**-19,102**	**22,696**	**3,406**
Performing loans	333,879	-2,647	331,232	338,467	-2,705	335,762	-4,530
Performing loans represented by securities	18,020	-401	17,619	19,220	-934	18,286	-667
Loans to customers	**397,480**	**-22,527**	**374,953**	**399,485**	**-22,741**	**376,744**	**-1,791**

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

The table above shows an increase in the first half of 2012 of non-performing loans, net of adjustments, by 3,406 million euro (+15%) compared to the end of the prior year. This trend led to a higher incidence of non-performing loans on total loans to customers, increasing from 6% to 7%. Coverage of non-performing loans came to approximately 42.7%, lower than the level at the end of 2011 (45.7%), but nevertheless deemed adequate to account for expected losses, also considering the guarantees securing the positions. The reduction in the percentage coverage, as described in more detail below, is related to both the sale without recourse in the first quarter of a doubtful loan portfolio, which had a high risk provision, and the inclusion under non-performing loans of positions past due by over 90 to 180 days, which have a low level of risk.
In particular, as at 30 June 2012, doubtful loans net of adjustments, reached 9.6 billion euro, up 6.7% since the beginning of the year. The level of doubtful loans was influenced by a sale without recourse for a net amount of approximately 270 million euro (1,640 million euro gross value). The impact on total loans was 2.6% and the coverage ratio reached 62.3%.
Compared to 31 December 2011, substandard loans increased 14.6% to 10,460 million euro. Substandard loans as a proportion of total loans to customers increased from 2.4% to 2.8% in the first six months of the year, and the coverage ratio, adequate for the risk intrinsic to this portfolio, was 20.3%, essentially in line with the figure at the end of the prior year.
Restructured loans stood at 3,319 million euro, down slightly compared to the beginning of the year (-3.1%), with a coverage ratio of 16.6% up around 15% compared to the prior year. Past due loans increased 1,576 million euro to 2,723 million euro from 1,147 million euro for the prior year. The sharp increase was essentially attributable to the change in regulations that, as already reported above, require exposures past due by more than 90 days to be classified under non-performing loans with effect from 1 January 2012. Previously the limit was 180 days, for Italian counterparties and for certain regulatory portfolios. As a consequence, the percentage of this type of non-performing loans increased to 0.7% from 0.3% at the end of December. The coverage ratio fell to 9.4% from the previous 13%, due to the lower risk on loans past due less than 180, which were not included under non-performing loans at the end of the prior year.
Performing exposures decreased slightly, from 336 billion euro in the prior year to 331 billion euro. In this context, the cumulated collective adjustments on these loans totalled 0.8% of the gross exposure to customers, a value that is essentially unchanged compared to the figure recorded at the end of 2011.

MARKET RISKS

TRADING BOOK

The quantification of trading risks is based on daily and periodic VaR 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.

A number of the other Group subsidiaries hold smaller trading portfolios with a marginal risk (around 3% of the Group's overall risk). In particular, the risk factors of the international subsidiaries' trading books were interest rates and foreign exchange rates, both relating to linear pay-offs.

For some of the risk factors indicated above, the Supervisory Authority has validated the internal models for the reporting of the capital absorptions of both Intesa Sanpaolo and Banca IMI.

In particular, the validated risk profiles for market risks are: (i) generic on debt securities and generic/specific on equities for Intesa Sanpaolo and Banca IMI, (ii) position risk on quotas of funds underlying CPPI (Constant Proportion Portfolio Insurance) products for Banca IMI, (iii) position risk on dividend derivatives and (iv) position risk on commodities for Banca IMI, the only legal entity in the Group authorised to hold open positions in commodities.

The requirement for stressed VaR is included when determining capital absorption effective 31 December 2011. 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 II 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 historical series to be used for all portfolio risk factors.

In keeping with the historical simulation approach employed to calculate VaR, the latter point is a discriminating condition in the selection of the holding period. In fact, 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 the document, the period relevant to the measurement of stressed VaR had been set as:

– 1 April 2008 to 31 March 2009 for Banca IMI;
– 1 July 2008 to 30 June 2009 for Intesa Sanpaolo.

The analysis of market risk profiles relative to the trading book 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. The following paragraphs provide the estimates and evolution of VaR, defined as the sum of VaR and of the simulation on illiquid parameters, for the trading book of Intesa Sanpaolo and Banca IMI.

In the second quarter of 2012, market risks generated by Intesa Sanpaolo and Banca IMI decreased with respect to the averages for the first quarter of 2012. The average VaR for the period totalled 79.9 million euro.

Daily VaR of the trading book for Intesa Sanpaolo and Banca IMI[(a)]

(millions of euro)

	2012				2011			
	average 2nd quarter	minimum 2nd quarter	maximum 2nd quarter	average 1st quarter	average 4th quarter	average 3rd quarter	average 2nd quarter	average 1st quarter
Intesa Sanpaolo	24,6	23,1	27,5	24,1	25,0	21,4	15,3	18,7
Banca IMI	55,3	47,2	73,7	72,9	70,6	45,3	21,1	17,4
Total	**79,9**	**71,0**	**99,7**	**97,0**	**95,6**	**66,7**	**36,4**	**36,1**

(a) Each line in the table sets out past estimates of daily VaR calculated on the quartely 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.

During the first six months of 2012, market risks generated by Intesa Sanpaolo and Banca IMI increased with respect to the values for 2011.

(millions of euro)

	2012			2011		
	average 1st half	minimum 1st half	maximum 1st half	average 1st half	minimum 1st half	maximum 1st half
Intesa Sanpaolo	24,4	23,1	27,5	17,0	14,0	21,5
Banca IMI	64,1	47,2	92,1	19,3	13,6	27,5
Total	**88,5**	**71,0**	**115,4**	**36,3**	**30,7**	**42,4**

[a] 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.

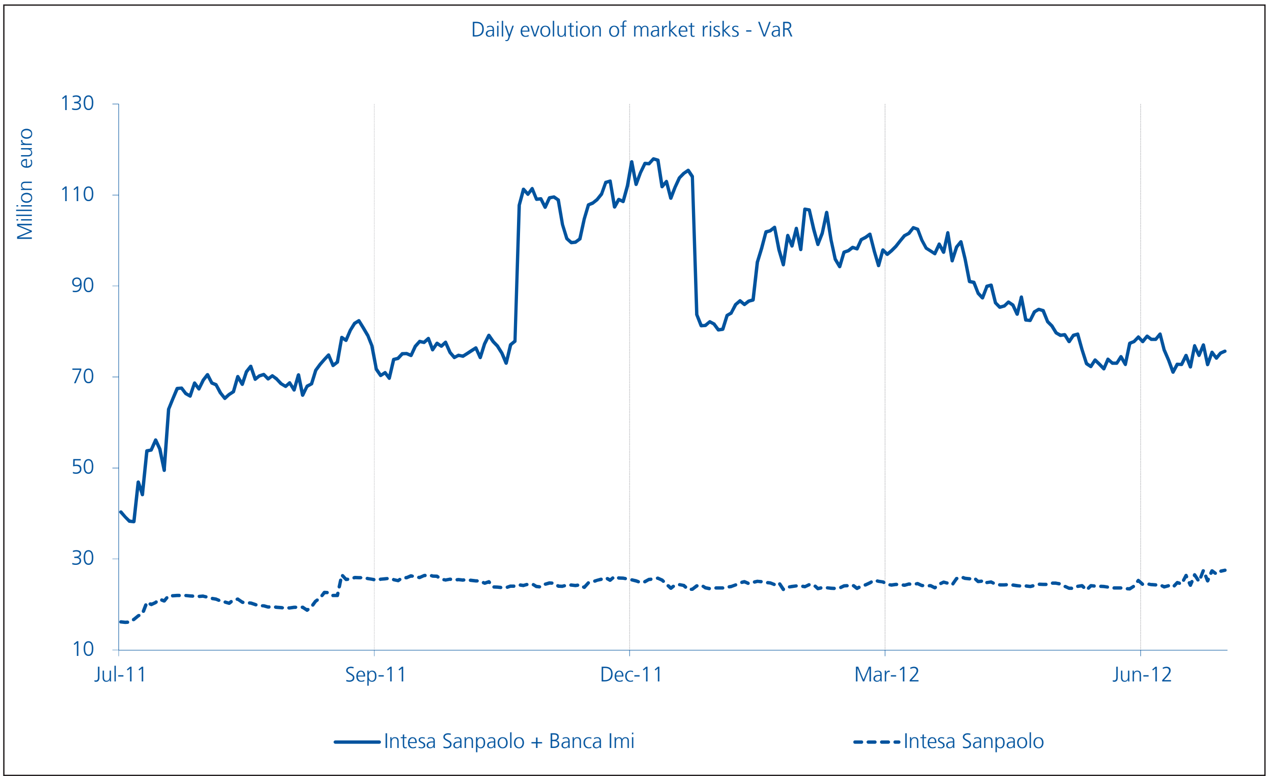
For Intesa Sanpaolo the breakdown of risk profile in the second quarter of 2012 with regard to the various factors shows the prevalence of the hedge fund risk, which accounted for 42% of total VaR; for Banca IMI credit spread risk was the most significant, representing 68% of total VaR.

Contribution of risk factors to overall VaR [a]

2nd quarter 2012	Shares	Hedge funds	Rates	Credit spreads	Foreign exchange rates	Other parameters	Comodities
Intesa Sanpaolo	4%	42%	18%	28%	3%	5%	0%
Banca IMI	4%	0%	19%	68%	1%	4%	4%
Total	**4%**	**13%**	**19%**	**55%**	**2%**	**4%**	**3%**

[a] Each line in the table sets out the contribution of risk factors considering 100% the overall capital at risk, calculated as the average of daily estimates in the second quarter of 2012, broken down between Intesa Sanpaolo and Banca IMI and indicating the distribution of overall capital at risk.

VaR in the last twelve months is set out below. During the second quarter of 2012 VaR a downward trend is recorded as a result of the rolling effect of the scenarios and to a decrease in the Italian government bonds trading component. The risk measurements regarding Intesa Sanpaolo remained constant.



Risk control with regard to the trading activity of Intesa Sanpaolo and Banca IMI also uses scenario analyses and stress tests. The impact on the income statement of selected scenarios relating to the evolution of stock prices, interest rates, credit spreads, foreign exchange rates and commodity prices at the end of June is summarised as follows:

– on stock market positions, a bearish scenario, that is a 5% decrease in stock prices with a simultaneous 10% increase in volatility would have led to a 1 million euro gain; the opposite scenario would have led to a flat result;

– on interest rate exposures, a parallel +25 basis point shift in the yield curve would have led to a 2 million euro loss, whereas a parallel -25 basis point shift would have led to a 6 million euro gain;
– on exposures sensitive to credit spread fluctuations, a 25 basis point widening in spreads would have led to a 71 million euro loss, 3 million euro of which due to structured credit products (SCPs), whereas a 25 basis point tightening of the spreads would have led to a 76 million euro gain, 3 million euro of which due to SCPs;
– on foreign exchange exposures, the portfolio would have recorded a 7 million euro loss if the Euro were to appreciate against the US dollar (+10%);
– lastly, on commodity exposures an 8 million euro loss would have been recorded in the event of a 50% decrease in prices.

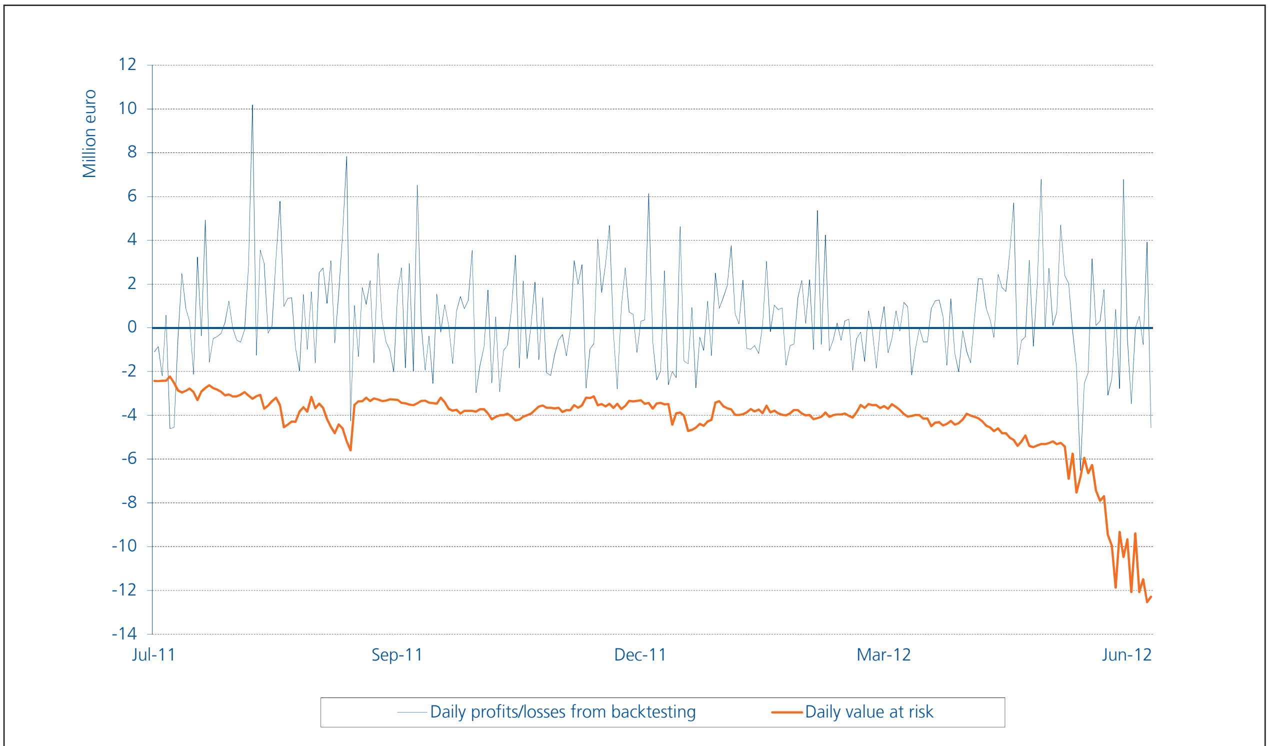
(millions of euro)

	EQUITY		INTEREST RATES		CREDIT SPREADS		FOREIGN EXCHANGE RATES		COMMODITY	
	volatility +10% and prices -5%	volatility -10% and prices +5%	-25bp	+25bp	-25bp	+25bp	-10%	+10%	-50%	+50%
Total	1	0	6	-2	76	-71	8	-7	-8	8
of which SCP					*3*	*-3*				

Backtesting
The effectiveness of the VaR calculation methods must be monitored daily via backtesting which, as concerns 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 such as commissions and intraday activities.

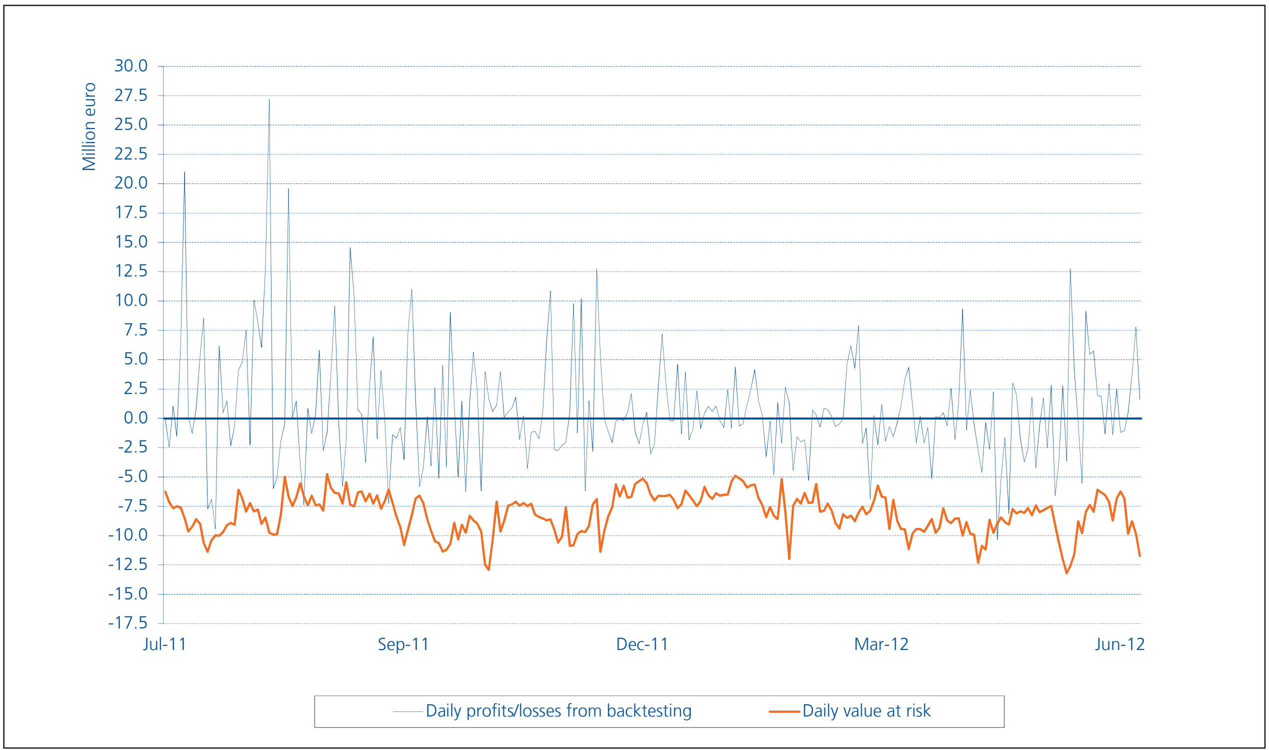
Backtesting allows verification of the model's capability of correctly seizing, from a statistical viewpoint, the variability in the daily valuation of trading positions, covering an observation period of one year (approximately 250 estimates). Any critical situations relative to the adequacy of the Internal Model are represented by situations in which daily profits/losses based on backtesting highlight more than three 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 P&L series recorded and the theoretical series. The latter is based on revaluation of the portfolio value through the use of pricing models adopted for the VaR measurement calculation. The number of significant backtesting exceptions is determined as the maximum between those for actual P&L and theoretical P&L.

Backtesting in Intesa Sanpaolo
Intesa Sanpaolo backtesting exceptions refer to the actual P&L data shown in the following chart. The two excesses in July 2011 are attributable to the sovereign debt crisis that has affected Italian government issues, resulting in high volatility in government bond spreads. It should be emphasised that the VaR subject to the internal model for Intesa Sanpaolo (reduced perimeter of factors compared to VaR) is concentrated on the interest rate risk factor.



Backtesting in Banca IMI

Banca IMI three backtesting exceptions refer to the theoretical P&L data shown in the following chart. The first of these backtesting exceptions can be associated with the sovereign debt crisis. The more recent exceptions refer to changes in interbank rates. Unlike Intesa Sanpaolo, Banca IMI shows validated risk factors with greater diversification (interest rate risk and equity risk).



BANKING BOOK

Market risk originated by the banking book arises primarily in the Parent Company and in the other main Group companies that carry out retail and corporate banking. The banking book also includes exposure to market risks deriving from the equity investments in quoted companies not fully consolidated, mostly held by the Parent Company and by Equiter, IMI Investimenti and Private Equity International.
The following methods are used to measure financial risks of the Group's banking book:
- Value at Risk (VaR);
- Sensitivity Analysis.

Value at Risk is calculated as the maximum potential loss in the portfolio's market value that could be recorded over a 10-day holding period with a 99% confidence level (parametric VaR).
Shift sensitivity analysis quantifies the change in value of a financial portfolio resulting from adverse movements in the main risk factors (interest rate, foreign exchange, equity). For interest rate risk, an adverse movement is defined as a parallel and uniform shift of ±100 basis points of the interest rate curve. The measurements include an estimate of the prepayment effect and of the risk originated by customer demand loans and deposits.
Furthermore, interest margin sensitivity is measured by quantifying the impact on net interest income of a parallel and instantaneous shock in the interest rate curve of 100 basis points, over a period of 12 months. This measure highlights the effect of variations in interest rates on the portfolio being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a predictor of the future levels of the interest margin.

Hedging of interest rate risk is aimed at (i) protecting the banking book from variations in the fair value of loans and deposits due to movements in the interest rate curve or (ii) 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) and options on interest rates stipulated 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 or liabilities (micro-hedging), mainly consisting of bonds issued or acquired by Group companies and loans to customers. In addition, macro-hedging is carried out on the stable portion of on demand deposits and in order to hedge against fair value changes intrinsic to the instalments under accrual generated by floating rate operations. The Group is exposed to this risk in the period from the date on which the rate is set and the interest payment date.
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). In other cases, micro cash flow hedges are applied to specific assets or liabilities (micro cash flow hedge).
The Risk Management Department is in charge of measuring the effectiveness of interest rate risk hedges for the purpose of hedge accounting.

In the first six months of 2012, interest rate risk generated by the Intesa Sanpaolo Group's banking book, measured through shift sensitivity analysis, registered an average value of 401 million euro settling at 405 million euro at the end of June, almost entirely concentrated on the euro currency; this figure compares with 482 million euro at the end of 2011.
Interest margin sensitivity – assuming a 100 basis point change in interest rates – amounted to 293 million euro at the end of June 2012 (240 million euro at the end of 2011).
Interest rate risk, measured in terms of VaR, averaged 114 million euro during the first six months of 2012 (139 million euro at the end of 2011), with a maximum value of 130 million euro and a minimum value of 93 million euro. At the end of June 2012 VaR totalled 115 million euro. Price risk generated by minority stakes in listed companies, mostly held in the AFS (Available for Sale) category and measured in terms of VaR, recorded an average level of 91 million euro in the first six months of 2012 (102 million euro at the end of 2011), with a maximum value of 101 million euro and a minimum of 68 million euro. The VaR at the end of June 2012 amounted to 80 million euro.
Lastly, an analysis of banking book sensitivity to price risk, measuring the impact on Shareholders' Equity of a price shock on the above quoted assets recorded in the AFS category shows a sensitivity to a 10% negative shock equal to -50 million euro at the end of June 2012.

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 procure funds on the market (funding liquidity risk) or liquidate its assets (market liquidity risk).
Preparing an adequate management and monitoring system for this risk is of fundamental importance in maintaining stability, not only at the level of each individual bank, but also of the market at large, given that imbalances within a single financial institution may have systemic repercussions. Such a system must be integrated into the overall risk management system and provide for incisive controls consistent with developments in the context of reference.
The "Guidelines for Group Liquidity Risk Management" approved by Intesa Sanpaolo's corporate bodies in 2011, in addition to the significant changes adopted by the Group relating to the management and monitoring of liquidity risk introduced in the "New regulations for the prudential supervision of banks and banking groups" – Circular 263 of 27 December 2006 (4th update of 13 December 2010), describe the tasks of the various company departments, 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. The key principles underpinning the Liquidity Policy of the Intesa Sanpaolo Group are:
- the existence of liquidity management guidelines approved by senior management and clearly disseminated throughout the bank;
- the existence of an operating structure that works within set limits and of a control structure that is independent from the operating structure;

- the constant availability of an adequate amount of liquidity reserves in relation to the pre-determined liquidity risk tolerance threshold;
- the assessment of the impact of various scenarios, including stress testing scenarios, on the cash inflows and outflows over time and the quantitative and qualitative adequacy of liquidity reserves;
- the adoption of a fund internal transfer pricing system that accurately incorporates the cost/benefit of liquidity, on the basis of the Intesa Sanpaolo Group’s funding conditions.

From an organisational standpoint, a detailed definition is prepared of the tasks assigned to the strategic and management supervision 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 warning indicators used to activate emergency plans.
The departments of the Parent Company that are in charge of ensuring the correct application of the Guidelines are, in particular, the Treasury Department, responsible for liquidity management, and the Risk Management Department, directly responsible for measuring liquidity risk on a consolidated basis.

With regard to liquidity risk measurement metrics and mitigation tools, in addition to defining the methodological system for measuring short-term and structural liquidity indicators, the Group also formalises the maximum tolerance threshold (risk appetite) for liquidity risk, the criteria for defining liquidity reserves and the rules and parameters for conducting stress tests.
The short-term Liquidity Policy is aimed at ensuring 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, in order to respond to periods of tension, including extended periods of tension, on the various funding sourcing markets, also by establishing adequate liquidity reserves in the form of liquid securities on private markets and securities eligible for refinancing with Central Banks. To that end, and in keeping with the liquidity risk appetite, the system of limits consists of two short-term indicators for holding periods of one week (cumulative projected imbalance in wholesale operations) and of one month (Short Term Gap).
The aim of Intesa Sanpaolo Group’s structural Liquidity Policy is to control and manage the risks deriving from the mismatch of the medium to long-term maturities of the assets and liabilities and involves the adoption of internal limits for the transformation of maturity dates aimed at preventing the medium to long-term operations from giving rise to excessive imbalances to be financed in the short term.
The Guidelines also call for the periodic preparation of an impact estimate in an acute combined stress scenario (including both stresses specific to the Group and at the level of the market) and the introduction of a target threshold for the stressed short-term gap, aimed at establishing an overall level of reserves suitable to meeting greater cash outflows during a period of time adequate to take the required operating measures to restore the Group to balanced conditions.
The 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, the immediate lines of action, and the intervention measures for the resolution of emergencies. The pre-warning indexes, aimed at spotting the signs of a potential liquidity strain, both systematic and specific, are monitored with daily frequency by the Risk Management Department.

In the first half of 2012, the Group’s liquidity position remained within the risk limits established in the Group’s Liquidity Policy both in terms of short-term and structural liquidity indicators. Adequate, timely information regarding the development of market conditions and the position of the Bank and/or Group was provided to company bodies and internal committees in order to ensure full awareness and manageability of the prevalent risk factors.
In the first half, the extensive liquidity reserves available to the Group allowed the continued use of secured funding in response to the difficulties in the orderly functioning of the interbank market. As at 30 June 2012, the liquidity reserves eligible with the various Central Banks came to 111 billion euro, of which 50 billion euro was available spot (net of the haircut) and remained unused.

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 finance transactions, hedge fund investments and transactions in derivatives with customers.

DETERMINATION OF THE FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

General principles

This chapter summarises the criteria used by the Group to measure the fair value of financial instruments. These criteria are unchanged with respect to those adopted for the previous year financial statements, details of which can be found in the Annual Report 2011.
Fair value is the amount for which an asset may be exchanged or a liability settled between knowledgeable, willing counterparties in an arm’s length transaction. Underlying the definition of fair value is an assumption that an entity is a going concern without any need to liquidate or curtail materially the scale of its operations or to undertake a transaction on adverse terms. Fair value reflects the credit quality of the instrument since it incorporates counterparty risk.
The fair value of financial instruments is determined through the use of prices obtained from financial markets in the case of instruments quoted on active markets or via internal valuation techniques for other financial instruments.
A market is regarded as active if quoted prices, representing actual and regularly occurring market transactions considering a normal reference period, are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency.
When no quote 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-offer 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 of a hypothetical arm’s length transaction, motivated by normal business considerations, as at the measurement date. Such techniques include:

- reference to market values indirectly connected to the instrument to be valued and deduced from products with the same risk profile (Comparable Approach);
- valuations performed using – even partially – inputs not identified from parameters observed on the market, which are estimated also by way of assumptions made by the valuator (Mark-to-Model).

The choice between the aforesaid methodologies is not optional, since they must be applied according to a hierarchy: absolute priority is attributed to effective market quotes (level 1) for valuation of assets and liabilities or for similar assets and liabilities measured using valuation techniques based on market-observable parameters other than financial instruments quotes (Comparable Approach - level 2) and a lower priority to assets and liabilities whose fair value is determined using valuation techniques based on non-observable and, therefore, more discretional inputs (Mark-to-Model Approach - level 3).
The valuation technique defined for a financial instrument is adopted over time and is modified only following significant changes in market conditions or the subjective conditions related to the issuer of the financial instrument.

The valuation process of financial instruments ("Fair Value Policy") entails the following phases:

- identification of the sources for measurements: for each asset class, the Market Data Reference Guide establishes the processes necessary to identify market parameters and the means according to which such data must be extracted and used;
- certification and treatment of market data for measurements: this stage consists of the accurate verification of the market parameters used (verifying the integrity of data contained on the proprietary platform with respect to the source of contribution), reliability tests (consistency of each single figure with similar or comparable figures) and verification of concrete application means;
- certification of pricing models and Model Risk Assessment: this phase is aimed at verifying the consistency and the adherence of the various measurement techniques used with current market practice, at highlighting any critical aspects in the pricing models used and at determining any adjustments necessary for measurement;
- monitoring consistency of pricing models over time: periodical monitoring of the adherence to the market of the pricing model in order to discover any gaps promptly and start the necessary verifications and interventions.

The Fair Value Policy also provides for adjustments to reflect the model risk and other uncertainties relating to valuation. In particular, model risk is represented by the possibility that the valuation of a complex instrument is materially influenced by the model chosen. Indeed, it is possible that models using price elementary instruments with the same quality may give rise to different prices for exotic instruments. In these cases, where possible, alternative models are compared, and where necessary, model inputs are subjected to stress tests, thus obtaining useful elements to quantify fair value adjustments, expressed in terms of measurable financial indicators (vega, delta, correlation shift), and periodically reviewed. These fair value adjustments, due to model risks, are part of a Mark to Market Adjustment Policy adopted for the purpose of considering, in addition to model risk described above, also other factors eligible to influence valuation and essentially attributable to:

- high and/or complex risk profile;
- position illiquidity determined by temporary or structural market conditions or in relation to the entity of exchange values held (in case of excessive concentration) and
- valuation difficulties due to the lack of liquid and observable market parameters.

For additional details on the Fair Value Policy and the fair value measurement criteria see the disclosure provided in the 2011 Annual Report.

Fair value hierarchy

The table below shows financial assets and liabilities designated at fair value through profit and loss broken down by fair value hierarchy levels.

(millions of euro)

Financial assets / liabilities at fair value	30.06.2012			31.12.2011		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	11,983	53,109	988	10,525	48,076	1,362
2. Financial assets designated at fair value through profit or loss	31,043	6,444	355	27,727	6,335	191
3. Financial assets available for sale	80,853	5,233	2,322	61,878	4,920	1,979
4. Hedging derivatives	-	11,705	3	-	10,247	1
Total	**123,879**	**76,491**	**3,668**	**100,130**	**69,578**	**3,533**
1. Financial liabilities held for trading	4,026	49,985	910	4,250	43,534	956
2. Financial liabilities designated at fair value through profit or loss	-	24,854	-	-	22,653	-
3. Hedging derivatives	-	9,851	-	-	8,567	9
Total	**4,026**	**84,690**	**910**	**4,250**	**74,754**	**965**

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

As shown in the above table, level 3 instruments, which have more discretion in fair value measurement, still account for a limited portion of the financial instruments portfolio. Conversely, approximately 61% of the financial assets measured at fair value are determined based on market prices and therefore without any discretion by the valuator.

The sensitivity analysis of level 3 financial assets and liabilities shows a 22 million euro[1] decrease in fair value, relating to complex credit derivatives, when the following parameters change:

- risk-neutral probability of default derived from market spreads (10%);
- recovery rate (from 5% to 25%, based on the type of risk of the underlying product);
- correlation between the value of collaterals present in the structure (from 25% to 80%, based on the type of risk of the underlying product);
- expected residual life of the contract (one-year increase over the expected term).

[1] This amount is shown net of adjustments to valuations relating to the main input parameters which were already considered to determine the fair value of financial instruments.

STRUCTURED CREDIT PRODUCTS

During the first six months of 2012 the portfolio management strategy continued to focus on gradually reducing exposure. In particular, it should be noted the Group's withdrawal both from risk positions classified as part of the trading book and from those classified as part of the loan portfolio.
In the first half of 2012 the contribution to profit/loss, despite the slight decrease, was an overall profit of 24 million euro, compared to 55 million euro as at 31 December 2011 and 37 million euro for the first half of 2011.
The risk exposure to structured credit products amounted to 2,284 million euro as at 30 June 2012 with respect to funded and unfunded ABSs/CDOs, compared to 2,772 million euro as at 31 December 2011, in addition to an exposure of 30 million euro with respect to structured packages (41 million euro as at 31 December 2011). The decrease in exposure during the first half of 2012 was related to the termination of a number of unfunded structures included among subprime exposures, the "Contagion Area" and "Other structured credit products – unfunded Super Senior CDOs". Added to this was the strong decline both in the exposure to securities classified under the Parent Company portfolio, down by approximately 160 million euro, and in the exposure to Banca IMI trading securities which decreased by around 180 million euro.
As at 30 June 2012 the creditworthiness of around 29.3% of outstanding positions was downgraded, the trend in this phenomenon being slower in the second half of 2012 (+3.5% compared to the previous quarter).
The situation of the structured credit product portfolio at the end of the first six months of 2012 is described by the following indicators:

- 65% of exposure was Investment Grade, lower than the figure as at 31 December 2011 (70%);
- 17% had an AAA rating and 31% had an AA rating;
- 35% had a BBB rating or less, compared to 30% as at 31 December 2011;
- approximately 10% of the exposure has a pre-2005 vintage[2];
- 36% has a 2005 vintage;
- only 10% of exposure related to the US Residential segment, and 70% to the European segment.

In terms of underlying contract types, slightly less than half the exposure consisted of CLOs (23%) and CDOs (24%); the rest was almost entirely made up of ABSs (11%) and RMBSs (35%), with CMBSs representing 8% of the total.
As concerns valuation methods, of "long" positions approximately 46% are measured using the mark-to-model (100% of unfunded positions, 36% of funded positions, 100% of positions in funds, 100% of the monoline risk and the non-monoline packages), 47% with the Comparable Approach (56% of funded positions) and 7% are measured using Effective Market Quotes (8% of funded positions). "Short" positions, made up entirely of CMBX and CDS hedges, are all measured using Effective Market Quotes.
In the summary tables provided below, table (a) sets out risk exposure as at 30 June 2012 and income statement captions (sum of realised charges and profits, write-downs and write-backs) in the first half of 2012, compared with the corresponding values recorded as at 31 December 2011.
Table (b) sets out figures related to structured packages, normally made up of an asset (security) whose credit risk is entirely hedged by a specific credit default swap. Risk exposure in the table refers to the protection seller and not to the issuer of the asset hedged.
Values expressed in USD as at 31 December 2011 were translated at an exchange rate of 1.2939 euro per dollar, and as at 30 June 2012 at an exchange rate of 1.2950 euro per dollar.

Structured credit products: summary tables

a) Exposure in funded and unfunded ABSs/CDOs

(millions of euro)

Financial assets held for trading	**30.06.2012**		**31.12.2011**	
	Risk exposure (*) (including write-downs and write-backs)	**Income Statement** Profits (Losses) on trading	**Risk exposure** (*) (including write-downs and write-backs)	**Income Statement** Profits (Losses) on trading
US subprime exposure	**9**	**-3**	**28**	**8**
Contagion area	**116**	**-4**	**162**	**24**
- Multisector CDOs	39	-4	87	11
- Alt-A	-	-	-	-
- TruPS	77	-	75	13
- Prime CMOs	-	-	-	-
Other structured credit products	**586**	**26**	**769**	**12**
- European/US ABS/CDOs	439	19	625	1
- Unfunded super senior CDOs	147	10	155	4
- Other unfunded positions	-	-3	-11	7
Total	**711**	**19**	**959**	**44**
in addition to:				
Positions of funds	-	9	-	-5
Total Financial assets held for trading	**711**	**28**	**959**	**39**

[2] Date of generation of the collateral underlying the securitisation. It is an important factor in the assessment of the risk of the mortgages underlying securitisations since, especially in the US, the phenomenon of mortgages granted to entities with inadequate income and with low prior assessment of documentation became significant as of 2005.

(millions of euro)

Loans	30.06.2012		31.12.2011	
	Risk exposure (**) (including write-downs and write-backs)	**Income Statement**	**Risk exposure** (**) (including write-downs and write-backs)	**Income Statement**
US subprime exposure	**3**	**-**	**3**	**-**
Contagion area	**55**	**-**	**63**	**-1**
- Multisector CDOs	9	-	9	-1
- Alt-A	31	-	36	-
- TruPS	-	-	-	-
- Prime CMOs	15	-	18	-
Other structured credit products	**1,515**	**-1**	**1,747**	**7**
- Funded European/US ABS/CDOs	1,116	-4	1,280	-9
- Funded super senior CDOs	399	3	467	16
- Other Romulus funded securities	-	-	-	-
Total	**1,573**	**-1**	**1,813**	**6**
in addition to:				
Positions of funds	-	-	-	-
Total Loans	**1,573**	**-1**	**1,813**	**6**
TOTAL	**2,284**	**27**	**2,772**	**45**

(*) The column "Risk exposure" sets out: for securities, fair value; for derivatives, the nominal value of the contract, net of write-downs and write-backs recorded at reference date. Such amounts correspond, for "long" positions, to the maximum potential loss (in the event of a 100% default and a recovery rate of 0). For "short" positions, vice versa, they indicate the maximum potential gain (in the same scenario in terms of default and recovery levels).

(**) For assets reclassified to loans, exposure to risk is provided by the carrying amount of the security, equal to its fair value at the reclassification date, plus accrued interest calculated at the effective interest rate net of net value adjustments to the portfolio.

b) Exposure in packages

(millions of euro)

	30.06.2012		31.12.2011	
	Credit exposure to monoline insurers (CDS fair value post write-down for CRA)	**Income Statement** Profits (Losses) on trading	**Credit exposure to monoline insurers** (CDS fair value post write-down for CRA)	**Income Statement** Profits (Losses) on trading
Monoline risk	21	-3	25	9
Non monoline packages	9	-	16	1
TOTAL	**30**	**-3**	**41**	**10**

From an income statement perspective, structured credit products generated a net income of 24 million euro as at 30 June 2012 compared to + 55 million euro for 2011.

The exposure in funded and unfunded ABSs/CDOs had an effect on "Profits (Losses) on trading – Caption 80" of 28 million euro. The profit on this segment was a result of the effects of:

– unfunded Super Senior CDO positions included in "Other structured credit products" (+10 million euro as at 30 June 2012); the good performance compared to the end of 2011 (+6 million euro) is attributable to a structure in which the risk profile has improved considerably as maturity draws near;
– European and US funded ABSs/CDOs (+19 million euro) mainly attributable to profits achieved by the subsidiary Banca IMI (+15 million euro) from partial disposal of the trading book;
– other unfunded positions (-3 million euro), also included in the area "Other structured credit products";
– the US Subprime exposure (-3 million euro), mainly attributable to funded positions included in the segment;
– instruments included in the "Contagion Area"; in detail, only the Multisector CDOs recorded a negative result of 4 million euro, offset by the positive contribution (+9 million euro) from the positions in related funds. Of these, 7 million euro referred to profits achieved as a result of the market sale of fund units included in the segment.

The securities reclassified to the loan portfolio had a negative overall impact on the income statement, as at 30 June 2012, of 1 million euro, of which +5 million euro in gains from the disposal of positions and -6 million representing impairment losses on securities issued by SPEs resident in Spain.

As at 30 June 2012 the loan portfolio contained ABSs issued by parties resident in EU countries in situations of financial difficulty (known as "PIGS"). In particular, these consist of:

– 208 million euro in nominal value of securities issued by parties resident in Spain; as at 30 June 2012 these securities had a book value of 166 million euro and a fair value of 115 million euro;

– 36 million euro in nominal value of securities issued by parties resident in Portugal; as at 30 June 2012 these securities had a book value of 32 million euro and a fair value of 18 million euro;
– 8 million euro in nominal value of securities issued by parties resident in Greece; as at 30 June 2012 these securities had a book value of 6 million euro and a fair value of 2 million euro;
– 3 million euro in nominal value of securities issued by parties resident in Ireland; as at 30 June 2012 these securities had a book value of 2 million euro and a fair value of 1 million euro.

The "Monoline risk" and "Non-monoline packages" made a negative contribution of 3 million euro as at 30 June 2012, down compared to the +10 million euro recorded at the end of 2011. The segment trend reflects the spread volatility for the counterparty on which this exposure is concentrated.

It should be noted that the "Structured credit products" aggregate was identified in 2007, immediately following the outbreak of the "subprime phenomenon" and, in disclosure to the market, has been kept essentially constant.

As at 30 June 2012, the aggregate included bonds reclassified as loans, which are summarised in the tables below.

(millions of euro)

	Nominal value	Risk exposure (*) (including write-downs and write-backs)	Fair value as at 30.06.2012	Benefit from the reclassification as at 30.06.2012	Effect on Shareholders' Equity
Reclassified securities:					
- from financial assets available for sale to loans	170	139	54		85
- from financial assets held for trading to loans	1,312	1,220	1,019	201	
Total Securities reclassified to loans	**1,482**	**1,359**	**1,073**	**201**	**85**
Securities classified under loans on initial recognition	217	214			
Total securities classified under loans on initial recogni	**217**	**214**			
TOTAL LOANS	**1,699**	**1,573**	**1,073**	**201**	**85**

(*) For assets reclassified to loans, exposure to risk is provided by the carrying amount of the security, equal to fair value at the reclassification date, plus accrued interest calculated at the effective interest rate net of net value adjustments to the portfolio.

(millions of euro)

Negative economic effect without reclassification for 2008	-299
Negative economic effect without reclassification for 2009	-7
Positive economic effect without reclassification for 2010	117
Negative economic effect without reclassification for 2011	-25
Positive economic effect without reclassification for 1st half 2012	13
BENEFIT FROM THE RECLASSIFICATION AS AT 30.06.2012	**-201**

In addition to the structured credits identified during the subprime crisis, the Group continues to invest in this type of security as part of its normal customer lending operations. In particular, securities were recorded in the loan portfolio of the conduit Duomo for a nominal value of 1,182 million euro, with underlyings originated in recent years, but not impacted by the 2007 crisis. As at 30 June 2012, there were no signs of impairment of the collateral of the structured products in question.

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 are considered Special Purpose Entities (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 (CBs), developing and/or financing specific business initiatives, undertaking leveraged buy-out transactions, or managing credit risk inherent in an entity's portfolio).

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. There have not been any changes in the consolidation criteria compared to those reported in the 2011 financial statements.

Funding SPEs

These are entities established abroad to raise funds on specific markets. The SPEs issue financial instruments, guaranteed by Intesa Sanpaolo, and transfer the funds raised to the Parent Company. The change in Italian law which enables the Parent Company Intesa Sanpaolo to directly issue hybrid notes eliminated the funding activities carried out through these methods.

There were no significant changes in the investments in this type of SPE compared to 31 December 2011.

SPEs for insurance products

These are entities (UCITS) established for the purpose of investing internal funds of unit-linked and index-linked products of the Group's insurance companies. The latter retain the majority of the risks and rewards of the companies in question and, as a consequence, are consolidated pursuant to IAS 27/SIC 12.
Compared to 31 December 2011, note the considerable increase in net total assets recorded in the first half of 2012, increasing from 16 billion euro at the end of the year to 24 billion euro as at the end of June 2012 (of which around 7 billion euro relative to funds managed by Fideuram Gestions). The effect is attributable both to the increase in the funds' investments and to the increased percentage of Group companies' investments in these funds.

Securitisation SPEs

These are SPEs that enable an entity to transfer assets from its balance sheet assets, transforming them in securities which can be placed on the market. The crisis which began in 2007 caused a sharp slowdown in this type of transactions, which were replaced by structures used for raising funds through securitisations of a portion of assets owned by the transferor. In particular, this involves the spin-off of a package of balance sheet assets (generally loans) and its subsequent transfer to a vehicle which, to finance the purchase, issues securities later placed on the market (traditional securitisations) or purchased in full by the issuer (self-securitisations). In the first case, the funds raised in this way are reversed to the seller, whereas the commitments to the subscribers are met using the cash funds generated by the loans sold. This category also includes SPEs used by Intesa Sanpaolo to implement the covered bond issue programme.
SPEs of this type, which were included in the scope of consolidation as at 30 June 2012, are the same as those reported in the financial statements as at 31 December 2011. The securitised assets of vehicles in this category are represented by performing mortgages, non-performing mortgages and lease-related performing mortgages. For the Augusto, Colombo and Diocleziano vehicles the assets were made up of land financing or receivables for public works.
During the first half of 2012, Intesa Sanpaolo repurchased the class A of the Adriano Finance (series 1) securitisation from the vehicle ISP CB Ipotecario for 4.3 billion euro. As a consequence, to compensate for the reduction in the cover pool resulting from this repurchase and in consideration of the overcollateralisation and the requirement for compliance with the tests established under the programme secured by mortgages, certain covered bond series were terminated ahead of maturity that were originally purchased under the programme, for a total amount of 5.6 billion euro.
In February all the covered bond issues under the programme were downgraded by Moody's (from Aa1 to Aa2) because, after Italy's downgrading from A3 to A2, it was no longer possible to maintain an Aa1 rating on covered bonds issued by an Italian bank.
Given the recent downgradings of both Italy and Intesa Sanpaolo, the Group decided to rationalise its securitisation transactions and CB issue programmes.
In June 2012, Intesa Sanpaolo offered the holders of covered bonds (CB) guaranteed by the vehicle ISP CB Pubblico S.r.l. the opportunity to exchange their bonds with new ones guaranteed by the vehicle ISP CB Ipotecario S.r.l., which have a higher rating.
In particular:

– the 2 billion euro issue (yield 3.25% and maturity 28 April 2017), guaranteed by ISP CB Pubblico, was exchanged with a new issue guaranteed by ISP CB Ipotecario, with the same yield and maturity date. The exchange price was 100. The trade, concluded in early July, resulted in the issue of 1.8 billion euro in new securities;
– the 1.5 billion euro issue (yield 5% and maturity 27 January 2021), guaranteed by ISP CB Pubblico, was exchanged with a new issue guaranteed by ISP CB Ipotecario, with the same yield and maturity date. The exchange price was 100. The trade, concluded in early July, resulted in the issue of 1.3 billion euro in new securities;

At the same time as the exchange offer, the Group also proposed the introduction of certain changes to the ISP CB Pubblico covered bond programme, approved at the beginning of July by holders of the covered bonds in question.
Also in the first half of the year, the Parent Company repurchased the mortgage portfolio transferred to the Adriano Finance 2 vehicle, with subsequent early settlement of the self-securitisation. Then in reference to the securitisation implemented through the vehicle Intesa SEC 2 S.p.A., the Group decided to exercise the clean-up call option, i.e. to settle the transaction.
In June the new multi-originator CB issue programme was launched, secured by mortgages totalling 30 billion euro. Designed for retained issues, the programme is unrated and therefore the securities issued benefit from the rating of the issuer, Intesa Sanpaolo. The inaugural issues, for a total of around 12 billion euro, are at floating rate with an approximate 2 year duration, listed on the Luxembourg Stock Exchange and characteristics offering eligibility for transactions on the Eurosystem.
The programme is collateralised by mortgages granted by Intesa Sanpaolo (approximately 8 billion euro in residual debt at the time of transfer), mostly those deriving from the partially settled Adriano Finance 2 self-securitisation, as well as by mortgages granted by Banco di Napoli (around 5 billion euro in residual debt at the time of transfer).

Pursuant to SIC 12, Intesa Sanpaolo controls two conduits, Romulus Funding Corporation and Duomo Funding Plc..
The total assets of the vehicle Romulus include receivables from Duomo for 1,908 million euro. The remainder of the vehicle's assets refer to cash and other assets for 2 million euro. The vehicle has issued securities for a total of 1,886 million euro.
With regard to the portfolio of the vehicle Duomo, as at 30 June 2012 – in addition to receivables from Group banks for a total of 712 million euro – this portfolio includes loans to customers for 1,097 million euro. In portfolio, the vehicle holds quotas of a mutual fund originated by an Intesa Sanpaolo Group company with a value of 145 million euro as at 30 June 2012.
Compared to the information already provided in the 2011 financial statements, note:

– the increase to 1,182 million euro (762 million euro as at the end of 2011) in structured securities subscribed as part of normal lending to customers, the collateral on which has shown no signs of impairment;
– the portfolio concentration of the two vehicles mainly with underlyings originated in Italy;
– the confirmation of the good rating of the loan exposures.

Financial Engineering SPEs

These SPEs carry out investment and funding transactions that achieve better risk/return combinations than those generated by standard transactions, through their special structures aimed at optimising accounting, tax and/or regulatory aspects. These structures have been set up to respond to the needs of primary customers and provide solutions that offer financing at competitive interest rates and investments with higher returns.

In June 2012 the Management Board of Intesa Sanpaolo resolved on the merger by incorporation of the only vehicle of this kind, Intesa Investimenti S.p.A., as the vehicle has now completed its mission and is essentially inactive.
The Lunar Funding vehicle, however, is still included in the scope of consolidation.

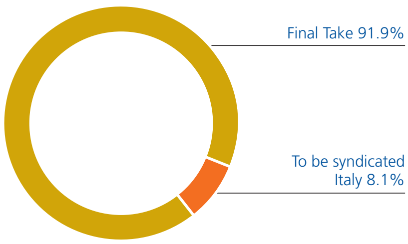
Other unconsolidated Special Purpose Entities

With regard to the other unconsolidated SPEs (Project Financing, Asset Backed and Credit Derivatives) reference should be made to the financial statements as at 31 December 2011. For the Asset Backed SPEs in which the Group has the majority of voting rights, held by just one international subsidiary, total assets fell to 46 million euro (44 million euro in December 2011). In fact, almost all the SPEs in this category were merged by incorporation into the subsidiary holding the related equity investments.
For operations involving the vehicles used for Leveraged & Acquisition Finance transactions a description is provided in the sections below.

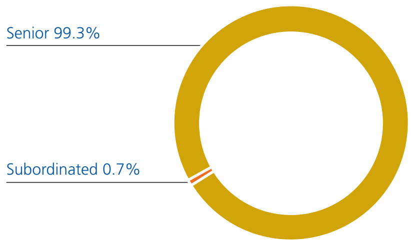
LEVERAGED FINANCE TRANSACTIONS

Since there is no univocal and universally agreed-upon definition of leveraged finance transactions, Intesa Sanpaolo decided to include in this category the exposures (loans granted and disbursed in relation to structured financing operations, normally medium/long term) to legal entities in which the majority of share capital is held by private equity funds.
These are mainly positions in support of Leveraged Buy Out projects (therefore with high financial leverage), i.e. linked to the full or partial acquisition of companies through recourse to SPEs created for this purpose. After acquisition of the target company's shares/quotas package, these SPEs are normally merged into the target. The target companies generally have good economic prospects, stable cash flows in the medium term and low original leverage levels. Intesa Sanpaolo has financed entities of this type, as normal borrowers, without acting as sponsor.
None of these SPEs is consolidated, since the guarantees to support the transaction are solely instrumental for the granting of the financing and are never directed to the acquisition of direct or indirect control over the vehicle.
As at 30 June 2012, 116 transactions for a total amount granted of 4,278 million euro met the above definition.
These exposures are classified under the loans portfolio. They also include the portions of syndicated loans underwritten or under syndication. In line with disclosure requirements, breakdown of exposures by geographical area, economic sector and by level of subordination is set out below.

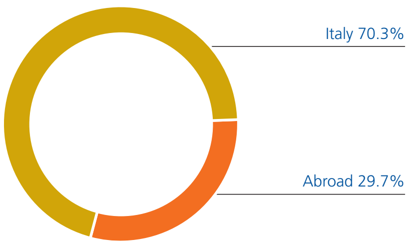
Breakdown by type of risk



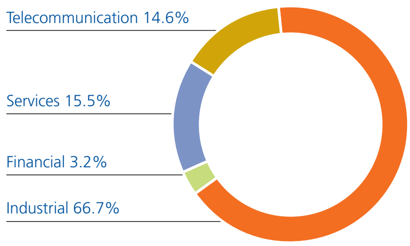
Breakdown by subordination level



Breakdown by geographical area



Breakdown by economic sector



INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The hedge fund portfolio as at 30 June 2012 totalled 682 million euro, compared to the 665 million euro recorded at the end of 2011. The increased value of this portfolio in the first half of 2012 can be largely attributed to the write-down of positions expressed in foreign currencies.
As at the same date, there was an overall gain of 28 million euro, a sharp improvement compared both to the end of 2011 (-114 million euro) and to the end of the first half of 2011 (-24 million euro).
During the first half of the year there were no significant changes in the portfolio's strategic asset allocation, which still remains prevalently geared towards benefiting from the implementation of specific corporate events, also partly independent from the general market trend. However, the exposure to the Global Macro strategy, with underlying investments made on the basis of global macro-economic trend forecasts, was increased.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering only relations with customers, as at 30 June 2012, 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 7,375 million euro (3,818 million euro as at 31 December 2011). The notional value of such derivatives totalled 58,423 million euro (50,708 million euro as at 31 December 2011). Of these, notional value of plain vanilla contracts was 52,310 million euro (44,113 million euro as at 31 December 2011), and of structured contracts was 6,113 million euro (6,595 million euro as at 31 December 2011).
Please note that the fair value of structured contracts outstanding with the 10 customers with the highest exposures was 377 million euro (335 million euro as at 31 December 2011). The same indicator, referred to the total contracts with a positive fair value, was 4,684 million euro.
Conversely, negative fair value determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 1,316 million euro, again as at 30 June 2012 (960 million as at 31 December 2011).
The notional value of such derivatives totalled 17,562 million euro (14,751 million euro as at 31 December 2011). Of these, notional value of plain vanilla contracts was 15,928 million euro (13,690 million euro as at 31 December 2011), and of structured contracts was 1,634 million euro (1,061 million euro as at 31 December 2011).
The fair value of derivative financial instruments stipulated with customers was determined considering, as for all other OTC derivatives, the creditworthiness of the single counterparty ("Credit Risk Adjustment"). With regard to contracts outstanding as at 30 June 2012, this led to a negative effect of 51 million euro being recorded under "Profits (Losses) on trading" in the income statement.
As concerns the means of calculation of the aforesaid Credit Risk Adjustment and, in general, the various methodologies used in the determination of the fair value of financial instruments, see the specific paragraphs in this chapter.
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 defined as the risk of suffering losses due to inadequacy or failures of processes, human resources and internal systems, or as a result of external events. Operational risk includes legal risk, that is, the risk of losses deriving from breach of laws or regulations, contractual, out-of-contract responsibilities or other disputes; strategic and reputation risks are not included.
The Intesa Sanpaolo Group has for some time defined the overall operational risk management framework by setting up a Group policy and organisational processes for measuring, managing and controlling operational risk.
With regard to Operational Risk, the Group has adopted the Advanced Measurement Approaches (AMA – internal model) to determine the associated capital requirement for regulatory purposes:

- effective from 31 December 2009, for an initial set including the Organisational Units, Banks and Companies of the Banca dei Territori Division (excluding network banks belonging to Cassa di Risparmio di Firenze Group, but including Casse del Centro), Leasint, Eurizon Capital and VUB Banka;
- effective from 31 December 2010, for a second set of companies within the Corporate and Investment Banking Division, in addition to Setefi, the remaining banks of the Cassa di Risparmio di Firenze Group and PBZ Banka;
- effective from 31 December 2011, for a third set including Banca Infrastrutture Innovazione e Sviluppo.

The remaining companies, currently using the Standardised approach (TSA), will migrate progressively to the Advanced approaches starting from the end of 2012, based on the roll-out plan presented to the Management and Supervisory Authorities.

The control of the Group’s operational risks was attributed to the Management Board, which identifies risk management policies, and to the Supervisory Board, which is in charge of their approval and verification, as well as of the guarantee of the functionality, efficiency and effectiveness of the risk management and control system.
The tasks of the Group Compliance and Operational Risk Committee include periodically reviewing the overall operational risk profile, authorising any corrective measures, coordinating and monitoring the effectiveness of the main mitigation activities and approving operational risk transfer strategies.
The Group has a centralised function within the Risk Management Department for management of the Group’s operational risk. This function is responsible for the definition, implementation, and monitoring of the methodological and organisational framework, as well as for the measurement of the risk profile, the verification of mitigation effectiveness and reporting to Top Management.
In compliance with current requirements, the individual Organisational Units are responsible for identifying, assessing, managing and mitigating risks. Specific officers and departments have been identified within these business units to be responsible for Operational Risk Management (collection and structured census of information relative to operational events, scenario analyses and evaluation of the business environment and internal control factors).
The Integrated self-assessment process, conducted on an annual basis, allows the Group to:

- identify, measure, monitor and mitigate operational risk through identification of the main operational problem issues and definition of the most appropriate mitigation actions;
- create significant synergies with the specialised functions of the Organisation and Security Department that supervise the planning of operational processes and business continuity issues and with control functions (Compliance and Audit) that supervise specific regulations and issues (Legislative Decree 231/01, Law 262/05) or conduct tests of the effectiveness of controls of company processes.

The Self-assessment process identified a good overall level of control of operational risks and contributed to enhancing the dissemination of a business culture focused on the ongoing control of these risks.
The process of collecting data on operational events (in particular operational losses, obtained from both internal and external sources) provides significant information on the exposure. It also contributes to building knowledge and understanding of the exposure to operational risk, on the one hand, and assessing the effectiveness or potential weaknesses of the internal control system, on the other hand.
The internal model for calculating capital absorption is conceived in such a way as to combine all the main sources of quantitative (operational losses) and qualitative information (self-assessment).
The quantitative component is based on an analysis of historical data concerning internal events (recorded by organisational units, appropriately verified by the central function and managed by a dedicated IT system) and external events (by the Operational Riskdata eXchange Association).
The qualitative component (scenario analyses) focuses on the forward-looking assessment of the risk exposure of each unit and is based on the structured, organised collection of subjective estimates expressed directly by management (subsidiaries, Parent Company’s business areas, the Corporate Centre) with the objective of assessing the potential economic impact of particularly serious operational events.
Capital-at-risk is therefore identified as the minimum amount at Group level required to bear the maximum potential loss (worst case); Capital-at-risk is estimated using a Loss Distribution Approach model (actuarial statistical model to calculate the Value-at-risk of operational losses), applied on quantitative data and the results of the scenario analysis assuming a one-year estimation period, with a confidence level of 99.90%; the methodology also applies a corrective factor, which derives from the qualitative analyses of the risk level of the business environment, to take account of the effectiveness of internal controls in the various organisational units.
Operational risks are monitored by an integrated reporting system, which provides management with support information for the management and/or mitigation of the operational risk.
In order to support the operational risk management process on a continuous basis, a structured training programme was fully implemented for employees actively involved in this process.
In addition, the Group has activated a traditional operational risk transfer policy (to protect against offences such as employee disloyalty, theft and theft damage, cash and valuables in transit losses, computer fraud, forgery, earthquake and fire, and third-party liability), which contributes to mitigating exposure to operational risk, although it does not have an impact in terms of capital requirements. The deductible and limit of liability levels have already been changed and the internal model insurance mitigation component will be submitted for regulatory approval in 2012.
To determine its capital requirements, the Group employs a combination of the methods allowed under applicable regulations. The capital absorption resulting from this process amounts to 1,990 million euro as at 30 June 2012 (1,986 million as at 31 December 2011 essentially unchanged as at 31 March 2012).

Legal risks

Legal risks are thoroughly and individually analysed by both the Parent Company and the individual Group companies concerned. Provisions are made to the Allowances for risks and charges when there are legal obligations that are likely to result in a financial outlay and where the amount of the disbursement may be reliably estimated.
During the first six months of 2012, no new significant legal procedures were commenced and there were no important developments with respect to those underway. Though reference should be made to the Notes to the 2011 consolidated financial statements for a more detailed description of the litigation regarding bonds in default, the insolvency of the Cirio Group, the tax-collection litigation with the former Gest Line, the Angelo Rizzoli litigation, the Allegra Finanz AG dispute and labour litigation, the issues recording certain developments during the half year are described below.

With regard to the dispute relating to anatocism in particular, after March 1999, the Italian Court of Cassation reversed its stance and found the quarterly capitalisation of interim interest payable on current accounts to be unlawful, on the grounds that the relevant clauses in bank contracts do not integrate the contract with a "regulatory" standard practice, but merely with a "commercial" practice, and therefore such clauses are not adequate to derogate from the prohibition of anatocism pursuant to Art. 1283 of the Italian Civil Code.
The subsequent Legislative Decree 342 of 1999 confirmed the legitimacy of interim capitalisation of interest on current accounts, as long as interest is calculated with the same frequency on deposits and loans. From April 2000 (the date on which this regulation came into effect), quarterly capitalisation of both interest income and expense was applied to all current accounts.
Therefore the dispute on this issue concerns only those contracts which were stipulated before the indicated date.
In the judgment no. 24418 handed down by its Joint Sections on 2 December 2010, the Court of Cassation again made its voice heard on the matter, finding any form of capitalisation of interest to be unlawful and further ruling that the ten-year term of prescription applicable to account-holders' entitlement to reimbursement of unduly paid interest begins to toll on the date the account is closed, if the account had an overdraft facility and the facility's limit was respected, or on the date on which deposits were made to cover part or all of previous interest debits if the account was drawn beyond such limits or did not have an overdraft facility.
Although the application of such principles is limited to contracts entered into prior to 2000, it is not believed possible to prepare a general, a priori estimate of the impact that this judgment may have on ongoing litigation, given that a case-by-case assessment is instead required.
With Law Decree 225 of 29 December 2010, enacted, with amendments, as Law 10/2011, the legislator set forth an official interpretation, establishing that the term of prescription of rights arising from account entries begins to toll on the date of the entry itself and thus, for anatocistic interest, on the date of each individual account debit.
The constitutionality of this regulation was subsequently challenged. The Constitutional Court ruling of 2 April 2012 accepted the exception, repealing the aforementioned provision. Based on the effective date of the prescription, the legislative principles pronounced by the Joint Sections of the Court of Cassation in 2010 are once again applicable.
The overall number of pending cases is at a non insignificant level in absolute terms, and is the subject of constant monitoring. The risks related to these disputes are covered by specific, adequate provisions to the allowances for risks and charges.
Regarding the Codacons class action, it should be remembered that on 5 January 2010, Codacons, acting on behalf of a single account holder, served Intesa Sanpaolo with a writ of summons for a class-action suit pursuant to art. 140-*bis* of Legislative Decree 206/2005 (Consumer Code).
The suit, brought before the Court of Turin, seeks a finding that the new fee structure introduced by the Bank to replace the overdraft charges is unlawful and, accordingly, a sentence ordering the Bank to provide compensation for the alleged damages, which may also be determined on an equitable basis, suffered by the claimant (who has quantified them at 1,250 euro) and all other customers in the same class who elect to participate in the initiative.
On 4 June 2010, the Court of Turin filed an order stating the inadmissibility of such class action. The order was appealed before the Turin Court of Appeal, which in an order filed on 25 October 2010 rejected the appeal. Codacons challenged this last decision by appeal brought before the Court of Cassation, which by ruling no. 9772 filed on 14 June 2012 rejected the appeal as inadmissible.

With reference to the Altroconsumo class action, on 17 November 2010, the association Altroconsumo, acting on behalf of three account holders, served Intesa Sanpaolo with a writ of summons for a class-action suit pursuant to art. 140-*bis* of Legislative Decree 206/2005 (Consumer Code).
The suit originally sought a finding that application of overdraft charges and the new fee for overdrawing accounts without credit facilities in place is unlawful. It also sought an inquiry into whether the "threshold rate" set out in Law 108/96 (usury) has been exceeded and a sentence enjoining the restitution of any amounts collected by the Bank in excess of that threshold. The claim had been quantified at a total of 456 euro in connection with the three accounts cited in the suit.
By order of 28 April 2010, the Court of Turin declared the suit inadmissible. Following the complaint filed by the plaintiffs, the Turin Court of Appeal, by order of 16 September 2011, overturned the previous order, declaring the suit admissible as limited solely to account overdraft charges applied effective 16 August 2009. The Bank appealed against this ruling before the Court of Cassation, which is expected to pronounce upon the underlying reasons for the appeal.
The class action was therefore re-opened before the Court which by order filed on 15 June 2012 established the advertising terms and methods for the joinder of class action participants, setting the date of the hearing for continuation of the proceedings as 14 March 2013.
With respect to the merits of the dispute – which will be examined only after the aforementioned hearing – it is believed that the Bank has valid arguments in support of the legitimacy of the account overdraft charge.

The criminal investigation instigated by the New York District Attorney's Office and the Department of Justice aimed at verifying the methods used for clearing through the United States of payments in dollars to/from countries embargoed by the US government in the years from 2001 to 2008, an update on which has been provided each year in the Notes to the consolidated financial statements, was concluded in the Bank's favour on 19 June 2012.

On 3 April 2012, the Bank was notified that the Department of Justice had decided to drop the proceedings, having found no sufficient evidence to justify the infliction of any criminal sanctions. A little more than two and a half months later, and for the same reasons, the New York District Attorney's Office decided to close the investigation.
As regards the transactions in question (the handling of bank transfers in dollars through the SWIFT interbank payments service, cleared through US banks), the Bank remains subject to assessments still in progress by the OFAC (Office of Foreign Assets Control), the authority of the United States Department of the Treasury responsible for foreign exchange control.
Parallel administrative proceedings are also still pending, initiated in March 2007 by the US banking supervisory authorities that, having found certain weaknesses in 2006 in the anti-money laundering systems of the New York branch, requested a series of actions (already implemented) to strengthen the anti-money laundering procedures and an examination of the payment traffic of the first half of 2006 by an independent consultant to verify the existence of any violation of the local anti-money laundering and embargo regulations.
While a settlement agreed by the OFAC and the banking supervisory authorities could still theoretically involve the payment of a fine by ISP, available information does not allow a forecast of the timing, outcome and amount of the possible fine.

Banca Infrastrutture Innovazione e Sviluppo (BIIS), as the successor to Banca OPI, was involved in a case pending before the Court of Taranto brought by the Municipality of Taranto in relation to the subscription in May 2004 by Banca OPI of a 250 million euro bond issued by the Municipality.
In its judgement of 27 April 2009, the Court declared the invalidity of the operation, ordering the Bank to reimburse, with interest, the partial repayments of the loan made by the Municipality of Taranto. The latter was ordered to reimburse, with interest, the loan granted. Lastly, the Court ordered compensation for damages in favour of the Municipality, to be calculated by separate proceedings.
The Municipality and the Bank jointly agreed not to enforce the judgement.
On 20 April 2012 the Court of Appeal, without prejudice to the findings of the separate proceedings regarding the alleged damages, partially reformulated the first instance ruling by ordering that:
- BIIS reimburse the sums paid by the Municipality of Taranto, plus legal interest;
- the Municipality of Taranto reimburse BIIS for the sums disbursed in execution of the bond loan, less amounts already repaid, plus legal interest and currency appreciation corresponding with the difference between the net rate of return on government bonds and the reasonable assessment of legal interest;
- BIIS reimburse the Municipality for first instance legal costs, compensated against those for the appeal.

In the meantime, the insolvency procedure entity for the Municipality of Taranto informed BIIS that the Municipality's debt to the Bank for the repayment of the 250 million euro bond had been added to "the insolvency procedures' list of debts". The fact that the Municipality's debt to the Bank has been included in the insolvency procedure's "list of debts" instead of in the "rebalanced financial statements" does not, in and of itself, have consequences for the Bank's right to repayment of its loan to the Municipality and, accordingly, on the position's risk profile. The Bank nonetheless appealed the judgment before the Regional Administrative Court of Puglia, which found the appeal inadmissible, ruling that the dispute fell within the jurisdiction of the civil courts and establishing – albeit on an incidental basis – that the appealed judgment was devoid of dispositional content and was thus incapable of undermining the Banks' credit claims.

In November 2006 the Piemonte Regional Government issued two bond loans with bullet repayments for a total of 1,856 million euro, of which 430 million euro in bonds subscribed by the former Banca OPI, now BIIS (the remainder subscribed by two leading international financial institutions). Under the terms of these issues and in compliance with law, the Regional Government finalised two derivative financial instrument transactions subscribed by the former Banca OPI for a notional amount of 628 million euro, together with the other two lending banks.
At the beginning of 2011 the Regional Government launched verification and comparison proceedings with the banks concerned to assess the financial and legal profiles of the swap transactions. BIIS provided all the necessary clarification through studies assigned to expert external consultants on the various issues. The studies confirmed the technical fairness of the signed contracts and their full compliance with the legal framework.
In July 2011 the Piemonte Regional Government notified BIIS of the launch of self-protection proceedings with a view to annulment and/or cancellation of all administrative documents based on assumption, consequent to or in any event associated with the derivative contracts finalised between the Regional Government and the Bank in 2006. The Bank prepared and filed a document containing its exhaustive counterclaims to these proceedings, and on 10 August 2011, acting in concert with another bank, filed a special claim form with the High Court of the Royal Courts of Justice in London for ascertainment of the validity and fairness of the derivatives signed with the Regional Government given that the related contracts are governed by British law.
In January 2012 the Regional Government arranged the cancellation of its own action regarding the derivative contracts. On 30 January 2012 BIIS therefore informed the Piemonte Regional Government of the claim form that had been filed with the High Court of the Royal Courts of Justice in London, with the effect of instigating the related proceedings and devolvement to the British court of the decision regarding the validity of the derivative contracts in question and any related jurisdictional issues.
Appealing against the action taken by the Regional Government to conclude the self-protection proceedings, BIIS (with another bank) also filed an appeal before the Piemonte Regional Administrative Court in Turin, requesting annulment subject to suspension of the prejudicial effects of the proceedings.
At the Regional Administrative Court hearing of 19 April 2012 the banks waived their injunction claim in view of the hearing to discuss the merits being set for 8 November 2012
With reference for the proceedings before the British courts, to date the Piemonte Regional Government has not filed its appearance despite the deadline for doing so having passed. This does not exclude their option of doing so at any time during the course of proceedings.
Furthermore, in the meantime the Piemonte Regional Government has not complied with the netting payment due on 27 May 2012 in relation to one of the two swap contracts. Given this failure to pay, pursuant to ISDA documentation, on 10 July 2012 the Bank served Notice of Failure to Pay, inviting the Regional Government to arrange payment within the three business days thereafter, to which there was no reply.

In this context, with regard to the consequences of the self-protection cancellation arrangements adopted by the Piemonte Regional Government and the Bank's risk of a negative outcome in the proceedings brought before the Piemonte Regional Administrative Court, external legal experts have pointed out that: (i) at present the cancellation proceedings have no effect on the existence of the swap contracts, which in any event remain fully valid between the Region and the Bank until such a time as the competent civil court pronounces it null, (ii) the risk of a negative outcome for the Bank in the proceedings before the Piemonte Regional Administrative court can be considered remote.
In the light of these conclusions, agreed with the relevant Departments of the Bank, it was not deemed appropriate at present to propose a precautionary allocation to reserves.

Tax litigation
With regard to pending tax litigation and the related risks and provisions, detailed information is provided in the Notes to the 2011 consolidated financial statements.
In relation to Intesa Sanpaolo tax litigations, as at 30 June 2012 there are three aspects worth specific mention:
The first regards the negative first instance ruling of the Milan Provincial Tax Committee, which unexpectedly confirmed the IRES tax recovery claimed by the Agenzia delle Entrate – Italian Revenue Agency to be unlawful in relation to the sale without recourse of loans to the company Castello Finance in 2005 by ISP and Intesa Gestione Crediti. An appeal was naturally filed against this ruling.
The second event, on the other hand, involves the positive outcome at appeal before the Regional Tax Committee of Turin, in the matter of the stamp duty in relation to the compulsory accounting figures for the years 2005 and 2006, with regard to which the legitimacy has ultimately been recognised of the Bank's actions in preparing a hard copy of the journal ledger for the daily totals of the individual general ledger accounts, whereas the individual entries recorded were considered absolutely irrelevant for such purpose.
Lastly, the third refers to the similarly positive outcome at appeal, again before the Regional Tax Committee of Turin, regarding recognition of the tax relevance of loans deriving from repurchase agreements to the effects of calculation of the ceiling on the write-down of losses in relation to 2003. However, this favourable case law guidance did not stop the negative first instance outcome of a similar litigation regarding 2005 from continuing to be seen as such.
Two other legal outcomes should also be specifically mentioned, these against two Italian companies in the Group.
This case refers to the confirmation obtained in first instance proceedings before the Milan Provincial Tax Committee of the findings against Intesa Sanpaolo Private Banking regarding reclassification as goodwill of costs incurred as remuneration for the provision of presentation services to customers, which the Agenzia delle Entrate – Italian Revenue Agency claims are equivalent to a case of business unit transfer.
The other notice concerns Banca IMI's recourse against 2003 findings, which at appeal saw a worsening of the previous outcome, which had already been negative on other aspects, by confirming: i) the lawful nature of the unpaid revenue agency demand, also with regard to the presumed loan on the quota of dividends distributed by an international subsidiary, and ii) the withholding tax obligation on the manufactured dividend paid to foreign banking counterparties, and on the liability for related sanctions which were instead disregarded – due to objective uncertainty concerning the reference regulations – at the first instance proceedings. The Company filed an appeal against this ruling before the Court of Cassation.
Furthermore, in the final few days of the half year a decision was reached by the administrative court on the tax litigation brought against Fideuram Investimenti SGR, in accordance with the criteria of convenience recorded in the 2011 year-end reporting.

Lastly, with regard to investigations by the Public Prosecutor's Office of Biella into the alleged tax irregularities committed by Cassa di Risparmio di Biella e Vercelli when it was a member of the Intesa Sanpaolo Group, it should be emphasised that these relate to transactions completed in 2006 considered by the competent offices of the Bank to be fully compliant with the civil and tax regulations in force.
Note that the tax litigation in question is included among those already settled with the Agenzia delle Entrate - Italian Revenue Agency, disclosure of which was also made in the Notes to the 2011 consolidated financial statements. The settlement of the aforementioned litigations was agreed, though fully confident of the fairness of its operations, based on the inappropriateness of nurturing litigations that are time-consuming and costly.

INSURANCE RISKS

Life business

The typical risks of a life insurance portfolio can be divided into three main categories: premium risks, actuarial and demographic risks and reserve risks.
Premium risks are managed initially during definition of the technical features and product pricing, and over the life of the instrument by means of periodic checks on the sustainability and profitability (both at product level and at portfolio level, including liabilities).
Actuarial and demographic risks are guarded against by a regular statistical analysis of the evolution of liabilities, divided by type of risks and through simulations of expected profitability on the assets which cover technical reserves.
Reserve risk is managed through the exact calculation of mathematical reserves, with a series of detailed checks as well as overall verifications, by comparing results with the estimates produced on a monthly basis.
The mathematical reserves are calculated on almost the entire portfolio, on a contract-by-contract basis, and the methodology used to determine the reserves takes account of all the future commitments of the company.

Non-life business

The risks of the non-life insurance portfolio are essentially premium risk and reserve risk.
Premium risks are managed initially during definition of the technical features and product pricing, and over the life of the instrument by means of periodic checks on sustainability and profitability (both at product level and at portfolio level, including liabilities).
Reserve risk is guarded against through the exact calculation of technical reserves.

Financial risks

In line with the growing focus in the insurance sector on the issues of value, risk and capital in recent years, a series of initiatives has been launched with the objective of both strengthening risk governance and managing and controlling financial risks.
With reference to investment portfolios, set up both as coverage of obligations with the insured and in relation to free capital, the Investment Framework Resolution is the main control and monitoring instrument for market and credit risks.
The Resolution defines the goals and the operating limits that are needed to distinguish the investments in terms of eligible assets and asset allocation, breakdown by rating classes and credit risk, concentration risk by issuer and sector, market risks, in turn measured in terms of sensitivity to variations in risk factors and Value at Risk on a 1-month holding period.

Investment portfolios

The investments of the insurance companies of Intesa Sanpaolo Group (Intesa Sanpaolo Vita, Intesa Sanpaolo Assicura, Intesa Sanpaolo Life and Fideuram Vita) are made with their free capital and to cover contractual obligations with customers. These essentially refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies.
As at 30 June 2012, the investment portfolios of Group companies, recorded at book value, amounted to 78,475 million euro; of these, the share regarding traditional revaluable life policies, non-life policies and free capital (Class C portfolio or portfolio at risk) amounted to 45,387 million euro, while the other component (Class D portfolio or portfolio with total risk retained by the insured) mostly comprised investments related to pension funds, index- and unit-linked policies and totalled 33,088 million euro.
Considering the various types of risks, the analysis of investment portfolios, described below, concentrates on the assets included in the "portfolio at-risk".
In terms of breakdown by asset class, net of derivative positions, 94.0% of assets, i.e. approximately 42,966 million euro, were bonds, while assets subject to equity risk represented 1.6% of the total and amounted to 719 million euro. The remaining part (2,000 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (4.4%).
The carrying value of derivatives came to approximately -298 million euro, almost entirely relating to hedging derivatives, with effective management derivatives[3] only amounting to around -22 million euro.

At the end of the first six months of 2012, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 2,271 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 83 million euro.
The modified duration of the bond portfolio, or the synthetic financial term of assets, is approximately 5 years. The reserves relating to the revaluable contracts under Separate Management have an average modified duration of approximately 5.7 years. The related portfolios of assets have a modified duration of around 4.6 years.
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 2,034 million euro. On the basis of this hypothetical scenario, the value of hedging derivatives in the portfolio undergoes an approximate 122 million euro rise which partly offsets the corresponding loss on the bonds.

[3] ISVAP Regulation 36 of 31/01/2011 on investments defines effective management derivatives as 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.

The investment portfolio has a good credit rating. AAA/AA bonds represented approximately 6.2% of total investments and A bonds approximately 78.3%. Low investment grade securities (BBB) were approximately 7.3% of the total and the portion of speculative grade or unrated was minimal (approximately 2.2%). 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 71.5% of the total investments, while financial companies (mostly banks) contributed almost 18.8% of exposure and industrial securities made up approximately 3.7%.
At the end of the first half of 2012, 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 2,235 million euro, with 1,808 million euro due to government issuers and 427 million euro to corporate issuers (financial institutions and industrial companies).