1.3 BANKING GROUP - LIQUIDITY RISK

QUALITATIVE INFORMATION

General aspects, liquidity risk management processes and measurement methods
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.

The provisions on liquidity - introduced in the European Union in June 2013 with the publication of Regulation (EU) 575/2013 and Directive 2013/36/EU - were updated in early 2015 with the publication in the *Official Journal of the European Union* of Commission Delegated Regulation (EU) 61/2015 with regard to liquidity coverage requirements (liquidity coverage ratio - LCR), supplementing and partially amending previous regulations. Under Delegated Regulation 61/2015, from 1 October 2015 banks are required to comply with the new short-term indicator according to the phase-in process provided for in Art. 38 (60% from 1 October 2015, 70% from 1 January 2016, 80% from 1 January 2017 and 100% from 1 January 2018).

The Guidelines for Group Liquidity Risk Management, which already referred to Bank of Italy Circulars 263 and 285, and to Directive 2013/36/EU (CRD IV) and Regulation (EU) 575/2013 (CRR), were therefore updated with effect from March 2015 to reflect the above additional regulations, which revised the composition of the liquid assets eligible for liquidity reserves and the definition of 30-day liquidity flows valid for the calculation of the LCR. With respect to structural liquidity, the most recent regulatory provisions of the Basel Committee concerning the Net Stable Funding Ratio (NSFR) with its October 2014 publication were also adopted.

The "Guidelines for Group Liquidity Risk Management" approved by Intesa Sanpaolo's corporate bodies illustrate the tasks of the various corporate 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, the Planning Head Office Department and the Active Value Management Department, responsible for liquidity management, and the Financial and Market Risks 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 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 - LCR).

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 aim of the 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 (NSFR). 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 at the end of the legislative process in progress for the application of the global reform package on CRR and CRD IV (Regulation 575/2013 and Directive 2013/36/EU).

The Guidelines for Group Liquidity Risk Management also envisage the time extension of the stress scenario for the 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. Within this framework, the Treasury Head Office Department and the Planning and Active Value Management Head Office Department were officially entrusted with drawing up the Contingency Funding Plan (CFP), which contains the various lines of actions that can be activated in order to face potential stress situations, specifying the extent of the mitigating effects attainable in the short-term (6 months). These actions must be updated periodically to verify their compatibility with the market conditions and the stress scenario adopted.
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 Financial and Market Risks Department.
Moreover, there are no medium/long-term loan contracts containing contractual clauses that result in the immediate collectability of the loans following the downgrading of the bank.
For several medium/long-term loan contracts from supranational bodies, compensation for the rating trigger, i.e. loss of the minimum rating, may be requested with the issue of additional guarantees or additional collateral deemed suitable by the counterparty.

The Group's sound liquidity position - supported by suitable high quality liquid assets (HQLA) and the significant contribution from retail stable funding - remained well within the risk limits set out in the current Group Liquidity Policy for all of 2016: both indicators (LCR and NSFR) were met, already reaching a level above the limits under normal conditions. As at 31 December 2016, the Central Banks eligible and liquid reserves, mainly under centralised management by the Treasury Head Office Department of the Parent Company, including the reserves (cash and deposits) held with Central Banks, came to a total of 150 billion euro (117 billion euro at December 2015), of which 86 billion euro, net of haircut, was unencumbered (78 billion euro at the end of December 2015).
Also the stress tests, when considering the consistent 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 the corporate bodies and internal committees in order to ensure full awareness and manageability of the main risk factors.

QUANTITATIVE INFORMATION

1. Breakdown by contractual residual maturity of financial assets and liabilities

The breakdown by maturity of financial assets and liabilities is shown in the tables below according to the rules set forth in financial statement regulations (Bank of Italy Circular 262 and related clarifications issued by the Supervisory Authority), using accounting information organised by contractual residual maturity.

Therefore, no operational data was used that would require, for example, the modelling of demand liabilities and the representation of cash items according to their level of liquidability.

Currency of denomination: Euro

(millions of euro)

Type / Residual maturity	On demand	Between 1 and 7 days	Between 7 and 15 days	Between 15 days and 1 month	Between 1 and 3 months	Between 3 and 6 months	Between 6 months and 1 year	Between 1 and 5 years	Over 5 years	Unspecified maturity
Cash assets	**55,423**	**21,665**	**9,108**	**16,197**	**19,105**	**18,050**	**27,014**	**132,138**	**121,876**	**24,113**
A.1 Government bonds	15	4	1	159	343	1,269	2,987	27,649	23,978	-
A.2 Other debt securities	28	4	1,293	2,934	248	477	817	4,783	9,612	-
A.3 Quotas of UCI	1,821	-	-	-	-	-	-	-	-	-
A.4 Loans	53,559	21,657	7,814	13,104	18,514	16,304	23,210	99,706	88,286	24,113
- Banks	*9,072*	*827*	*1,015*	*813*	*1,980*	*1,013*	*863*	*693*	*131*	*24,113*
- Customers	*44,487*	*20,830*	*6,799*	*12,291*	*16,534*	*15,291*	*22,347*	*99,013*	*88,155*	-
Cash liabilities	**227,763**	**22,073**	**2,152**	**8,977**	**10,891**	**13,114**	**18,446**	**94,985**	**26,431**	**1,575**
B.1 Deposits and current accounts	219,047	1,551	928	3,381	4,394	3,809	5,163	11,804	1,518	1
- Banks	*3,879*	*63*	*51*	*27*	*58*	*153*	*257*	*2,385*	*357*	-
- Customers	*215,168*	*1,488*	*877*	*3,354*	*4,336*	*3,656*	*4,906*	*9,419*	*1,161*	*1*
B.2 Debt securities	43	193	495	1,413	5,339	8,348	12,346	35,128	20,381	1,572
B.3 Other liabilities	8,673	20,329	729	4,183	1,158	957	937	48,053	4,532	2
Off-balance sheet transactions										
C.1 Financial derivatives with exchange of capital										
- Long positions	*422*	*5,894*	*4,890*	*8,456*	*13,124*	*7,884*	*5,938*	*18,241*	*9,586*	-
- Short positions	*2,098*	*6,146*	*3,098*	*8,188*	*10,527*	*4,315*	*5,854*	*13,398*	*8,880*	-
C.2 Financial derivatives without exchange of capital										
- Long positions	*27,036*	*2*	*31*	*29*	*118*	*116*	*392*	*546*	*63*	-
- Short positions	*30,762*	*18*	*33*	*30*	*102*	*154*	*431*	*546*	*63*	-
C.3 Deposits and loans to be settled										
- Long positions	*31,166*	-	-	*50*	-	-	-	-	-	-
- Short positions	-	*31,166*	-	*50*	-	-	-	-	-	-
C.4 Irrevocable commitments to lend funds										
- Long positions	*2,715*	*27,072*	*673*	*589*	*4,140*	*55*	*618*	*15,800*	*2,570*	-
- Short positions	*52,117*	*51*	*4*	*100*	*64*	*181*	*228*	*1,436*	*887*	-
C.5 Financial guarantees given	171	1	2	6	70	65	33	69	13	-
C.6 Financial guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of capital										
- Long positions	-	-	-	-	*544*	*457*	*1,793*	*4,433*	*1,207*	-
- Short positions	-	-	-	-	*544*	*457*	*1,793*	*4,433*	*1,207*	-
C.8 Credit derivatives without exchange of capital										
- Long positions	*816*	-	-	-	-	-	-	-	-	-
- Short positions	*761*	-	-	-	-	-	-	-	-	-

Currency of denomination: Other currencies

(millions of euro)

Type / Residual maturity	On demand	Between 1 and 7 days	Between 7 and 15 days	Between 15 days and 1 month	Between 1 and 3 months	Between 3 and 6 months	Between 6 months and 1 year	Between 1 and 5 years	Over 5 years	Unspecified maturity
Cash assets	**6,171**	**2,665**	**1,028**	**3,344**	**5,277**	**4,212**	**5,603**	**18,780**	**8,389**	**1,628**
A.1 Government bonds	2	29	67	320	1,049	763	786	3,428	2,932	-
A.2 Other debt securities	20	201	59	207	107	91	224	2,137	1,151	-
A.3 Quotas of UCI	261	-	-	-	-	-	-	-	-	-
A.4 Loans	5,888	2,435	902	2,817	4,121	3,358	4,593	13,215	4,306	1,628
- Banks	*3,865*	*1,015*	*364*	*576*	*1,475*	*901*	*1,324*	*254*	*94*	*1,628*
- Customers	*2,023*	*1,420*	*538*	*2,241*	*2,646*	*2,457*	*3,269*	*12,961*	*4,212*	-
Cash liabilities	**11,948**	**4,004**	**3,689**	**5,634**	**4,077**	**1,223**	**1,732**	**9,337**	**6,341**	**2**
B.1 Deposits and current accounts	11,167	2,226	1,151	2,640	1,555	768	924	1,455	475	-
- Banks	*1,154*	*487*	*228*	*451*	*354*	*41*	*147*	*346*	*198*	-
- Customers	*10,013*	*1,739*	*923*	*2,189*	*1,201*	*727*	*777*	*1,109*	*277*	-
B.2 Debt securities	4	23	1,600	201	413	210	716	7,101	5,448	-
B.3 Other liabilities	777	1,755	938	2,793	2,109	245	92	781	418	2
Off-balance sheet transactions										
C.1 Financial derivatives with exchange of capital										
- Long positions	*83*	*10,189*	*4,676*	*12,460*	*14,320*	*6,306*	*9,410*	*15,599*	*9,600*	-
- Short positions	*268*	*9,844*	*6,524*	*12,702*	*16,391*	*10,057*	*9,796*	*18,092*	*9,762*	-
C.2 Financial derivatives without exchange of capital										
- Long positions	*1,614*	*20*	*2*	*21*	*34*	*28*	*26*	*33*	*184*	-
- Short positions	*1,415*	*4*	*2*	*7*	*37*	*22*	*64*	*33*	*184*	-
C.3 Deposits and loans to be settled										
- Long positions	*143*	-	-	-	-	-	-	-	-	-
- Short positions	*71*	*51*	*14*	*7*	-	-	-	-	-	-
C.4 Irrevocable commitments to lend funds										
- Long positions	*32*	*5*	*4*	*30*	*193*	*465*	*607*	*13,873*	*879*	-
- Short positions	*15,420*	*23*	*7*	*83*	*175*	*704*	*273*	*1,447*	*10*	-
C.5 Financial guarantees given	326	1	6	4	23	33	20	16	1	-
C.6 Financial guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of capital										
- Long positions	-	-	-	-	-	*9*	*330*	*2,045*	*9*	-
- Short positions	-	-	-	-	-	*9*	*330*	*2,045*	*9*	-
C.8 Credit derivatives without exchange of capital										
- Long positions	*268*	-	-	-	-	-	-	-	-	-
- Short positions	*298*	-	-	-	-	-	-	-	-	-

2. Self-securitisations

The Intesa Sanpaolo Group has carried out securitisations in which all the liabilities issued by the vehicle companies involved were subscribed by Group companies.
A brief description of the existing transactions as at 31 December 2016 is provided below.

Adriano Lease SEC S.r.l.

The transaction in question is a securitisation undertaken pursuant to Law 130/99 with the support of the vehicle Adriano Lease SEC S.r.l., which took the form of the sale by the subsidiary Leasint S.p.A. (subsequently merged into Mediocredito Italiano) of a portfolio of loans selected on the basis of pre-defined criteria and arising from performing property, equipment and car lease contracts, for a total amount of approximately 5.8 billion euro, with the purpose to expand the liquidity reserve that may be activated through refinancing transactions on the Eurosystem.
The vehicle Adriano Lease SEC issued two series of notes:

– a senior series, with a nominal value of 2.8 billion euro, listed and assigned an A+ rating by Standard & Poor's and AAA by DBRS. The security amortisation period started on July 2013; as at 31 December 2015, it had been fully amortised;
– a junior series, with a nominal value of 3 billion euro, unlisted and unrated, is still being repaid. As at 31 December 2016, securities for 2.1 billion euro were still to be repaid.

All these notes were purchased by the subsidiary Leasint (now Mediocredito Italiano). Until January 2016, the junior notes were partially assigned through a repurchase agreement to Intesa Sanpaolo, which partially used them as collateral for a loan received.
In December 2016, the Board of Directors of Mediocredito Italiano approved the early redemption of the transaction, considering that, after the repayment in full of the senior tranche, this no longer contributes to the formation of collateral for the refinancing transactions with the ECB, which is the source of fixed costs to maintain the underlying structure, and that alternative uses for the junior tranche are not foreseen.
For the purposes of the early closing of the transaction, in January 2017 Mediocredito Italiano reacquired from Adriano Lease Sec the portfolio of loans at its book value (2.2 billion euro) and terminated all the contracts related to the transaction.
It should be noted that, having reconsolidated all the securitised assets in its financial statements as these were not subject to derecognition, the repurchase of the portfolio did not have any economic or capital impact on the Bank.
On the payment date of 27 January 2017 Adriano Lease Sec repaid all the securities in full.

Intesa Sanpaolo SEC S.A.

The securitisation of loans issued to large international corporate customers by some international branches of Intesa Sanpaolo (Frankfurt, Hong Kong, Madrid and New York) was finalised in August 2013. The securitisation was conducted through the Luxembourg-based vehicle company Intesa Sanpaolo SEC. SA.
The securities issued, with a total value of about 326 million euro, were subscribed by Intesa Sanpaolo and used for a value of about 308 million euro (corresponding to the most senior class of notes issued, representing the principal of the securitised loans) as collateral of a loan received by a primary European bank.

Intesa Sanpaolo Securitisation Vehicle S.r.l.

In December 2014, a new securitisation was approved, involving three portfolios of loans originated by CIB Bank ZRT, primarily non-performing positions, secured by guarantees and mortgages and denominated in euro, Hungarian forints and Swiss francs. Those portfolios were transferred without recourse to Intesa Sanpaolo, which on 30 December 2014 in turn sold the three portfolios without recourse to the vehicle for 241 million euro, 17.1 billion Hungarian forints and 57.2 million Swiss francs, respectively.

Intesa Sanpaolo is the servicer of the portfolio and CIB Bank ZRT the sub-servicer, in accordance with applicable legislation.

In February 2015, Intesa Sanpaolo Securitisation Vehicle S.r.l. issued two classes of notes for each of the three separate asset pools. All classes of notes, which are unlisted and unrated, were subscribed for by Intesa Sanpaolo, as summarised below:

- class-A (senior) notes of 138.2 million euro and class-J (junior) notes of 103.3 million euro were issued for the portfolio of securitised loans in euro;
- class-A (senior) notes of 7.8 billion forints and class-J (junior) notes of 9.3 billion forints were issued for the portfolio of securitised loans in Hungarian forints;
- class-A (senior) notes of 29.4 million francs and class-J (junior) notes of 27.9 million francs were issued for the portfolio of securitised loans in Swiss francs.

As at 31 December 2016, the asset pools held by the vehicle were composed as follows:

- securitised assets in euro of 79.1 million, in addition to cash of 12.9 million euro. The securities in issue had a residual value of 74.3 million euro (class A) and 103.3 million euro (class J);
- securitised assets in Hungarian forints with a value in euro of 15.6 million and cash with a value in euro of 1.8 million euro. The securities in issue had a residual value of 12.9 million euro (class A) and 30.1 million euro (class J);
- securitised assets in Swiss francs with a value in euro of 5.1 million euro and cash with a value in euro of 0.5 million euro. The securities in issue had a residual value of 1.5 million euro (class A) and 26 million euro (class J);

The table below shows the characteristics of the securities issued by the vehicles and subscribed by the Group companies.

(millions of euro)

Vehicle		Type of security issued	Type of asset securitised	External rating	Principal as at 31.12.2015
Adriano Lease SEC S.r.l.					**2,137**
		Senior	Receivables from lease payments	A+	-
		Junior	Receivables from lease payments	no rating	2,137
Intesa Sanpaolo SEC SA					**326**
of which issued in EUR					291
	Secured Principal Notes	Senior	Receivables from large international corporate customers	no rating	276
	Secured Income Notes	Junior	Receivables from large international corporate customers	no rating	15
of which issued in USD					35
	Secured Principal Notes	Senior	Receivables from large international corporate customers	no rating	33
	Secured Income Notes	Junior	Receivables from large international corporate customers	no rating	2
Intesa Sanpaolo Securitisation Vehicle SRL					**349**
of which issued in EUR					241
	Class A ABS F/R Notes	Senior	Commercial mortgage loans	no rating	138
	Class J ABS F/R and Additional Return Notes	Junior	Commercial mortgage loans	no rating	103
of which issued in CHF					53
	Class A ABS F/R Notes	Senior	Commercial mortgage loans	no rating	27
	Class J ABS F/R and Additional Return Notes	Junior	Commercial mortgage loans	no rating	26
of which issued in HUF					55
	Class A ABS F/R Notes	Senior	Commercial mortgage loans	no rating	25
	Class J ABS F/R and Additional Return Notes	Junior	Commercial mortgage loans	no rating	30
TOTAL					**2,812**

OTHER INFORMATION ON FINANCIAL RISKS

SOVEREIGN RISK EXPOSURE BY COUNTRY OF RESIDENCE OF THE COUNTERPARTY

The following table illustrates the value of the main exposures of the Intesa Sanpaolo Group to sovereign risk.

(millions of euro)

	DEBT SECURITIES							LOANS
	BANKING GROUP					INSURANCE COMPANIES (**)	TOTAL	
	Loans and Receivables	Financial assets available for sale	Investments held to maturity	Financial assets designated at fair value through profit and loss	Financial assets held for trading (*)			
EU Countries	**6,977**	**50,467**	**959**	**725**	**2,401**	**54,550**	**116,079**	**16,981**
Austria	-	-	4	-	-6	3	1	-
Belgium	-	609	-	-	28	8	645	-
Bulgaria	-	-	-	-	-	59	59	-
Croatia	94	161	2	725	67	61	1,110	1,103
Cyprus	-	-	-	-	-	-	-	-
Czech Republic	-	-	-	-	-	-	-	9
Denmark	-	19	-	-	-	-	19	-
Estonia	-	-	-	-	-	-	-	-
Finland	-	83	-	-	-	9	92	6
France	101	3,446	-	-	217	90	3,854	6
Germany	-	9,569	-	-	131	867	10,567	-
Greece	-	-	-	-	-	-	-	-
Hungary	33	643	-	-	126	39	841	27
Ireland	-	77	-	-	-9	101	169	-
Italy	6,461	26,291	355	-	1,521	51,852	86,480	15,099
Latvia	-	21	-	-	-	-	21	50
Lithuania	-	57	-	-	6	-	63	-
Luxembourg	-	-	-	-	-	-	-	-
Malta	-	-	-	-	-	-	-	-
Netherlands	-	553	-	-	1	100	654	-
Poland	17	89	-	-	41	19	166	-
Portugal	17	-	-	-	-4	-	13	25
Romania	-	150	-	-	4	132	286	1
Slovakia	-	348	598	-	-	-	946	123
Slovenia	-	225	-	-	-	8	233	247
Spain	254	8,036	-	-	225	1,202	9,717	285
Sweden	-	-	-	-	53	-	53	-
United Kingdom	-	90	-	-	-	-	90	-
North African Countries	**-**	**605**	**-**	**-**	**-**	**-**	**605**	**-**
Algeria	-	-	-	-	-	-	-	-
Egypt	-	605	-	-	-	-	605	-
Libya	-	-	-	-	-	-	-	-
Morocco	-	-	-	-	-	-	-	-
Tunisia	-	-	-	-	-	-	-	-
Japan	**-**	**-**	**-**	**-**	**709**	**-**	**709**	**-**

(*) Taking into consideration on-balance sheet positions

(**) Debt securities of insurance companies are classified almost entirely to the available-for-sale portfolio

As illustrated in the table, the exposure to Italian government securities totalled approximately 86 billion euro, in addition to around 15 billion euro represented by loans. The value of debt security exposures decreased by approximately 1.5 billion euro compared to the figure recorded as at 31 December 2015.

INFORMATION ON STRUCTURED CREDIT PRODUCTS

The risk exposure to structured credit products reached 2,471 million euro as at 31 December 2016 with respect to funded and unfunded ABS/CDOs, compared to 2,429 million euro as at 31 December 2015, in addition to an exposure of 7 million euro with respect to structured packages, which compares with the 2 million euro as at 31 December 2015.
The strategy regarding the portfolio in question in 2016 focused on investments to exploit market opportunities, on the one hand, and on disposing of the portfolio hard hit by the financial crisis, which is now managed by Capital Light Bank, on the other.

The rise in exposure in funded and unfunded ABS/CDOs designated at fair value (from 1,988 million euro in December 2015 to 2,081 million euro in December 2016) is attributable to higher investments in ABS by the subsidiary Banca IMI, part of which was classified to the available-for-sale portfolio, as well as to European ABS acquired by the Parent Company and classified in the trading portfolio, only partially offset by the sales of the period.
Banca IMI's investments mainly consist of securities with underlying residential mortgages and CLOs with mainly AA ratings. The Parent Company confirmed its transactions in European RMBS with mainly AAA ratings, aimed at seizing market opportunities, with new investments that are only partially offset by sales.
With regard to the exposure represented by securities classified under the loan portfolio, on the other hand, a decrease was recorded (from 441 million euro in December 2015 to 390 million euro in December 2016), attributable to the sales that concerned the portfolio of the Parent Company and Banca IMI, only partially offset by higher investments.
The increase in the exposure of structured packages is attributable to valuation components of the period.

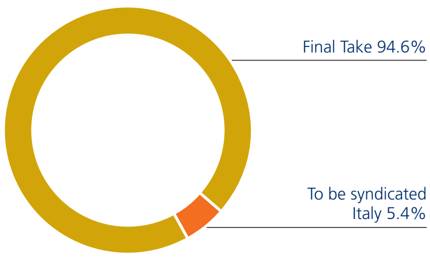
From an income statement perspective, a result of +13 million euro was recorded in 2016, compared to -1 million euro for 2015.
As at 31 December 2016 the “Profits (losses) on trading – caption 80” of the exposure to funded and unfunded ABSs/CDOs came to +12 million euro, generated by the positions in funded European and U.S. ABSs/CDOs, while positions in multi-sector CDOs and U.S. subprime had a nil result.
The exposure to funded and unfunded ABSs/CDOs in securities classified by the subsidiary Banca IMI in the available-for-sale portfolio recorded a net increase in fair value of 5 million euro, accounted for in the specific Shareholders’ Equity Reserve, and an impact on the income statement for sales made in the period of +5 million euro. The securities reclassified in the Loan portfolio recorded an impact of -6 million euro in 2016, to be attributed to the Parent Company, which posted negative adjustments due to the impairment of several securities in the portfolio (-1 million euro in 2015).

The “Monoline risk” and “Non-monoline packages” segments made a contribution to “Profits (Losses) on trading – caption 80” of +2 million euro in 2016, compared with the nil contribution in 2015.

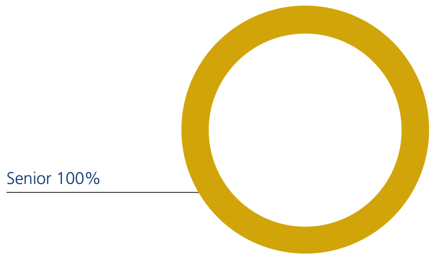
INFORMATION ON LEVERAGED FINANCE TRANSACTIONS

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 31 December 2016, 111 transactions for a total amount granted of 3,024 million euro met the above definition.
These exposures are classified under the loans portfolio. They also include the portions of syndicated loans underwritten or under syndication. In line with disclosure requirements, breakdown of exposures by geographical area, economic sector and by level of subordination is set out below.

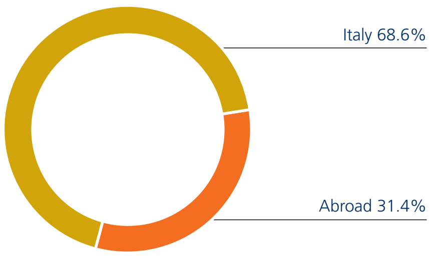
Breakdown by type of risk



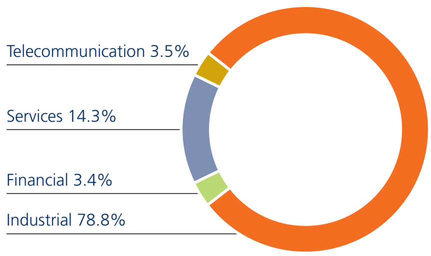
Breakdown by subordination level



Breakdown by geographical area



Breakdown by economic sector



INFORMATION ON INVESTMENTS IN HEDGE FUNDS

The hedge fund portfolio held for trading as at 31 December 2016 totalled 352 million euro, compared to 758 million euro recorded in December 2015, 80% of which were funds on the MAP platform.
The reduction in the portfolio is mainly due to significant distributions and redemptions starting in the second quarter - aimed at reducing the risk level of the exposure and resulting from the obligation to comply with the instructions of the Volker Rule on U.S. Funds - as well as to the decrease in the value of the units underwritten mainly during the first quarter, partly offset by recoveries recorded in the last few months of the year.
As at the same date, the economic result of the investments in this segment was negative for 35 million euro, compared to the positive 8 million euro of "Profits (Losses) on trading – caption 80" in the third quarter of 2015. The 35 million euro net loss is almost entirely attributable to a decline in the NAV of several funds witnessed in the first quarter.
More specifically, the greatest losses were recorded on the Paulson fund (16 million euro), which is heavily exposed to the healthcare sector, which was affected by idiosyncratic events and is at the centre of the US electoral campaign on the price of drugs, and on the Eurizon Penghua fund (4 million euro), focusing on the Asian equity market, and the Chinese one in particular; several losses also concerned funds on the Map 12 and Map 10 platforms, focused on financials and the Italian banking system. On the contrary worth mentioning are the positive results of the Map19 fund, which skilfully takes advantage of merger arbitrage and corporate recapitalisation and restructuring operations.
Overall, the portfolio's strategy remains oriented towards benefiting from the occurrence of specific corporate events, largely independent of the general trend, and the reduction of risk through a general downwards revision of allocations of individual funds in response to market uncertainty.

INFORMATION ON TRADING TRANSACTIONS IN DERIVATIVES WITH CUSTOMERS

Considering relations with customers only, as at 31 December 2016, the Intesa Sanpaolo Group, in relation to derivatives trading with retail customers, non-financial companies and public entities (therefore excluding banks, financial and insurance companies), presented a positive fair value,

not having applied netting agreements, of 7,532 million euro (7,670 million euro as at 31 December 2015). The notional value of these derivatives totalled 47,698 million euro (45,855 million euro as at 31 December 2015). Of these, the notional value of plain vanilla contracts was 44,451 million euro (42,521 million euro as at 31 December 2015), while that of structured contracts was 3,247 million euro (3,334 million euro as at 31 December 2015).

Please note that the positive fair value of contracts outstanding with the 10 customers with the highest exposures came to 5,175 million euro (5,161 million euro as at 31 December 2015), of which 463 million euro (493 million euro as at 31 December 2015) referred to structured contracts.

Conversely, the negative fair value referring to total contracts outstanding, determined with the same criteria, for the same types of contracts and with the same counterparties, totalled 1,971 million euro as at 31 December 2016 (1,929 million euro as at 31 December 2015). The notional value of these derivatives totalled 22,030 million euro (20,304 million euro as at 31 December 2015). Of these, the notional value of plain vanilla contracts was 18,745 million euro (17,999 million euro as at 31 December 2015), while that of structured contracts was 3,285 million euro (2,305 million euro as at 31 December 2015).

The fair value of derivative financial instruments entered into 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 31 December 2016, this led to a negative effect of 18 million euro being recorded under “Profits (Losses) on trading” in the income statement.

As regards the methodologies used in determining the fair value of financial instruments, see the specific paragraphs in Part A of the Notes to the consolidated financial statements.

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.