

## SECTION 2 – RISKS OF INSURANCE COMPANIES

### 2.1 INSURANCE RISKS

#### QUALITATIVE AND QUANTITATIVE INFORMATION

##### Life business

The typical risks of the life insurance portfolio (managed by Intesa Sanpaolo Vita, Intesa Sanpaolo Life and Fideuram Vita) 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). During the definition of a product, profit testing is used, aimed at measuring profitability and identifying any weaknesses beforehand, by means of specific sensitivity analyses. The issue process for a product involves its prior presentation to the Product Committee in order to take account of and validate its structure and features.

Actuarial and demographic risks arise when an unfavourable trend is recorded in the actual loss ratio compared with the trend estimated when the rate was calculated, and these risks are reflected in the level of “reserves”. The loss ratio refers not only to actuarial loss, but also to financial loss (guaranteed interest rate risk). The Company guards against these risks 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 (for example, checking that all the variables required for the calculation such as yields, quotations, technical foundations, parameters for the supplementary reserves, and recalculation of the value of single contracts are correctly saved in the system) as well as overall verifications, by comparing results with the estimates produced on a monthly basis. Specific attention is paid to checking the correct assumption of contracts, by checking the relative portfolio against the reconstruction of movements during the period, divided by purpose, and checking the consistency of the amounts settled compared with the movements of reserves.

The tables below show the structure of the mathematical reserves by expiry date, excluding reserves for amounts to be paid and before intercompany netting, and the structure of the guaranteed minimum yield as at 31 December 2014.

	(millions of euro)	
<b>Breakdown of mathematical reserves of life branch: maturity</b>	<b>Mathematical reserve</b>	<b>%</b>
up to 1 year	2,391	3.27
1 to 5 years	3,441	4.70
6 to 10 years	3,554	4.86
11 to 20 years	1,531	2.09
over 20 years	62,226	85.08
<b>TOTAL</b>	<b>73,143</b>	<b>100.00</b>

	(millions of euro)	
<b>Breakdown of risk concentration by type of guarantee</b>	<b>Total Reserves</b>	<b>%</b>
<b>Insurance and investment products with guaranteed annual yield</b>		
0% - 1%	25,521	32.18
from 1% to 3%	37,990	47.90
from 3% to 5%	4,645	5.86
<b>Insurance products</b>	<b>4,987</b>	<b>6.29</b>
<b>Shadow reserve</b>	<b>6,160</b>	<b>7.77</b>
<b>TOTAL</b>	<b>79,303</b>	<b>100.00</b>

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.

The following table shows a breakdown by maturity of financial liabilities, before intercompany netting, represented by assets covering commitments arising under unit- and index-linked policies and subordinated liabilities.

Breakdown of financial liabilities by maturity	(millions of euro)			
	Within 12 months	Over 12 months	Total as at 31.12.2014	Total as at 31.12.2013
Unit linked	433	36,874	37,307	29,748
Index linked	154	295	449	1,099
Subordinated liabilities	-	1,423	1,423	703
<b>Total</b>	<b>587</b>	<b>38,592</b>	<b>39,179</b>	<b>31,550</b>

### Non-life business

The typical risks of the non-life insurance portfolio (managed through Intesa Sanpaolo Assicura and Intesa Sanpaolo Vita) mainly relate to premium 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).

Reserve risk is guarded against through the exact calculation of technical reserves. More specifically, for companies with non-life business the technical reserves may be broken down into: premium reserves, claims reserves, profit sharing and reversal reserves, other technical reserves and the equalisation reserve.

With regard to risk assumption, policies are checked when acquired through an automatic system aimed at detecting the underwriting parameters associated with the applicable tariff. The check is thus not only formal, but also substantive, and in particular allows the identification of exposures in terms of capital and limits of liability, in order to verify that the portfolio matches the technical and tariff scheme agreed upon with the sales network.

Subsequently, statistical checks are carried out to verify potentially anomalous situations (such as concentration by area or by type of risk) and to keep under control accumulation at the level of individual persons (with particular reference to policies that provide cover in the accident and health branches). This is also carried out in order to provide the Reinsurance department with suitable indications of the portfolio characteristics in order to prepare the annual reinsurance plan.

The following table presents the development of claims by year of generation, broken down into the major business lines of operation, as at 31 December 2014.

Development of Claims Reserves	(millions of euro)					TOTAL
	YEAR OF GENERATION/EVENT					
	2010	2011	2012	2013	2014	
<b>Reserve amount:</b>						
as at 31/12 generation year N	66	69	92	116	125	
as at 31/12 year N+1	60	78	92	111		
as at 31/12 year N+2	54	74	89			
as at 31/12 year N+3	52	70				
as at 31/12 year N+4	51					
<b>Total claims paid</b>	<b>47</b>	<b>58</b>	<b>66</b>	<b>68</b>	<b>37</b>	<b>276</b>
<b>Claims reserve booked as at 31.12.2014</b>	<b>4</b>	<b>12</b>	<b>23</b>	<b>43</b>	<b>88</b>	<b>170</b>
<b>Final claims reserve for previous years</b>						<b>5</b>
<b>Total claims reserve booked as at 31.12.2014</b>						<b>175</b>

## 2.2 FINANCIAL RISKS

### Financial Risks

These risks derive from the level or volatility of market prices of financial instruments that impact the book value of both assets and liabilities. The risk factors identified by the company are as follows:

- Interest rate risk: impacts assets and liabilities whose value is sensitive to changes in the forward structure of interest rates or the volatility of interest rates;
- Equity price risk: derives from the level or volatility of market prices of equities and impacts assets and liabilities whose value is sensitive to changes in equity prices;
- Property risk: derives from the level or volatility of market prices of real estate property and impacts assets and liabilities sensitive to said changes;
- Foreign exchange risk: derives from changes in the level or volatility of foreign exchange rates;
- Spread risk: impacts assets and liabilities whose value is sensitive to adverse changes in credit spreads;
- Concentration risk: reflects the risk of holding high percentages of financial assets of the same counterparty.

### Investment portfolios

As at 31 December 2014, the investment portfolios of Group companies, recorded at book value, amounted to 120,300 million euro. Of these, the part regarding 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 amounted to 77,302 million euro. The other component, whose risk is borne solely by the policyholders, mainly consists of investments related to Index-Linked policies, Unit-Linked policies and pension funds and amounted to 42,998

million euro.

Considering the various types of risks, the analysis of investment portfolios, described below, concentrates on the financial assets used to cover traditional revaluable life policies, non-life policies and free capital.

#### Financial assets under segregated funds and free capital

In terms of breakdown by asset class, net of loans on policies and positions in derivative financial instruments (-373 million euro at book value) detailed below, approximately 92% of the assets (71,188 million euro) consisted of bonds, whereas assets subject to equity price risk represented approximately 1% of the total and amounted to 1,027 million euro. The remaining 5,460 million euro (approximately 7%) consisted of investments relating to UCI, private equity and hedge funds.

Investments relating to the free capital of Intesa Sanpaolo Vita and Fideuram Vita amounted to 2,415 million euro (market values, net of current account balances) and had a risk level in terms of Value at Risk (99% confidence level, 10-day holding period) of approximately 72 million euro.

#### Interest rate risk exposure

The breakdown by maturity of bonds showed 11% short-term (under 1 year), 26% medium-term and 54% long-term (over five years).

(millions of euro)			
Financial assets	Book value	%	Duration
<b>Fixed-rate bonds</b>	<b>65,237</b>	<b>83.99</b>	<b>5.64</b>
up to 1 year	8,721	11.23	
1 to 5 years	16,543	21.30	
over 5 years	39,973	51.46	
<b>Floating rate/indexed bonds</b>	<b>5,951</b>	<b>7.66</b>	<b>2.57</b>
up to 1 year	79	0.10	
1 to 5 years	3,842	4.95	
over 5 years	2,030	2.61	
<b>TOTAL</b>	<b>71,188</b>	<b>91.65</b>	<b>-</b>
<b>Equities or similar capital securities</b>	<b>1,027</b>	<b>1.32</b>	
<b>UCI, Private Equity, Hedge Fund</b>	<b>5,460</b>	<b>7.03</b>	
<b>TOTAL AS AT 31.12.2014</b>	<b>77,675</b>	<b>100.00</b>	

The modified duration of the bond portfolio, or the synthetic financial term of assets, is 5.4 years. The reserves relating to the life policies with profit participation under segregated funds have an average modified duration of 5.7 years. The related portfolios of assets have a modified duration of around 4.9 years.

The sensitivity of the fair value of the portfolio of financial assets to interest rate movements is summarised in the table below which highlights both exposure of the securities portfolio and the effect of positions represented by hedging derivatives which reduce its sensitivity.

(millions of euro)				
	Book value	%	Fair value changes due to interest rate fluctuations	
			+100 bps	-100 bps
Fixed-rate bonds	65,236	91.64	-6,685	4,632
Floating rate/indexed bonds	5,952	8.36	-290	91
Interest rate risk hedging effect	-	-	-	-
<b>TOTAL</b>	<b>71,188</b>	<b>100.00</b>	<b>-6,975</b>	<b>4,723</b>

#### Credit risk exposure

The table below sets forth the distribution of the bond portfolio by rating class: AAA/AA bonds represented approximately 5% of total investments and A bonds approximately 4%. Low investment grade securities (BBB) were approximately 81% of the total, while the portion of speculative grade or unrated was minimal (2%).

With regard to exposure to BBB rated securities, approximately 53 billion euro was related to bonds issued by the Republic of Italy.

Breakdown of financial assets by issuer rating	(millions of euro)	
	Book value	%
<b>Bonds</b>	<b>71,189</b>	<b>91.65</b>
AAA	2,528	3.26
AA	1,031	1.33
A	2,839	3.65
BBB	63,001	81.11
Speculative grade	1,549	1.99
Unrated	241	0.31
<b>Equities or similar capital securities</b>	<b>1,026</b>	<b>1.32</b>
<b>UCI, Private Equity, Hedge Fund</b>	<b>5,460</b>	<b>7.03</b>
<b>TOTAL</b>	<b>77,675</b>	<b>100.00</b>

The analysis of the exposure in terms of the issuers/counterparties produced the following results: securities issued by governments, central banks and other public entities made up approximately 74% of the total investments, whereas the securities of corporate issuers contributed around 17%.

The sensitivity values of the fair value of the bonds with respect to a variation in the creditworthiness of the issuers, namely a market credit spread shock of  $\pm 100$  basis points, as at end of 2014, are shown in the table below.

	Book value	%	(millions of euro)	
			Fair value changes due to credit spread fluctuations	
			+100 bps	-100 bps
Government bonds	57,628	80.95	-6,072	6,610
Corporate bonds	13,560	19.05	-1,125	1,167
<b>TOTAL</b>	<b>71,188</b>	<b>100.00</b>	<b>-7,197</b>	<b>7,777</b>

#### Equity risk exposure

The sensitivity of the equity portfolio to a hypothetical deterioration in equity prices of 10% amounts to approximately 102 million euro, as shown in the table below.

	Book value	%	(millions of euro)
			Fair value changes due to stock price fluctuations
			-10%
Equities - Financial institutions	262	25.54	-26
Equities - Non-financial companies and other counterparties	764	74.46	-76
<b>TOTAL</b>	<b>1,026</b>	<b>100.00</b>	<b>-102</b>

#### Exchange risk exposure

The investment portfolio is not appreciably exposed to foreign exchange risk: approximately 98% of investments are made up of assets denominated in euro. The remaining part hedges the reserves of the insurance policies which lead to payments in foreign currency.

#### Financial derivative instruments

Financial derivative instruments are used to hedge the financial risks of the investment portfolio or for effective management. Liquidity risk associated with positions in financial derivative instruments is primarily attributable to plain-vanilla derivatives (chiefly interest rate swaps, constant-maturity swaps and credit default swaps) traded on OTC markets with significant liquidity characteristics and sizes. These instruments are thus also liquid and easily liquidated both with the counterparty with which they were traded and with other market operators.

The table below shows the book values of the financial derivative instruments as at 31 December 2014.

Type of underlying	INTEREST RATES		EQUITIES, EQUITY INDICES, COMMODITIES, EXCHANGE RATES		TOTAL	
	Quoted	Unquoted	Quoted	Unquoted	Quoted	Unquoted
	Hedging derivatives	-	-49	-	-	-
Effective management derivatives	-	-278	-	-46	-	-324
<b>TOTAL</b>	-	<b>-327</b>	-	<b>-46</b>	-	<b>-373</b>

The capital losses shown for the hedging derivatives are offset, due to the nature of the instruments, by the capital gains on the positions hedged. For the purpose of reducing investment risk, the instruments shown under effective management derivatives are also netted with the appreciation of the associated assets.