Part E – Information on risks and relative hedging policies

SECTION 1 – RISKS OF THE BANKING GROUP

The Intesa Sanpaolo Group attaches great importance to risk management and control as conditions to ensure reliable and sustainable value creation in a context of controlled risk, where capital adequacy, earnings stability, liquidity and a strong reputation are key to protecting current and prospective profitability.
The risk management strategy aims to achieve a complete and consistent overview of risks, given both the macroeconomic scenario and the Group's risk profile, by fostering a culture of risk-awareness and enhancing the transparent representation of the risk level of the Group's portfolios.
The efforts of recent years to secure the Supervisory Authority's validation of internal models for credit, operational, market and credit derivative risk should be seen in this context.
The definition of the Risk Appetite Framework and the resulting operating limits related to market risk indicators, the use of risk measurement instruments in granting and monitoring loans and controlling operational risk and the use of capital at risk measures for management reporting and assessment of capital adequacy within the Group represent fundamental milestones in the operational application of the strategic and management guidelines defined by the Supervisory Board and the Management Board along the Group's entire decision-making chain, down to the single operating units and to the single desk.
The main principles in risk management and control are:
– clear identification of responsibility for acceptance of risk;
– measurement and control systems in line with international best practices;
– organisational separation between the functions that carry out day-to-day operations and those that carry out controls.

The policies relating to the acceptance of risks are defined by the Supervisory Board and the Management Board of the Parent Company with support from specific operating Committees, the most important of which is the Control Committee, and from the Group Risk Governance Committee and Chief Risk Officer reporting directly to the Chief Executive Officer. The Chief Risk Officer is responsible for proposing the Risk Appetite Framework, setting the Group's risk management, compliance and legal guidelines and policies in accordance with company strategies and objectives and coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, including within the various corporate departments. The Chief Risk Officer ensures oversight of the Group's overall risk profile by establishing methods and monitoring exposure to the various types of risk.
Assessments of each single type of risk for the Group are integrated in a summary amount – the economic capital – defined as the maximum "unexpected" loss the Group might incur over a year. This is a key measure for determining the Group's financial structure and its risk tolerance, and guiding operations, ensuring the balance between risks assumed and shareholder return. 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 normal 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.
The Group sets out these general principles in policies, limits and criteria applied to the various risk categories and business areas with specific risk tolerance sub-thresholds, in a comprehensive framework of governance, control limits and procedures.
The risks identified, covered and incorporated within the economic capital, considering the benefits of diversification, are as follows:
– credit and counterparty risk. This category also includes concentration risk, country risk and residual risks, both from securitisations and uncertainty on credit recovery rates;
– market risk (trading book), including position, settlement and concentration risk on the trading book;
– financial risk of the banking book, mostly represented by interest rate and foreign exchange rate risk;
– operational risk, including legal risk;
– strategic risk;
– risk on equity investments not subject to line by line consolidation;
– risk on real estate assets owned for whichever purpose;
– insurance risk.

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.
Particular attention is dedicated to managing the short-term and structural liquidity position by following specific policies and procedures to ensure full compliance with the limits set at the Group level and operating sub-areas in accordance with international regulations and the risk appetite approved at the Group level.
The Group also intends to maintain adequate levels of protection against reputation risk so as to minimise the risk of negative events that might jeopardise its image. To that end, it has embarked upon an ex-ante risk management process to identify the major reputation and compliance risks for the Group, define prevention and mitigation tools and measures in advance and implement specific, dedicated reporting flows.

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. For the main Group subsidiaries, these functions are performed, on the basis of an outsourcing contract, by the Parent Company's risk control functions, which periodically report to the Board of Directors and the Audit Committee of the subsidiary.
For the purposes described above, Intesa Sanpaolo uses a wide-ranging set of tools and techniques for risk assessment and

management, detailed in this Part E of the Notes to the consolidated financial statements.
The information provided in this part of the document is based on internal management data and does not necessarily coincide with that contained in Parts B and C. Tables and information for which the indication of "book values" is specifically required represent an exception.

Other risks
In addition to credit, market, operational and insurance risks, discussed in detail in the following paragraphs, the Group has also identified and monitors the following other risks.

Strategic risk
The Intesa Sanpaolo Group defines current or prospective strategic risk as risk associated with a potential decline in profits or capital due to changes in the operating context, misguided company decisions, inadequate implementation of decisions, or an inability to react sufficiently to changes in the competitive scenario.
The Group's response to strategic risk is represented first and foremost by policies and procedures that call for the most important decisions to be deferred to the Management Board and the Supervisory Board, supported by a current and forward-looking assessment of risks and capital adequacy. The high degree to which strategic decisions are made at the central level, with the involvement of the top corporate governance bodies and the support of various company functions, ensures that strategic risk is mitigated.
An analysis of the definition of strategic risk leads to the observation that this risk is associated with two distinct fundamental components:
- a component associated with the possible impact of misguided company decisions and an inability to react sufficiently to changes in the competitive scenario: this component does not require capital, but is one of the risks mitigated by the ways in which, and the levels at which, strategic decisions are reached, where all significant decisions are always supported by specific activities aimed at identifying and measuring the risks implicit in the initiative;
- the second component is more directly related to business risk; in other words, it is associated with the risk of a potential decline in profits as a result of the inadequate implementation of decisions and changes in the operating context. This component is handled not only by using systems for regulating company management, but also via specific internal capital, determined according to the Variable Margin Volatility (VMV) approach, which expresses the risk arising from the business mix of the Group and its business units.

Strategic risk is also assessed as part of stress tests based on a multiple-factor model that describes the relations between changes in the economic scenario and the business mix resulting from planning hypotheses.

Reputation risk
The Intesa Sanpaolo Group attaches great importance to reputation risk, namely the current and prospective risk of a decrease in profits or capital due to a negative perception of the Bank's image by customers, counterparties, shareholders, investors and supervisory authorities.
The Group has adopted and published a Code of Ethics that sets out the basic values to which it intends to commit itself and enunciates the principles of conduct for dealings with all stakeholders (customers, employees, suppliers, shareholders, the environment and, more generally, the community) with objectives more ambitious than those required by mere compliance with the law. On the subject of customer relations, it should be recalled that the Group has set up a systematic dialogue process. It has also issued voluntary conduct policies (environmental policy and arms industry policy) and adopted international principles (UN Global Compact, UNEP FI, Equator Principles) aimed at pursuing respect for the environment and human rights. The Group also provides effective governance for compliance risk as a prerequisite for mitigating reputation risk.
There has been a particular focus on financial advisory services for customers, for which the MiFID Directive was taken as an opportunity to update the entire marketing process and associated controls.
Accordingly, the Group has reinforced its longstanding general arrangement, which calls for the adoption of processes supported by quantitative methods for managing the risk associated with customers' investments in accordance with a broad interpretation of the law with the aim of safeguarding customers' interests and the Group's reputation.
This has allowed assessments of adequacy during the process of structuring products and rendering advisory service to be supported by objective assessments that contemplate the true nature of the risks borne by customers when they undertake derivative transactions or subscribe for financial investments.
More in particular, the marketing of financial products is also governed by specific advance risk assessment from the standpoint of both the Bank (along with risks, such as credit, financial and operational risks, that directly affect the owner) and the customer (sustainability in terms of risk to return ratio, flexibility, concentration, consistency with objectives and risk tolerance profiles, and knowledge and awareness of the products and services offered).

Risk on owned real-estate assets
The risk on owned real-estate assets may be defined as risk associated with the possibility of suffering financial losses due to an unfavourable change in the value of such assets and is thus included in the category of banking book financial risks. Real estate management is highly centralised and represents an investment that is largely intended for use in company operations. The degree of risk in the portfolio of owned properties is represented by using a VaR-type model based on indexes of mainly Italian real estate prices, which is the main type of exposure associated with the Group's property portfolio.

The Basel 2 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[8] and

[8] In December 2012 the full demerger of the Bank was completed in favour of the Parent Company Intesa Sanpaolo S.p.A. and Leasint S.p.A..

Mediocredito Italiano (effective from 31 December 2010; the FIRB approach had been in use since December 2008) and the foreign company Intesa Sanpaolo Bank Ireland Plc. (effective from 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 from June 2010, extended to the former Casse del Centro network banks effective from the report as at 31 December 2011 and to VUB Banka with effect from the report as at 30 June 2012;
- authorisation for transition to the IRB approach was granted for the SME Retail segment effective from December 2012 report, extending to a scope that includes the Parent Company, network banks and Mediocredito Italiano.

The Group is also proceeding with development of the rating models 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 2012 the Group presented its 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 methodologies 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 (www.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.

The internal control system

To ensure a sound and prudent management, Intesa Sanpaolo combines business profitability with an attentive risk-acceptance activity and an operating conduct based on fairness.
Therefore, the Bank, in line with legal and supervisory regulations in force and consistently with the Corporate Governance Code for listed companies, has adopted an internal control system capable of identifying, measuring and continuously monitoring the risks typical of its business activities.
Intesa Sanpaolo’s internal control system is built around a set of rules, procedures and organisational structures aimed at ensuring compliance with Company strategies and the achievement of the following objectives:
- the effectiveness and efficiency of Company processes;
- the safeguard of asset value and protection from losses;
- reliability and integrity of accounting and management information;
- transaction compliance with the law, supervisory regulations as well as policies, plans, procedures and internal regulations.

The internal control system is characterised by a documentary infrastructure (regulatory framework) that provides organised and systematic access to the guidelines, procedures, organisational structures, and risks and controls within the business, incorporating both the Company policies and the instructions of the Supervisory Authorities, and provisions of law, including the principles laid down in Legislative Decree 231/2001 and Law 262/2005.
The regulatory framework consists of “Governance Documents” that oversee the operation of the Bank (Articles of Association, Code of Ethics, Group Regulations, Authorities and powers, Policies, Guidelines, Function charts of the Organisational Structures, Organisational Models, etc.) and of more strictly operational regulations that govern business processes, individual operations and the associated controls.
More specifically, the Company rules set out organisational solutions that:
- ensure sufficient separation between the operational and control functions and prevent situations of conflict of interest in the assignment of responsibilities;
- are capable of adequately identifying, measuring and monitoring the main risks assumed in the various operational segments;
- enable the recording, with an adequate level of detail, of every operational event and, in particular, of every transaction, ensuring their correct allocation over time;
- guarantee reliable information systems and suitable reporting procedures for the various managerial levels assigned the functions of governance and control;
- ensure the prompt notification to the appropriate levels within the business and the swift handling of any anomalies found by the business units and the control functions.

The Company’s organisational solutions also enable the uniform and formalised identification of responsibilities, particularly in relation to the tasks of controlling and correcting the irregularities found.

At Corporate Governance level, Intesa Sanpaolo has adopted a dual governance model, in which the functions of control and strategic management, performed by the Supervisory Board, are separated from the management of the Company, which is exercised by the Management Board in accordance with the provisions of art. 2409-octies and subsequent of the Italian Civil Code and art. 147-ter and subsequent of the Consolidated Law on Finance.
The Supervisory Board has established an internal Control Committee that proposes, advises and enquires on matters regarding the internal control system, risk management and the accounting and IT system. The Committee also performs the duties and tasks of a Surveillance Body pursuant to Legislative Decree 231/2001 on the administrative liability of companies, supervising operations and compliance with the Organisational, Management and Control Model adopted by the Bank.

From a more strictly operational perspective the Bank has identified the following macro types of control:
- line controls, aimed at ensuring the correct application of day-to-day activities and single transactions. Normally, such controls are carried out by the productive structures (business or support) or incorporated in IT procedures or executed as part of back office activities;
- risk management controls, which are aimed at contributing to the definition of risk management methodologies, at verifying the respect of limits assigned to the various operating functions and at controlling the consistency of operations of single productive structures with assigned risk-return targets. These are not normally carried out by the productive structures;
- compliance controls, made up of policies and procedures which identify, assess, check and manage the risk of non-compliance with laws, Supervisory Authority measures or self-regulating codes, as well as any other rule which may apply to the Bank;
- internal auditing, aimed at identifying anomalous trends, violations of procedures and regulations, as well as assessing the overall functioning of the internal control system. It is performed by different structures which are independent from productive structures.

The internal control system is periodically reviewed and adapted in relation to business development and the reference context.
As a consequence, Intesa Sanpaolo's control structure is in compliance with the instructions issued by the Supervisory Authorities. Indeed, alongside an intricate system of line controls involving all the function heads and personnel, a Chief Risk Officer area has been established specifically dedicated to second level controls that incorporates both units responsible for the control of risk management (in particular, the Risk Management Department, Credit Quality Monitoring, and Internal Validation in accordance with Basel 2 rules), and the management of compliance controls (Compliance Department, Anti-Money Laundering Service). Also reporting in functional terms to the Chief Risk Officer is the Legal Affairs Department, which monitors and controls the legal risk of Intesa Sanpaolo and its Group.
There is also a dedicated Internal Auditing Department, which reports directly to the Chairman of the Management Board and the Chairman of the Supervisory Board, and is also functionally linked to the Control Committee.

Risk Management

In the context of second level internal controls, the Risk Management Department is responsible for developing methods for controlling risk exposure within the various business units, reporting on the overall situation to corporate governance bodies, adopting risk capital measures for management reporting and the assessment of the adequacy of the Group's internal capital and providing the supervisory authorities with the information required by applicable regulations. The Department's tasks and functions are discussed in detail in the subsequent chapters of Part E.

Internal Validation

The internal control system implemented by the Bank includes the validation function, the purpose of which is ongoing evaluation, in accordance with the New Regulations for Prudential Supervision issued by the Bank of Italy, of the compliance of internal risk measurement and management systems over time as regards determination of the capital requirements with regulatory provisions, company needs and changes in the market of reference. The validation function is entrusted to Internal Validation, which is responsible for the activity at the Group level in accordance with the requirements of supervisory regulations governing uniform management of the control process on internal risk measurement systems. The Internal Validation function reports directly to the Chief Risk officer and is independent of the functions that manage internal system development activities and the function in charge of internal auditing. It ensures that internal models, whether already operational or in the development stages, are validated with regard to all risk profiles covered by Pillars I and II of the Basel II Accord, in accordance with the independence requirements established by the Bank of Italy.
With respect to the first pillar in particular, it conducts ongoing assessments of risk management and measurement systems in terms of models, processes, information technology infrastructure and their compliance over time with regulatory provisions, company needs and changes in the market of reference by developing adequate methodologies, tools and operating solutions.
Both during the initial application phase and on an ongoing basis (at least annually), the results of Internal Validation activities, documented in accordance with pre-determined standards, are presented to the competent functions, transmitted to the Internal Auditing Department for its related internal auditing work, as well as to the competent managerial committees and governance bodies for the resolution certifying the compliance of internal systems with regulatory requirements, and forwarded to the Supervisory Authorities.
With respect to pillar-two risks, Internal Validation conducts analyses of methodologies, verifying in particular that the measurement or assessment metrics adopted in quantifying significant risks are economically and statistically consistent, the methodologies adopted and estimates produced to measure and assess significant risks are robust and comparing alternative methodologies for measuring and aggregating individual risks. The main analyses are conducted in the context of the prudential control process and summarised in the ICAAP book.
The function also manages the internal validation process at the Group level, interacting with Supervisory Authorities, the company bodies of reference and the functions responsible for the level-three controls provided for in regulations.
The Internal Validation function adopts a decentralised approach for companies with local validation functions (certain international companies), coordinating and supervising the activities of such companies, and a centralised approach for the others.
The methodologies adopted were developed in implementation of the principles that inspire the New Regulations for Prudential Supervision issued by the Bank of Italy, Community Directives, general orientations of international committees and best practices in the area and take the form of documentary, empirical and operating practice analyses.
The function generally also provides advice and suggestions to company and Group functions on an ongoing basis with the aim of improving the efficacy of the processes of risk management, control and governance of internal risk measurement and management systems for determining capital requirements.

In 2012, the main validation activities in the area of credit risks pertained to:
- the adoption of the AIRB approach for the regulatory SME Retail segment (PD and LGD models);
- the adoption of the AIRB approach for Leasint and Mediofactoring (LGD model);
- the adoption of the AIRB approach for the specialist Structured Finance models (LAF/AF/CRE/PF);
- the periodic quantitative analyses required by the Bank of Italy for the regulatory Residential Mortgage for Private Individuals and Corporate segments (PD and LGD models);

- monitoring analyses (backtesting, performance analyses and empirical analyses of use tests) for the Residential mortgage for Private Individuals and Corporate segments authorised for the IRB approach in the context of the annual validation report;
- the analyses functional to the assessment of the measures taken on the corporate FIRB and mortgage IRB system of VUB, conducted together with the local validation function in order to meet the requirements of regulators (slotting models for SPV and real estate development exposures, IALC PD, SME and mortgage PD recalibration, measures to improve the mortgage LGD model, new calculation methods for the conservative margin for determining the central tendency and refinements of the validation framework).

Validation activities for Operational Risk conducted in 2012 primarily took the form of:
- monitoring the measures taken in accordance with the requirements set in the regulatory capital “floor” revision order of summer 2011;
- amongst validation activities aimed at presenting three applications: the application for the inclusion of insurance policies in the AMA internal system for the purposes of calculating the capital requirement for operational risks; the application to extend the AMA internal system to the first tranche of what is known as the “fourth scope” of adoption, consisting of the main companies of the Fideuram Group and the two subsidiaries of the VUB Group, VUB Leasing and Consumer Financial Holding (the analyses of the subsidiaries of the VUB Group were conducted together with the local validation function); and, lastly, the application for the modification of the method of allocating the requirement calculated with the AMA internal method;
- executing the annual validation analyses (annual report).

For the purposes of such validation activities, the information drawn from documentary and empirical analyses was supplemented, for certain organisational units, by specific onsite inspections aimed at ascertaining the actual application of the monitoring and management process for operational risks and by methodological analyses.

Internal validation activity relating to the market risk component focused on the following areas:
- validation activity aimed at the application for authorisation of the extension of the market risk internal model to the “specific debt security risk” factor (Spread VaR and Incremental Risk Charge models);
- annual validation analyses (annual report);
- monitoring of the existing model for calculating stressed VaR, which entails a half-yearly revision of the adequacy of the historical stress period to be used in the calculation. The analyses were replicated on an extraordinary basis in August 2012 inasmuch as stressed VaR was in some cases lower than non-stressed VaR in the third quarter of 2012;
- periodic analyses required by the Bank of Italy on the progress of corrective measures applied to the spread VaR and IRC models.

The Bank of Italy conducted two pre-validation visits in 2012 relating to counterparty risk, currently used for management purposes only by the Parent Company and Banca IMI. The Internal Validation function analysed both the calculation system implemented and the organisational processes and information technology systems underlying the management of counterparty risk.

The main analyses conducted in 2012 with regard to Pillar II risks pertain to:
- the method used to assess loan portfolio concentration risk;
- the updating of the model for measuring banking book property risk;
- the core deposit behavioural component pertaining to banking book interest rate risk;
- certain components of liquidity risk (for example, committed lines of credit).

Stress testing methodologies, foreign exchange risk, equity risk for the banking book, insurance risk and strategic risk, which were validated in previous years, were not subject to change in 2012. It was therefore not deemed necessary to update the associated validation analyses.

The Compliance Department

The governance of compliance risk is of strategic importance to the Intesa Sanpaolo Group as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust.
Management of non-compliance risk is entrusted to the Compliance Department, which reports to the Chief Risk Officer, from a position of autonomy with respect to operational departments, and of separation from internal auditing.
The Group's Compliance Model is set out in the Guidelines approved by Intesa Sanpaolo's Management Board and Supervisory Board. These Guidelines identify the responsibilities and macro processes for compliance, aimed at mitigating the risk of non-compliance through a joint effort by all the company functions. The Compliance Department is responsible, in particular, for overseeing the guidelines, policies and methodologies relating to the management of non-compliance risk. The Compliance Department, including through the coordination of other corporate functions, is also responsible for the identification and assessment of the risks of non-compliance, the proposal of the functional and organisational measures for their mitigation, the assessment of the company’s bonus system, the pre-assessment of the compliance of innovative projects, operations and new products and services, the provision of advice and assistance to the governing bodies and the business units in all areas with a significant risk of non-compliance, the monitoring, including through the use of information provided by the Internal Auditing Department, of ongoing compliance, and the promotion of a corporate culture founded on the principles of honesty, fairness and respect for the spirit and the letter of the rules.
The Compliance Department submits periodic reports to Corporate Bodies on the adequacy of compliance control. On an annual basis, these reports include an identification and assessment of the primary non-compliance risks to which the Group is exposed and a schedule of the associated management measures, and on a semi-annual basis they include a description of the activities performed, critical issues noted, and remedies identified. A specific notice is also given when events of particular significance occur.
The Compliance Guidelines call for the adoption of two distinct models in relation to direction and control of the Group. These models are organised in such a way as to account for the Intesa Sanpaolo Group’s structure in operational and territorial terms. In particular:
- compliance supervision activities for specifically identified Network Banks and Italian Companies whose operations show a high degree of integration with the Parent Company are centralised with the Compliance Department;

- for the other Companies, specifically identified on the basis of the existence of a legal obligation or their material nature, as well as for Branches Abroad, an internal compliance function is established and a local Compliance Officer is appointed. In functional terms, the Compliance Officer reports to the Compliance Department and is assigned compliance responsibilities.

The activities carried out during the year concentrated on the regulatory areas considered to be the most significant in terms of non-compliance risk, including in light of the most significant ongoing projects, such as Out-of-branch offering and initiatives aimed at achieving compliance with new regulations enacted at an international level (e.g., EMIR, Dodd Frank Act, short-selling law). In particular:

– in the financial intermediation and investment services area, monitoring of the procedural organisational structure in support of the service model adopted by the Bank continued. In this context, work was done on both the internal rules that govern the provision of investment services, adjusting those roles to the changed economic scenario, and on the procedures that apply to operations with the aim of improving the service rendered to customers, with particular reference to the adequacy assessment model. Work also continued in the area of monitoring personal transactions, clearing new products and services and controlling customer operations in order to prevent market abuse. In the area of conflict of interest management and the circulation of insider information, work continued to be done with the aim of enhancing the model adopted by the Bank, including through changes to the internal rules applicable in the area;
– legislative developments in the areas of banking products and services were monitored, with a particular focus on the issue of transparency, consumer credit and usury. Rules, procedures and operational practices were established to prevent violations or infractions of applicable rules governing such products and services in order to ensure that support and guidance are provided to business units with the aim of ensuring that customer-protection provisions are properly managed. In particular, work focused on revising the commission scheme applied to customers, in accordance with the new art. 117-bis of the Consolidated Law on Banking concerning "Interest on credit facilities and overdrafts" introduced by the "Save Italy" Decree;
– in the area of insurance and pension services, business functions received constant advice, concerning in particular new legal developments relating to motor policies and policies paired with mortgages. In addition, initiatives continued with the aim of enhancing governance of non-compliance risks pertaining to the insurance and pension segment, with respect to the Group's distribution networks. In this area, the line of pension products and the associated marketing process were revised and a project was launched in order to return the residual premium for policies associated with loans repaid in advance;
– the organisational, management and control Model pursuant to Italian Legislative Decree 231/2001 was overseen by verifying its compliance with the Company regulations, updating it to take into account the new predicate offences, and coordinating verification of its proper implementation.

Considerable importance was attached to personnel training programmes, involving the implementation, in collaboration with the competent company functions, of initiatives aimed at pre-defined targets in order to maximise their efficacy.

The Anti-Money Laundering Function

In August 2011, in line with the regulatory provisions issued by the Bank of Italy on 20 March 2011, responsibilities in the area of the prevention of money laundering and embargo management, previously entrusted to the Compliance Department, were reassigned to a specific Anti-Money Laundering Function reporting directly to the Chief Risk Officer. The function is charged with monitoring compliance risk in the area of money laundering, combating financing of terrorism and embargo management by:

– laying down the general principles to be adopted within the Group for the management of compliance risk;
– conducting ongoing monitoring, with the support of the competent functions, of developments in the national and international context of reference, verifying the adequacy of company processes and procedures with respect to applicable regulations and proposing appropriate organisational and procedural changes;
– providing advice to the functions of the Parent Company and subsidiaries on a centralised basis and establishing adequate training plans;
– preparing appropriate periodic information for corporate bodies and top management;
– discharging the required specific obligations on behalf of the Parent Company and subsidiaries on a centralised basis, including, in particular, enhanced customer reviews, controls of proper management of the Single Electronic Archive and the assessment of reports of suspicious transactions received from operating departments for the submission to the Financial Reporting Unit of reports deemed accurate.

During 2012, the Anti-Money Laundering Function devoted the utmost attention to projects aimed at reinforcing coverage of the Group's Italian and international companies in the area of money laundering and embargoes, including in light of the new provisions of law enacted at the national and international level. In further detail, organisational, information technology and training activities were performed with the aim of implementing applicable regulations in this area.

The Internal Auditing Department

With regard to internal auditing activities, the Internal Auditing Department is responsible for ensuring the ongoing and independent supervision of the regular progress of the Bank's operations and processes for the purpose of preventing or identifying any anomalous or risky behaviour or situation. The Internal Auditing Department assesses the functionality of the overall internal control system and its adequacy to ensure:

– the effectiveness and efficiency of Company processes;
– the safeguarding of asset value and protection from losses;
– the reliability and integrity of accounting and management information;
– the compliance of transactions with the policies set by Company governance bodies and internal and external regulations.

Furthermore, it provides consulting to the Bank's and the Group's departments, also through participation in projects, for the purpose of adding value and improving effectiveness of control, risk management and organisation governance processes.

The Internal Auditing Department uses personnel with the appropriate professional skills and expertise and ensures that its activities are performed in accordance with international best practice and standards for internal auditing established by the Institute of Internal Auditors (IIA). Internal auditors conduct their activity in accordance with the principles laid down in the Internal Auditor's Code of Ethics, inspired by that proposed by the Institute of Internal Auditors. The Function has earned the maximum rating in the external Quality Assurance Review envisaged by the international standards: "Generally Compliant".

The Internal Auditing Department has a structure and a control model which is organised consistently with the divisional model of Intesa Sanpaolo and the Group.

During the year, the auditing was performed directly for the Parent Company Intesa Sanpaolo and for Banche dei Territori, and also other subsidiaries with an outsourcing contract. For the other Group companies second level controls were conducted (indirect surveillance).
The Internal Auditing Department also enjoyed free access to the data and documents of all company functions.
Supervision activity was conditioned by the continuing delicate economic scenario. Consequently, also in accordance with instructions issued by the Control Committee and the top management, verifications were primarily aimed at monitoring the evolution of the risks associated with credit quality, liquidity risk measurement and management, interest rate, property and counterparty risk, internal capital adequacy estimation criteria and international activities. Particular attention was also devoted to the themes of compliance with money laundering prevention legislation.
Control activity was generally oriented towards the processes of structures with the aim of assessing:
– the functionality of line and risk management controls;
– compliance with internal and external rules;
– the reliability of operating structures and delegation mechanisms;
– the accuracy of the information available in the various activities and the adequate use of the same.

Direct surveillance was carried out in particular through:
– control of the processes of the network and central structures, including through onsite intervention;
– the surveillance, via distance monitoring integrated by on-site visits, of the credit origination and management process, verifying its adequacy with respect to the risk control system and the functioning of measurement mechanisms in place;
– the surveillance over the process for the measurement, management and control of the Group’s exposure to various market, counterparty, property, liquidity, interest rate, operational and credit risks. Particular attention was dedicated to the adequacy of the processes and criteria for estimating internal capital in accordance with Basel 2 and Prudential Supervision regulations;
– the verification of the control processes carried out by compliance risk governance functions, in particular of provisions of law concerning embargoes, money laundering, investment services, conflicts of interest, transactions with related parties, transparency, and the administrative liability of entities pursuant to Legislative Decree 231/01;
– the valuation of adequacy and effectiveness of information technology system development and management processes, to ensure their reliability, security and functionality;
– the surveillance of the processes related to financial operations and the adequacy of related risks control systems;
– measures affecting Italian product company subsidiaries, with a priority focus on credit quality and processes, as well as the money laundering prevention process;
– the verification of the operations performed by foreign banks, companies and branches, with interventions by both local internal auditors and internal auditors from the Parent Company;
– the timely performance of the activities requested by Supervisory Authorities in specific areas such as management remuneration and incentive systems, the Parent Company's management and coordination powers over asset management companies and obligations under new authorisations.

During the year the Internal Auditing Department also ensured the supervision of all the main development projects, paying particular attention to control mechanisms in the new Bank’s models and processes and, in general, to the efficiency and the effectiveness of the control system established within the Group.
Indirect audit was conducted via the steering and practical coordination of the auditing departments of Italian and international subsidiary banks and companies, to guarantee control consistency and adequate attention to the different types of risks, also verifying the effectiveness and efficiency levels under both structural and operational profiles. Direct reviews and verification interventions were also conducted.
In conducting its duties, the Internal Auditing Department used methodologies for the preliminary analysis of risks in the various areas. Based on the assessments made and on the consequent priorities, the Internal Auditing Department prepared and submitted an Annual Intervention Plan for prior examination to the Control Committee, the Management Board and the Supervisory Board, on the basis of which it conducted its activities during the year, completing the scheduled audits.
Any weak points have been systematically notified to the Departments involved for prompt improvement actions which are monitored by follow-up activities.

The valuations of the internal control system deriving from the checks have been periodically transmitted to the Control Committee, to the Management Board and to the Supervisory Board which receive detailed updates also on the state of solutions under way to mitigate weaknesses; furthermore, the most significant events have been promptly signalled to the Control Committee.
A similar approach is used with respect to the responsibilities of administrative bodies pursuant to Legislative Decree 231/01 for the Control Committee, as surveillance body.
Finally, the Internal Auditing Department ensured constant assessment of its own efficacy and efficiency in line with the internal “quality assurance and improvement" plan drafted in accordance with the recommendations of international standards for professional practice.

Certification as required by art. 154-bis of the Consolidated Law on Finance

As required by art. 154-bis of the Consolidated Law on Finance, the delegated management bodies and the Manager responsible for preparing the Company’s financial reports must issue a specific report annexed to the financial statements in which it is certified that the administrative and accounting procedures were adequate and effectively applied during the period, the Company’s accounting documents match the contents of accounting books and records, the documents are suitable to providing a true and fair view of the assets, liabilities, profit or loss and financial position of the Company and the set of companies included in the scope of consolidation, and the analysis of the Group’s performance and results presented in the Report on operations is reliable, along with a description of the main risks and uncertainties to which the Group is exposed.
Intesa Sanpaolo has established a governance and control system that is appropriate to monitoring the risks typical of the company and the Group on an ongoing basis. In detail, the internal control system for accounting and financial information is supervised by the Manager responsible for preparing the Company’s financial reports in accordance with the Company Regulations “Guidelines for administrative and financial governance”, which concern the methods of implementation for verification of the adequacy and effective application of administrative and accounting procedures at the Group level, as well

as responsibilities and rules for the maintenance of an adequate system of relationships with the corporate functions of the Parent Company and subsidiaries.
The monitoring of the quality of accounting and financial information is based on a joint review of:

- the efficacy and efficiency of the organisational arrangements adopted, in specific reference to the functionality of internal controls of financial information, through an audit plan aimed at ongoing assessment of the adequacy and effective application of the administrative and accounting procedures instrumental to the preparation of financial statement documents and all other financial disclosures to the markets, including, in particular, the Basel 2 Pillar 3 public disclosure document; in order accurately to document the quality of arrangements for controlling the flow of accounting data and information presented to the market, reviews are conducted not only of administrative and accounting processes, narrowly construed, but also of all phases of work that involve acquiring, recording, processing and presenting data managed in guidance and control processes (planning, management control and risk control), business processes (lending, financial intermediation, asset management and insurance, etc.), supporting processes (operations) and general governance rules for technological infrastructure and applications conceived to ensure proper management of information processes and appropriate forms of monitoring of development activities regarding information technology systems, particularly those used to produce accounting and financial information;
- the completeness and consistency of the information disclosed to the market by enhancing surveillance of internal communications processes with the management by the Manager responsible for preparing the Company's financial reports of a structured system of information flows that the functions of the Parent Company and subsidiaries regularly transpose, reporting significant events for the purposes of accounting and financial information, especially as regards the main risks and uncertainties to which they are exposed.

The Manager responsible for preparing the Company's financial reports, aided by the Administrative and Financial Governance Unit, has identified the scope of the subsidiaries viewed as material to financial information on the basis of their respective contributions to captions of the consolidated income statement and balance sheet and qualitative assessments of the complexity of the processes of producing financial information in relation to the specific nature of the business, risk profiles and operating context. The schedule of reviews of the adequacy and effective application of administrative and accounting procedures privileged the examination of:

- the reliability of the processes of producing and disseminating the financial statement information deemed most sensitive;
- the reliability of the methods and assumptions on which forecasting estimates and valuation models are based;
- the logical consistency of the criteria for presenting the main risks and uncertainties to which the Group is exposed.

The resulting schedule set for the year was implemented in accordance with the criteria set out in the Regulation "Guidelines for administrative and financial governance", applying the methods taken as reference, which reflect international standards deriving from the COSO and COBIT Framework[9] to ensure homogeneous application of the verification process conducted on Group companies and valuation criteria for the system of internal controls on financial information. In particular, the method involves an initial overall assessment of the state of the internal control system at the Company-wide level aimed at determining whether there are adequate governance systems, standards of conduct inspired by ethics and integrity, effective organisational structures, a clear structure of delegated powers and responsibilities, adequate risk policies, effective codes of conduct and fraud prevention systems and personnel disciplinary systems. These general areas are examined on the basis of enquiries and evidence provided by Internal Auditing functions, followed by further inquiry by the Manager responsible for preparing the Company's financial reports, primarily concerning company regulations, organisational arrangements and the operating mechanisms most relevant to management of the administrative and accounting system. In a subsequent phase, the method calls for further development of general assessments involving a set of case-by-case reviews of the adequacy and effective application of administrative and accounting procedures and governance rules for technological infrastructure and applications. This examination is conducted according to specific techniques, reinforced by auditing standards, overseen by the Manager responsible for preparing the Company's financial reports through dedicated structures (Administrative and Financial Governance Unit) and on the basis of enquiries and evidence provided by the various Company control functions with a view towards fully sharing information and maximising operational synergies. Once Group activity has been completed, each Company then prepares a Report on the internal control system functional to financial reporting, which is enhanced in concert with the Parent Company's Administrative and Financial Governance Unit before being formally sent to the Manager responsible for preparing the Company's financial reports. These Reports, presented as part of the periodic information provided to each company's supervisory bodies, were drafted to include:

- the results of the reviews conducted by control functions and enquiries carried out with the management, as well as suggestions submitted by the independent auditors in the performance of their duties in certifying the financial statements;
- the information flows sent to the Manager responsible for preparing the Company's financial reports by the companies with the aim of presenting facts that may have a material effect on earnings or financial position and the elements helpful to consolidated presentation of operating performance and margins, highlighting the main risks and potential uncertainties to which the Group is exposed.

The Reports thus present an overview of the Company's situation, with a particular focus on the factors of greatest operational complexity to be dealt with to ensure the reliability of accounting information processes and the efficacy of the system of internal controls safeguarding them. In addition, a specific illustration is provided of the schedule of reviews carried out during the year, with a summary of the results and a description of the situations of deficiency detected and the measures taken to restore full functionality of the internal control system on processes sensitive to financial reporting. The Administrative and Financial Governance Unit coordinates the assessment process to be conducted within each company according to consistent methods and technical instructions. The process is then completed through the submission to the Manager responsible for preparing the Company's financial reports of an equal number of reports on the internal control system for financial reporting, accompanied by certification of responsibility by the respective delegated body. Once the assessment phase has been completed on a company basis, all of the deficiencies detected within the Group are factored and evaluated on a consolidated basis, assessing the possible

[9] The COSO Framework was prepared by the Committee of Sponsoring Organizations of the Treadway Commission, the U.S. organisation dedicated to improving the quality of financial reporting through ethical standards and an effective system for corporate governance and organisation. The COBIT Framework - Control Objectives for IT and related technology is a set of rules prepared by the IT Governance Institute, the U.S. organisation whose aim is to define and improve the standards of corporate IT.

connections and the risk of potential distortion effects on financial reporting, and setting the related intervention priorities and work schedules to be monitored over time in accordance with the significance of the operational malfunctions.
Once the assessment process conducted in concert with Group companies has been completed, the Administrative and Financial Governance Unit prepares a periodic report that the Manager responsible for preparing the Company's financial reports presents to the Control Committee and Financial Statements Committee, for subsequent presentation to the Supervisory Board and Management Board. The above report contains:
- the degree of dissemination of the administrative and financial governance model achieved within the Group, a process of gradual extension of which to companies of more limited operating scope also continued in 2012;
- monitoring of the functionality of the organisational and control arrangements already adopted by all significant companies, including a review of the regularity of the planned communication flows with the management, control bodies and independent auditors;
- the main initiatives carried out with the aim of enhancing the administrative and accounting system during the year, with regards to the completion of measures aimed at developing the application architecture for generating the Group's accounting information and rationalising processing steps instrumental to generating consolidated supervisory reports;
- the improvements made to company processes, which contemplate the phases of acquisition, recording, processing and presentation of data sensitive to financial reporting, with an assessment of the compliance of accounting processing phases with respect to changes in regulations that have been incorporated into the Group Accounting Rules;
- the malfunctions detected, specifying the potential risk of distortion of information and the accounts that may have been affected, as well as of the compensatory controls that had a mitigating effect;
- an overarching judgment, considering the information provided during the year by the companies and Parent Company's functions, the opinions stated by management and any suggestions made by the independent auditors.

Upon completion of the set of reviews conducted during the year to express an opinion of the adequacy and effective application of controls of administrative and accounting procedures, the reliability of the internal control system for accounting and financial information is confirmed. However, the fact that administrative and accounting procedures are suitable to providing an accurate representation of the assets, liabilities, profit or loss and financial position of the Bank and Group in the financial statements does not mean that there is not room for improvement, which is then the object of measures taken by the interested units and systematic monitoring by the Manager responsible for preparing the Company's financial reports.
The information is presented to the Control Committee, Management Board and Supervisory Board in relation to their respective spheres of competence. The work done provided the basis for the Managing Director – CEO and Manager responsible for preparing the Company's financial reports to issue the certifications required by art. 154-bis of Legislative Decree 58/98 with respect to the 2012 Annual Report, in accordance with the model established by the Consob Regulation (Annex 3c-ter to the Issuers Regulation).

Subsidiaries subject to the laws of non-EU member states
As is common knowledge, Consob, in accordance with Law 262/2005 governing the protection of savings and the regulation of financial markets, has set certain conditions for the listing of companies that control companies incorporated and subject to the laws of non-EU member states (art. 36, paragraph 1 of the Market Regulation).
In connection with this provision, the "material" companies to be included in the scope of mandatory monitoring for 2012 were identified. The scope of monitoring was determined by considering the individual contribution to the captions of the consolidated income statement and balance sheet (quantitative analysis), as well as by evaluating the complexity of the processes of generating financial information associated with the specific nature of the business and the operating scenario of reference (qualitative analysis). For such companies, compliance was achieved with provisions requiring that:
a) the public be provided access to the accounting positions prepared for the purposes of drafting the consolidated financial statements;
b) articles of association, membership and powers of the control bodies be acquired;
c) the Independent Auditor of the Parent Company, Intesa Sanpaolo, be provided with the information necessary to perform annual and interim audits of the parent company, ensure that the subsidiary possesses an administrative and accounting system appropriate for regular reporting to the management and independent auditor of the parent company of the income statement, balance sheet and cash flow data necessary for the preparation of the consolidated financial statements.

In further detail, with respect to the provisions of c) above, which represent the most complex component of their responsibilities, the "material" subsidiaries:
- systematically provided the Parent Company with the information required to draft the consolidated financial statements and publish individual accounting situations;
- awarded a specific audit engagement to certify the accuracy of the transposition of the information from the local financial statements to the consolidated financial statements (auditing of the reporting package);
- took measures to ensure, in accordance with the Regulation "Guidelines for administrative and financial governance", that:
  - the Manager responsible for preparing the Company's financial reports regularly received the required set of information flows and timely notice of all material facts bearing on accounting and financial information;
  - the schedule of reviews to be conducted locally in execution of the directives of the Manager responsible for preparing the Company's financial statements, with the coordination of the Administrative and Financial Governance Unit, was managed with the aim of verifying the adequacy of administrative and accounting procedures; following the completion of these activities, a Report on the internal control system for financial reporting was drafted, characterised by the same degree of pervasiveness of analysis and evaluative rigour as observed for compliance with the requirements of art. 154 bis of the Consolidated Law on Finance.

The set of initiatives conducted in relation to companies located in and governed by the laws of non-EU member states results in a high level of integration of the administrative and financial governance model extended to the entire Group. In further detail, the possibility of formulating a comparative opinion of the quality of the administrative and accounting procedures implemented within the various entities has been reinforced, in a manner also functional to an appreciation of the processes of estimating and measuring captions of the financial statements at a time of severe turbulence and a high degree of uncertainty affecting certain local markets. In addition, it was ensured that there was an adequate level of exchange and communication between local

management and the Parent Company and independent auditors for informed, timely management of information and the sharing of suggestions regarding the enhancement of the system of controls on accounting information.
In the case of companies considered "immaterial" in accordance with the law, the Parent Company nonetheless remained committed to implementing a uniform administrative and financial governance model, in relation to which it obtained the various companies' articles of association, as well as the powers and compositions of their corporate bodies, in addition to extending certain forms of control, such as the auditing of the reporting package and/or local financial statements by the auditor. Lastly, more indirect forms of supervision applied to companies qualifying as "exempt", such as the auditing of financial statements in accordance with local law and observance of corporate and regulatory obligations towards the Parent Company.
In the case of subsidiaries subject to compulsory auditing in accordance with the provisions of the cited art. 36, the work done allowed the acquisition of the necessary information and the conduct of reviews aimed at determining whether legal conditions had been met. As part of the filing process for documents due before the Shareholders' Meeting, the Parent Company will ensure that the public is provided access to the accounting positions prepared by these companies for use in drafting the consolidated financial statements. On this basis, the listed Parent Company's administrative body may certify that the conditions required by law have been met.

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As required by the instructions provided by the Bank of Italy, the information in this section - Risks of the Banking Group - is furnished solely with respect to the banking group, as defined in the Supervisory Instructions, except when it is expressly indicated to the contrary that all companies within the scope of consolidation are considered.
The tables that refer to the banking group alone include the share proportional to the interest held of the assets and liabilities of jointly controlled banking, financial and instrumental companies consolidated proportionally for regulatory purposes Amounts are stated gross of transactions with other companies within the scope of consolidation.
Where the contribution of transactions between the banking group and the other companies in the financial statement scope of consolidation is material, the details of such transactions are provided.