Part E – Information on risks and relative hedging policies

Basic principles

The Intesa Sanpaolo Group attaches great importance to risk management and control to ensure reliable and sustainable value creation in a context of controlled risk.
The risk management strategy aims to achieve a complete and consistent overview of risks, given both the macroeconomic scenario and the Group's risk profile, by fostering a culture of risk-awareness and enhancing the transparent and accurate representation of the risk level of the Group's portfolios.
Risk-acceptance strategies are summarised in the Group's Risk Appetite Framework (RAF), approved by the Board of Directors. The RAF is established to ensure that risk-acceptance activities remain in line with shareholders' expectations, taking into account the Group's risk position and the economic situation. The framework establishes the general risk appetite principles, together with the controls for the overall risk profile and the main specific risks.
The general principles that govern the Group's risk-acceptance strategy may be summarised as follows:

- The Intesa Sanpaolo Banking Group is focused on a commercial business model in which domestic retail activity remains the Group's structural strength;
- the Group does not aim to eliminate risks, but rather attempts to understand and manage them so as to ensure an adequate return for the risks taken, while guaranteeing the Company's solidity and business continuity in the long term;
- Intesa Sanpaolo has a moderate risk profile in which capital adequacy, earnings stability, a sound liquidity position and a strong reputation are the key factors to protecting its current and prospective profitability;
- Intesa Sanpaolo aims at a capitalisation level in line with its main European peers;
- Intesa Sanpaolo intends to maintain strong management of the main specific risks (not necessarily associated with macroeconomic shocks) to which the Group may be exposed;
- the Group attaches great importance to the monitoring of non-financial risks, and in particular:
  - limits are set for operational risks (including specific treatment for ICT and Cyber Risk);
  - with regard to legal risk, the Group endeavours to fulfil all its legal and statutory responsibilities in order to minimise claims and litigation it is exposed to;
  - for compliance risk, the Group aims for formal and substantive compliance with rules in order to avoid penalties and maintain a solid relationship of trust with all of its stakeholders;
  - for reputational risk, the Group strives to actively manage its image and aims to prevent and contain any negative effects on said image.

The general principles apply both at Group level and business unit or company level. In the event of external growth, these general principles shall be applied, by considering the specific characteristics of the market and the competitive scenario where the growth takes place.
The Risk Appetite Framework thus represents the overall framework in which the risks assumed by the Group are managed, with the establishment of general principles of risk appetite and the resulting structuring of the management of:

- the overall risk profile; and
- the Group's main specific risks.

Management of the overall risk profile is based on the general principles laid down in the form of a framework of limits aimed at ensuring that the Group complies with minimum solvency, liquidity and profitability levels even in case of severe stress. In addition, it aims to ensure the desired operational, reputational and compliance risk profiles.
In detail, management of overall risk is aimed at maintaining adequate levels of:

- capitalisation, also in conditions of severe macroeconomic stress, in relation to both Pillar 1 and Pillar 2, by monitoring the Common Equity Ratio, the Total Capital Ratio, the Leverage Ratio and the Risk Bearing Capacity;
- liquidity, sufficient to respond to periods of tension, including extended periods of tension, on the various funding sourcing markets, with regard to both the short-term and structural situations, by monitoring the internal limits of the Liquidity Coverage Ratio, Net Stable Funding Ratio, Loan/Deposit Ratio and Asset Encumbrance;
- earnings stability, by monitoring the adjusted net income and the adjusted operating costs on revenues, which represent the main potential causes for their instability;
- management of operational, compliance and reputational risk, in order to minimise the potential impact of negative events that jeopardise the Group's economic stability and image.

In compliance with the EBA guidelines (EBA/GL/2015/02) concerning the "Minimum list of quantitative and qualitative recovery plan indicators", the Group has also included new asset quality, market-based and macroeconomic indicators as early warning indicators in the RAF, to ensure consistency with its Recovery Plan.
The main specific risks considered concern the particularly significant risk concentrations for the Group (e.g. concentration on individual counterparties, on sovereign risk and on the public sector. Said management is implemented by establishing specific limits, management processes and mitigation measures to be taken in order to limit the impact of especially severe scenarios on the Group. These Risks are assessed also considering stress scenarios and are periodically monitored within the Risk Management systems.

A specific Credit Risk Appetite Framework (CRA) was already established in 2015. The CRA identifies areas of growth for loans and areas to be monitored, using an approach based on ratings and other useful predictive statistical indicators, to guide lending growth by optimising the management of risk and expected loss. In 2017, the CRA was extended to the structured finance portfolios, to large corporate and to real estate. The limits set are approved within the RAF and are continuously monitored by the Credit Risk Management Head Office Department.
During the 2017 update, the Group RAF was further strengthened through the following main activities:
- refinement of the methods for setting limits, focusing on the limits in the market risk area;
- identification of new specific risks and definition of appropriate limits/mitigation actions for their control;
- further rationalisation of the cascading of limits on the Divisions and Group companies.

Defining the Risk Appetite Framework is a complex process headed by the Chief Risk Officer, which involves close interaction with the Chief Financial Officer and the Heads of the various Business Units, is developed in line with the ICAAP, ILAAP and Recovery Plan processes, and represents the risk framework in which the Budget and Business Plan are developed. Consistency between the risk-acceptance strategy and policy and the Plan and Budget process is thus guaranteed.
The definition of the Risk Appetite Framework and the resulting operating limits for the main specific risks, the use of risk measurement instruments in loan management processes and controlling operational risk, the use of capital-at-risk measures for management reporting and assessment of capital adequacy within the Group represent fundamental milestones in the operational application of the risk strategy defined by the Board of Directors along the Group’s entire decision-making chain, down to the single operational units and to the single desks.
The Group sets out these general principles in policies, limits and criteria applied to the various risk categories and business areas, in a comprehensive framework of limits and procedures for governance and control.

The assessment of the total Group risk profile is conducted annually with the ICAAP, which represents the capital adequacy self-assessment process according to the Group’s internal rules.
In accordance with the ECB requirements, the ICAAP process incorporates two complementary perspectives:
- Regulatory perspective, in which the baseline scenario and the stress scenario are presented over the short term (one year) and the medium and long term (three years). From 2017, the stress scope has been extended to the insurance segment to better capture the specific characteristics of the Group’s business model (financial conglomerate);
- Financial and operating perspective, in which the baseline scenario is presented, over the short term (one year). The report provides details of the sensitivity of economic capital to changes in the confidence interval (CI).

The quantitative reconciliation between regulatory requirements and management estimates of capital adequacy is set out in a specific document in the ICAAP, which reports the differences in scope and definition of risks considered in both areas, as well as the differences, where appreciable, between what is considered in the two perspectives in terms of the main parameters (e.g. confidence interval and holding period) and assumptions (such as those relating to the diversification of effects).

The Group is required to provide a Recovery Plan according to indications received by Supervisory Authorities. The process that oversees the preparation of that plan is an integral part of the regulatory response to cross-border resolution for “too-big-to-fail” banks and financial institutions. The Recovery Plan (introduced by the Bank Recovery and Resolution Directive, transposed into Italian law by Legislative Decree 180 of 16 November 2015) establishes the methods and measures to be used when an institution comes under severe stress and in an early intervention phase, in order to restore financial strength and long-term viability.
Within the annual preparation process for the Recovery Plan, the Chief Risk Officer Governance Area identifies the stress scenarios suitable of highlighting the main vulnerabilities of the Group and its business model (e.g. significant exposure to the domestic market), as well as measuring their potential impacts on the Group's risk profile. The final results showed that the Group has a high level of resilience. In addition, as per the Road Map agreed with the Joint Supervisory Team, the inclusion in the Group Recovery Plan of the subsidiaries within the SSM scope was completed (VUB Group, Banka Intesa Sanpaolo d.d., Intesa Sanpaolo Bank Ireland, Intesa Sanpaolo Bank Luxemburg, CIB, Privredna Banka Zagreb Group and Intesa Sanpaolo Romania). The other foreign subsidiaries will continue to be managed according to the regulations in their countries.

The table below shows the mapping of risk disclosure regarding the financial statements and Pillar 3.

	FINANCIAL STATEMENTS		PILLAR 3
	Section/Chapter	Paragraph	Section
RISKS OF THE BANKING GROUP	PART E - SECTION 1		
- Credit risk	Chapter 1.1	*Paragraph A and B*	Sections 6-7-8-9-10
- Securitisations		*Paragraph C*	*Section 12*
- Counterparty risk	Chapter 1.1 - Chapter 1.2		Section 11
- Market risk	Chapter 1.2		Section 13
- Regulatory trading book		*Paragraph 1.2.1*	
- Banking book		*Paragraph 1.2.2*	
- Sovereign risk	Chapter 1.3		
- Liquidity risk	Chapter 1.3		Section 5
- Operational risk	Chapter 1.4		Section 14
- Legal risk	Chapter 1.4		
RISKS OF INSURANCE COMPANIES	PART E - SECTION 2		
- Insurance risks	Chapter 2.1		
- Financial risks	Chapter 2.2		
RISKS OF OTHER COMPANIES	PART E - SECTION 3		

Risk culture

The Group continues its strategic orientation towards a moderate risk profile, maintaining high levels of capital and liquidity, supported by ongoing attention to the internal control system and strengthened by operating limits and rules that favour compliance with the regulations. A culture based on widespread responsibility, balanced judgment aptitude and long-lasting sustainability of development initiatives is promoted, through extensive staff training aimed both at acquiring in-depth knowledge of the overall risk management framework (approaches, methods, internal models, rules and limits, controls) and at internalizing the Group's values (Code of Ethics, behaviour, rules of conduct and relations).
Particular attention is paid to full awareness of the principles and guidelines, by systematically updating the reference documents (Tableau de Bord, ICAAP, Risk Appetite Framework) and the information set for the exercise of activities, whose contents are clarified through structured training approaches (Risk Academy). Ongoing relations are maintained with the Chief Risk Officers of the Group companies, in order to share information on development plans and the progress of strategic projects, with the examination of the specific operational and regulatory aspects of the local markets. To obtain an extensive and in-depth picture of the Group's risk culture, a survey was conducted, involving approximately 7,700 managers (Heads of Departments, Sub-Departments and Offices) and all the governance, steering and control functions of the Parent Company and the Divisions, as well many representatives from the business units and the commercial network. The survey collected and processed information, gathered through questionnaires and interviews, on perceptions and opinions regarding a range of dimensions of the risk culture, including: awareness of the risks to be addressed, clarity on sustainable risk, compliance with the rules and the limits set, level and diffusion of responsibility, timeliness of response to difficulties, ability to learn from mistakes, quality of the reporting and communication processes, orientation towards cooperation and openness to dialogue, and willingness to nurture talent and experience. The results were compared with the data obtained from the same survey on a sample of international peers. The broad-based participation (80% survey participation rate) is clear evidence of the sensitivity to the values and conduct about risks. The perceptions on the risk culture dimensions, that are widely converging, provide an idea of the Group's close-knit management team and reflect the internalization of the system of values, principles, rules, models and relationships. The outcomes concerning the risk awareness and tolerance, the appropriate self-control behaviours, the compliance to rules, the openness to comparison, made the Group stand out from its peers and confirmed the perception of an effective internal control system. Supporting actions to strenghthen orientation to cooperation and internal communication have been launched in order to promote a wider dissemination of working approaches strongly geared towards innovation and proactive problem-solving of the issues.

Risk governance organisation

The policies relating to risk taking and the governance processes for management of the risk that the Group is or could be exposed to are defined by Board of Directors of Intesa Sanpaolo as the Parent Company, with the support of the Committees appointed by the Board, including primarily the Risks Committee. The Management Control Committee, which is the body with control functions, supervises the adequacy, efficiency, functionality and reliability of the risk management process and of the Risk Appetite Framework.
The Managing Director and CEO has the power to submit proposals for the adoption of resolutions concerning the risk system and implements all the resolutions of the Board of Directors, with particular reference to the implementation of the strategic guidelines, the RAF and the risk governance policies defined by the Board of Directors.

The Corporate Bodies also benefit from the action of selected Management Committees on risk management. These Committees operate in compliance with the primary responsibilities of the Corporate Bodies regarding internal control system and the prerogatives of Corporate control functions, and specifically the risk control function. Among these:

– The Steering Committee, chaired by the Managing Director and CEO, is a body with a decision-making, consulting and reporting role, which, within the Group Risk Analysis Session, seeks to ensure the control and management of risks and safeguard business value at Group level. Its various tasks include examining the RAF, for the presentation of the related proposal to the Board of Directors, and the allocation, on authority from the Board of Directors, of the Group RAF limits to the Divisions and/or the Group companies.

- The Group Financial Risks Committee is a technical body with decision-making, reporting and consulting powers, focused both on the banking business (proprietary financial risks for banking and trading books, as well as Active Value Management) and the life insurance business (result exposure to the trend in market variables). The functions of said Committee are set out in two sessions:
  - the Risk Analysis and Assessment Session, chaired by the Chief Risk Officer, is responsible, inter alia, for evaluating, in advance of approval by the Corporate Bodies, the methodological and measurement guidelines for financial risks and proposals for operational limits, in addition to defining the distribution thereof amongst the Group's major units; in addition, the session verifies the financial risk profile of the Group and its main operational units;
  - the Management Guidelines and Operating Choices Session, chaired by the Chief Financial Officer, provides operational guidelines in implementation of the strategic guidelines and risk management policies laid down by the Corporate Bodies in respect of management of the banking book, liquidity, interest rate and exchange risk and periodically verifies the Group's overall financial risk profile, as well as appropriate measures aimed at mitigating it.

- the Control Coordination and Operational Risk Committee is a technical body whose goal is to strengthen the coordination and the interdepartmental cooperation mechanisms as part of the Group internal control system, thus promoting the integration of the risk management process. The Functions of the Group Control Coordination and Operational Risk Committee are organised into specific, separate sessions:
  - Integrated Internal Control System Session, for reporting and consulting purposes;
  - Operational Risk session, with decision-making, reporting and consulting purposes (in this context, the Committee's duties 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 Manager responsible for preparing the Company's financial reports participates in the Committee meetings as a permanent member. This contributes to fulfilling the assigned legal obligations and the responsibilities established in the Company Regulations on the supervision of the financial reporting process. It also enables the promotion of the inter-functional coordination and integration of control activities, within its area of responsibility.

The Chief Risk Officer, to whom the Governance Area in charge of the risk management functions as well as the controls on the risk management and internal validation process reports, represents a "second line of defence" in the management of corporate risks that is separate and independent from the business supporting functions.
The Chief Risk Officer is responsible for proposing the Risk Appetite Framework and setting the Group's risk management guidelines and policies, in accordance with the company's strategies and objectives, and coordinates and verifies their implementation by the responsible units of the Group, also within the various corporate areas, in addition to ensuring the 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 Chief Risk Officer also carries out II level controls on credit and other risks, and ensures the validation of internal risk measurement systems.
To that end, the Chief Risk Officer Governance Area is broken down into the following Organisational Units:
- Credit Risk Management Department;
- Financial and Market Risks Department;
- Enterprise Risk Management Department;
- Internal Validation and Controls Department;
- Coordination of Risk Management Initiatives.

The Chief Risk Officer Governance Area is responsible for operational implementation of the strategic and management guidelines along the Bank's entire decision-making chain, down to individual operational units.
The risk control functions of subsidiaries with a decentralised management model and the representatives of the Parent Company's risk control function at subsidiaries with a centralised management model report to the Area.

The Chief Compliance Officer, who reports directly to the Managing Director and CEO, in a position that is independent from operating departments and separate from internal auditing, ensures the monitoring of the risk of non-compliance with Group regulations. Within the Risk Appetite Framework, the Chief Compliance Officer proposes the statements and limits set for compliance risk and monitors their implementation. He/she also collaborates with (i) the Chief Risk Officer Governance Area in the monitoring and control of operational risks for compliance purposes, in the proposal of operating loss limits and, if these limits are exceeded, in the identification/analysis of events attributable to non-compliance with regulations and in the identification of appropriate corrective measures; (ii) together with the other Corporate control functions, in accordance with the procedures set out in the "Integrated internal control system Regulation", in order to achieve effective integration of the risk management process.

The Parent Company performs a guidance and coordination role with respect to the Group companies, aimed at ensuring effective and efficient risk management at Group level, exercising responsibility in setting the guidelines and methodological rules for the risk management process, and pursuing, in particular, integrated information at Group level to the Corporate Bodies of the Parent Company, with regard to the completeness, adequacy, functioning and reliability of internal control system. For the corporate control functions in particular, there are two different types of models within the Group: (i) the centralised management model based on the centralisation of the activities at the Parent Company and (ii) the decentralised management model that involves the presence of locally established corporate control functions that conduct their activities under the direction and coordination of the same corporate control functions of the Parent Company, to which they report in functional terms.

Irrespective of the control model adopted within their company, the corporate bodies of the Group companies are aware of the choices made by the Parent Company and are responsible for the implementation, within their respective organisations, of the control strategies and policies pursued and promoting their integration within the group controls.

The internal control system

To ensure a sound and prudent management, Intesa Sanpaolo combines business profitability with an attentive risk-acceptance activity and an operating conduct based on fairness.
Therefore, the Bank, in line with legal and supervisory regulations in force and consistently with the Corporate Governance Code for Listed Companies, has adopted an internal control system capable of identifying, measuring and continuously monitoring the risks typical of its business activities.
Intesa Sanpaolo's internal control system is built around a set of rules, functions, structures, resources, processes and procedures aimed at ensuring, in compliance with sound and prudent management, the achievement of the following objectives:

– the verification of the implementation of Company strategies and policies;
– the containment of risk within the limits indicated in the reference framework for determining the Bank's risk appetite (Risk Appetite Framework – RAF);
– the safeguarding of asset value and protection from losses;
– the effectiveness and efficiency of the Bank processes;
– the reliability and security of Company information and IT procedures;
– the prevention of the risk that the Bank may be involved, including involuntarily involved, in illegal activities (with special regard to those relating to money-laundering, usury and financing of terrorism);
– the compliance of transactions with the law and supervisory regulations, as well as internal policies, procedures and regulations.

The internal control system plays a crucial role and involves the entire corporate organisation (bodies, units, hierarchical levels, all personnel). In compliance with the provisions of Bank of Italy Circular 285/2013 (First Part, Title IV, Chapter 3) the "Integrated Internal Control System Regulation" was finalised. This aims to define the guidelines of Intesa Sanpaolo's internal control system, in its capacity as Bank and Parent Company of the Banking Group, through the adaptation of the reference principles and the definition of the responsibilities of the Bodies and of the functions with control duties, which contribute, in various ways, to the proper operation of the internal control system, as well as the identification of coordination arrangements and information flows supporting system integration. The structure of internal controls is also outlined by the entire set of company documentation (regulatory framework) that provides organised and systematic access to the guidelines, procedures, organisational structures, and risks and controls in force, incorporating all the Company policies, the instructions of the Supervisory Authorities, and provisions of law, including the principles laid down in Legislative Decree 231/2001 and Law 262/2005.
The regulatory framework consists of "Governance Documents" that oversee the operation of the Bank (Articles of Association, Code of Ethics, Group Internal Code of Conduct, Group Regulations, Group Committees Regulation, Regulation on Related Party Transactions, Integrated Internal Control System Regulations, Authorities and powers, Guidelines, Function charts of the Organisational Structures, etc.) and more strictly operational regulations that govern business processes, individual operations and the associated controls.
More specifically, the Company rules set out organisational solutions that:

– ensure sufficient separation between the operational and control functions and prevent situations of conflict of interest in the assignment of responsibilities;
– are capable of adequately identifying, measuring and monitoring the main risks assumed in the various operational segments;
– enable the recording, with an adequate level of detail, of every operational event and, in particular, of every transaction, ensuring their correct allocation over time;
– guarantee reliable information systems and suitable reporting procedures for the various managerial levels assigned the functions of governance and control;
– ensure the prompt notification to the appropriate levels within the business and the swift handling of any anomalies found by the business units, the internal auditing department and the other control functions;
– ensure adequate levels of business continuity.

The Company's organisational solutions also include controls at each operational level that enable the uniform and formalised identification of responsibilities, particularly in relation to the tasks of controlling and correcting the irregularities found.
In terms of Corporate Governance, Intesa Sanpaolo adopted the one-tier corporate governance system, pursuant to Articles 2409-sexiesdecies and following of the Italian Civil Code. It therefore conducts its operations through a Board of Directors, certain members of which are also members of the Management Control Committee
Based on this model:

– the Board of Directors is the body responsible for strategic supervision and performs all the tasks assigned to it by the Articles of Association, the applicable regulations and the Bank's governance documents;
– the Managing Director and CEO performs the tasks assigned by the supervisory regulations to the body responsible for management, as set out in the Bank's governance documents, approved by the Board of Directors, except for the responsibilities assigned to the Board;
– the Management Control Committee performs the control function.

The Board of Directors elects a Managing Director from its members, other than the Chairman of the Board, the members of the Management Control Committee or the minimum number of Independent Directors.
The Intesa Sanpaolo Group adopts an internal control system based on three levels, in line with the legal and regulatory provisions in force.

Such a model provides for the following types of control:

– ***Level I***: line controls which are aimed at ensuring proper performance of operations (for example, hierarchical, systematic and sample-based controls) and which, to the extent possible, are incorporated in the IT procedures. These are conducted by the same operating and business structures, also through a unit dedicated exclusively to control duties or carried out by the back office;

- ***Level II***: risk and compliance controls for the purpose of ensuring, inter alia:
  - the correct implementation of the risk management process;
  - compliance with the operating limits assigned to the various functions;
  - compliance of company operations with the rules, including self-governance rules.

  The functions assigned to such controls are separate from the ones in charge of production and contribute to the definition of the risk governance policies and the risk management process. In the Intesa Sanpaolo Group, Level II includes the following Parent Company structures and the equivalent local units of the Group companies, where established:
  - Chief Compliance Officer, who is assigned the duties and responsibilities of the "compliance" function, as defined in the reference regulations. The Chief Compliance Officer's area also includes the Anti-Money Laundering Department, which is tasked with the duties and responsibilities of the "anti-money laundering function", as defined by the reference regulations;
  - Chief Risk Officer Governance Area, which is assigned the role of the risk management function, as defined by the applicable regulations. The Chief Risk Officer Governance Area also includes the Internal Validation and Controls Head Office Department, which is tasked, among other things, with the duties and responsibilities of the "validation function", as defined by the applicable regulations.
- ***Level III***: internal audit controls to identify breaches of procedures and regulations, as well as to periodically assess the completeness, adequacy, functionality (in terms of efficiency and effectiveness) and reliability of the internal control system and the IT system at Group level, at scheduled deadlines in relation to the nature and intensity of the risks. In the Intesa Sanpaolo Group, internal auditing is carried out by the Internal Auditing Head Office Department of the Parent Company and the equivalent local units of Group companies, where established.

The internal control system is periodically reviewed and adapted in relation to business development and the reference context.
Intesa Sanpaolo has an internal control structure consistent with the indications provided by the Supervisory Authorities.

The Risk Management and Internal Validation Function

The Chief Risk Officer Governance Area is responsible for operational implementation of the strategic and management guidelines for risk along the Bank's entire decision-making chain, down to individual operational units. The tasks and functions are discussed in detail in the subsequent chapters of Part E.

Through the Internal Validation and Controls Head Office Department, the Chief Risk Officer Governance Area carries out II level controls on credit and other risks. The activities conducted on credit consider the quality, composition and evolution of the various loan portfolios, also through controls, sampled by a risk-based or a statistical approach, on proper classification and provisioning of single positions ("single name" controls).
In general, the control activities development includes the credit processes assessment also to verify that suitable I level controls are in place, including proper execution and traceability.
The control of risks other than credit risks is aimed at verifying that I level controls are properly established in terms of completeness, efficiency, detection and traceability, identifying areas to be strengthened and, where necessary, requesting corrective measures.

The internal control system implemented by the Bank includes the validation function, which is in charge of the ongoing evaluation, in accordance with the supervisory regulations for banks[11], of the compliance of internal risk measurement and management systems for the determination of the capital requirements with regulatory provisions, Company needs and changes in the reference market. The managerial models and IFRS 9 framework are as well as evaluated. The validation function is assigned to the Internal Validation and Controls Head Office Department, which is responsible for the activity at the Group level in accordance with the requirements of supervisory regulations requesting a uniform management of the control process on internal risk measurement systems, in line with the independence requirements established by the applicable regulations.
In line with recent regulatory developments, the Validation function has developed a specific framework for the analysis of the Model Risk that will accompany the activities and the validation framework already implemented for the management and control of the Pillar 1 and 2 risks.
On an annual basis a validation plan, submitted to the Board of Directors for approval, is prepared.

With respect to Pillar 1 risks, validation is a prerequisite for use of the internal systems for regulatory purposes. The validation function assesses the management and measurement systems in terms of models, processes, information technology infrastructure and their compliance over time with regulatory provisions, company needs and changes in the market of reference. The level of involvement of the structure depends on the different types of validation (development/adoption of internal systems, extension of the internal systems/request for model change, ex ante notification and ongoing validation).
Both during the initial application phase and on an ongoing basis (at least annually), the results of the activities are presented to the competent functions, transmitted to the Internal Auditing Head Office Department for its related internal auditing work, as well as to the competent Managerial Committees and Governing Bodies for approval of the compliance of internal systems with regulatory requirements, and forwarded to the Supervisory Authorities.

With respect to Pillar 2 risks, the Validation function conducts analyses on methodologies, verifying in particular that the measurement metrics adopted in quantifying significant risks are economically and statistically consistent, assessing that the methodologies adopted and the estimates produced to measure significant risks are robust and comparing alternative methodologies for measuring and aggregating individual risks. The analyses are conducted both ex-ante, when adopting/modifying the internal systems used for Pillar 2 purposes, and ex post as part of the prudential control process. The latter are summarised in the ICAAP/ILAAP report while, for substantial or significant modifications of internal systems, the

[11] EU Regulation 575/2013 (CRR), EBA Guidelines, EU Directive 2013/36 (CRD IV), Bank of Italy Circular 285/2013.

Validation function produces a report to be submitted to the competent Managerial Committees and the Governing Bodies[12].
The function also manages the internal validation process at Group level, interacting with the Supervisory Authorities, the relevant Corporate Bodies and the functions responsible for the level III controls provided for in regulations. It adopts a decentralised approach for companies with local validation functions[13] (several international companies), coordinating and supervising the activities of those companies, and adopting a centralised approach for the others. The adopted methodologies were developed in implementation of the principles that inspire the Supervisory Provisions for banks, EU directives and regulations, general guidelines of international committees and best practices in the area and take the form of documentary, empirical and operating practice analyses.
The function generally also provides advice and suggestions to company and Group functions on an ongoing basis, with the aim of improving the efficacy of the processes of risk management, control and governance of internal risk measurement and management systems for determining capital requirements.

In terms of cross-cutting activities, the Validation function carried out the following in 2017:
- validation of the main methodological and process implementations for compliance with IFRS 9 in the areas of classification & measurement and impairment (loans & bonds); for the impairment project, validation of the Corporate and Retail models and implementation of the requests made by the Regulator in the Thematic Review (preparation of the IFRS 9 manual and validation of thresholds for classification into stages); and the examination of a first set of international subsidiary banks for the implementation of the IFRS 9 framework;
- publication of an updated version of the Rules for the validation of the Group's internal systems, which includes the procedures for analysis and assessment of the validation results and the main elements of the framework for the validation of the risk model; validation manuals were also published at the same time;
- Target Review of Internal Models (TRIM/TRIMIX) relating to market risk (performed in Q2 2017), counterparty risk (completed in November 2017) and credit risk (from April 2017), with particular attention given to compliance with the prior requests set out in the "TRIM Expectation Guide" and those made by the inspection teams;
- completion of the preliminary analysis and priority setting stage, identifying an initial set of models (Pillar 1 and Pillar 2) and priority methodologies according to significance and potential risk model (Cluster I), for which further analysis work has been planned for 2018;
- assurance and analysis activities within the Vivaldi project, relating to the integration of the recently acquired former Venetian banks;
- validation of progressive implementations for the RADAR project.

With regard to Credit Risks, the main areas of investigation in which the function had a significant involvement in 2017 are listed below:
- validation for the submission of the Retail (PD, LDG and EAD) and EAD Corporate application;
- assurance activities required by the regulator on the Corporate and Institutions remediation plans;
- calculation of default rates for CT update;
- preparation of a methodological document containing flows and choices underlying the calculation of default rates;
- validation for management/regulatory adoption of internal models by the International Subsidiary Banks.

With regard to operational risk, the validation activities in 2017 concerned, as usual, the assessment of the due maintenance of the ORM framework and monitoring of the performance of the model calculation (AMA scope). In addition, the function participated in the pilot exercise, requested by the ECB, concerning the implementation of common metrics for the validation of the AMA models: the template with the summary of the information and simulations required was prepared as instructed and sent to the ECB.

With regard to market and counterparty risks, the observations made by the inspection teams acknowledged the quality of the analyses carried out, providing suggestions for further analysis. Particular importance was given to the request to extend the scope of the analysis to the regular and continuous validation of the pricing functions of the financial instruments adopted in the risk calculation architecture. In acknowledgement of the observation made by the inspectors during the market risk TRIM, during the subsequent TRIM on counterparty risks, the first validation analyses of the pricing functions were submitted and the new operational process was duly described in the internal regulations produced. In 2017, work began on analysing the hypothetical portfolios and designing the operating process. Additional investigations were conducted on the model changes for the counterparty risk internal model (ex-ante notification for interest rate simulation, request for equity and exchange rate simulation). Monitoring continued of the progress of the main projects with impacts on market and counterparty risks (e.g. Fundamental Review of Trading Book, Independent Pricing Verification). The analyses conducted on an ongoing basis included the backtesting (issued quarterly for both risks), the review of the stress period for the calculation of the Stressed VaR (market risk area) and the monitoring of the model's calibration parameters (counterparty risks model).

For the Pillar 2 Risks, the main areas of analysis in 2017 were:
- assessment of the new treatment of the AFS portfolio;
- analysis of the changes made to the methodology for determining the risk parameters through the Country Risk and CCF model solely for the Sovereign segment;
- assessment of the changes made to the model for the calculation of the economic capital with respect to interest rate risk in the banking book (particularly for the management of negative rates);
- revision of behavioural models for core deposits and prepayment;
- updating of the historical series used for credit risk (portfolio model and non-performing loans model);
- assessment of changes made to the methodology for calculating the economic capital with respect to insurance risk;

[12] In the event of substantial/significant modifications, the approval process requires that the Risk Management Head Office Department submit updates to the Internal Management System, accompanied by the impact analysis on the risk metrics and the report of the validation unit, to the competent Managerial Committee for approval. Subsequently, reporting is provided on those modifications to the Board of Directors.

[13] Note that the functional reporting of local validation units to the Internal Validation and Controls Head Office Department has been formalised.

- assessment of minor changes made to other risks such as pension risk, equity risk in the banking book, strategic risk, etc.;

In addition, structural changes to the general prudential assessment framework were evaluated, including for example:
- change in the percentile for the calculation of the economic capital (from 99.90% to 99.85%);
- removal of the stressed AFR/Economic Capital RAF indicator;
- addition of the “economic outlook” and “regulatory outlook” to the stress tests.

The analyses conducted by the Validation function are reported in specific detail memos, summarised in the 2017 ICAAP&ILAAP Book and in the annual report on the models used for operational purposes, prepared in July 2017.

Compliance
The governance of compliance risk is of strategic importance to the Intesa Sanpaolo Group as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust.
The responsibilities and duties of the compliance function are assigned to the Chief Compliance Officer, who is independent and autonomous in relation to the operational structures, reports directly to the Corporate Bodies and has access to all activities within the Bank, as well as any significant information for the performance of his/her duties.
The Group's Compliance Model is set out in the Guidelines approved by Intesa Sanpaolo's Corporate Bodies, which indicate the responsibilities of the various company structures and macro processes to mitigate compliance risk:
- identifying and assessing compliance risk;
- proposing the functional and organisational measures for mitigation of this risk;
- conducting pre-assessments of the compliance of innovative projects, operations and new products and services;
- providing advice and assistance to the governing bodies and the business units in all areas with significant compliance risk;
- monitoring, including through the use of information provided by the other control functions, of ongoing compliance;
- disseminating a corporate culture founded on the principles of honesty, fairness and respect for the spirit and the letter of the rules.

The regulatory scope and the procedures for monitoring regulatory areas that present significant risks of non-compliance for the Group are defined in the aforementioned guidelines. The Chief Compliance Officer submits periodic reports to corporate bodies on the adequacy of compliance control, with regard to all regulatory aspects applicable to the Group which show compliance risks. On an annual basis, these reports include an identification and assessment of the primary compliance risks to which the Group is exposed and a schedule of the associated management measures, and on a half-yearly basis they include a description of the activities performed, critical issues noted, and remedies identified. A specific notice is also given when events of particular significance occur.
The Compliance Guidelines call for the adoption of two distinct models in relation to direction, coordination and control of the Group. These models are organised in such a way as to account for the Group’s structure in operational and territorial terms. In particular:
- for specifically identified Italian Banks and Companies, whose operations are highly integrated with the Parent Company, the compliance supervision is centralised at the Parent Company;
- for the other Companies, that have a legal obligation or have been specifically identified based on the business conducted, as well as the International Branches, an internal compliance function is established and a local Compliance Officer is appointed, which are assigned compliance responsibilities. The local Compliance Officers of the subsidiaries functionally report to the Chief Compliance Officer structures, while those of the International Branches, except where not permitted by local regulations, hierarchically report to the Chief Compliance Officer structures.

Anti-Money Laundering
The duties and responsibilities of the Anti-Money Laundering Function, as envisaged by regulations, are assigned to the Anti-Money Laundering Department, which reports directly to the Chief Compliance Officer.
Specifically, the Anti-Money Laundering Head Office Department ensures monitoring of compliance risk in the area of money laundering, terrorist financing and embargoes, corruption (financial crime) and weapons, in addition to administrative liability of entities, by:
- laying down the general principles to be adopted within the Group for the management of compliance risk;
- conducting ongoing monitoring, with the support of the competent functions, of developments in the national and international context of reference, verifying the adequacy of company processes and procedures with respect to applicable regulations and proposing appropriate organisational and procedural changes;
- providing advice to the functions of the Parent Company and subsidiaries on a centralised basis and establishing adequate training plans;
- preparing appropriate periodic reporting for corporate bodies and top management;
- discharging the required specific obligations on behalf of the Parent Company and subsidiaries on a centralised basis, including, in particular, enhanced customer reviews, controls of proper management of the data storage Archive and the assessment and monthly submission to the Financial Reporting Unit of data relating to aggregated anti-money laundering reports, and the assessment reports of suspicious transactions received from operating departments for the submission to the Financial Reporting Unit of reports deemed accurate.

Internal Auditing
The internal auditing activities are assigned to the Internal Auditing Head Office Department, which reports directly to the Board of Directors (and on its behalf to its Chairman), which also reports functionally to the Management Control Committee, subject to appropriate liaison with the Managing Director and CEO. The Internal Auditing Head Office Department does not have any direct responsibilities for the operational areas.

The Department has a structure and a control model which is organised consistently with the evolution of the organisational model of Intesa Sanpaolo and of the Group.
The Internal Auditing structures of the Group's Italian and international companies report to the Internal Auditing Department in terms of functions.
The Internal Auditing Department performs overall level 3 assessment of the internal control system, reporting possible improvements to the corporate bodies, with specific regard to the RAF, the risk management process and risk measurement and control instruments.
In particular, the Department assesses the completeness, adequacy, functionality and reliability of the components of the internal control system, the risk management process and the corporate processes, also with regard to their ability to identify and prevent errors and irregularities. In this context, amongst others, it audits the risk control and regulatory compliance corporate functions, also through participation in plans so as to generate added value and improve the effectiveness of the control and corporate governance processes.
The audit action directly concerns Intesa Sanpaolo and the Group companies.
The Internal Auditing Department is also responsible for assessing the effectiveness of the corporate RAF definition process, the internal consistency of the overall framework and compliance of Bank operations with the RAF.
The Head of the Internal Auditing Department enjoys due autonomy and independence from the operating structures. The Department has access to all the activities conducted at both the head office departments and the local structures. If third parties are assigned significant activities for the functioning of the internal control system (e.g. data processing), the internal auditing department must also have access to the activities carried out by those parties.
The Department uses personnel with the appropriate professional skills and expertise and ensures that its activities are performed in accordance with international best practices and standards for internal auditing established by the Institute of Internal Auditors (IIA).
As required by the international standards, the department is subject to an external quality assurance review every five years. The last review was carried out in 2016 and assigned the department the highest assessment envisaged ("Generally Compliant").
In performing its duties, the Department uses structured risk assessment methods to identify existing situations of greatest interest and the main new risk factors. Based on the assessments emerging from risk assessment and the resulting priorities, as well as on any specific requests for further enquiry expressed by top management and corporate bodies, it prepares and submits an Annual Intervention Plan for prior examination by the Management Control Committee, and subsequent approval by the Board of Directors, on the basis of which it conducts its activities during the year, in addition to a Long-Term Plan.
The Internal Auditing Head Office Department ensures the proper conduct of the internal process for managing whistleblowing reports.

Auditing was performed directly for the Parent Company, the Network Banks and other subsidiaries under an outsourcing contract. For the other Group companies having their own internal audit departments, steering and practical coordination of the local departments was performed to guarantee control consistency and adequate attention to the different types of risks, also verifying the effectiveness and efficiency levels under both structural and operational profiles. Direct auditing and review activities, in the capacity of Parent Company, were also performed for those companies, as mentioned above.
Any weaknesses detected during control activities have been systematically notified to the company functions involved for prompt improvement actions, which are monitored by follow-up activities to verify their effectiveness.
Summary Internal control system assessments from the checks have been periodically submitted to the Management Control Committee and the Board of Directors. The findings of the audits completed with a negative opinion or with the identification of major shortcomings were sent in full to the Board of Directors, the Managing Director and CEO and the Management Control Committee, as well as the Boards of Directors and Boards of Statutory Auditors of the subsidiaries concerned.
The main weaknesses detected and their development over time have been included in the Audit Tableau de Bord (TdB), with details of the mitigation actions underway, together with the related responsibilities and deadlines envisaged, so they can be systematically monitored. Lastly, the Internal Auditing Department ensured constant assessment of its own effectiveness and efficiency in line with the internal "quality assurance and improvement" plan drafted in accordance with the recommendations of international standards for professional audit practice. In this regard, the enhancement of the audit model in line with the new European supervisory standards laid down by the EBA (SREP framework) was completed in 2017.

Manager responsible for preparing the Company's financial reports

Supervision on the reliability of the Company financial reports and on the financial reporting process is carried out by Intesa Sanpaolo's Manager responsible for preparing the Company's financial reports, in compliance with the provisions of Article 154-bis of the Consolidated Law on Finance and the related implementing provisions. This control is also ensured over the subsidiaries governed by the laws of non-EU countries, in accordance with the supervisory rules on management and accounting systems set by Article 15 of Consob Market Regulation 20249/2017 (effective from 3 January 2018, formerly Article 36 of Consob Market Regulation 16191/2007).

In order to comply with the aforesaid provisions, the Manager responsible for preparing the Company's financial reports:
- performs a steering and coordination role in Group companies with regard to administrative matters and in the monitoring of the internal control system functional to financial reporting;
- supervises the implementation of legal requirements according to a shared approach at Group level, set out in specific internal regulations.

In particular, the Manager responsible for preparing the Company's financial reports:
- issues the instructions for the correct and uniform application of the accounting standards and measurement criteria, formalised as part of the Group Accounting Rules, which are subject to regular periodic updates;
- prepares appropriate administrative and accounting procedures for the preparation of the separate and the consolidated financial statements, and updates them to ensure compliance with the corporate disclosure requirements in force;
- verifies the adequacy of the administrative and accounting procedures and the effectiveness of the control system on the

financial reporting process;
- oversees the correspondence between the corporate reporting to the market with the accounting records; to this end, it has the right to promptly obtain any information deemed necessary for the performance of his/her duties and coordinates the exchange of information with the independent auditors.

With specific regard to the financial reporting processes, the Manager responsible for preparing the Company's financial reports:
- maintains a system of contact and information flows with the function of the Parent Company and of the Group Companies, in order to ensure the adequacy of balance sheet, income statement and financial positions and the descriptions of the main types of risks and uncertainties to which the Group may be exposed, monitoring the reliability of the of acquisition of relevant data and information;
- oversees the internal control system on the financial reporting process, drawing up audit plans to ensure the adequacy and effective application of administrative and accounting procedures over the period, also by subsidiaries subject to the laws of countries that are not part of the European Union, pursuant to art. 15 of Consob Market Regulation; periodically reports to the Board of Directors and the Management Control Committee on the scope and results of the audits;
- acquires, in relation to the effects on the financial reporting process and the reliability of the company information, the results of the activities carried out by the Corporate control functions and, in particular, by the Internal Audit Department, which is responsible for the overall assurance for the internal control system in accordance with the "Integrated Internal Control System Regulation";
- acquires any recommendations formulated by the independent auditors at the end of the process of auditing the separate financial statements of the Parent Company and the consolidated financial statements, as well as the related feedback in terms of measures to improve the procedures that have an impact on accounting data, monitoring their implementation and effectiveness;
- shares with the Surveillance Body established pursuant to Legislative Decree 231/01, the findings of the audit plan carried out in implementation of the monitoring of the financial reporting process, focusing on preventing the criminal and administrative offences described in the "Organisation, Management and Control Model pursuant to Legislative Decree No. 231 of 8 June 2001".

The Manager responsible for preparing the company's financial reports contributes to supervising the independence of the independent auditors, in accordance with the procedures governed by specific Company Regulations, in line with the provisions of law (Legislative Decree 39/2010 amended by Legislative Decree 135/2016, which transposed Directive 2014/56/EU into the Italian legal framework, and EU Regulation 537/2014). The above-mentioned Company Regulations assign to the Manager responsible for preparing the Company's financial reports the role of supervising, overseeing and monitoring the accounting audit engagements and other services entrusted by the Parent Company departments and the Group companies to independent auditors, their networks and their affiliates, in addition to the task of regularly informing the Management Control Committee in this regard.
The Manager responsible for preparing the Company's financial reports also ensures periodic reporting to the Board of Directors regarding the legal and regulatory obligations assigned to the Board for the monitoring of the adequacy of powers and means granted to the Manager responsible for preparing the Company's financial reports and of the effective observance of administrative and accounting procedures. This reporting is discussed beforehand with the Management Control Committee and the other Board Committees, for the aspects under their responsibility.

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

In relation to the supervisory and monitoring functions assigned, the Manager responsible for preparing the Company's financial reports:
- signs, jointly with the Managing Director and CEO, the attestations of the separate and consolidated financial statements required by the Article 154-bis, paragraph 5, of the Consolidated Law on Finance on the adequacy and actual application of administrative and accounting procedures, the compliance with the international accounting standards, the agreement of the financial statements with the supporting documentation, accounting books and records and their suitability to give a true and fair view of the financial and economic position of the Group, as well as a reliable analysis of the performance, operating result and the main risks to which the Group is exposed;
- certifies the correspondence of the documents and announcements disclosed to the market with the records, books and accounting entries, pursuant to Article 154-bis, paragraph 2, of the Italian Consolidated Law on Finance.

The monitoring of the accounting and financial reporting process is based on the review of:
- completeness and consistency of the information provided to the market through a structured reporting system originated from the functions of the Parent Company and the Companies concerning the events deemed significant for accounting/financial disclosure purposes, especially with regard to the main risks and uncertainties to which they are exposed;
- suitability of the processes and procedures used for the preparation of accounting documents and other communication of a financial nature deemed relevant pursuant to Article 154-bis of the Consolidated Law on Finance. Special attention is paid to monitoring the adequacy of the auditing approach and the proper conduct of the activities required for the financial reporting process; the focus of the controls is represented by the work stages which, within business processes, entail the recording, processing, evaluation and presentation of data and information. In addition to the adequacy of the structure of procedures and the effective application of related controls, the IT architecture and applications, operating processes and development interventions on the summary systems instrumental to financial reporting are taken into consideration.

The organisational model overseeing the adequacy of the administrative, accounting and financial reporting procedures and the related internal control system is governed by the company regulations "Administrative and Financial Governance Guidelines" updated in 2017 to reflect the adoption of the one-tier governance system, changes in the internal and external regulatory framework, and the evolution of financial reporting in terms of scope and content.

The Model prescribes assessment methodologies differentiated according to, on one hand, the risk of the processes deemed significant for accounting and financial reporting purposes and, on the other, the need to realise synergies with the control activities carried out by the Internal Auditing Department and the other Corporate Control Functions.
To this end, the procedures may be verified by means of in-depth analyses, conducted according to specific methodologies used to verify the correctness of the accounting and financial information, carried out by the structures that support the Manager responsible for preparing the Company's financial reports (analytical approach) and, if present, of the information collected by the Corporate control functions or by external entities such as Independent Auditors, Supervisory Authorities, etc. (synthetic approach).
Accordingly, the Model provides for the following activities:

- definition and regular update of the plan of controls and the scope of application;
- ongoing monitoring of the processes deemed significant for accounting and financial reporting purposes and the related internal control system;
- regular summary assessment of the adequacy of the procedures and internal control system for accounting and financial reporting;
- management of the system of information flows from the corporate functions of the Parent Company and the Group Companies to the Manager responsible for preparing the Company’s financial reports;
- management of the system of attestation on the validity of the administrative processes and completeness of the information flows, within the respective areas of competence issued to the Manager responsible for preparing the Company's financial reports by the Managers of the Business Units, the Governance Areas and the Group Central functions, and by the Delegated Bodies of Group Companies;
- preparation of the Report concerning the financial information process;
- management of the system of reporting by the Manager responsible for preparing the Company's financial reports to the Corporate Bodies;
- procedures for the steering and coordination of subsidiaries.

For the assessment of the adequacy of the relevant processes for the financial reporting, the Manager responsible for preparing the Company's financial reports uses the results of the controls carried out by the structures reporting directly to him, by the Internal Auditing Department and the other Corporate control functions. For this purpose, the Corporate control functions and the Manager responsible for preparing the Company's financial reports share the annual audit plans and related findings within the Control Coordination and Operational Risk Committee established by the Integrated Internal Control System. The critical issues arising from inspections conducted by external bodies (Independent Auditors, Supervisory Authorities) are also collected and assessed from the perspective of financial reporting risk.

To conclude the preparation of the Company's financial reports according to the rules and criteria set out in Part A of the Notes to the financial statements, and the supervisory activities conducted on the financial reporting processes, according to the guidelines described herein, the Managing Director and CEO and the Manager responsible for preparing the Company's financial reports sign the attestations required by Art. 154 bis, paragraph 5, of the Consolidated Law on Finance.
These attestations are included in the reporting packages for the separate financial statements of the Parent Company and the consolidated financial statements, and are provided to the public according to the model established by the Consob Regulation.

Report pursuant to Article 15 Consob Market Regulation 20249/2017 (effective from 3 January 2018, formerly Article 36 of Consob Market Regulation 16191/2007).
With regard to the protection of savings and the regulation of financial markets, the Italian Securities and Exchange Commission (Consob) has set certain conditions for the listing of parent companies incorporated and subject to the laws of non-EU member states (Article 15 of the Market Regulation cited). As a result, Intesa Sanpaolo has set up an action plan to ensure the existence of the conditions required for subsidiaries that are of material significance, identified in compliance with the criteria established in the rules of the cited Article 15:

- ensuring the public disclosure of the accounting positions of subsidiaries prepared for the purposes of drafting the consolidated financial statements;
- obtaining details from its subsidiaries of their articles of association, membership and powers of the control bodies;
- determining that the subsidiaries: i) provide the independent auditor of the parent company with the information necessary to perform annual and interim audits of the parent company; and ii) enjoy access to an administrative and accounting system appropriate for regular reporting to the management and independent auditor of the parent company of the income statement, balance sheet and cash flow data necessary for the preparation of the consolidated financial statements.

On conclusion of the activities performed and the verifications conducted, compliance is confirmed with the conditions required by Article 15 of Consob Market Regulation 20249/2017 (effective from 3 January 2018, formerly Article 36 of Consob Market Regulation 16191/2007).
The Management Control Committee and Board of Directors have been informed of compliance with those regulatory provisions governing companies incorporated in and subject to the laws of non-EU Member States, in the aforementioned “Report on the internal control system of the financial reporting process” drafted in order to illustrate the overall governance and control activities performed in accordance with the various provisions of laws and Group regulations governing the supervision of financial reporting, organically coordinated by the Manager responsible for preparing the Company’s financial reports.

Scope of risks

The risks identified, covered and incorporated within the Economic Capital are as follows:

- credit and counterparty risk. This category also includes concentration risk, country risk and residual risks, both from securitisations and uncertainty on credit recovery rates;
- market risk (trading book), including position, settlement and concentration risk on the trading book;
- financial risk of the banking book, mostly represented by interest rate and foreign exchange rate risk;
- operational risk, also including legal risk, compliance risk, ICT risk, model risk and financial reporting risk;
- insurance risk;
- strategic risk;
- risk on real estate assets owned for whichever purpose;
- risk on equity investments not subject to line-by-line consolidation;
- risks relating to defined-benefit pension funds.

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, including stress tests.
Special attention is dedicated to managing the short-term and structural liquidity position by following specific policies and procedures to ensure full compliance with the limits set at the Group level and operating sub-areas in accordance with international regulations and the risk appetite approved at the Group level.
The Group also attaches great importance to the management of reputational risk, which it pursues not only through organisational units with specific duties of promotion and protection of the company image, but also through *ex-ante* risk management processes (e.g. defining prevention and mitigation tools and measures in advance) and implementing specific, dedicated communication and reporting flows.
Assessments of each single type of risk for the Group are integrated in a summary amount – the Economic Capital – defined as the maximum “unexpected” loss the Group might incur over a year. This is a key measure for determining the Group’s financial structure and its risk tolerance, and guiding operations, ensuring the balance between risks assumed and shareholder return. It is estimated on the basis of the current situation and also as a forecast, based on the budget assumptions and projected economic scenario. The assessment of capital is included in business reporting and is submitted quarterly to the Steering Committee, the Risk Committee and the Board of Directors, as part of the Group’s Risks Tableau de Bord.

For the purposes described above, the Intesa Sanpaolo Group uses a wide-ranging set of tools and techniques for risk assessment and management, detailed in this Part E of the Notes to the consolidated financial statements, as required by the instructions from the Bank of Italy.
The information provided in this part of the document is based on internal management data and may not necessarily coincide with that contained in Parts B and C.

Other risks

In addition to credit, market, trading book, banking book financial, liquidity, operational and insurance risks, discussed in detail in the following paragraphs, the Group has identified and monitors the following other risks.

Strategic risk

The Intesa Sanpaolo Group defines current or prospective strategic risk as risk associated with a potential decline in profits or capital due to changes in the operating context, misguided Company decisions, inadequate implementation of decisions, or an inability to react sufficiently to changes in the competitive scenario.
The Group’s response to strategic risk is represented first and foremost by policies and procedures that call for the most important decisions to be deferred to the Board of Directors, supported by a current and forward-looking assessment of risks and capital adequacy. The high degree to which strategic decisions are made at the central level, with the involvement of the top corporate governance bodies and the support of various company functions ensures that strategic risk is mitigated.
An analysis of the definition of strategic risk leads to the observation that this risk is associated with two distinct fundamental components:

- a component associated with the possible impact of misguided Company decisions and an inability to react sufficiently to changes in the competitive scenario: this component does not require capital, but is one of the risks mitigated by the ways in which strategic decisions are reached and by their centralisation with top management, where all significant decisions are always supported by specific activities aimed at identifying and measuring the risks implicit in the initiative;
- the second component is more directly related to business risk; in other words, it is associated with the risk of a potential decline in profits as a result of the inadequate implementation of decisions and changes in the operating context. This component is handled not only by using systems for regulating Company management, but also via specific internal capital, determined according to the Variable Margin Volatility (VMV) approach, which expresses the risk arising from the business mix of the Group and its Business Units.

Strategic risk is also assessed as part of stress tests based on a multiple-factor model that describes the relations between changes in the economic scenario and the business mix resulting from planning hypotheses, with analyses to assess the impacts on both interest income and margins from the performance of net fees and commissions.

Reputational risk

The Intesa Sanpaolo Group attaches great importance to reputational risk, namely the current and prospective risk of a decrease in profits or capital due to a negative perception of the Bank’s image by customers, counterparties, shareholders, investors and Supervisory Authorities.
The reputational risk governance model of Intesa Sanpaolo envisages that management and mitigation of reputational risks is pursued:

- systematically and independently by the corporate structures with specific tasks aimed at preserving corporate reputation, through a structured system of organisational monitoring measures;
- across the various corporate functions, through the Reputational Risk Management processes coordinated by the Enterprise Risk Management Head Office Department.

The "systematic" monitoring of reputational risk envisages:
- specific organisational structures which, each for its purview, monitor the Bank's reputation and manage the relationships with the various stakeholders;
- an integrated monitoring system for primary risks, to limit exposure to them;
- compliance with standards of ethics and conduct;
- establishing and managing customers' risk appetite, through the identification of their various risk tolerance profiles according to subjective and objective traits of each customer.

A fundamental tool for reputational risk monitoring is the Code of Ethics adopted by the Group. This contains the basic values to which the Group intends to commit itself and enunciates the voluntary principles of conduct for dealings with all stakeholders (customers, employees, suppliers, shareholders, the environment and, more generally, the community) with broader objectives than those required by mere compliance with the law. The Group has also issued voluntary conduct policies (human rights policy, environmental policy and arms industry policy) and adopted international principles (UN Global Compact, UNEP FI, Equator Principles) aimed at pursuing respect for the environment and human rights.
In order to safeguard customers' interests and the Group's reputation, specific attention is also devoted to establishing and managing customers' risk tolerance, through the identification of their various risk appetite profiles according to subjective and objective traits of each customer. The assessments of adequacy during the process of structuring products and rendering advisory services are supported by objective assessments that contemplate the true nature of the risks borne by customers when they undertake derivative transactions or make financial investments.
More specifically, the marketing of financial products is also governed by specific advance risk assessment from the standpoint of both the Bank (along with risks, such as credit, financial and operational risks, that directly affect the owner) and the customer (portfolio risk, complexity and frequency of transactions, concentration on issuers or on foreign currency, consistency with objectives and risk tolerance profiles, and knowledge and awareness of the products and services offered).
The Group aims to achieve constant improvement of reputational risk governance also through an integrated compliance risk management system, as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust.

The "cross-function" monitoring of reputational risk is entrusted to the Reputational Risk Management (RRM) processes, which are coordinated by the Enterprise Risk Management Head Office Department and involve control, specialist and business functions, for various purposes.
This process includes the Reputational Risk Assessment, conducted yearly and aimed at integrating and consolidating the main findings provided by the organisational structures more directly involved in monitoring the company's reputation. The objective of that process is to identify and mitigate the most significant reputational risk scenarios to which the Intesa Sanpaolo Group is exposed through:
- the identification of the main risk scenarios to which the Group is exposed;
- the assessment of said scenarios by the Top Management;
- the definition and monitoring of adequate communication strategies and specific mitigation measures.

The overall framework of reputational risk governance also includes:
- the Reputational Risk Clearing processes, i.e. the set of activities, tools and methods aimed at assessing reputational risk within business operations;
- the Reputational Risk Monitoring processes, i.e. the set of activities aimed at collecting and analysing information to define the reputational risk profile – and the related risk – of the Intesa Sanpaolo Group.

In establishing the framework and its elements, particular attention was dedicated to the involvement of the corporate functions responsible for managing reputational aspects, to systematising their respective duties and responsibilities and to building a shared corporate framework.

The Intesa Sanpaolo Group carefully considers all the risks associated with climate change that may result in additional costs for the Bank or its customers. Specifically, with regard to changes in national and international regulations which could have significant financial effects on its customers, through the subsidiary Mediocredito Italiano, Intesa Sanpaolo has set up an Energy Desk specialising in supporting customer companies in energy efficiency projects and advanced advisory services on legal developments and how to suitably prepare for compliance with such regulations.
Furthermore, with regard to the risk of extreme weather events or emergencies due to climate changes, to meet the needs of customers that have incurred damages, following such events Intesa Sanpaolo shall suspend payment of mortgage loans and instalments of loans for retail customers and businesses in areas seriously impacted by weather events.

Risk on owned real-estate assets

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

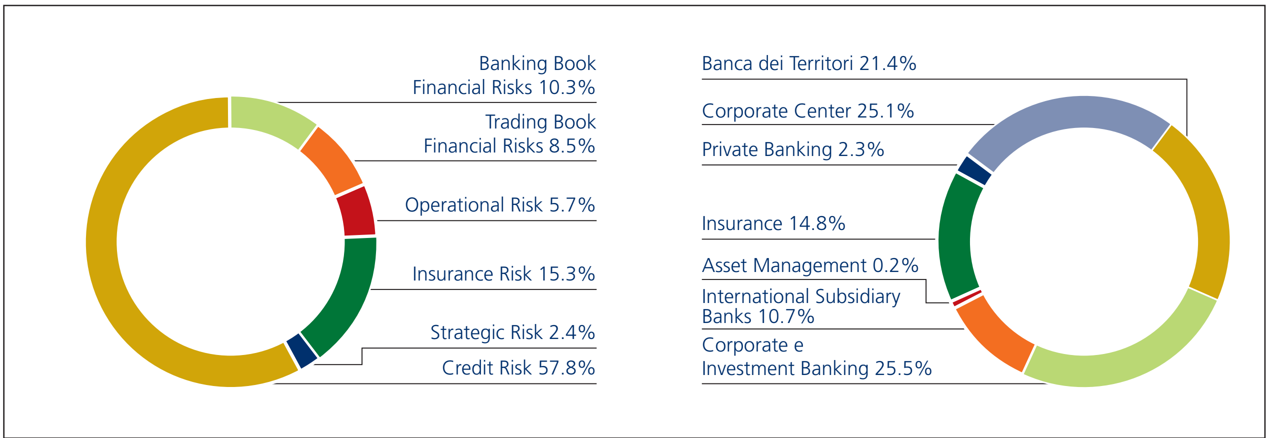
For the 2017 Financial Statements, Intesa Sanpaolo decided to initiate the revaluation for accounting purposes of its valuable art assets and properties (both operating and held for investment purposes), with the purpose of aligning their carrying amount to the current market values thus providing more meaningful information for the users of the financial statements.
In relation to the changes in the accounting policies in this area (described in detail in the Financial Statements – Notes to the consolidated financial statements – Part A – Accounting policies), the appropriate updates of the risk measurement and management techniques will be assessed, where necessary.

Risk on equity investments not subject to line-by-line consolidation
The risk in the equity investment portfolio is related to the possibility of incurring economic losses due to the adverse change in values of investments not subject to line-by-line consolidation.
The scope considered consists of the equity instruments held in financial and non-financial companies, and includes financial investment instruments, commitments to purchase, and derivatives with underlying equity instruments and equity funds.
The model used to estimate the Economic Capital is a PD/LGD approach similar to the credit risk portfolio model and it is used for the stand-alone equity investment portfolio. The applicable LGD is the regulatory LGD, whereas the model's other parameters are the same as those used in the portfolio model for credit risk.

Risk related to defined-benefit pension funds.
The risk related to defined-benefit pension funds is attributable to the possibility of having to increase the reserve that the Parent Company Intesa Sanpaolo maintains to guarantee the benefits of those pension funds, based on an adverse change in the value of the assets and/or liabilities of the pension funds concerned. This risk is fully considered within the assessment of capital adequacy, measured and controlled both with respect to Economic Capital, using a VAR model for the main macroeconomic variables, and to stress scenarios.

Absorption of Economic Capital by type of risk and Business Unit

The following is an illustration of the breakdown of the Group's Economic Capital by type of risk and Business Unit.



The absorption of Economic Capital by Business Unit reflects the distribution of the Group's various activities and the specialisations of the business areas.
The majority of risk is concentrated in the "Corporate & Investment Banking" Business Unit (25.5% of the total Economic Capital): this is attributable to the type of customers served (Corporate and Financial Institutions) and Capital Market activities. This Business Unit is assigned a significant share of credit risk and trading book risk.
The "Banca dei Territori" Business Unit (21.4% of the total Economic Capital) is a significant source of absorption of Internal Capital, in line with its role as core business of the Group, serving Retail, Private and Small/Middle Corporate customers. It is assigned a sizeable portion of credit risk and operational risk.
Most of the insurance risk is assigned to the "Insurance" Business Unit (14.8% of the total Economic Capital).
The "International Subsidiary Banks" Business Unit is assigned 10.7% of the total risk, predominantly credit risk.
In addition to credit risk, the "Corporate Centre" is attributed with the risks typical of this Business Unit, namely those resulting from investments, the risks pertaining to the Capital Light Bank, the Banking Book interest rate and exchange rate risk, the risks arising from the management of the Parent Company's AFS portfolio, and the residual portion of insurance risk (25.1% of the total Economic Capital).
Absorption of Economic Capital by the "Private Banking" and "Asset Management" Business Units is marginal (2.3% and 0.2%, respectively) due to the nature of their business, which is predominantly aimed at asset management activities.

Basel 3 regulations and the Internal Project

In view of compliance with the reforms of the previous accord by the Basel Committee ("Basel 3"), the Intesa Sanpaolo Group has undertaken adequate project initiatives, expanding the scope of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.
With respect to credit risks, the Group received authorisation to use internal ratings-based approaches effective from the report at 31 December 2008 on the Corporate portfolio for a scope including the Parent Company, the 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 Retail portfolios, as well as other Italian and foreign Group companies.
Among the main changes during the year, please note the authorisations received from the ECB to use internal ratings-based approaches for the Institutions portfolios – including the changes requested by the regulator on the respective remediation plans – to use the new Corporate model and the internal estimates of the Credit Conversion Factor (CCF) to calculate the EAD for the Corporate segment for a scope including the Parent Company, the banks in the Banca dei Territori Division and the main Italian and international Group companies, as represented in the table below.

<table>
<tr><th>Company</th><th>Corporate
FIRB</th><th>Corporate
AIRB LGD</th><th>Corporate
EAD</th><th>Retail Mortgage
IRB LGD</th><th>SME Retail
IRB LGD</th><th>Banks and Public Entities
IRB</th><th>Banking Book Equity*
IRB</th></tr>
<tr><td>Intesa Sanpaolo</td><td rowspan="6">Dec - 2008</td><td rowspan="7">Dec - 2010</td><td rowspan="7">Sep - 2017</td><td rowspan="7">Jun - 2010</td><td rowspan="7">Dec - 2012</td><td rowspan="7">Jun - 2017</td><td rowspan="7">Jun - 2017</td></tr>
<tr><td>Banco di Napoli</td></tr>
<tr><td>Cassa di Risparmio del Veneto</td></tr>
<tr><td>Cassa di Risparmio in Bologna</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>Mediocredito Italiano</td><td>Dec - 2009</td></tr>
<tr><td>Gruppo Cassa di Risparmio di Firenze</td><td>Dec - 2008</td><td>Dec - 2010</td><td>Sep - 2017</td><td>n.a.</td><td>Dec - 2012</td><td>Jun - 2017</td><td>n.a</td></tr>
<tr><td>Banca Prossima</td><td>n.a.</td><td>Dec - 2013</td><td>Sep - 2017</td><td>n.a.</td><td>Dec - 2013</td><td>Jun - 2017</td><td>n.a</td></tr>
<tr><td>Banca IMI</td><td>n.a.</td><td>Jun - 2012</td><td>Sep - 2017</td><td>n.a.</td><td>n.a.</td><td>Jun - 2017</td><td>Jun - 2017</td></tr>
<tr><td>IMI Investimenti</td><td>n.a.</td><td>n.a.</td><td>n.a.</td><td>n.a.</td><td>n.a.</td><td>n.a</td><td>Jun - 2017</td></tr>
<tr><td>Intesa Sanpaolo Bank Ireland</td><td>Mar - 2010</td><td>Dec - 2011</td><td>Sep - 2017</td><td>n.a.</td><td>n.a.</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>n.a.</td><td>Jun - 2012</td><td>Jun - 2014</td><td>n.a</td><td>n.a</td></tr>
<tr><td>Banka Intesa Sanpaolo d.d.</td><td>Mar - 2017</td><td>n.a.</td><td>n.a.</td><td>n.a.</td><td>n.a.</td><td>n.a</td><td>n.a</td></tr>
<tr><td>Intesa Sanpaolo Bank Luxembourg</td><td>n.a.</td><td>Jun - 2017</td><td>Sep - 2017</td><td>n.a.</td><td>n.a.</td><td>n.a</td><td>n.a</td></tr>
</table>

(*) Based on authorisation ECB/SSM/2017 - 2W8N8UU78PMDQKZENC08/95 "Decision on the Supervised Entity's application for approval of an internal model for credit risk", the internal PD/LGD system for Equity exposures is applied to the entire scope of Companies authorised to use the Corporate model, irrespective of the current materiality of the portfolio

In 2017, the Supervisory Authority made an on-site validation inspection for the authorisation to the use of internal models for determining the PD (Probability of Default), LGD (Loss Given Default), and EAD (Exposure at Default) for the Retail segment. During this inspection, the parameters for the residential mortgage portfolio, for which authorisation to the use of internal models had been obtained starting from June 2010, were also reviewed.
The Group is also proceeding with development of the IRB systems for the other segments and the extension of the scope of companies for their application in accordance with a plan presented to the Supervisory Authority.

With regard to counterparty risk, the Banking Group improved the measurement and monitoring of the risk, by refining the instruments required under Basel 3.
For reporting purposes, the Parent Company and Banca IMI are authorised to use the internal models approach for the reporting of the requirement with respect to counterparty risk both for OTC derivatives and for SFTs (Securities Financing Transactions, i.e. repos and securities lending).
This authorisation was obtained for derivatives from the first quarter of 2014, and for SFTs from the report as at 31 December 2016.
The banks of the Banca dei Territori Division received the same authorisation for derivatives from the report as at 31 December 2016.
For management purposes, the advanced risk measurement approaches have been implemented for the OTC derivatives of the Parent Company and Banca IMI since 2010 and were subsequently extended in 2015 to the Banca dei Territori Division and to Securities Financing Transactions.

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 adequacy of the internal control system for risks is also illustrated in the annual Internal Capital Adequacy Assessment Process Report, based on the extensive use of internal approaches for the measurement of risks and for the calculation of internal capital and total capital available. The document was approved and sent to the Supervisor in April 2017.

In 2018 Intesa Sanpaolo will participate, as a Significant Institution, in the EBA EU-Wide Stress Test 2018.
The test will cover 70% of the banking sector of the European Union and, as in the test conducted in 2016, will aim to assess the capital adequacy and impacts on profitability on the occurrence of an adverse scenario in the three-year period 2018-2020.

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 (www.group.intesasanpaolo.com) each quarter.

SECTION 1 – RISKS OF THE BANKING GROUP

As required by the instructions provided by the Bank of Italy, the information in this section - Risks of the Banking Group - is provided solely with respect to the Banking Group, as defined in the Supervisory Instructions, except when it is expressly indicated to the contrary that all companies within the scope of consolidation are considered.

The tables that refer to the Banking Group alone include the share proportional to the interest held of the assets and liabilities of jointly controlled banking, financial and instrumental companies consolidated proportionally for regulatory purposes. Amounts are stated gross of transactions with other companies within the scope of consolidation.

Where the contribution of transactions between the Banking Group and the other companies in the scope of consolidation is material, the details of such transactions are provided.

The following table contains the reconciliation of the consolidated balance sheet with the regulatory-scope balance sheet.

(millions of euro)

Assets		**31.12.2017 Financial Statements**	**Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)**	**31.12.2017 Regulatory-scope balance sheet**
10.	Cash and cash equivalents	9,353	10	9,363
20.	Financial assets held for trading	39,518	-476	39,042
30.	Financial assets designated at fair value through profit and loss	75,269	-74,406	863
40.	Financial assets available for sale	142,341	-77,374	64,967
50.	Investments held to maturity	1,174	-	1,174
60.	Due from banks	72,462	-579	71,883
70.	Loans to customers	410,746	4,283	415,029
80.	Hedging derivatives	4,217	-4	4,213
90.	Fair value change of financial assets in hedged portfolios (+/-)	-204	-	-204
100.	Investments in associates and companies subject to joint control	678	5,320	5,998
110.	Technical insurance reserves reassured with third parties	16	-16	-
120.	Property and equipment	6,678	-81	6,597
130.	Intangible assets	7,741	-673	7,068
	of which: goodwill	*4,056*	*-494*	*3,562*
140.	Tax assets	16,887	-528	16,359
150.	Non-current assets held for sale and discontinued operations	627	-278	349
160.	Other assets	9,358	-3,706	5,652
Total Assets		**796,861**	**-148,508**	**648,353**

Liabilities and Shareholders' Equity		**31.12.2017 Financial Statements**	**Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)**	**31.12.2017 Regulatory-scope balance sheet**
10.	Due to banks	99,990	-185	99,805
20.	Due to customers	323,443	4,039	327,482
30.	Securities issued	94,239	1,898	96,137
40.	Financial liabilities held for trading	41,285	-70	41,215
50.	Financial liabilities designated at fair value through profit and loss	68,169	-68,165	4
60.	Hedging derivatives	7,489	-	7,489
70.	Fair value change of financial liabilities in hedged portfolios (+/-)	478	-	478
80.	Tax liabilities	2,509	-646	1,863
	a) current	*364*	*-49*	*315*
	b) deferred	*2,145*	*-597*	*1,548*
90.	Liabilities associated with non-current assets held for sale and discontinued operations	264	-264	-
100.	Other liabilities	12,574	-1,945	10,629
110.	Employee termination indemnities	1,410	-7	1,403
120.	Allowances for risks and charges	5,481	-116	5,365
	a) post employment benefits	*1,104*	*-1*	*1,103*
	b) other allowances	*4,377*	*-115*	*4,262*
130.	Technical reserves	82,926	-82,926	-
140.	Valuation reserves	-789	-	-789
150.	Redeemable shares	-	-	-
160.	Equity instruments	4,103	-	4,103
170.	Reserves	10,921	-	10,921
180.	Share premium reserve	26,006	-	26,006
190.	Share capital	8,732	-	8,732
200.	Treasury shares (-)	-84	-	-84
210.	Minority interests (+/-)	399	-121	278
220.	Net income (loss)	7,316	-	7,316
Total Liabilities and Shareholders' Equity		**796,861**	**-148,508**	**648,353**

(*) The effects are attributable to :
- deconsolidation of companies that are not part of the Banking Group;
- proportional consolidation of the jointly controlled companies that are consolidated at equity in the financial statements.