Risk management

BASIC PRINCIPLES

As described in greater detail in the annual financial statements, the Intesa Sanpaolo Group's risk acceptance policies are defined by the Parent Company's Supervisory Board and Management Board. The Supervisory Board performs its activities through specific committees set up from among its members, including the Control Committee. The Management Board draws on the activities conducted by managerial committees, particularly the Group Risk Governance Committee. Both corporate bodies receive support from the Chief Risk Officer who reports directly to the Chief Executive Officer. The Chief Risk Officer is responsible for proposing the Risk Appetite Framework, setting the Group's risk management and compliance 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 management of the Group's overall risk profile by establishing methods and monitoring exposure to the various types of risk and reporting the situation periodically to the corporate bodies.
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 defining a risk-monitoring framework at Group level, capable of assessing the risks assumed by the Group from a regulatory and economic point of view. The level of absorption of economic capital, defined as the maximum "unexpected" loss 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 3 REGULATIONS AND THE INTERNAL PROJECT

With effect from 1 January 2014, the reforms of the accords by the Basel Committee ("Basel 3") were implemented in the EU legal framework. Their aim is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, improve risk management and governance, and strengthen banks' transparency and disclosures. In doing so, the Committee maintained the approach based on three Pillars, which was at the basis of the previous capital accord, known as "Basel 2", supplementing and strengthening it to increase the quantity and quality of intermediaries' available capital as well as introducing counter-cyclical regulatory instruments, provisions on liquidity risk management and financial leverage containment.
Therefore, the EU implemented "Basel 3" through two legislative acts:

- Regulation (EU) No. 575/2013 of 26 June 2013 (CRR), which governs the prudential supervision requirements of Pillar 1 and public disclosure requirements (Pillar 3);
- Directive 2013/36/EU of 26 June 2013 (CRD IV), which, among other things, deals with the access to the activity of credit institutions, freedom of establishment, freedom to provide services, supervisory review process, and additional equity reserves.

EU legislation is complemented by the provisions issued by the Bank of Italy and referring to Circular no. 285 of 17 December 2013, which contains the prudential supervision regulations applicable to banks and Italian banking groups, reviewed and updated to adjust the internal regulations to the new elements of the international regulatory framework, with special reference to the new regulatory and institutional structure of banking supervision of the European Union and taking into account the needs detected while supervising banks and other intermediaries.

In order to comply with the new rules envisaged by Basel 3, the Group has undertaken adequate project initiatives, expanding the objectives of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.
Additional information on own funds, which are now calculated according to the Basel 3 rules, and on capital ratios of the Group is provided in the section on balance sheet aggregates: Own funds and capital ratios, and in the document Basel 3 Pillar 3.

With respect to credit risks, the Group received authorisation to use internal ratings-based approaches effective from the report as at 31 December 2008 on the Corporate portfolio for a scope extending to the Parent Company, network banks in the Banca dei Territori Division and the main Italian product companies.
Progressively, the scope of application has been gradually extended to include the SME Retail and Mortgage portfolios, as well as other Italian and international Group companies, as shown in the following table.

<table>
<tr><th rowspan="2"></th><th colspan="2">Corporate</th><th>SME Retail</th><th>Mortgage</th></tr>
<tr><th>FIRB</th><th>AIRB LGD</th><th>IRB LGD</th><th>IRB LGD</th></tr>
<tr><td>Intesa Sanpaolo</td><td rowspan="12">Dec - 2008</td><td rowspan="11">Dec - 2010</td><td rowspan="11">Dec - 2012</td><td rowspan="10">Jun - 2010</td></tr>
<tr><td>Banco di Napoli</td></tr>
<tr><td>Cassa di Risparmio del Veneto</td></tr>
<tr><td>Cassa di Risparmio di Bologna</td></tr>
<tr><td>Cassa di Risparmio di Venezia</td></tr>
<tr><td>Cassa di Risparmio del Friuli Venezia Giulia</td></tr>
<tr><td>Cassa dei Risparmi di Forlì e della Romagna</td></tr>
<tr><td>Banca dell'Adriatico</td></tr>
<tr><td>Banca di Trento e Bolzano</td></tr>
<tr><td>Banca di Credito Sardo</td></tr>
<tr><td>Mediocredito Italiano</td><td>n.a.</td></tr>
<tr><td>Mediofactoring</td><td>Jun - 2012</td><td>*</td><td>n.a.</td></tr>
<tr><td>Gruppo Cassa di Risparmio di Firenze</td><td>Dec - 2009</td><td>Dec - 2010</td><td>Dec - 2012</td><td>Jun - 2010</td></tr>
<tr><td>Cassa di risparmio dell'Umbria</td><td>n.a.</td><td>Dec - 2010</td><td>Dec - 2012</td><td>Dec - 2011</td></tr>
<tr><td>Cassa di Risparmio della Provincia di Viterbo</td><td>n.a.</td><td>Dec - 2010</td><td>Dec - 2012</td><td>Dec - 2011</td></tr>
<tr><td>Cassa di Risparmio di Rieti</td><td>n.a.</td><td>Dec - 2010</td><td>Dec - 2012</td><td>Dec - 2011</td></tr>
<tr><td>Banca Monte Parma</td><td>n.a.</td><td>Dec - 2013</td><td>Mar - 2014</td><td>Dec - 2013</td></tr>
<tr><td>Banca Prossima</td><td>n.a.</td><td>Dec - 2013</td><td>Dec - 2013</td><td>n.a.</td></tr>
<tr><td>Banca IMI</td><td>n.a.</td><td>Jun - 2012</td><td>n.a.</td><td>n.a.</td></tr>
<tr><td>Intesa Sanpaolo Bank Ireland</td><td>Mar - 2010</td><td>Dec - 2011</td><td>n.a.</td><td>n.a.</td></tr>
<tr><td>Vseobecna Uverova Banka</td><td>Dec - 2010</td><td>Jun - 2014</td><td>Jun - 2014</td><td>Jun - 2012</td></tr>
</table>

(*) Banks included in the roll-out plan which have not yet obtained authorisation from the Supervisory Authority.

It should be noted, in particular, that effective from the report as at 30 June 2014, the Slovakian subsidiary VUB received authorisation from the Bank of Italy for transition to the AIRB approach for the Corporate segment and the IRB approach for the SME Retail segment.

Dedicated rating approaches have been developed for the Banks and Public Entities Portfolio according to the type of counterparty to be assessed. This was the subject of a pre-validation inspection by the Supervisory Authority conducted in December 2013 as part of the process leading up to the application for authorisation to be submitted in the first half of 2015.
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 reference to the Parent Company Intesa Sanpaolo and to Banca IMI, the Bank of Italy granted the authorisation to use the internal counterparty risk model for regulatory purposes, starting from the first quarter of 2014.

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

In April 2014 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 mentioned, as part of its adoption of Basel 3, the Group publishes information concerning capital adequacy, exposure to risks and the general characteristics of the systems aimed at identifying, monitoring and managing them in a document entitled "Basel 3 - Pillar 3" or simply "Pillar 3".
The document is published on the website (group.intesasanpaolo.com) on a quarterly basis.

CREDIT RISK

The 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 and mitigating potentially associated losses;
– given the current economic climate, favouring lending business aimed at supporting the real economy and production system and at developing relationships with customers;
– constantly monitoring relationships and the related exposures, through the use of both IT procedures and systematic surveillance of positions that show irregularities with the aim of detecting any symptoms of deterioration in a timely manner.

The 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 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 pre-set rules, positions which are attributed a persistent high-risk rating are intercepted (manually or automatically) and classified to the following categories based on their risk profile: 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.

(millions of euro)

	30.06.2014			31.12.2013			Changes
	Gross exposure	Total adjustments	Net exposure	Gross exposure	Total adjustments	Net exposure	Net exposure
Doubtful loans	36,324	-22,923	13,401	34,403	-21,504	12,899	502
Substandard loans	19,044	-4,476	14,568	17,979	-4,164	13,815	753
Restructured loans	2,962	-471	2,491	2,728	-413	2,315	176
Past due loans	1,957	-237	1,720	2,232	-274	1,958	-238
Non-performing loans	**60,287**	**-28,107**	**32,180**	**57,342**	**-26,355**	**30,987**	**1,193**
Performing loans	288,215	-2,421	285,794	300,341	-2,402	297,939	-12,145
Performing loans represented by securities	14,543	-306	14,237	15,207	-344	14,863	-626
Loans to customers	**363,045**	**-30,834**	**332,211**	**372,890**	**-29,101**	**343,789**	**-11,578**

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

The table above shows an increase for the first half of 2014 of non-performing loans, net of adjustments, by 1,193 million euro (+3.9%), compared to the end of the previous year. This trend led to a higher incidence of non-performing loans on total loans to customers, increasing from 9% to 9.7%. Coverage of non-performing loans came to approximately 46.6%, higher than the level at the end of 2013 (46%), however deemed adequate to meet the expected losses, also considering the guarantees securing the positions.
In particular, as at 30 June 2014, doubtful loans, net of adjustments, reached 13.4 billion euro, up 3.9% since the beginning of the year. The incidence on total loans was 4%, with a coverage ratio of 63.1%.
Compared to 31 December 2013, substandard loans increased 5.5% to 14.6 billion euro. Substandard loans as a proportion of total loans to customers increased from 4% to 4.4% in the first six months of the year, and the coverage ratio, adequate for the risk intrinsic to this portfolio, was 23.5%, slightly above the figure at the end of the prior year.
Restructured loans stood at 2,491 million euro, up compared to the beginning of the year (+7.6%), with a coverage ratio of 15.9%, up from 15.1% in the previous year.
Past due loans recorded a decrease of 238 million euro (-12.2%) to 1,720 million euro from 1,958 million euro for the previous year. This type of non-performing loans accounted for 0.5% of the total. The coverage ratio came to 12.1%, in line with the figure as at the end of 2013.
Performing exposures decreased, from 297.9 billion euro in the previous year to 285.8 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 in line with the figure recorded at the end of the previous year.

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.

Other Group subsidiaries hold smaller trading portfolios with a marginal risk (around 2% of the Group's overall risk). In particular, the risk factors of the international subsidiaries' trading books are local government bonds, positions in interest rates and foreign exchange rates relating to linear pay-offs.
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.
Effective from the report as at 30 September 2012, both banks have received authorisation from the Supervisory Authority to extend the scope of the model to specific risk on debt securities. The model was extended on the basis of the current methodological framework (a historical simulation in full evaluation), and required the integration of the Incremental Risk Charge into the calculation of the capital requirement for market risks.
Effective from June 2014, market risks are to be reported according to the internal model for capital requirements for the Parent Company's hedge fund portfolios (the full look-through approach).

The risk profiles validated are: (i) generic/specific on debt securities and on equities for Intesa Sanpaolo and Banca IMI, (ii) position risk on quotas of UCI underlying CPPI (Constant Proportion Portfolio Insurance) products for Banca IMI, (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 from 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 2 market risk framework":
- the period must represent a stress scenario for the portfolio;
- the period must have a significant impact on the main risk factors for the portfolios of Intesa Sanpaolo and Banca IMI;
- the period must allow real 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 this document, the period relevant to the measurement of stressed VaR had been set as 1 January to 31 December 2011 for Intesa Sanpaolo and at 1 July 2011 to 30 June 2012 for Banca IMI.

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, with 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 2014, market risks generated by Intesa Sanpaolo and Banca IMI decreased slightly with respect to the averages for the first quarter of 2014. The average VaR for the period totalled 44.7 million euro.

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

(millions of euro)

	2014				2013			
	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	9.6	7.9	12.0	9.4	10.5	8.2	11.7	14.1
Banca IMI	35.0	23.8	45.7	37.0	38.6	39.3	50.8	59.0
Total	**44.7**	**32.0**	**55.5**	**46.5**	**49.2**	**47.6**	**62.5**	**73.2**

(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 2014, market risks generated by Intesa Sanpaolo and Banca IMI markedly decreased with respect to the values for 2013.

(millions of euro)

	2014			2013		
	average 1st half	minimum 1st half	maximum 1st half	average 1st half	minimum 1st half	maximum 1st half
Intesa Sanpaolo	9.5	7.9	12.0	14.1	11.5	18.1
Banca IMI	36.0	23.8	45.7	59.0	46.0	74.2
Total	**45.6**	**32.0**	**55.5**	**73.2**	**60.2**	**88.5**

(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.

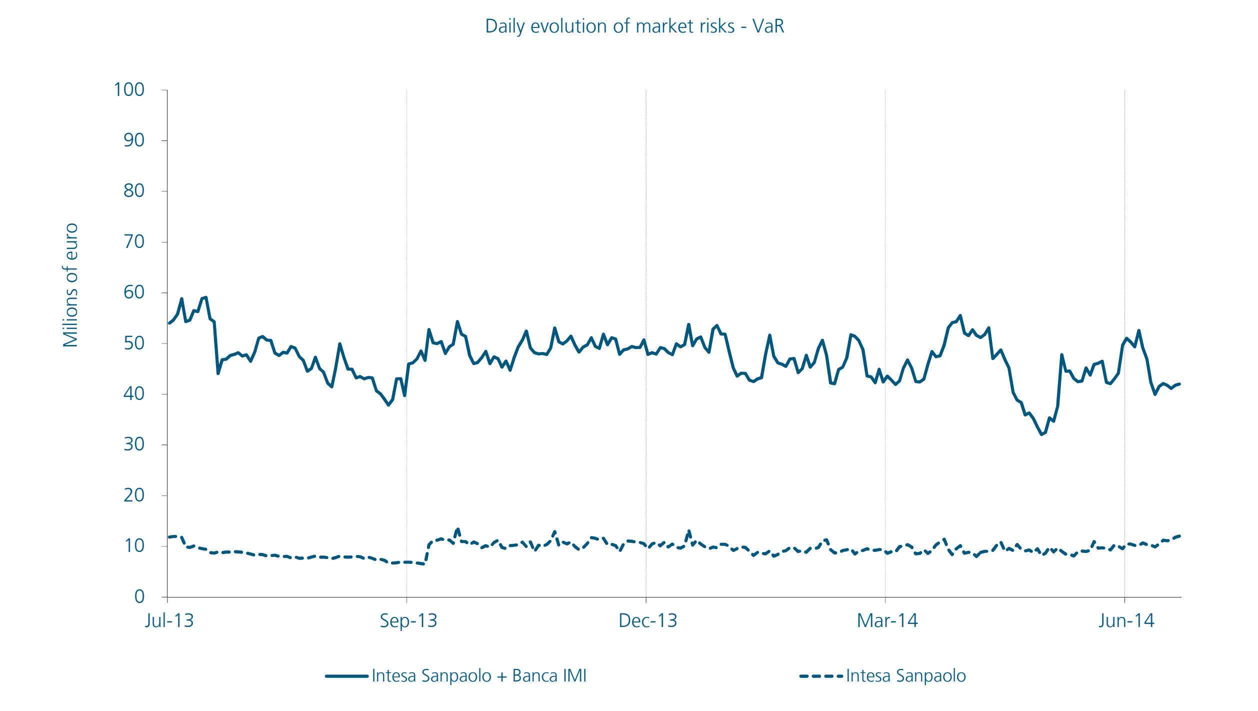
For Intesa Sanpaolo the breakdown of risk profile in the second quarter of 2014 with regard to the various factors shows the prevalence of the risk generated by hedge funds, which accounted for 35% of total VaR; for Banca IMI credit spread risk was the most significant, representing 63% of total VaR.

Contribution of risk factors to total VaR[(a)]

2nd quarter 2014	Shares	Hedge funds	Rates	Credit spreads	Foreign exchange rates	Other parameters	Commodities
Intesa Sanpaolo	28%	35%	8%	21%	7%	1%	0%
Banca IMI	6%	0%	12%	63%	1%	15%	3%
Total	**13%**	**10%**	**11%**	**50%**	**3%**	**11%**	**2%**

(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 2014, broken down between Intesa Sanpaolo and Banca IMI and indicating the distribution of overall capital at risk.

The evolution of VaR in the last twelve months is set out below. Risk measures declined slightly on average in the first half of 2014: in further detail, there was a decline in the average in the second quarter primarily for Banca IMI. The Group's risk performance is explained by the operations of Banca IMI, which following the peak in early April showed a gradual reduction through mid-May of exposure to Italian and Spanish government bonds (assumed within the approved limits of the Risk Appetite Framework). In May, risk measures reflected a new scenario of volatility affecting Italy risk, which resulted in an increase in VaR. In June, risk measures declined once again due to both the reduction in Italian and Spanish government bonds and the elimination from the historical simulation used to calculate VaR of scenarios concerning the June 2012 period:



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 bullish scenario, that is a 5% increase in stock prices with a simultaneous 10% decrease in volatility would have led to a 17 million euro gain or to a -16 million euro loss in the opposite scenario;
– on interest rate exposures, a parallel +70 basis point shift (average) would have led to a 58 million euro loss, whereas a parallel shift in the euro curve with near zero rates would have led to potential gains of 174 million euro;
– on exposures sensitive to credit spread fluctuations, a 25 basis point widening in spreads would have led to a 170 million euro loss;
– on foreign exchange exposures, an increase of the euro against the other currencies would have led to a loss of approximately 9 million euro;
– finally, on commodities exposures, a 50% increase in the prices of the underlying would have led to a 28 million euro loss.

(millions of euro)

	EQUITY		INTEREST RATES		CREDIT SPREADS		FOREIGN EXCHANGE RATES		COMMODITY	
	volatility +10% and prices -5%	volatility -10% and prices +5%	+70bp	lower rate	-25bp	+25bp	-10%	+10%	-50%	+50%
Total	-16	17	-58	174	156	-170	15	-9	28	-28

Backtesting

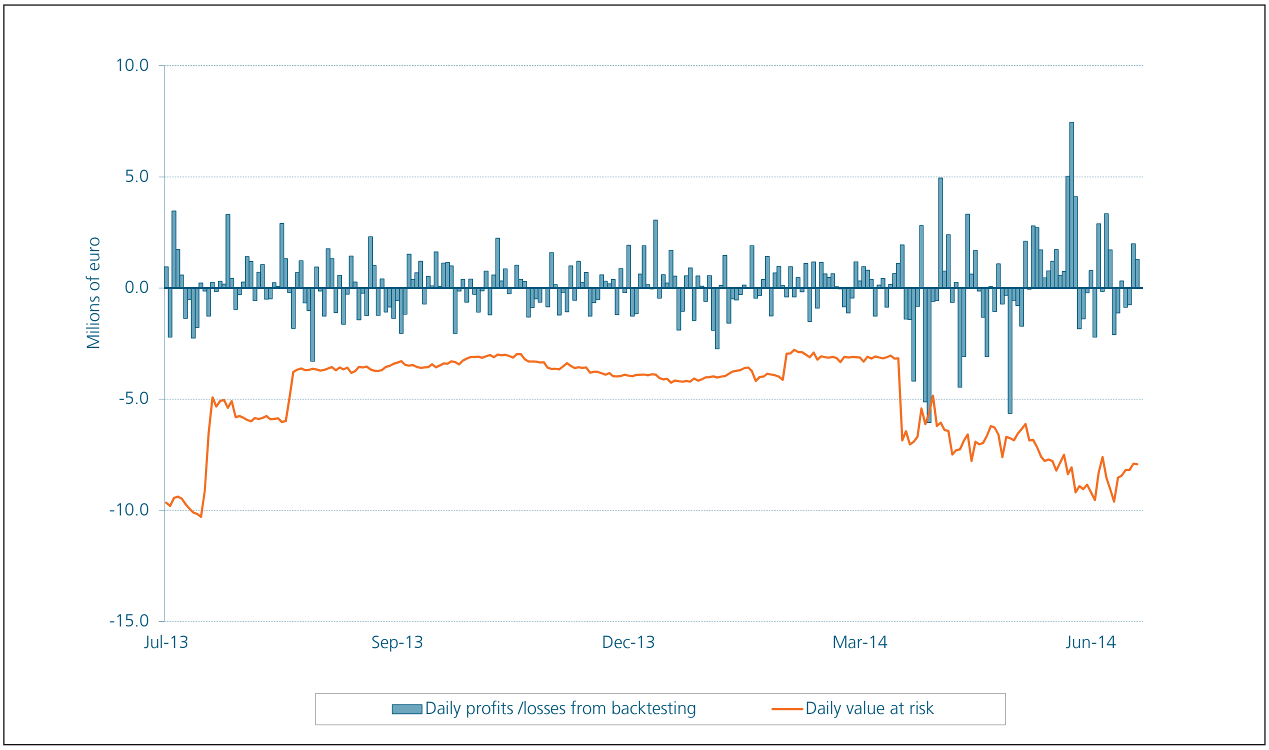
The effectiveness of the VaR calculation methods must be monitored daily via backtesting which, as concerns regulatory backtesting, compares:

– 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 valuation 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.

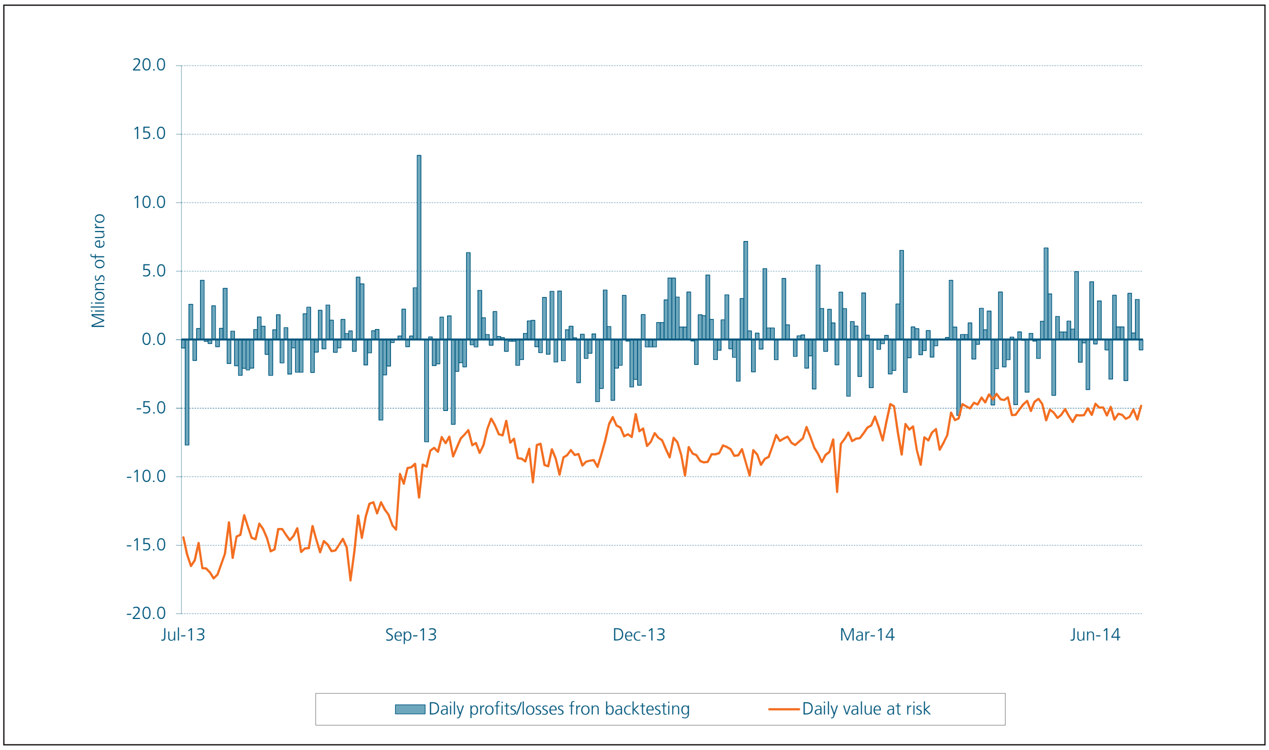
Backtesting in Intesa Sanpaolo

There was a single exception to theoretical backtesting during the last year. The loss is to be attributed to the performance of stock prices in April 2014.



Backtesting in Banca IMI

Banca IMI's backtesting exception refers to the actual P&L data. The loss is to be attributed to the fluctuation of Italian stock prices since early May 2014.



BANKING BOOK

Market risk originated by the banking book arises primarily in the Parent Company and in the other main Group companies involved in 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 that is being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a forecast indicator 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 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).
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 2014, interest rate risk generated by the Intesa Sanpaolo Group’s banking book, measured through shift sensitivity analysis, registered an average value of 130 million euro settling at 172 million euro at the end of June, almost entirely concentrated on the euro currency; this figure compares with 206 million euro at the end of 2013.
Interest margin sensitivity – assuming a 100 basis point change in interest rates – amounted to 212 million euro at the end of June 2014 (264 million euro at the end of 2013).
Interest rate risk, measured in terms of VaR, averaged 23 million euro during the first six months of 2014 (40 million euro at the end of 2013), with a maximum value of 28 million euro and a minimum value of 14 million euro; the latter figure coincides with the value at the end of June. 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 36 million euro in the first six months of 2014 (33 million euro at the end of 2013), with a minimum value of 30 million euro and a maximum value of 59 million euro, confirmed in the final figures at the end of June.
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 sensitivity to a 10% negative shock equal to 10 million euro at the end of June 2014.

LIQUIDITY RISK

Liquidity risk is defined as the risk that the Bank may not be able to meet its payment obligations due to the inability to obtain funds on the market (funding liquidity risk) or liquidate its assets (market liquidity risk).
The arrangement of a suitable control and management system for that specific risk has a fundamental role in maintaining stability, not only at the level of each individual bank, but also of the market as a whole, 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.
To reflect the new Basel 3 liquidity requirements, which in June 2013 were adopted by the European Union with the publication of Directive 2013/36/EU and Regulation 575/2013 (known as CRD IV and CRR), in December 2013 the Corporate Bodies of Intesa Sanpaolo updated the Liquidity Policy by replacing, starting from January 2014, the previous internal indicators with the LCR (Liquidity Coverage Ratio) and the NSFR (Net Stable Funding Ratio) metrics. These Guidelines illustrate the tasks of the various company functions, the rules and the set of control and management processes aimed at ensuring prudent monitoring of liquidity risk, thereby preventing the emergence of crisis situations. 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 adequate 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 an internal fund 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 early 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 and the Planning, Strategic ALM and Capital Management 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 with certain or estimated maturities included in 12 months' time horizon, in order to face to periods of tension, including extended ones, on different funding markets, also by establishing adequate liquidity reserves in the form of assets eligible for refinancing with Central Banks or liquid securities on private markets. 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 (Liquidity Coverage Ratio).
The cumulative projected wholesale imbalances indicator measures the Bank's independence from unsecured wholesale funding in the event of a freeze of the money market and aims to ensure financial autonomy, assuming the use on the market of only the highest quality liquidity reserves. The LCR indicator is aimed at strengthening the short-term liquidity risk profile, ensuring that sufficient unencumbered high quality liquid assets (HQLA) are retained that can be converted easily and immediately into cash on the private markets to satisfy the short-term liquidity requirements (30 days) in a liquidity stress scenario. To this end, the Liquidity Coverage Ratio measures the ratio between: (i) the stock of HQLA and (ii) the total net cash outflows calculated according to the scenario parameters defined by the regulations. The LCR requirement will gradually come into force, starting with a percentage of 60% from January 2015.
The aim of Intesa Sanpaolo Group's structural Liquidity Policy is to adopt the structural requirement provided for by the regulatory provisions of Basel 3: Net Stable Funding Ratio. This indicator is aimed at promoting the increased use of stable funding, to prevent medium/long-term operations from giving rise to excessive imbalances to be financed in the short term.
To this end, it sets a minimum "acceptable" amount of funding exceeding one year in relation to the needs originating from the characteristics of liquidity and residual duration of assets and off-balance sheet exposures. NSFR's regulatory requirement, which is still subject to a period of observation, will come into force starting from 1 January 2018.
Within the Liquidity Policy it is also envisaged the time extension of the stress scenario for LCR indicator, provided by the new regulatory framework, measuring, for up to 3 months, the effect of specific acute liquidity tensions (at bank level) combined with a widespread and general market crisis. The internal management guidelines also envisage an alert threshold (Stressed soft ratio) for the LCR indicator up to 3 months, with the purpose of establishing an overall level of reserves covering greater cash outflows during a period of time that is adequate to implement the required operating measures to restore the Group to balanced conditions.

The 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 early 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 six months of 2014 the Group's liquidity position remained largely within the limits provided for in the Group's Liquidity Policy in force: both regulatory indicators envisaged by Basel 3 (LCR and NSFR) were met, already reaching a level above the limits under normal conditions. As at 30 June 2014, the liquidity reserves eligible with the various Central Banks came to 107 billion euro (124 billion euro at the end of December 2013), of which 82 billion euro, net of haircut, was available spot (88 billion euro at the end of December 2013) and remained unused.
Also the stress tests, when considering the high availability of liquidity reserves (liquid or eligible), yielded results in excess of the target threshold for the ISP Group, with a liquidity surplus capable of meeting extraordinary cash outflows for a period of more than 3 months.
Adequate and timely information regarding the development of market conditions and the position of the Bank and/or Group was provided to company bodies and internal committees in order to ensure full awareness and manageability of the main risk factors.

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.

FAIR VALUE MEASUREMENT 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 2013.
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (i.e. not as part of the compulsory liquidation or a below-cost sale) as at the measurement date. Fair value is a market measurement criterion, not specifically referring to a single entity.Underlying the definition of fair value is the assumption that the company is carrying out normal operations, without any intention of liquidating its assets, significantly reducing the level of operations or carrying out transactions at unfavourable conditions.

An entity has to measure the fair value of an asset or liability by adopting the assumptions that would be used by market participants when pricing an asset or liability, presuming that they act with a view to satisfying their own economic interest in the best way possible.

The fair value of financial instruments is determined according to a hierarchy of criteria based on the origin, type and quality of the information used. In detail, this hierarchy assigns top priority to quoted prices (unadjusted) in active markets and less importance to unobservable inputs. Three different levels of input are identified:

- level 1: input represented by quoted prices (unadjusted) in active markets for identical assets or liabilities accessible by the entity as at the measurement date;
- level 2: input other than quoted prices included in level 1 that are directly or indirectly observable for the assets or liabilities to be measured;
- level 3: unobservable input for the asset or liability.

As ***level 1*** inputs are available for many financial assets and liabilities, some of which are traded in more than one active market, the company must pay particular attention to defining both of the following aspects:

- the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability;
- whether the company can complete a transaction involving the asset or liability at that price and in that market as at the measurement date.

The Intesa Sanpaolo Group considers the principal market of a financial asset or liability to be the market in which the Group generally operates.
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.
In specific cases regulated by internal policies and despite being quoted on regulated markets, research is carried out in order to verify the significance of official market values.

In the event of a significant reduction in the volume or level of operations compared to normal operations for the asset or liability (or for similar assets or liabilities) highlighted by a number of indicators (number of transactions, limited significance of market prices, significant increase in implicit premiums for liquidity risk, expansion or increase of the bid-ask spread, reduction or total lack of market for new issues, limited publicly-available information), analyses of the transactions or of the quoted prices are carried out.

The following are considered as level 1 financial instruments: contributed equities, bonds quoted on the EuroMTS circuit, those for which it is possible to continuously derive from the main contribution international platforms at least three bid and ask prices, and those for which prices are provided by the Markit platform, with at least three bid and ask prices for bonds and convertibles and at least five bid and ask prices for European ABSs, harmonised mutual funds contributed, spot exchange rates, and derivatives for which quotations are available on an active market (for example, futures and exchange traded options). Finally, level 1 instruments also include hedge funds for which the fund administrator provides the NAV (Net Asset Value) with the frequency established in the subscription contract, and the check list, which is the summary document of significant information on underlying assets of the fund, does not highlight any critical points in terms of liquidity risk or counterparty risk.
For level 1 financial instruments, the current bid price is used for financial assets and the current asking price for financial liabilities, struck on the principal active market at the close of the reference period.
For financial instruments with a scarcely significant bid-ask spread or for financial assets and liabilities with offsetting market risks, mid-market prices are used (again referred to the last day of the reference period) instead of the bid or ask price.
Conversely, all other financial instruments that do not belong to the above-described categories or that do not have the contribution level defined by the Fair Value Policy are not considered level 1 instruments.

When no quotations 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 at which, in an orderly transaction, the asset is sold or the liability transferred between market participants, as at the

measurement date, under current market conditions.
Such techniques include:
- the use of market values that are indirectly linked to the instrument to be measured, deriving from products with the same risk profile (level 2);
- valuations performed using – in whole or in part but primarily – inputs not identified from parameters observed on the market, for which estimates and assumptions made by the valuator are used (level 3).

In the case of level 2 inputs, the valuation is not based on the price of the same financial instrument to be measured, but on prices or credit spreads presumed from official listing of instruments which are similar in terms of risk factors, using a given calculation methodology (pricing model). The use of this approach requires the identification of transactions on active markets in relation to instruments that, in terms of risk factors, are comparable with the instrument to be measured. Level 2 calculation methodologies reproduce prices of financial instruments quoted on active markets (model calibration) and do not contain discretional parameters – parameters for which values may not be inferred from quotations of financial instruments present on active markets or fixed at levels capable of reproducing quotations on active markets – that significantly influence the final valuation.
The following are measured using level 2 input models:
- bonds without official quotations expressed by an active market and whose fair value is determined through the use of an appropriate credit spread which is estimated starting from contributed and liquid financial instruments with similar characteristics;
- derivatives measured through specific pricing models, fed by input parameters (such as yield, foreign exchange and volatility curves) observed on the market;
- ABSs for which significant prices are not available and whose fair value is measured using valuation techniques that consider parameters which may be presumed from the market;
- equities measured based on direct transactions, that is significant transactions on the stock registered in a time frame considered to be sufficiently short with respect to measurement date and in constant market conditions, using, therefore, the "relative" valuation models based on multipliers;
- loans measured through the discounting of future cash flows.

The calculation of the fair value of certain types of financial instruments is based on valuation models which consider parameters not directly observable on the market, therefore implying estimates and assumptions on the part of the valuator (level 3).
In particular, the valuation of the financial instrument uses a calculation methodology which is based on specific assumptions of:
- the development of future cash-flows, which may be affected by future events that may be attributed probabilities presumed from past experience or on the basis of the assumed behaviour;
- the level of specific input parameters not quoted on active markets, for which information acquired from prices and spreads observed on the market is in any case preferred. Where this is not available, past data on the specific risk of the underlying asset or specialised reports are used (e.g. reports prepared by Rating agencies or primary market players).

The following are measured under the Mark-to-Model Approach:
- debt securities for which at least one significant input for the purposes of calculating fair value is not observable on the market;
- debt securities and complex credit derivatives (CDOs and some ABSs) included among structured credit products and credit derivatives on index tranches;
- hedge funds not included in level 1;
- shareholding and other equities measured using models based on discounted cash flows;
- some loans, of a smaller amount, classified in the available-for-sale portfolio;
- derivative transactions relating to securitisations and equity-risk structured options;
- some OTC interest-rate derivatives relating to correlations between CMS (Constant Maturity Swap) rates;
- some commodities options;
- derivatives with counterparties in default;
- some derivatives for which the bCVA is calculated through the use of historical PD with a significant impact on the transaction's total fair value.

Regarding the valuation techniques used for financial instruments (securities, derivatives, structured products, hedge funds) classified within levels 2 and 3 of the fair value hierarchy, no changes are recorded compared to the description in the Annual Report 2013.
In particular, in valuing the derivative contracts, the Group considers the (own and counterparty) non-performance risk which is calculated through the bilateral Credit Value Adjustment method. Valuation of the "credit risk free" component of OTC derivatives determines the initial choice of the level of the fair value hierarchy, according to the level of observability of market parameters. Calculation of the component linked to the insolvency risk of the counterparty/issuer, with unobservable parameters such as historical PD, may involve reclassification to level 3 of the fair value hierarchy.

With regard to the attribution of fair value hierarchy levels, it is also underlined that, for the hedge funds managed through the Managed Account Fund (MAF) platform, the platform's characteristics make it possible to perform an analysis of the financial instruments underlying the funds and to assign the fair value hierarchy level based on the prevalence, in terms of percentage of NAV, of the weight of assets priced according to the various levels.

The Intesa Sanpaolo Group governs and defines the fair value measurement of financial instruments through the Group's Fair Value Policy, prepared by the Risk Management Department and also applied to the Parent Company and to all consolidated subsidiaries. The first part of the document, "General principles", once a favourable opinion has been given by the Group Financial Risks Committee and the Managing Director and CEO, is approved and revised at least on an annual basis by the Management Board, and specific notice thereof is given to the Control Committee and the Financial Statements Committee. The second part, "Detailed methods", is reviewed, approved and revised at least on an annual basis by the Group Financial Risks Committee, which is specifically delegated to do so by the Administrative Bodies, and which also reviews material changes and updates, proposal of which falls to the Risk Management Central Department.

The valuation process for financial instruments (as described in the "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.

Fair value hierarchy

Accounting portfolios: fair value by level

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)

Assets / liabilities at fair value	30.06.2014			31.12.2013		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets held for trading	18,643	32,734	694	16,938	31,309	753
2. Financial assets designated at fair value through profit or loss	35,691	2,424	344	32,374	3,004	383
3. Financial assets available for sale	108,330	4,942	5,078	105,489	4,196	5,608
4. Hedging derivatives	-	8,539	1	-	7,533	1
5. Property and equipment	-	-	-	-	-	-
6. Intangible assets	-	-	-	-	-	-
Total	**162,664**	**48,639**	**6,117**	**154,801**	**46,042**	**6,745**
1. Financial liabilities held for trading	4,678	36,257	248	7,063	31,756	400
2. Financial liabilities designated at fair value through profit or loss	-	33,441	-	-	30,733	-
3. Hedging derivatives	-	8,833	13	-	7,577	13
Total	**4,678**	**78,531**	**261**	**7,063**	**70,066**	**413**

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

In addition to the transfers relating to financial assets and liabilities measured at level 3 as detailed in the tables below, note that the following transfers were made in the first half of 2014:
– from level 1 to level 2:
  - o financial assets held for trading for 127 million euro (book value as at 30 June 2014);
  - o financial assets designated at fair value through profit and loss for 13 million euro (book value as at 30 June 2014);
  - o financial assets available for sale for 150 million euro (book value as at 30 June 2014);
  - o financial liabilities held for trading for 1,471 million euro (book value as at 30 June 2014).
– from level 2 to level 1:
  - o financial assets held for trading for 342 million euro (book value as at 30 June 2014);
  - o financial assets designated at fair value through profit and loss for 33 million euro (book value as at 30 June 2014);
  - o financial assets available for sale for 62 million euro (book value as at 30 June 2014);
  - o financial liabilities held for trading for 123 million euro (book value as at 30 June 2014).

Transfers between fair values levels derive from the empirical observation of phenomena inherent in the instrument in question or its market.
The transfer from level 1 to level 2 is due to an adequate number of contributors no longer being present, namely to the limited number of investors holding the existing float. This cases often occur when approaching maturity of the instruments. Conversely, securities that have limited liquidity and number of negotiations upon issue – classified, therefore, as level 2 – are transferred to level 1 when the existence of an active market is identified.

The caption "3. Financial assets available for sale" – level 3 – includes 3,182 million euro referring to the new stakes issued by the Bank of Italy in application of Law Decree 133 of 30 November 2013, converted into Law no. 5 of 29 January 2014, following the amendments to the Articles of Association approved by the Shareholders' Meeting of the Bank of Italy on 23 December 2013.

As required by IFRS 13, the following table provides the fair value of financial assets and liabilities measured at amortised cost.

Half-yearly changes in financial assets designated at fair value on a recurring basis (level 3)

(millions of euro)

	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Financial assets available for sale	Hedging derivatives	Property and equipment	Intangible assets
1. Initial amount	**753**	**383**	**5,608**	**1**	**-**	**-**
2. Increases	**4,376**	**28**	**205**	**-**	**-**	**-**
2.1 Purchases	4,214	-	67	-	-	-
2.2 Gains recognised in:	75	28	49	-	-	-
2.2.1 Income statement	*75*	*28*	*15*	-	-	-
- of which capital gains	*69*	*22*	-	-	-	-
2.2.2 Shareholders' equity	*X*	*X*	*34*	-	-	-
2.3 Transfers from other levels	74	-	16	-	-	-
2.4 Other increases	13	-	73	-	-	-
3. Decreases	**-4,435**	**-67**	**-735**	**-**	**-**	**-**
3.1 Sales	-4,224	-65	-139	-	-	-
3.2 Reimbursements	-32	-	-39	-	-	-
3.3 Losses recognized in:	-81	-	-67	-	-	-
3.3.1 Income statement	*-81*	-	*-51*	-	-	-
- of which capital losses	*-76*	-	*-51*	-	-	-
3.3.2 Shareholders' equity	*X*	*X*	*-16*	-	-	-
3.4 Transfers to other levels	-86	-	-459	-	-	-
3.5 Other decreases	-12	-2	-31	-	-	-
4. Final amount	**694**	**344**	**5,078**	**1**	**-**	**-**

"Transfers from other levels" of "Financial assets held for trading" are mainly due to derivative contracts with a positive fair value.

Half-yearly changes in financial liabilities designated at fair value on a recurring basis (level 3)

(millions of euro)

	Financial liabilities held for trading	Financial liabilities designated at fair value through profit or loss	Hedging derivatives
1. Initial amount	**400**	**-**	**13**
2. Increases	**37**	**-**	**3**
2.1 Issues	3	-	-
2.2 Losses recognised in:	32	-	3
2.2.1 Income statement	*32*	*-*	*3*
- of which capital losses	*32*	*-*	*3*
2.2.2 Shareholders' equity	*X*	*X*	-
2.3 Transfers from other levels	2	-	-
2.4 Other increases	-	-	-
3. Decreases	**-189**	**-**	**-3**
3.1 Reimbursements	-70	-	-
3.2 Repurchases	-24	-	-
3.3 Gains recognised in:	-65	-	-3
3.3.1 Income statement	*-65*	*-*	*-3*
- of which capital gains	*-41*	*-*	*-3*
3.3.2 Shareholders' equity	*X*	*X*	-
3.4 Transfers to other levels	-30	-	-
3.5 Other decreases	-	-	-
4. Final amount	**248**	**-**	**13**

"Financial liabilities held for trading" refer to derivative contracts with a negative fair value.

Assets and liabilities not measured at fair value or measured at fair value on a non-recurring basis: fair value by level

(millions of euro)

Assets/liabilities not measured at fair value or measured at fair value on a non-recurring basis	30.06.2014		31.12.2013	
	Book value	Level 1	Book value	Level 1
1. Investments held to maturity	1,455	1,488	2,051	2,050
2. Due from banks	30,882	30,349	26,448	26,345
3. Loans to customers	332,211	344,122	343,789	350,369
Total	**364,548**	**375,959**	**372,288**	**378,764**
1. Due to banks	34,557	34,085	52,244	51,741
2. Due to customers	233,343	233,811	228,777	228,783
3. Securities issued	136,832	138,936	138,197	139,059
Totale	**404,732**	**406,832**	**419,218**	**419,583**

Sensitivity analysis for financial assets and liabilities measured at level 3

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

(thousands of Euro)

Financial assets/liabilities	Non-observable parameters	Sensitivity (thousands of euro)	Change in non-observable parameter
Held for trading and available for sale securities	Credit spread	-55	1 bp
Held for trading and available for sale securities	Volatilità	6	1%
Held for trading and available for sale securities	Correlazione	-118	1%
Held for trading and available for sale securities	Recovery rate	-141	1%
OTC Derivatives - Interest rate	Correlation for spread options between swap rates (7 and 15 yrs)	-35	0.10
OTC Derivatives - Commodity	Volatility for the underlying Power Italia (PW IT Terna)	2	1%
OTC Derivatives - Equity	Correlation between underlying equity baskets	75	0.10

The sensitivity analysis performed on level 3 structured credit products highlights a negative change in fair value, referring to complex credit derivatives, for an amount not material[3] 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 collateral 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).

Information on the "Day-one-profit/loss"

Under IAS 39, financial instruments shall be initially recognised at fair value. The fair value of a financial instrument on initial recognition is normally the "transaction price", i.e. the fair value of the consideration given or received in relation to, respectively, financial assets and liabilities.

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

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

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

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

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

The following table shows the amount deferred in the balance sheet, indicating the portion taken to the income statement.

(millions of euro)

1. Initial amount	**17**
2. Increases	**-**
2.1 New transactions	-
3. Decreases	**-6**
3.1 Releases to the income statement	-6
4. Final amount	**11**

[3] This amount is shown net of the adjustments to valuations relating to the main input parameters which were already considered to determine the fair value of financial instruments (see paragraph "Fair value measurement" above).

STRUCTURED CREDIT PRODUCTS

The risk exposure to structured credit products amounted to 2,231 million euro as at 30 June 2014 with respect to funded and unfunded ABSs/CDOs, compared to 2,033 million euro as at 31 December 2013, in addition to an exposure of 28 million euro with respect to structured packages, essentially in line with the 26 million euro observed as at 31 December 2013.
The rise in the exposure (from 1,068 million euro in December 2013 to 1,393 million euro in June 2014) classified in the trading portfolio is largely attributable to higher investments in ABSs by the subsidiary Banca IMI, part of which was classified to the available-for-sale portfolio.
With regard to the exposure represented by securities classified under the loan portfolio, on the other hand, a significant decrease was recorded (from 965 million euro in December 2013 to 838 million euro in June 2014), almost entirely attributable to the Parent Company loan portfolio and for the most part due to sales.

From an income statement perspective, structured credit products generated a net income of 26 million euro as at 30 June 2014 compared to 67 million euro at the end of 2013 and 61 million euro as at 30 June 2013.
The exposure in funded and unfunded ABSs/CDOs had an effect on "Profits (Losses) on trading – Caption 80" of 24 million euro. The profit on this segment was a result of the effects of:
- unfunded Super CDO positions for +2 million euro;
- European and US funded ABSs/CDOs (+23 million euro), entirely attributable to the subsidiary Banca IMI. The impact is the sum of the 10 million euro of profits realised on the partial disposal of the trading book and 13 million euro from revaluation of outstanding positions;
- the negative contribution of the subprime exposure for 1 million euro;
- unfunded Multisector CDO positions for 2 million euro;
- other unfunded positions for -2 million euro.

The securities reclassified to the loan portfolio had a positive impact of 1 million euro on the income statement as at 30 June 2014. This result is the combination of the 5 million euro in profits realised on the sale of positions and 4 million euro in impairment losses on a security included in the portfolio.
The "Monoline risk" and "Non-monoline packages" made a contribution of +1 million euro to "Profits (Losses) on trading – caption 80" as at 30 June 2014, compared to the positive result of 40 million euro recorded as at 31 December 2013. The segment trend reflects the spread volatility for the counterparty on which this exposure is concentrated.

INFORMATION ON ACTIVITIES PERFORMED THROUGH SPECIAL PURPOSE ENTITIES (SPEs)

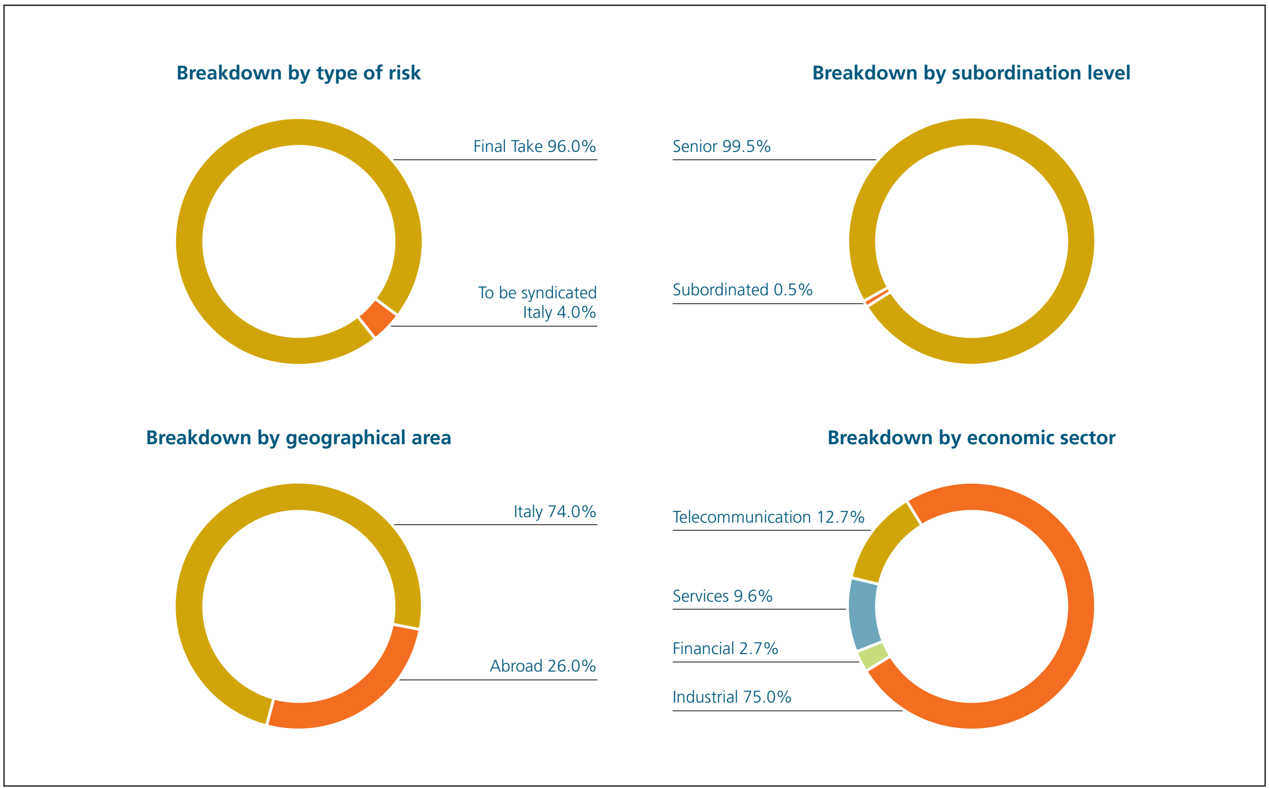
For the purpose of this analysis, legal entities established to pursue a specific, clearly defined and limited objective are considered Special Purpose Entities (raising funds on the market, acquiring/selling/managing assets both for asset securitisations, acquisition of funding through self-securitisations 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.
For consolidation purposes, note that the implementation of the new standard IFRS 10 caused the deconsolidation of insurance SPEs (UCIs underlying insurance policies), the risk of which is borne by the insured parties rather than by the Group company.
No amendments to the criteria are reported for the other SPE categories compared to the information already provided in the 2013 financial statements.

For information concerning the categories of SPEs subject to disclosure, reference should be made to the 2013 financial statements. Significant changes concerned the two segments below:
- a reduction of about 400 million euro in the securities issued by the funding SPE Intesa Funding LLC;
- in the insurance business, note the already mentioned deconsolidation of insurance SPEs, consequently to the new standard IFRS 10 coming into force;
- as part of the covered bonds issue programme of the vehicle ISP CB Ipotecario S.r.l., a new fixed-rate issue was placed on the institutional market for a nominal value of 1.25 billion euro with 12-year maturity;
- as part of the issue programme guaranteed by ISP CB Pubblico S.r.l., the sixth series was closed in advance for a total amount of 2.4 billion euro. At the same time, Intesa Sanpaolo issued series 9 for the nominal amount of 1 billion euro with floating-rate and two-year maturity. The securities, fully subscribed by the issuer to perform Eurosystem refinancing transactions, are listed on the Luxemburg Stock Exchange and rated A2 by Moody's;
- as part of the Multioriginator covered bond issue programme of the vehicle ISP OBG S.r.l., the first four series of bonds issued were redeemed in advance for a total of 19 billion euro in order to achieve closer matches between the maturities of the cover pool and the bonds issued. The issues in question were replaced with new floating-rate bonds with maturities of two to seven years. The total nominal amount of the covered bonds issued by Intesa Sanpaolo remained unchanged.

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 2014, 114 transactions for a total amount granted of 3,299 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.



INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The hedge fund portfolio as at 30 June 2014 totalled 739 million euro, compared to 744 million euro recorded in December 2013. In the analysis of changes in the portfolio, attention should be drawn not only to the positive impact of the net valuation of outstanding units, but also the effect of the distributions undertaken in the first half of the year and the change in the dollar exchange rate, which affected the value of the positions denominated in that currency.
As at the same date, the overall result of the investments in this segment was positive for 16 million euro, compared to 25 million euro of the "Profits (Losses) on trading – caption 80" as at 30 June 2013.
The 16 million euro of net profit, recognised as at 30 June 2014 under "Profits (Losses) on trading – caption 80", included:
– 13 million euro from net valuations of positions outstanding as at the end of June 2014;
– 2 million euro representing net profit realised from the trading of fund quotas;
– 1 million euro consisting of other income attributable to profits on foreign exchange transactions.

Net capital gains on the final residual amount (12 million euro) were spread across 27 positions, 14 of which with capital gains (26 million euro) and 13 with capital losses (13 million euro).
In the second quarter of 2014, the overall portfolio management strategy did not undergo significant change, but rather continued to focus primarily on benefiting from the occurrence of specific corporate events largely independent of the general market trend.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering only relations with customers, as at 30 June 2014, 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 6,738 million euro (5,542 million euro as at 31 December 2013). The notional value of such derivatives totalled 53,767 million euro (54,087 million euro as at 31 December 2013). Of these, the notional value of plain vanilla contracts was 47,907 million euro (51,817 million euro as at 31 December 2013), and of structured contracts was 5,860 million euro (4,475 million euro as at 31 December 2013).
Please note that the positive fair value of structured contracts outstanding with the 10 customers with the highest exposures was 454 million euro (363 million euro as at 31 December 2013). The same indicator, referred to the total contracts with a positive fair value, was 4,580 million euro.
Conversely, negative fair value determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 672 million euro as at 30 June 2014 (606 million euro as at 31 December 2013).
The notional value of such derivatives totalled 20,810 million euro (17,627 million euro as at 31 December 2013). Of these, the notional value of plain vanilla contracts was 19,452 million euro (17,787 million euro as at 31 December 2013), and of structured contracts was 1,358 million euro (1,030 million euro as at 31 December 2013).

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 ("Bilateral Credit Value Adjustment"). With regard to contracts outstanding as at 30 June 2014, this led to a negative effect of 39 million euro being recorded under "Profits (Losses) on trading" in the income statement.
As regards the means of calculation of the aforesaid Bilateral 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 RISKS

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 Approach (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 full demerger of the Bank in favour of the Parent Company Intesa Sanpaolo and Leasint was completed in December 2012;
– effective from 30 June 2013, for a fourth scope including several companies of the Banca Fideuram group (Banca Fideuram, Fideuram Investimenti, Fideuram Gestions, Fideuram Asset Management Ireland and Sanpaolo Invest) and two international subsidiaries of VUB Banka (VUB Leasing and Consumer Finance Holding).

The remaining companies, currently using the Standardised approach (TSA), will migrate progressively to the Advanced Measurement approaches starting from the end of 2014, 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.
In addition, tasks assigned to the technical managerial committee responsible for operational risks 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 (structured collection 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 Personnel and Organisation Department that supervise the planning of operational processes and business continuity issues and with control functions (Compliance, Administrative and Financial Governance and Internal Auditing) 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 diffusion 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 severe 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 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. At the end of June, in order to allow optimum use of the available operational risk transfer tools and to take advantage of the capital benefits, pursuant to applicable regulations the Group stipulated an insurance coverage policy named Operational Risk Insurance Programme, which offers additional coverage to traditional policies, significantly increasing the limit of liability, transferring the risk of significant operational losses to the insurance market. The internal model's insurance mitigation component was approved by the Bank of Italy in June 2013 with immediate effect of its benefits on operations and on the capital requirements.

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 1,770 million euro as at 30 June 2014, down compared to 31 December 2013 (1,819 million euro).

Legal risks

Legal risks are thoroughly analysed by the Parent Company and Group companies. Provisions are made to the Allowances for risks and charges when there are legal obligations for which it is probable that funds will be disbursed and where the amount of the disbursement may be reliably estimated.
During the first six months of 2014, no new significant legal procedures were commenced and there were no important developments with respect to those underway. The reader is therefore referred to the Notes to the 2013 financial statements for a thorough description of material legal proceedings and lawsuits. The following is an account of significant developments during the half-year.

Dispute relating to the acquisition of Bank of Alexandria - In 2006 Sanpaolo IMI acquired from the Egyptian government an 80% investment in Bank of Alexandria, as part of the government privatisation programme launched in the 1990's. In 2011, two proceedings were initiated before the Administrative Court of Cairo, by two private entities against several members of the previous government, aimed at the cancellation of the administrative measure for privatisation and the resulting deed of purchase and sale, based on alleged irregularities in the administrative process and the alleged unfairness of the share transfer price. Bank of Alexandria has intervened in both proceedings to fight the lawsuits, claiming the lack of jurisdiction of the administrative judge in the pre-trial proceedings and the groundlessness of the opponents' claims on the merits. Concerning the latter aspect, it has been inferred, with the support of suitable documentation, that the privatisation procedure was conducted correctly and - contrary to the opponents' allegations - in the form of public auction, with the participation of numerous international banks, as a result of which Intesa Sanpaolo was judged as the best bidder. The two proceedings, which are going forward at the same time and have been subject to numerous postponements and slowdowns, are currently in the preliminary investigation phase. As things stand, and in consideration of the current phase of the proceedings, there are no critical issues in view with regard to the problems which are the focus of the disputes. Law 32/2014 was enacted on 24 April 2014. The statute clarifies the subjective requirements for appealing previous privatisations by limiting standing to sue to the original contracting parties only. The counsel to the defence believe that the statute is also applicable to the ongoing proceedings to which Bank of Alexandria is a party. Moreover, the statute was recently reviewed by Egypt's Constitutional Court due to contentions of unconstitutionality that arose in other proceedings to which Bank of Alexandria is not a party. Both lawsuits are constantly monitored by the Parent Company, also in terms of possible developments of the reference scenario.

***Altroconsumo** class action* – In 2010, Altroconsumo, representing three account holders, brought a class-action suit seeking a finding of the unlawfulness of overdraft charges and the fee for overdrawing accounts without credit facilities, the latter of which had been adopted in 2009 as part of adjustments of contracts to the new rules imposed by lawmakers regarding bank fees. The suit also sought a finding that the "threshold rate" set out in the law on usury had been exceeded. By order of 28 April 2010, the Court of Turin declared the suit inadmissible. Following the complaint filed by the plaintiffs, the Torino Court of Appeal, by order of 16 September 2011, overturned the previous order, restricting the scope of the suit solely to account overdraft charges applied effective 16 August 2009. A total of 104 applications to join the suit were then filed within the terms set by the Court. The suit was resolved by the judgment filed on 10 April 2014, in which 101 of the 104 applications were found to be inadmissible due to formal irregularities of presentation or failure to meet consumer requirements by some of the applicants. On the merits, having rejected the claims regarding usury, the judgment finds that the account overdraft charge is void on the basis of the principle according to which, in the absence of a formal credit facility, an overdraft would not justify the application of additional costs to the account holder, given that no banking service requiring compensation has been provided in such cases. The decision will be appealed because it is founded upon an untenable interpretation of the statute concerned. At the level of the income statement, the judgment is of negligible significance: the few account holders admitted to the suit may lay claim to a total refund of approximately 1,200 euro. It bears clarifying that the contested fee was replaced, effective October 2012, by the expedited approval fee introduced by the Monti administration's Save Italy Decree.

Interporto Sud Europa (ISE) lawsuit against Banco di Napoli - By write of summons served on 28 December 2013, Interporto Sud Europa (ISE) summoned Banco di Napoli and another bank before the Court of Santa Maria Capua Vetere, calling for them to be jointly ordered to compensate for damages, quantified at 186 million euro.
In further detail, the plaintiff claimed that it decided to assume the debt arising from the first tranche of a pool loan disbursed to Comes S.r.l. (a total of 70 million euro for the construction of the shopping centre in Marcianise) on the understanding that the two banks concerned would then have disbursed an additional loan of 35 million euro for which ISE had applied directly (while reducing the original loan from 70 million to 35 million euro).
However, that loan was not in fact disbursed, and this situation allegedly resulted in a serious lack of liquidity for ISE, which, among other effects, purportedly prevented it from selling said shopping centre to third parties at a price regarded as expedient.
However, during the internal assessment process, various factual elements were brought to light, justifying the two banks' decision not to provide the loan.
The hearing, initially scheduled for 15 July 2014, has been postponed until 22 September.

Arbitration proceedings initiated by Acotel Group S.p.A. - In its document initiating arbitration proceedings served on 4 November 2013, Acotel Group S.p.A. seeks an award ordering ISP to provide compensation for damages, quantified at a total of 150 million euro, caused by alleged breach of a complex cooperation agreement, which took the concrete form of various contracts aimed at developing and selling an innovative telephone SIM card known as SIM Noverca to bank customers. Acotel assumes that the failure of the commercial initiative and the resulting damages were the result solely of breach of contract by ISP due to the lack of interest shown in the promotion and distribution of the product amongst its customers, which culminated in the cancellation and termination of the commercial agreements. The Bank defended itself by raising a large number of objections of a procedural natural (such as the lack of jurisdiction of the arbitrator due to the termination and/or novation of the Master Agreement that contained the arbitration clause, the lack of standing to sue due to the fact that the party to the commercial agreements was not Acotel Group but rather its subsidiary Noverca Italia and the lack of interest in taking action due to the fact that cancellation of the commercial contract was the consequence of lawful exercise of an expressly established prerogative). On the merits, ISP argued that the reasons for the transaction's lack of success may be found to lie in the technological inadequacy of the SIM card, which was rapidly rendered obsolete by the development of other, more attractive propositions on the market and the low level of competitiveness of the rate scheme, both of which were problems that Noverca was unable to overcome. Due to the lack of interest in proceeding with the arbitration shown by Acotel (which reserved the right to take action in the ordinary courts) and its consequent inactivity, the Chamber of Arbitration of Milan declared the proceedings closed by decision of 10 June 2014. At present, Acotel has yet to take action in the ordinary courts.

POTROŠAČ litigation against PBZ relating to loans denominated in CHF. In the context of historically low interest rates on assets denominated in Swiss francs (CHF), starting from 2004, numerous Croatian banks have disbursed retail loans in Swiss francs. This practice was immediately appreciated by customers. Therefore, in order to avoid erosion of market share, PBZ also began to offer similar products in February 2005.
Though it was following market trends, PBZ implemented procedures significantly different than those of other banks. In particular, in informing its customers of exchange rate risk, PBZ included specific clauses in its loan contracts which notified customers of the possibility that the amount of their instalments could change due to the volatility of exchange rates.
In addition to foreign currency, a fundamental characteristic of this loan portfolio is the presence of so-called "administered interest rate", which means that interest rates could be changed at the discretion of the Bank, without a clearly identified underlying index. This type of interest rate was the most common type in the Croation banking sector along with fixed interest rates. Only with the introduction of the new law on consumer credit administered interest rates were banned for all new loans starting from January 2013. PBZ correctly complied with these law provisions by introducing index-linked interest rates.
By writ of summons served on 23 April 2012, PBZ was sued, along with seven major Croatian banks (subsidiaries of non-Croation groups) by a consumer association (Potrošač). Extremely in brief, the association called for the banks to be sentenced for:
– not having appropriately informed customers of the risks of an exposure in a foreign currency such as the Swiss franc;
– not having clearly set out in the contracts the rules for determining the interest rate, which the bank could unilaterally change.
On 4 July 2013, in the first instance, the Commercial Court of Zagreb had substantially accepted the requests of the consumers association, ordering the banks to transform their receivables into Kuna at the exchange rate at the disbursement date and to a fixed interest rate equal to the interest rate applicable to loan contracts on the date of their subscription.
The execution of the first instance ruling had been suspended pending the judgment on the appeal.
On 16 July 2014, the High Commercial Court of the Republic of Croatia rendered its judgment of the second instance. This judgment is currently being reviewed by the Croatian subsidiary's legal counsel with the aim of assessing all of its implications.
In effect, the judgment modifies the decision of the first instance, upholding the legal applicability of the foreign exchange rate clause that effectively ties the repayment of principal and interest (made in the local currency, the Croatian kuna) to the reference currency (in the case at hand, Swiss francs). This releases the bank from the primary risk, which involved the presumed need to recalculate the exposures and payments using the exchange rate as at the date of disbursement.
The judgment also agrees that the banks were not entitled to modify the interest rates applied on the basis of their internal decisions alone. At the same time, the judgment does not require that the rates be restored to their original values.
An additional important element brought to light by the judgment is the fact that recourse to class action is excluded. Essentially, in order to obtain compensation, customers will need to sue the bank individually and not on a collective basis.
In the cases previously taken to the courts, the various local judges have always ruled in the banks' favour.
PBZ is also considering the possibility of appealing the decision before the Supreme Court of the Republic of Croatia.

Istituto per il Credito Sportivo – Istituto per il Credito Sportivo is a public entity with both private (banks and insurance companies) and public owners. The Institute has been in extraordinary administration since 28 December 2011 owing to governance issues.
The appointed administrators, considering it to be a part of their duties, have sought to re-open the question of the origin of and title to the funds for specific purposes allocated in 2004-2005. This process of reconstruction resulted in the approval (in 2005) by Ministerial Decree of new Articles of Association for ICS, clarifying the principles for allocating and assigning the resources generated by operations to capital.
Upon the administrators' initiative, in 2012 the Prime Minister's Office opened proceedings for the cancellation of the ICS Articles of Association of 2005 and of the related approval decree.
On 12 March 2013 the Prime Minister's Office announced adoption by the "Ministry for Regional Affairs, Tourism and Sport" and the "Ministry for Cultural Heritage and Activities", in concert with the "Ministry for the Economy and Finance", of the Interministerial Decree of 6 March 2013 declaring cancellation of the ICS Articles of Association of 2005. Along with the Institute's other private owners, the Bank appealed the Decree authorising cancellation before the Regional Administrative Court of Lazio. However, the application was denied, and this decision was then in turn appealed by the applicants.
On 16 April 2013, the administrators gave notice that they had initiated the procedure for automatic cancellation of the resolutions authorising distribution of dividends from 2005 to 2010, as well as the determination of a new allocation. The September 2013 decision was then also appealed by the private owners before the Regional Administrative Court of Lazio, which, however, recently found that it lacked jurisdiction.
On 19 April 2014, ICS' new Articles of Association (2014 Articles of Association) were published in Italy's Official Journal. This new

version includes the results of the recalculation of ownership stakes performed by the Ministry of the Economy and Finance on a presumptive basis and according to a technically objectionable methodological approach. The interests held by the private stakeholders have been reduced from the previous 73% to the current approximately 11%.
Naturally, the private owners lodged an additional appeal against this decision before the Regional Administrative Court of Lazio: the judges did not approve the application for a stay, but rather solicited the parties to apply for a hearing on the merits in short order.
Considering that the 2014 Articles of Association, despite being subject to appeal, currently remain in effect, a negative impact of 37 million euro has been recognised as a result of the Bank's changed equity interest in the Institute.
On the basis of opinions from qualified experts, the Bank currently does not believe that it is necessary to provision for the risks associated with the civil suit seeking restitution of the 2005-2010 dividends.

Tax litigation

With regard to pending tax litigation and the related risks and provisions, detailed information is provided in the Notes to the 2013 consolidated financial statements.
In regard to developments during the period ended 30 June 2014, the Torino office of the Italian Revenue Agency issued an assessment notice to Intesa Sanpaolo for the year 2009 concerning a series of transactions, subject to audit with respect to the 2007-2011 period, implemented for recapitalisation purposes by issuing innovative equity instruments (preference shares) through international subsidiaries (LLCs based in Delaware, USA). The allegation formulated in the assessment notice, which is to be regarded as unfounded, is that the subordinated deposits in place between the international subsidiaries and the Parent Company can be reclassified as loans, subject to 12.50% final withholding tax pursuant to the last paragraph of art. 26 of Italian Presidential Decree no. 600/1973. The claim put forth in the above assessment notice, which is currently under appeal, amounts to approximately 38 million euro in withholdings, penalties and interest.
With respect to the other Group companies, it bears noting that Setefi reached an administrative settlement of the assessment notices associated with the allegation – also involving other banking groups – regarding the reorganisation transaction by the VISA Group undertaken in July 2004, which gave rise to VISA Europe Ltd., according to which that transaction purportedly entailed the contribution to the latter of intangible assets yielding an unreported capital gain on which taxes were not paid. Although significant arguments could be made against the allegations, the result may nonetheless be regarded as particularly advantageous and financially expedient, considering the risks and expense of a tax dispute involving especially complex technical subject matter entailing problems of international tax law for which there is a lack of specific case-law precedents. Moreover, the other banks affected by the same allegations have also adhered to the settlement to the extent of their respective involvement.

INSURANCE RISKS

Life business

The typical risks of the life insurance portfolio may 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 sustainability and profitability (both at product level and at portfolio level, including liabilities).
Actuarial and demographic risks are controlled by means of systematic statistical analysis of the evolution of liabilities in its own contract portfolio, divided by risk type, and through simulations of expected profitability of the assets hedging technical reserves.
Reserve risk is guarded against 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 (VaR).

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 refer to traditional revaluable life insurance policies, Index- and Unit-linked policies, pension funds and non-life policies.
As at 30 June 2014, the investment portfolios of Group companies, recorded at book value, amounted to 122,498 million euro. Of these, the part of 66,708 million euro relates to traditional revaluable life policies, the financial risk of which is shared with the policyholders by virtue of the mechanism whereby the returns on assets subject to segregated management are determined, non-life policies and free capital. The other component, whose risk is borne solely by the policyholders, consists of investments related to Index-linked policies, Unit-linked policies and pension funds and amounted to 55,790 million euro.

Considering the various types of risks, the analysis of investment portfolios, described below, concentrates on the assets held to cover traditional revaluable life policies, non-life policies and free capital.
In terms of breakdown by asset class, net of derivative financial instruments, 93.3% of assets, i.e. approximately 62,649 million euro, were bonds, whereas assets subject to equity risk represented 1.2% of the total and amounted to 808 million euro. The remainder (3,665 million euro) consisted of investments relating to UCI, Private Equity and Hedge Funds (5.1%).
The carrying value of derivatives came to approximately -414 million euro, almost entirely relating to effective management derivatives[4]. The hedging derivatives amounted to a total of approximately -7 million euro.

At the end of the first six months of 2014, investments made with the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to approximately 2,389 million euro at market value, and presented a risk in terms of VaR (99% confidence level, 10-day holding period) of approximately 71 million euro.
The modified duration of the bond portfolio, or the synthetic financial term of assets, is approximately 5.7 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 5.0 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 3,349 million euro. On the basis of this hypothetical scenario, the value of hedging derivatives in the portfolio undergoes an approximate 3 million euro rise which partly offsets the corresponding loss on the bonds.
The distribution of the portfolio by rating class is as follows. AAA/AA bonds represented approximately 5.0% of total investments and A bonds approximately 3.8%. Low investment grade securities (BBB) were approximately 82.2% of the total and the portion of speculative grade or unrated was minimal (approximately 2.3%).
A considerable portion of the BBB area is made up of securities issued by the Republic of Italy.
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 75.2% of the total investments, while financial companies (mostly banks) contributed almost 13.5% of exposure and industrial securities made up approximately 4.6%.

[4] ISVAP Regulation 36 of 31 January 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.

At the end of the second quarter of 2014, 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 3,459 million euro, with 2,953 million euro due to government issuers and 506 million euro to corporate issuers (financial institutions and industrial companies).