Financial statements,
Independent auditor's report
and Directors' report as at 31 December 2019

Intesa Sanpaolo Bank Luxembourg S.A.
Société Anonyme
19-21, boulevard du Prince Henri
L-1724 Luxembourg

R.C.S. Luxembourg: B 13.859

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Board of Directors' report
31 December 2019

Development of the activity

In 2019, the implementation of the new business model undertaken in recent years by Intesa SanPaolo Luxembourg Bank (the Bank hereafter) to strengthen the ability to consolidate and grow in an external difficult context continues. The Bank achieves solid results with a corporate flavor in a market characterized by the persistence of negative trends. In the first quarter of 2019 the Equity markets rebounds worldwide making gains while Government and Corporate bonds advance after the weak end of 2018 as concerns over the US-China trade dispute eases and major central banks grow more accommodative. The US Fed decided in fact no further interest rate rises during the year, blocking on the 2.25% - 2.5% range, with a revised growth forecasts down to 2.1% from the previous 2.3%, causing the Treasury 3M/10Y yield curve inversion for the first time since 2007, a pre-recession signal. European Central Bank promises as well to keep rates unchanged until the end of the year, setting the base for the third TLTRO program, of two years starting in September, to stimulate the European economy whose macroeconomic slowdown is higher than expected. Nevertheless, the TLTRO details released in March disappoint the markets, while ongoing low interest rates continue to erode net interest margins for Banks and the delay to Brexit beyond March 2019 leads to a Risk off sentiment. The eurozone economy grows by just 0.2% in the last quarter of 2018 and in the same time Germany sees zero growth while Italy slips into recession. In this contest, while the 10-year Bund becomes a safety investment with its yields more than 30 bps lower, falling below zero toward the end of March for the first time since October 2016, the stock market sectors show a mixed picture. Economically sensitive areas of the market such as industrials and information technology perform well, especially in US, after having suffered a difficult Q4, but also the safe haven consumer staples and real estate sectors are among the top performers. Healthcare generates instead more muted gains due to uncertainty over potential regulatory changes while gains in financials are also hindered by the Fed's and ECB's comments on rate trajectory. High yield credit outperforms investment grade, with both outperforming government bond markets. Global growth concerns remain a drag, however. China's economy grows at its weakest pace since 1990. The Chinese government lowers its full-year growth target to 6-6.5% and outlines higher public spending and tax cuts, while the central bank cuts the reserve requirement ratios for banks. The Bank closes the Q1 with positive results in all its Business Divisions even if these results are lower than expected due to a delay in the closing of new deals and because of a risk off strategy on Italian Securities.

The second quarter of 2019 continues to be driven by concerns over the US-China trade war, which causes a steep fall in May when it escalates. US raises tariffs on 200 $Bn worth of Chinese imports and adds Chinese telecommunications group Huawei to a trade blacklist while China counters with retaliatory tariffs on US goods. However, developed Stock markets increase, supported by increasingly accommodative central banks and hopes of progress in trade tensions by the end of June, when signs emerge of progress in talks, following the G20 Osaka summit. Q2 is a positive quarter for both riskier assets and government bonds making gains as the Fed and ECB confirm the growing positiveness among policymakers, with both clearing the way for further policy measures if needed. In the Eurozone, the Equities top performing sectors included again information technology, consumer discretionary and industrials and in US, the S&P 500 set a new record high while trade-exposed areas of the market, such as semiconductors and carmakers ebb and flow over the quarter as trade tensions persist. Investors mainly switch to US financial assets after the Q1 GDP positive release of 3.2%, revised at 3.1%, higher than expected. President Mario Draghi hints that further monetary policy easing, such as new bond purchases, or rates cuts could be used if the eurozone inflation outlook fails to improve; cyclical areas of the financial markets as well as Financials generally perform strongly. In the Eurozone the GDP growth is at 0.4% quarter-on-quarter, slightly over the expectations with an annual inflation of 1.2% for June, stable if compared to the one of May, with the need for an ECB intervention. In Italy, after a cut of European Commission forecast for 2019 GDP growth to 0.1% from 0.2% and some concerns about the ability to keep

Deficit/GDP under 3%, the 10Y BTP/Bund Spread widens temporary at a level of 274 bps. In Spain, the general elections see the incumbent Socialist Party (PSOE) emerges as the largest party making some turbulences. The Eurozone financial markets suffer a political instability related to Brexit as Theresa May resigns as leader of the Conservative Party in UK with the announcement of an extension to the Brexit deadline making the UK 10-year yield underperforming and 10-year German Bund becoming again a safety investment with yield falling over 25bps lower at -0.33%. In the Q2 the Bank continues to perform as in the first quarter with positive outcomes from the Corporate activity and Credit Risk management.

The third quarter of 2019 is a mixed one for Equities, with developed markets making small gains and Government bond yields declining markedly due to heightened risk aversion in August when US-China trade tensions escalate again and speculation over possible impeachment proceedings for President Trump further add uncertainty. Corporate bonds outperform government bonds, benefit from the decline in global yields and, more recently, an improvement in risk sentiment. With such a risk aversion, Investment grade corporate bonds outperform the riskier high yield part of the market. Ongoing global growth concerns rumble on, but central banks remain supportive. Despite US economic data is largely stable, the August growth concerns lead to a rate cut by the Fed for an amount of 25 bps. The direct effect is a yield curve inversion indicating significant economic pessimism among bond investors. For the first time since 2007, the 10Y Treasury yield is traded less than 2Y one while in UK the Brexit issue and internal political leads to unrest as well to a yield curve inversion for the first time since 2008. In the Eurozone, the ECB takes steps to boost the flagging economy, including restarting quantitative easing and committing to buying. Christine Lagarde, head of the International Monetary Fund, replaces Mario Draghi as president of the ECB at the end of his term on 31st of October. Economic data remains lackluster with confirmation that the Eurozone economy expand just 0.2% in Q2 and Germany Q2 GDP is negative for the first time at -0.1%. In such a situation, the market Risk off leads the already negative 10Y Bund yield to a level of -0.58%, a threshold even lower than the 3-month Euribor and the ECB deposit rate. In Italy, politics are back in focus as the governing coalition of the right-wing League and populist Five Star break up. Instead, Five Star forms a new coalition with the Democratic Party, which helps the 10Y BTP/Bund Spread to narrow under the resistance of 200 bps. Meanwhile UK sees an elevated political uncertainty as Boris Johnson takes over as the UK's new prime minister on a "do or die" pledge to achieve Brexit. In the third Quarter, the Bank maintains a positive and stable cruising speed that replays the same revenues trend of the previous year with an increasing weight of the corporate incomes.

During the fourth quarter global Equity markets is broadly higher in the fourth quarter for progress on the US-China trade deal which reaches a partial conclusion with the agreement in the so called "phase one". Duties are suspended and the tariff on 120 $Mio of Chinese goods is halved to 7.5%, while China increases the purchases of American products by 32 $Bn in the next two years. The exception is for emerging markets that struggle with a stronger US dollar while Government bonds yields rise and corporate bonds outperform, as markets reflect the better mood and central banks remain again supportive. The Fed lowers interest rates by 25 basis points, as expected, for the third time this year to a range of 1.5% to 1.75%, while European Central Bank starts a "depo tearing" program on the 1st of November. Christine Lagarde takes over as president of the ECB alleviating the recent economic tensions in the eurozone by stating that inflation will reach 1.7% in the fourth quarter of 2022 and outlining a better scenario, with the first signs of price growth, economic stabilization and less risk. Positive signs of growth arrive also from macroeconomic data with a Eurozone GDP growth for Q3 removing recession worries, expanding by 0.2% quarter-on-quarter. Only UK equities underperform against the backdrop of a very strong rebound in sterling but the elections victory of Boris Johnson, who obtains an absolute majority of the seats, determines a high probability of a definitive Brexit on 31 January. Worldwide, consumer discretionary, IT and healthcare in US, industrials and materials are among the top gaining sectors, supported by hopes of an improving trade picture. By contrast, defensive sectors such as consumer staples and utilities are weak during the quarter. Emerging market equities record a strong return, benefiting from a pick-up in risk appetite. Commodities side the Brent crude advances 3% ahead of the December OPEC meeting while natural gas rallies 17%. Conversely, the combination of a stronger US dollar and the initial uncertainty over a potential US-China "phase one" trade deal weighs on industrial metals prices. The Bank ends the year with a final rush that leads to present a better economic results in comparison with the previous year: all the

Divisions show a positive economic return taking profit from every available opportunity and showing a solid operating organization. Finally is to be highlighted the ongoing growth of the Corporate Portfolio, especially in terms of volume, which will compensate the incomes coming from the year end maturity of intragroup loans.

Corporate governance

The Bank is 100% owned by Intesa Sanpaolo Holding International S.A., Luxembourg is itself fully owned by Intesa Sanpaolo S.p.A. ("the Parent Company").

As Parent Company of the Intesa Sanpaolo Banking Group (Banking Group), the Parent Company is responsible, pursuant to the Italian Consolidated Law on Banking, for the management and coordination of the companies belonging to the Banking Group and issues rules as required for the implementation of Bank of Italy instructions in the interest of the Group's stability. The Group's subsidiaries must comply with such rules.

For the purpose of application of such rules, the Parent Company has designed reporting procedures between it and its subsidiaries, through which the latter refer.

Intesa Sanpaolo Bank Luxembourg S.A. duly complies with the requirements and provisions set forth by its Parent Company, especially in terms of assessing effective and transparent financial reporting.

The Bank is an issuer under a EUR 70 billion medium term note issuance programme on the Luxembourg Stock Exchange under the guarantee of the Parent Company. The notes issued under this programme by the Bank are of a minimum quota of EUR 100,000.

Information on corporate governance and ownership structures in Italy is required under art. 123-bis of the Italian Consolidated Law on Banking. In compliance with this law, the Parent Company produces a separate report on this matter which can be viewed in the Governance section of the Intesa Sanpaolo website, at www.group.intesasanpaolo.com. The Intesa Sanpaolo Banking Group has also adopted a Corporate Governance Code available on the Borsa Italiana website (under Borsa Italiana/Rules/Corporate Governance).

In Luxembourg, the Bank has chosen Luxembourg as its origin member country and therefore applies CSSF circular 12/552 as subsequently amended.

The Bank has drawn up a Corporate Governance Policy in accordance with the CSSF Circular 12/552 (as amended), which requires institutions to set out in writing governance central administration arrangements and the internal controls framework.

Risk Control

The risk management process, developed in connection with local requirements and Parent Company guidelines, consists in the identification, analysis and mitigation of major risks of the Bank (compliance and reputational risk, market risks, liquidity risk, credit risk and operational risk). It includes different mitigating controls and structures.

The Assets/Liabilities Committee monitors the financial risks incurred by the Bank. The Committee performs the supervision of the Bank's investment strategies, assets/liabilities mismatching, interest rate risk, liquidity risk and the liquidity policy. Its main purpose is to ensure that the risk profiles remain at the sustainable limit fixed for the Bank.

The work of the Assets/Liabilities Committee is directly supported by the Risk Control Function.

The Compliance function identifies, assesses and controls the compliance risks by ensuring adherence to legal and regulatory requirements and ethical principles including AML.

Credit risk is mainly monitored by the Credit Department on a daily basis. A monthly report on Credit Risk is prepared by the Risk Control Function with periodical reporting of the risks to the governance bodies of the Bank.

The Legal Department monitors constantly the legal risks of the Bank and coordinates and monitors activities with external lawyers.

The Internal Audit function evaluates the effectiveness of the Bank's risk management process and the Internal Control System. It performs various audit missions with relevant reporting of the results and residual risks of the different processes to the Bank's Management and Corporate bodies.

Subsidiaries and branches

The Bank holds only one fully owned subsidiary, Lux Gest Asset Management S.A., Luxembourg, which is active as a management company for investment funds.

The Bank purchased the Intesa Sanpaolo S.p.A. Amsterdam Branch from the Group through a contribution in kind on 1 February 2016.

As a consequence, the Bank operates through its head-office located in Luxembourg-city and through its Branch located in Amsterdam at 31 December 2019.

Perspectives

As a subsidiary of Intesa Sanpaolo S.p.A., the Bank operates within the worldwide business strategy of the Intesa Sanpaolo Banking Group.

As per current Business Plan, the Bank is expected to continue with the further strengthening of the corporate activities. More in detail:

- Intesa Sanpaolo Bank Luxembourg ("ISPBL") within the Group Corporate & Investment Banking Division (CIB Division) will continue to serve Corporate clients and Financial Institutions (FIs) in strict coordination with the CIB Division of the Intesa Sanpaolo Group (ISP Group), offering a wide range of products/services, which can be synthetized in: Commercial Banking, Transaction Banking, and Structured Finance. ISPBL also provides Private Banking Services, mostly to private and institutional clients related to the Intesa SanPaolo Group.
- ISPBL will provide local coverage to customers located in the Benelux area, in line with the service model adopted by the CIB Division, will aim to be the specialist local bank for Italian groups and other foreign customers in Benelux, will develop relationship with major international FIs, in particular for Treasury products and debt programs, and will act as the local platform to support ISP International network in structuring and underwriting international corporate debt, monitoring, managing and optimizing lending books;
- The World Health Organization declared the coronavirus (COVID-19) to be a public health emergency on January 30 2020. The virus has had important consequences across the globe, and its full impact is not yet known. In addition to the immeasurable human toll, the coronavirus is altering business and consumer activity in affected areas and beyond. There are obvious and well-publicized impacts common to most companies, like to the supply chain, but the indirect impacts may be overlooked in times of crisis.

Governing bodies of the Bank are monitoring the situation on a continuous basis in connection and coordination with the relevant structures of its ultimate Parent Company and the Regulators. In particular the Bank:

- created a dedicated Crisis Unit since February 24 2020 for the identification and management of all operational risks;
- started an analysis on credit exposures possibly affected in direct or indirect way by COVID-19 consequences;
- strengthened liquidity management in strict coordination with Head Office;
- took several decisions to reduce operational impacts, like kick off of Smart Working since the second week of March 2020 for 100 relevant employees of the Bank (potentially extended to all staff by the third week of March);
- started an overall and continuous assessment of the whole activities to identify any potential new impact in order to react promptly.

With reference to relationships with the relevant structures of the ultimate Parent Company, the Bank started a strict coordination with Intesa Sanpaolo Group in terms of information flows to the European Central Bank (ECB) (the Bank, in fact, is directly involved in weekly meetings with the ECB Joint Supervisory Team dedicated to the crisis) as well to CSSF (who raised some questions and received proper answers by the Bank).

At the moment, thanks to the ongoing monitoring activities and actions put in place, the Bank is not experiencing specific issues on IT, Operations, Liquidity and Credit risk and it can guarantee a proper evolution of its activities.

Deposit Guarantee Scheme and Resolution Mechanism

The Luxembourg Government has transposed in national law the following two European directives on 18 December 2015:

- 2014/59
- 2014/49

which respectively established:

- a framework for the recovery and resolution of credit institutions and investment firms;
- a deposit guarantee scheme.

The introduction of the two above mentioned directives had a direct impact on the Bank, which was called to contribute to the Resolution Fund paying an amount of EUR 5,501,915 and to contribute to the Fonds de garantie des dépôts (FGDL) paying an amount of EUR 46,667.

Financial elements for 2019

Total assets as at 31 December 2019 stood at EUR 22.2 billion (31 December 2018: EUR 21.0 billion).

Loans and advances to credit institutions (including balances with central banks) amounted to EUR 9.3 billion as at 31 December 2019, showing a slight increase when compared to 31 December 2018 (EUR 8.1 billion). Loans and advances granted to customers other than credit institutions amounted to EUR 10.6 billion as at 31 December 2019 (EUR 10.4 billion as at 31 December 2018).

Financial assets held for trading are mainly composed of derivative financial instruments measured at their fair value and amounted to EUR 30 million at 31 December 2019 (31 December 2018: EUR 48 million). Those are mainly composed of cross currency interest rate swaps and foreign exchange derivative contracts.

Financial assets designated at fair value through profit or loss included one asset disposed at the beginning of 2019; it amounted to EUR 10.4 million as at 31 December 2018 and it was a financial debt instrument purchased to be kept in the Bank's portfolio but measured at fair value.

Financial instruments measured at Fair Value through Other Comprehensive Income (FVTOCI), which amounted to EUR 2.3 billion as ar 31 December 2019 (31 December 2018: EUR 2.4 billion), are composed of sovereign debt securities (Italian, Spanish, French, Luxembourgish, German, Dutch and Belgian Governments) for an amount of EUR 1.7 billion, debt securities issued by the other public entities for an amount of EUR 0.2 billion and other bonds for an amount of EUR 0.4 billion. The caption also included one loan, which has been valued at fair value for an amount of EUR 7.0 million.

Concerning liabilities, during 2016 Intesa Sanpaolo Bank Luxembourg S.A. participated in the Long Term Refinancing Operation (LTRO) mechanism with the Luxembourg Central Bank ("BCL") for an amount of EUR 0.8 billion. To enter into such program, the Bank pledged in favour of the BCL part of its debt instruments kept in its financial assets at fair value through other comprehensive income portfolio, which were eligible for such purpose.

Deposits from customers amounted to EUR 3.2 billion at end of the year (31 December 2018: EUR 6.3 billion). The Bank also issued debt certificates for an amount of EUR 12.7 billion as at 31 December 2019 (31 December 2018: EUR 10.2 billion) composed as follows:

- certificates of deposit: EUR 5.4 billion (mainly subscribed by Intesa Sanpaolo Holding International S.A., the Bank's local parent company);
- non-convertible bonds: EUR 7.3 billion, which are part of a European Commercial Paper program and of the European Medium Term Notes program described herein.

The net profit for the year amounted to EUR 94.1 million as at 31 December 2019 (2018: EUR 104.0 million), with a ROE equal to 4.06%.

Net interest income amounted to EUR 154.1 million at the end of 2019 (end 2018: EUR 143.0 million). Interest income and expense reflected the corporate lending activity development.

Net fee and commission income was positive and amounted to EUR 35.4 million as at 31 December 2019, showing a decrease when compared to 2018 (EUR 42.5 million).

Net (un)realised losses on financial assets and liabilities held for trading amounted to EUR 39.0 million as at 31 December 2019 (31 December 2018: loss of EUR 60.3 million). The lower loss compared to last year was mainly due to NPV trend of derivatives contracts during 2019 and lower differentials paid compared to 2018.

Net realised gains on financial assets and liabilities not at fair value through profit or loss amounted to EUR 5.3 million as at 31 December 2019 (31 December 2018: gain of EUR 25.2 million) mainly thanks to gains of EUR 5.2 million realised on the sale of several securities measured at FVTOCI.

Total administrative expenses amounted to EUR 43.2 million, higher than 2018 administrative expenses caption mainly due to a higher contribution the Bank paid to the Single Resolution Fund.

Due to the implementation of IFRS 9 principle, which came into force starting from 1 January 2018, the Bank booked a net impairment loss on financial assets for EUR 6.6 million in 2019. Detailed information are presented in Note 3 and 26.

Due to the implementation of IFRS 16 principle, which came into force starting from 1 January 2019, the Bank booked higher depreciations for EUR 2.2 million in 2019, mainly due to operating leases on real estate location contracts.

Provisions booked in relation to current income taxes are linked to the Amsterdam branch; the Luxembourg Head Quarter has not booked any provision in relation to current income taxes due to the fact that current taxes are managed applying the local rules on the consolidation of taxable results with the ones generated by its direct shareholder in Luxembourg.

However, deferred tax assets and deferred tax liabilities generated by temporary differences have been booked as at 31 December 2019.

The net profit of the year available for distribution, including retained earnings (but excluding First Time Adoption "FTA" and reclassification from revaluation reserves) amounted to EUR 94,094,546. Retained earnings amount included also functional property revaluation of EUR 24,513,535, which has been reclassified from revaluation reserve to retained earnings following the functional property disposal concluded in 2018.

The Board of Directors will propose the following allocation of the profit to the Annual General Meeting, which will be held to approve the financial statements as at 31 December 2019:

(EUR)	
Net profit of 2019 financial year	94,082,728
Retained profit from previous year (excluding FTA and reclassification from revaluation reserves)	11,818
Amount attributable to shareholders	**94,094,546**
Allocation to legal reserve (5% net profit)	4,704,137
Allocation to the NWT reserve	17,256,550
Dividend for the financial year (77% rounded up)	72,100,000
Total	**94,060,687**
Retained profit carried forward to the next financial year (excluding first time adoption)	*33,859*

Subsequent events

The Bank is not aware of any adjusting or non-adjusting event that would have occurred between 31 December 2019 and the date when the present financial statements were authorised for submission by the Board of Directors to the Annual General Meeting of Shareholders.

Miscellaneous

The Bank did not purchase own shares during the year 2019. No research and development costs have been sustained during the year 2019.

Conclusion

The Board of Directors is satisfied concerning the profits generated. It thanks the Authorised Management of the Bank for its activity and all the employees for their professional behaviour and the quality of the services provided to the Bank's client, in this challenging year.

Luxembourg, 20 March 2020

Massimo Torchiana
Administrateur Délégué & CEO

Paolo Enrico Pernice
Chief Financial Officer

KPMG Luxembourg, Société coopérative
39, Avenue John F. Kennedy
L-1855 Luxembourg

Tel.: +352 22 51 51 1
Fax: +352 22 51 71
E-mail: info@kpmg.lu
Internet: www.kpmg.lu

To the Board of Directors of
Intesa Sanpaolo Bank Luxembourg S.A.
19-21 boulevard du Prince Henri
L-1724 Luxembourg

REPORT OF THE REVISEUR D'ENTREPRISES AGREE

Report on the audit of the financial statements

Opinion

We have audited the financial statements of Intesa Sanpaolo Bank Luxembourg S.A. (the "Bank"), which comprise the statement of financial position as at 31 December 2019, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Basis for Opinion

We conducted our audit in accordance with the EU Regulation N° 537/2014, the Law of 23 July 2016 on the audit profession ("Law of 23 July 2016") and with International Standards on Auditing ("ISAs") as adopted for Luxembourg by the "Commission de Surveillance du Secteur Financier" ("CSSF"). Our responsibilities under the EU Regulation N° 537/2014, the Law of 23 July 2016 and ISAs are further described in the « Responsibilities of "Réviseur d'Entreprises agréé" for the audit of the financial statements » section of our report. We are also independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code") as adopted for Luxembourg by the CSSF together with the ethical requirements that are relevant to our audit of the financial statements, and have fulfilled our other ethical responsibilities under those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

KPMG

Impairment of loans and advances to customers

a) *Why the matter was considered to be one of most significance in our audit of the financial statements for the year ended 31 December 2019*

Loans and advances to customers represent a significant amount of EUR 10,586,894,810 as at 31 December 2019. Certain aspects of the accounting for impairment of loans and advances to customers require significant judgments, such as the identification of credit exposures that are deteriorating, their staging, the estimation of expected credit losses as per IFRS 9 and of the recoverable value of credit exposures.

Impairment on loans and advances to customers are the Management best estimates of the expected credit losses at the balance sheet date. They are calculated on an individual basis for stage 3 exposures based on the expected discounted future cash flows or observable data markets and on a collective basis for stage 1 and 2 exposures based on internal models developed by the Bank with the support of the Intesa Sanpaolo S.p.A. Group ("the Group").

Due to the significance of loans and advances to customers and the related estimation uncertainty, we consider the valuation of loans as a key audit matter.

Please refer to notes 3, 7 and 26 of the financial statements for further information on the impairments of loans and advances to customers.

b) *How the matter was addressed in our audit*

Our audit approach included testing both the effectiveness of internal controls around determining loan loss provisions as well as substantive audit procedures.

We tested the design, implementation and operating effectiveness of the key controls the Bank implemented to monitor its credit exposures and support its specific and collective impairment calculation:

- Loan approval process;
- Annual review of credit exposures by the Credit department;
- Monthly review of the watch-list by Management and the Credit Committee;
- Monthly review of the past-due credit exposures by the Credit and the Risk Management departments;
- Timely review of the IFRS 9 impairment model's components, data quality and calculation at the Group level;
- Local management oversight monitoring of outsourced impairment calculation to the Group.

On a sample of credit operations, we tested the creditworthiness of the counterparty to assess the classification of the IFRS 9 staging.

For all significant stage 3 exposures at year end, we verified the estimation of allowance for losses on loans and advances to customers recorded by the Bank.

We involved our financial risk management specialists to challenge key assumptions and judgements made by management relating to the IFRS 9 expected credit loss model and evaluated the reasonableness of management's key judgements and estimates made in preparing adjustments.

Finally, we assessed whether the disclosures in the financial statements appropriately reflect the Bank's exposure to credit risk.

Valuation of the Bank's swaps' portfolio

a) *Why the matter was considered to be one of most significance in our audit of the financial statements for the year ended 31 December 2019*

The Bank enters into cross currency swaps and interest rate swaps derivatives to create risk management solutions for clients and to manage and hedge its own risks.

This portfolio of derivatives is only composed of Over-The-Counter operations measured by the Bank based on observable data markets and are classified as Level 2 financial instruments.

Given the amount and number of swaps in the Bank's portfolio, the use of wrong parameters or inappropriate yield curves might give rise to potential significant misstatements. Therefore we consider the valuation of those derivatives as a key audit matter.

Please refer to notes 3, 5 and 15 of the financial statements for further information on the valuation of derivatives.

b) *How the matter was addressed in our audit*

We tested the design, implementation and effectiveness of the monthly controls implemented by the risk management department of the Bank on the swaps valuation to monitor, identify and analyze any difference between the Bank's internal valuation and the valuation from the Group.

We obtained the swaps portfolio from risk management department and asked Management to correct the differences we noted with accounting records.

We obtained and inspected a sample of derivatives term sheets and contracts to obtain assurance that they have been properly entered into the Bank's IT system.

We performed direct testing over the fair value on a sample of derivatives at year-end based on observable data markets and the derivatives characteristics.

Where differences were identified between our independent valuation and management's valuation, we performed additional testing over each variance to support our assessment of the appropriateness of the fair value.

Other information

The Board of Directors is responsible for the other information. The other information comprises the information stated in the management report but does not include the financial statements and our report of "Réviseur d'Entreprises agréé" thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report this fact. We have nothing to report in this regard.

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Responsibilities of the Board of Directors and Those Charged with Governance for the financial statements

The Board of Directors is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs as adopted by the European Union, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Responsibilities of the Réviseur d'Entreprises agréé for the audit of the financial statements

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue a report of "Réviseur d'Entreprises agréé" that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the EU Regulation N° 537/2014, the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the EU Regulation N° 537/2014, the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

— Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.

KPMG

- Conclude on the appropriateness of Board of Directors'use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our report of the "Réviseur d'Entreprises agréé" to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report of the "Réviseur d'Entreprises agréé". However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our report unless law or regulation precludes public disclosure about the matter.

Report on other legal and regulatory requirements

We have been appointed as "Réviseur d'Entreprises agréé" by the Board of Directors and the duration of our uninterrupted engagement, including previous renewals and reappointments, is 8 years.

The management report is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

We confirm that the prohibited non-audit services referred to in the EU Regulation No 537/2014 were not provided and that we remained independent of the Bank in conducting the audit.

Luxembourg, 20 March 2020

KPMG Luxembourg,
Société coopérative
Cabinet de révision agréé

S. Hustinx
Associate Partner

Intesa Sanpaolo Bank Luxembourg S.A.

Statement of financial position
31 December 2019
(expressed in EUR)

Assets	**Notes**	**31.12.2019**	**31.12.2018**
Cash and cash balances with central banks	**3, 4**	**726,382,833**	**109,032,333**
Financial assets measured at fair value through profit or loss ("FVTPL")	**3, 5**		
Financial assets held for trading		30,193,047	48,445,482
Financial assets designated at fair value		-	10,365,456
Financial assets mandatorily measured at fair value		613,898	789,701
		30,806,945	**59,600,639**
Financial assets measured at fair value through other comprehensive income ("FVTOCI")	**3, 6**	**2,265,365,852**	**2,351,170,517**
Loans and advances	**3, 4, 7**		
Loans and advances to credit institutions		8,558,435,684	7,991,992,641
Loans and advances to customers		10,586,894,810	10,390,345,939
		19,145,330,494	**18,382,338,580**
Derivatives held for hedging	**3, 15**	**2,111,798**	**210,014**
Tangible fixed assets	**8, 34**	**4,608,604**	**782,391**
Intangible assets	**9**	**469**	**1,593**
Current tax assets	**10**	**8,969,210**	**6,201,905**
Deferred tax assets	**10**	**5,754,733**	**22,975,999**
Other assets	**3, 11**	**35,638,829**	**25,473,149**
Total assets		**22,224,969,767**	**20,957,787,120**

The accompanying notes form an integral part of the financial statements.

Intesa Sanpaolo Bank Luxembourg S.A.

Statement of financial position (continued)
31 December 2019
(expressed in EUR)

Liabilities and equity

	Notes	31.12.2019	31.12.2018
Deposits from central banks	3, 12	**809,894,291**	**812,487,716**
Financial liabilities measured at fair value through profit or loss ("FVTPL")			
Financial liabilities held for trading	3	80,700,893	67,343,507
Financial liabilities designated at fair value	3, 13	-	10,240,794
		80,700,893	**77,584,301**
Financial liabilities measured at amortised cost ("AC")	3, 14		
Deposits from credit institutions		2,874,862,323	1,072,688,424
Deposits from customers		3,164,036,018	6,295,783,310
Debts evidenced by certificates		12,730,158,046	10,183,437,695
		18,769,056,387	**17,551,909,429**
Derivatives held for hedging	3, 15	**98,241,822**	**69,043,776**
Provisions	16	**4,377,959**	**3,059,512**
Current tax liabilities	10	**6,760,165**	**9,174,660**
Deferred tax liabilities	10	**3,524,440**	**3,176,749**
Other liabilities	11	**39,621,981**	**49,128,944**
Total liabilities		**19,812,177,938**	**18,575,565,087**
Equity	6, 17		
Share capital		1,389,370,555	1,389,370,555
Share premium		7,720,692	7,720,692
Revaluation reserve		(5,170,699)	(40,545,366)
Other reserves and retained earnings		926,788,553	921,678,999
Net profit for the year		94,082,728	103,997,153
Total equity		**2,412,791,829**	**2,382,222,033**
Total liabilities and equity		**22,224,969,767**	**20,957,787,120**

The accompanying notes form an integral part of the financial statements.

Intesa Sanpaolo Bank Luxembourg S.A.

Statement of profit or loss and other comprehensive income
For the year ended 31 December 2019
(expressed in EUR)

CONTINUING OPERATIONS:	**Notes**	**31.12.2019**	**31.12.2018**
Interest income		277,649,165	274,873,684
Interest expenses		(123,567,681)	(131,862,197)
Net interest income	**18**	**154,081,484**	**143,011,487**
Fee and commission income		95,055,176	74,599,552
Fee and commission expenses		(59,704,907)	(32,063,819)
Net fee and commission income	**19**	**35,350,269**	**42,535,733**
Dividend income	**20**	**50,878**	**672,427**
Net (un)realised losses on financial assets and liabilities held for trading	**21**	**(39,047,692)**	**(60,292,897)**
Net unrealised gains/(losses) on financial assets and liabilities held for hedging	**15**	**(156,650)**	**148,117**
Net (un)realised gains on financial assets and liabilities at fair value through profit or loss	**22**	**44,528**	**98,102**
Net realised gains on financial assets and liabilities not at fair value through profit or loss	**23**	**5,255,755**	**25,205,201**
Other income		2,919,397	7,563,784
Other expenses		(4,586,124)	(10,420,388)
Net other expenses	**24**	**(1,666,727)**	**(2,856,604)**
Administrative expenses	**25, 31**	**(43,203,915)**	**(38,841,193)**
Depreciation and amortization	**8, 9, 34**	**(2,235,676)**	**(960,820)**
Provisions	**16**	**(1,172,388)**	**178,688**
Net impairment result on financial assets	**26**	**(6,591,048)**	**(2,616,536)**
Tax (expense) income	**10**	**(6,626,090)**	**(2,284,552)**
NET PROFIT FOR THE YEAR		**94,082,728**	**103,997,153**

The accompanying notes form an integral part of the financial statements.

Statement of profit or loss and other comprehensive income (continued)
For the year ended 31 December 2019
(expressed in EUR)

	31.12.2019	31.12.2018
Net profit for the year	**94,082,728**	**103,997,153**
Other comprehensive income:		
Items that will not be reclassified to profit or loss		
Tangible assets	-	(24,513,535)
Income tax relating to items that will not be reclassified	-	6,638,265
Items that are or may be reclassified to profit or loss		
Net change in fair value on financial assets at fair value through other comprehensive income and expected credit losses	47,907,295	(58,424,220)
Deferred tax relating to the components of other comprehensive income	(12,532,628)	15,198,298
Other comprehensive income for the year, net of tax	**35,374,667**	**(61,101,192)**
Total comprehensive income for the year	**129,457,395**	**42,895,961**

The accompanying notes form an integral part of the financial statements.

Intesa Sanpaolo Bank Luxembourg S.A.

Statement of changes in equity
31 December 2019
(expressed in EUR)

	Issued share capital	Share premium	Revaluation reserves	Reserves: Legal reserve	Reserves: Other reserves	Reserves: Retained earnings	Total Reserve and retained earnings	Profit of the year before appropriation	Total
Note	17		6, 17	17	17	17		17	
Balance as at 1st January 2018	**1,389,370,555**	**7,720,692**	**19,840,795**	**59,641,565**	**812,541,743**	**(9,777,131)**	**862,406,177**	**135,474,318**	**2,414,812,537**
Total comprehensive income	-	-	(60,386,161)	-	-	(715,031)	(715,031)	103,997,153	**42,895,961**
Transfers and appropriation of prior year's profit	-	-	-	6,773,716	28,726,284	(25,682)	35,474,318	(35,474,318)	**-**
Dividend for the financial year	-	-	-	-	-	-	-	(100,000,000)	**(100,000,000)**
Recycling from OCI	-	-	-	-	-	24,513,535	24,513,535	-	**24,513,535**
Capital decrease	-	-	-	-	-	-	-	-	-
Capital increase	-	-	-	-	-	-	-	-	-
Balance as at 31 December 2018	**1,389,370,555**	**7,720,692**	**(40,545,366)**	**66,415,281**	**841,268,027**	**13,995,691**	**921,678,999**	**103,997,153**	**2,382,222,033**
Balance as at 1st January 2019	**1,389,370,555**	**7,720,692**	**(40,545,366)**	**66,415,281**	**841,268,027**	**13,995,691**	**921,678,999**	**103,997,153**	**2,382,222,033**
Total comprehensive income	-	-	35,374,667	-	-	-	-	94,082,728	**129,457,395**
Transfers and appropriation of prior year's profit	-	-	-	5,199,858	-	(2,705)	5,197,153	(5,197,153)	-
Dividend for the financial year	-	-	-	-	-	-	-	(98,800,000)	**(98,800,000)**
Foreign translation difference	-	-	-	-	-	(87,599)*	(87,599)	-	**(87,599)**
Capital decrease	-	-	-	-	-	-	-	-	-
Capital increase	-	-	-	-	-	-	-	-	-
Balance as at 31 December 2019	**1,389,370,555**	**7,720,692**	**(5,170,699)**	**71,615,139**	**841,268,027**	**13,905,387**	**926,788,553**	**94,082,728**	**2,412,791,829**

**Foreign translation difference generated by IFRS 9 FTA due to loss allowance calculation on loans and advances denominated in foreign currencies.*

The accompanying notes form an integral part of the financial statements.

Intesa Sanpaolo Bank Luxembourg S.A.

Statement of cash flows
For the year ended 31 December 2019
(expressed in EUR)

	Notes	31.12.2019	31.12.2018
Profit before tax		**100,708,818**	**106,281,705**
Adjustments:			
Depreciation / amortization	**8, 9**	251,270	960,820
Impairment for credit losses	**26**	14,115,047	18,747,448
Reversal of loan impairment	**26**	(7,523,999)	(16,130,912)
Provisions and other income/expenses	**16**	1,318,447	1,380,374
Fair value adjustments		57,864,454	50,102,102
Cash flows from operating profits before changes in operating assets and liabilities		**166,734,037**	**161,341,537**
Net (Increase)/decrease in trading assets		(767,282)	13,249,423
Net (Increase)/decrease in loans and advances to credit institutions		(1,723,119,410)	2,390,680,668
Net (Increase)/decrease in loans and advances to customers		(202,652,178)	(1,672,449,676)
Net (Increase)/decrease in financial assets at FVTOCI		133,133,866	793,041,817
Net (Increase)/decrease in financial assets designated at fair value through profit and loss		12,709,584	1,693,304
Net (Increase)/decrease in other assets		(10,165,680)	(3,100,716)
Net Increase/(decrease) in relation to leasing contracts	**2, 8, 34**	(1,984,406)	-
Net Increase/(decrease) in trading financial liabilities		(7,054,437)	54,312,778
Net Increase/(decrease) in deposits from credit institutions		1,802,212,417	364,352,626
Net Increase/(decrease) in deposits from central banks		(2,593,425)	(501,562,107)
Net Increase/(decrease) in deposits from customers		(3,134,314,305)	(288,214,886)
Net Increase/(decrease) in financial liabilities at FVtPL & in other liabilities		(19,872,418)	(5,482,192)
Net cash flows from/(used in) operating activities		**(2,987,733,637)**	**1,307,862,576**
Dividends received	**20**	50,878	672,427
Acquisition and disposal of property and equipment	**8**	436,542	31,072,055
Net cash flows/(used in) from investing activities		**487,420**	**31,744,482**
Dividends paid	**17**	(98,800,000)	(100,000,000)
Net increase/(decrease) in debts evidenced by certificates	**14**	2,546,720,351	(828,336,269)
Net cash flows/(used in) from financing activities		**2,447,920,351**	**(928,336,269)**
Net (decrease)/increase in cash and cash equivalents		**(539,325,866)**	**411,270,789**

The accompanying notes form an integral part of the financial statements.

Statement of cash flows (continued)
For the year ended 31 December 2019
(expressed in EUR)

	Notes	31.12.2019	31.12.2018
Cash and cash equivalents at the beginning of the year		**4,158,672,594**	**3,747,401,805**
Net increase/decrease in cash and cash equivalents		(539,325,866)	411,270,789
Cash and cash equivalents: exchange rate fluctuations		-	-
Cash and cash equivalents at the end of the year	**4**	**3,619,346,728**	**4,158,672,594**

The accompanying notes form an integral part of the financial statements.

Note 1 – General information

Intesa Sanpaolo Bank Luxembourg S.A. (hereafter the "Bank" or "ISPBL") was incorporated in Luxembourg on 2 June 1976 as a limited company under Luxembourg Law.

The Extraordinary General Meeting held on 5 October 2015 has changed the name of the Bank from "Société Européenne de Banque S.A." to "Intesa Sanpaolo Bank Luxembourg S.A.".

The main activities of the Bank are focused on corporate business, private banking and financial markets activities. Until 6 July 2008, the Bank provided services to investment funds such as central administration, transfer agent and custodian. On 7 July 2008, following a decision of the Extraordinary Shareholders' Meeting held on 25 June 2008, these activities were transferred for no consideration to another Luxembourg entity of the Intesa Sanpaolo Group. At the same date, private banking and corporate activities were transferred for no consideration from another Luxembourg entity of Intesa Sanpaolo Group to the Bank.

Since 31 December 2012, the Bank prepares consolidated financial statements according to the Transparency Law, as the Bank issues European Medium Term Notes on the Luxembourg stock market and fully controls the company Lux Gest Asset Management S.A. and until 31 March 2013 Intesa Sanpaolo Private Bank (Suisse) S.A..

On 1 February 2016, the Bank purchased the Intesa Sanpaolo S.p.A. Amsterdam Branch (the "Branch") from the Group through a contribution in kind. For that purpose, 13,750 shares have been issued to Intesa Sanpaolo S.p.A. consisting of EUR 4,279,308.01 to share capital and EUR 7,720,691.99 to share premium in exchange of the Branch.

On 22 September 2016, the Bank performed a capital increase of EUR 449,999,892.27 through the issuance of 1,445,911 shares integrally subscribed by Intesa Sanpaolo Holding International S.A.. The subscribed capital of the Bank as at 31 December 2016 was therefore of EUR 989,370,720.28, composed of 3,178,983 shares (integrally subscribed).

On 25 October 2017, the Bank performed a capital increase of EUR 399,999,835.08 through the issuance of 1,285,254 shares integrally subscribed by Intesa Sanpaolo Holding International S.A.. The subscribed capital of the Bank as at 31 December 2017 was therefore of EUR 1,389,370,555.36 composed of 4,464,237 shares (integrally subscribed).

On 1 October 2018, the Bank issued a subordinated loan of EUR 200,000,000 subscribed by Intesa Sanpaolo Holding International S.A.. The subordinated loan matures on 2 October 2028.

As at 31 December 2019, 100% of the Bank share capital is owned by Intesa Sanpaolo Holding International S.A..

Intesa Sanpaolo Holding International S.A. is fully consolidated in the consolidated financial statements of Intesa Sanpaolo S.p.A. (hereafter the "Group"). Intesa Sanpaolo S.p.A. produces consolidated financial statements available for public use that comply with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

The Bank co-operates to a significant extent with its ultimate Parent Company and other entities of the Intesa Sanpaolo Group.

These financial statements were authorised for submission to the Shareholders' Annual General Meeting by the Bank's Board of Directors on 20 March 2020.

The registered office of the Bank is: 19-21, boulevard Prince Henri in Luxembourg.

Note 2 – Significant accounting policies

(a) Basis of preparation

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and the relative interpretations of the International Financial Reporting Interpretations Committee (IFRIC) as adopted for use in the European Union ("IFRS") and with the going concern principle.

This is the first set of financial statements in which IFRS 16 *Leases* has been applied. The related changes to significant accounting policies are described below.

(b) Significant accounting judgements, estimates and assumptions

In preparing the financial statements, the Board of Directors is required to make accounting judgements, estimates and assumptions that affect reported income, expenses, assets, liabilities and disclosure of contingent assets and liabilities. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the financial statements.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The most significant use of judgements and estimates are as follows:

Fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation techniques incorporate all of the factors that market participants would take into account in pricing a transaction.

Note 2 – Significant accounting policies (continued)

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor is based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis but no later than when the valuation is wholly supported by observable data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market risk or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities based on the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

Impairment losses on financial assets

Judgements are made in establishing the criteria for determining whether credit risk on the financial assets has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of expected credit losses ("ECL") and selection and approval of models used to measure ECL.

Classification of financial assets and liabilities

Assessments are made for every financial asset and liability of the business model within which the assets are held and assessment of whether the contractual terms of the financial assets are solely payments of principal and interests ("SPPI") on the principal amount outstanding.

Valuation of unquoted equity investments and credit exposures

Valuation of unquoted equity investments and credit exposures is normally based on one of the following:

- recent arm's length transactions;
- current fair value of another instrument that is substantially the same;
- expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

Note 2 – Significant accounting policies (continued)

The determination of the cash flows and discount factors for unquoted equity investments and credit exposures requires significant estimation. The Bank calibrates the valuation techniques periodically and tests them for validity using either prices from observable current market transactions in the same instrument of from other available observable market data.

(c) Changes in accounting policies

The Bank initially applied the following standards and amendments to standards from 1 January 2019:

- *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7);*
- IFRS 16 *Leases.*

A number of other new standards are also effective from 1 January 2019 but they do not have a material effect on the Bank's financial statements.

***IBOR Reform*:**
Please refer to dedicated section in Note 3.

***IFRS 16*:**
The regulations

The new accounting standard IFRS 16, issued by the IASB in January 2016 and endorsed by the European Commission through Regulation no. 1986/2017, replaced IAS 17 "Leases", IFRIC 4 "Determining whether an arrangement contains a lease", SIC 15 "Operating leases – Incentives" and SIC 27 "Evaluating the substance of transactions involving the legal form of a lease", with effect from 1 January 2019, established the requirements for accounting for lease contracts.

In accordance with the new standard, entities are required to decide whether a contract is (or contains) a lease, based on the concept of control of the use of an identified asset for a set period of time. As a result, rental, hire or free loan agreements come under the scope of the new rules.

In view of the above, significant changes have been made to the accounting for lease transactions in the financial statements of the lessee/user, with the introduction of a single accounting model for lease contracts for the lessee, based on the right-of-use model. Specifically, the main change consists of the elimination of the distinction between operating and finance leases, established by IAS 17: all lease contracts must therefore be accounted for in the same way with the recognition of an asset and a liability.

Unlike the standards in force until 31 December 2018, the accounting model envisages the recognition of the right of use of the leased asset under the Statement of the Financial Position - Assets and for lease payments not yet paid to the lessor under the Statement of the Financial Position - Liabilities.

The method of recognition of the profit or loss components has also changed: in IAS 17 lease payments were shown under the caption Administrative Expenses, whereas under IFRS 16 the charges relating to the amortisation of the "right of use" and the interest expense on the payable are recognised.

Note 2 – Significant accounting policies (continued)

In terms of disclosure, the minimum information required from the lessees includes:

- the sub-division of the leased assets among different "classes";
- an analysis by due date of the liabilities related to the leases;
- the information that is potentially helpful for a better understanding of the entity's activities with regard to the lease contracts (for example, prepayment or extension options).

For leases by the lessors there are no substantial changes, other than some additional disclosure requirements, for the accounting, where the current distinction is maintained between operating leases and finance leases.

In addition, in accordance with the requirements of IFRS 16 and the IFRIC clarifications ("Cloud Computing Arrangements" document of September 2018), software has been excluded from the scope of IFRS 16 and is therefore accounted for in accordance with IAS 38 and its requirements.

From 1 January 2019, the effects on the financial statements resulting from the adoption of IFRS 16 can be identified for the lessee – with the same income and final cash flows – as an increase in the assets recorded in the financial statements (leased assets), an increase in the liabilities (the payable for the leased assets), a reduction in administrative expenses (lease payments) and an accompanying increase in financial costs (the remuneration of the payable recognised) and depreciation (relating to the right of use).

With regard to the *statement of profit and loss*, when the entire term of the contracts is considered, the economic impact does not change over the period of the lease, both when the former IAS 17 or the new IFRS 16 are applied, but its distribution over time is different.

In 2018, the Bank, jointly with Intesa Sanpaolo Group, initiated a specific project for the implementation of IFRS 16 – Leases, aimed at examining and determining the qualitative and quantitative impacts, and identifying and implementing the practical and organisational measures required for consistent, systematic and effective adoption within the Group as a whole and for each of its individual subsidiaries. From a procedural perspective, a specific application has been implemented at Group level for the determination of values according to IFRS 16.

Scope of the contracts – lessee side

Classification and analysis of lease transactions in light of the applicable regulations

As noted above, the Standard applies to all types of contracts containing a lease, i.e. contracts that give the lessee the right to control the use of an identified asset for a particular period of time (period of use) in exchange for consideration. The logic underlying the Standard is that "control" over an asset requires that asset to be identified, for example when it is explicitly specified in the contract, or if it is implicitly specified at the time it is made available for use by the customer. An asset is not specified if the supplier has the substantive right to substitute it, or if the supplier has the practical ability to substitute the asset with alternative assets throughout the period of use and benefits economically from the exercise of that right.

Note 2 – Significant accounting policies (continued)

Once it has been established that the underlying asset of the contract is an identified asset, it is necessary to assess whether the entity has the right to control its use because it has both the right to obtain substantially all of the economic benefits from the use of the asset and the right to direct the use of the identified asset. For the Bank, the analysis of contracts falling within the scope of this standard concerned those relating to the following cases:
(i) real estate,
(ii) and vehicles.

The real estate lease contracts represent the most significant area of impact from implementation, because these contracts represent 95% of the value of the rights of use. In contrast, although they are significant in terms of number, the impact of vehicles leases is negligible in terms of the amount of the right of use.

Real estate lease contracts include properties designated for use as offices. The contracts normally have a term of more than 12 months and typically have renewal and termination options that can be exercised by the lessor and the lessee in accordance with the law or specific contractual provisions. These contracts do not include significant restoration costs for the Bank at the end of the lease.

For vehicles, these are long-term rental contracts relating to the company fleet made available to employees (mixed use) in Luxembourg and to the organisational structure of the branch in Amsterdam. They have a multi-year term, with no renewal options, and these contracts do not include the option to purchase the asset.

The choices made by the Bank (in accordance with the Group)

The Bank has chosen to carry out the first-time adoption (FTA) of IFRS 16 through the recognition of the cumulative effect of the adoption of the standard at the date of first-time adoption and not restating the comparative information of the financial statements of first-time adoption of IFRS 16.

As a result, the financial statements figures for 2019 will not be comparable with regard to the valuation of the rights of use and the corresponding lease liability.

Upon first-time adoption, the Bank has adopted some of the practical expedients provided for in the standard in paragraph C10 and following. In particular, contracts with a remaining lease term of 12 months or less ("short term") have not been included.

Also after full adoption, the Bank has also decided not to apply the new standard to contracts with a total lease term of 12 months or less and to contracts with a value of the underlying asset, when new, of 5,000 euro or less ("low value"). In this case, the lease payments for these leases are recognised as an expense – in the same way as in the past – on a straight-line basis for the lease term or on another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

With regard to the sale and leaseback agreement outstanding as at the date of first-time adoption, the Bank has applied the transition model for the other lease contracts to the leases resulting from these transactions, and classified as operating leases according to IAS 17 requirements, as required by the standard. A summary is provided below of some of the choices made by the Bank regarding the treatment of leases on the lessee side, such as, for example, the contractual term, discount rate, and lease and non-lease components.

Note 2 – Significant accounting policies (continued)

Contractual term

The lease term is determined by the non-cancellable period for which the Bank has the right to use the underlying asset, also considering:

(i) the periods covered by the option to extend the lease, if the lessee is reasonably certain to exercise that option;

(ii) and the periods covered by the option to terminate the lease, if the lessee is reasonably certain not to exercise that option.

At the transition date and at the commencement date of each contract entered into after 1 January 2019, the Bank has established the term of the lease, based on the facts and circumstances that exist at that date and that have an impact on the reasonable certainty of exercising the options included in the lease arrangements.

In line with the choice made for the real estate contracts, for the other types of leases, in which the contract includes a renewal clause, the Bank has decided – for all the new contracts (and also at the FTA date) – to assess the reasonable certainty of exercising the option, taking into account both the requirements of the Standard and the strategy regarding the individual contracts.

Discount rate

With regard to the discount rate, based on the requirements of IFRS 16, the Bank uses the implicit interest rate for each lease contract, when it is available. For leases from the lessee's point of view, in some cases, for example for rental agreements, the implicit interest rate cannot always be readily determined without using estimates and assumptions (the lessee does not have enough information about the unguaranteed residual value of the leased asset). In these cases, the Bank has developed a methodology for setting the incremental interest rate as an alternative to the implicit interest rate and has decided to adopt the Funds Transfer Pricing (FTP) method. This is based on an unsecured and amortising rate curve, which envisages lease payments for the lease contract that are typically constant over the lease term, rather than a single payment upon maturity. The FTP method takes into account the creditworthiness of the lessee, the term of the lease, the nature and quality of the collateral provided and the economic environment in which the transaction takes place and is therefore in line with the requirements of the standard.

The effects of the first time adoption (FTA) of IFRS 16

The adjustment of the opening balance sheet following the adoption of IFRS 16 using the modified retrospective approach has resulted in an increase in assets following the recognition of the new rights of use of 5.6 million euro in caption "*property plan and equipment*" and in the financial liabilities (payable to the lessor) of the same amount in caption "*financial liabilities measured at amortised cost*". There have therefore been no impacts on shareholders' equity from the first-time adoption of the standard, because, as a result of the decision to adopt the modified approach (option B), upon first-time adoption the values of the assets and liabilities are the same, net of the reclassification of accruals and deferrals and the presentation of leases previously classified as finance leases under IAS 17.

Note 2 – Significant accounting policies (continued)

At the time of the transition, IFRS 16 allows a company to choose whether to apply the new definition of lease contract to all contracts or whether to use a "practical expedient" whereby the company may continue to regard as valid the assessment of the contracts previously identified as leases under IAS 17 and IFRIC 4 (paragraph C3 of IFRS 16).

Specifically, the Bank has used the practical expedient provided for in paragraph C3 above for the FTA. In particular, for all operating leases already covered by IAS 17, it has recognised the liability determined as the discounted future lease payments and the right of use of the same amount (so-called modified B).
To provide a better representation of any differences between the scope of IAS 17 and the new standard, the table below shows the reconciliation between the two scopes (as required by paragraph C12 of IFRS 16), detailing in particular:

- the commitments arising from operating leases disclosed in accordance with IAS 17 as at 31 December 2018;
- the effect of the discounting of the operating leases using the incremental borrowing rate as at the date of initial application;
- and the lease liabilities recognised in the Statement of Financial Position as at the date of initial application.

Reconciliation between Commitments for IAS 17 operating leases as at 31 December 2018 and Liabilities for IFRS 16 leases as at 1 January 2019

(in EUR)	**Liabilities**
Operating lease commitments at 31 December 2018 as disclosed under IAS 17	**5,690,762**
IFRS 16 recognition exemption	(21,621)
Recognition exemption for leases with less than 12 months of lease term at transition	*(14,421)*
Recognition exemption for leases of low-value assets	*(7,200)*
Other variations (i.e. non-deductible T.V.A.)	(50,093)
Operating leases under IFRS 16 – before discounting	**5,619,048**
Discounting effect	(46,678)
Lease liabilities recognized at 1 January 2019	**5,572,370**

The weighted average incremental borrowing rate for the lessee applied to the lease liabilities recognised in the balance sheet at the date of initial application is 0.533% for real estate in Luxembourg, 0.59% for real estate in Amsterdam and 0.477% for vehicles.

With regard to leases, the table below shows the breakdown of the categories of rights of use identified. Specifically, the rights of use acquired through leases relating to real estate contracts are shown under sub-caption "building and land"; those relating to contracts for cars and other vehicles are shown under sub-caption "other".

(in EUR)	**Assets**
Right-of-use assets acquired through leases as at 1 January 2019	**5,572,370**
Building and land	5,310,466
Other	261,904

Note 2 – Significant accounting policies (continued)

Standards issued but not yet adopted

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Bank has not early adopted them in preparing these financial statements.

The following amended standards are not expected to have a significant impact on the Bank's financial statements:

- *Amendments to References to Conceptual Framework in IFRS Standards;*
- *Definition of a Business (Amendments to IFRS 3).*

(d) Summary of significant accounting policies

Except for the changes explained in (c) Changes in accounting policies, the accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Foreign currency translation

The financial statements are presented in euro (EUR), which is the Bank's functional and presentation currency.

Foreign currency transactions are translated at the exchange rate prevailing at the date of the transaction.

Monetary assets and liabilities denominated in currencies other than in euro are translated into euro at the exchange rates prevailing at the statement of financial position date. The gain or loss arising from such translation is recorded in the statement of profit or loss.

Non-monetary items in a foreign currency that are measured in terms of historical cost are translated using the exchange rates at the dates of the initial transactions. Non-monetary items in a foreign currency measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Exchange differences on non-monetary financial assets are a component of the change in their fair value. Depending on the classification of a non-monetary financial asset, exchange differences are recognised either in the statement of profit or loss or in other comprehensive income. The elements of the statement of profit or loss are translated into euro on a daily basis using the prevailing exchange rates.

Financial assets and Financial liabilities

(i) Recognition and initial measurement

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on their value date. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on their value date, which is the date on which the Bank becomes part to the contractual provisions of the instrument.

Note 2 – Significant accounting policies (continued)

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are attributable to its acquisition or issue.

(ii) Classification

<u>Financial assets</u>

On initial recognition, a financial asset is classified as measured at: amortised cost, FVTOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both the following conditions and is not designated at FVTPL:
- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

A debt instrument is measured at FVTOCI only if it meets both of the following conditions and is not designated at FVTPL:
- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVTOCI as at FVTPL if doing so eliminated or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Bank assesses the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:
- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;
- How the performance of the portfolio is evaluated and reported to the Bank's management;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed;

Note 2 – Significant accounting policies (continued)

- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an all-overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual terms nor held both to collect contractual cash flows and to sell financial assets.

Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, "principal" is defined as the fair value of the financial asset on initial recognition. "Interest" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other lending risks and costs, as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Bank considered contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of the contractual cash flows such that it would not meet the condition. In making the assessment, the Bank considers:
- Leverage features;
- Prepayment and extension terms;
- Terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse loans); and
- Features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL depending on the business model allocation and the SPPI test result.

(iii) Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

Note 2 – Significant accounting policies (continued)

Any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVTOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

(iv) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when the Bank has a legally enforceable right to offset the recognised amounts and the transactions are intended to be settled on a net basis or realise the asset and settle the liability simultaneously.

Financial assets at fair value through profit or loss

Assets and liabilities held for trading

Assets and liabilities held for trading are assets and liabilities acquired by the Bank for the purpose of selling or repurchasing in the near term, or held as part of a portfolio that is managed together for the short-term profit or position taking.

Assets and liabilities held for trading are initially recognised and subsequently measured at fair value in the statement of financial position, with transaction costs recognised in profit or loss. All changes in fair value are recognised as part of the net trading income in profit or loss.

Designation at fair value through profit or loss

Financial assets
At initial recognition, the Bank has designated certain financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, which would otherwise arise.

Note 2 – Significant accounting policies (continued)

Financial liabilities
The Bank has designated certain financial liabilities as at FVTPL because the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Loans and advances

Loans and advances captions in the statement of financial position include:
- loans and advances measured at amortised cost; they are initially measured at fair value plus incremental direct transactional costs, and subsequently at their amortised cost using the effective interest method;
- finance lease receivables.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo or stock borrowing), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the Bank's financial statements.

Financial assets at FVTOCI

The financial assets at FVTOCI in the statement of financial position include:
- Debt investment securities measured at amortised cost: these are initially measured at fair value plus incremental transaction costs, and subsequently at their amortised cost using the effective interest rate;
- Debt and equity investment securities mandatorily measured at FVTPL or designated as at FVTPL: these are at fair value with changes recognised immediately in profit or loss;
- Debt securities measured at FVTOCI; and
- Equity investment securities designated at FVTOCI;
- Loans belonging to the "*Originate to share*" deals, where a syndicated loan is either originated by the Bank or by a third-party with the intent to distribute a quota on the primary or post-primary market and holding the rest. If there is the willingness and the possibility to sell to third-parties a part of the loan, that amount is designated at FVTOCI.

For the debt securities measured at FVTOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:
- interests revenue using the effective interest method; and
- Foreign exchange gains and losses.

When debt securities measured at FVTOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Note 2 – Significant accounting policies (continued)

Gains and losses on such equity instruments are never re-classified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the impairment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

Financial liabilities other than held for trading and hedging

(i) Classification

The Bank classifies its financial liabilities other than derivatives in the following categories: financial liabilities measured at amortised cost and financial liabilities at fair value through profit or loss. The Bank uses the fair value option either when:

- it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring liabilities or recognise the gains and losses on them on different bases; or
- a group of financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the Bank is provided internally on that basis to the entity's key management personnel.

(ii) Initial recognition and subsequent measurement

Interest-bearing liabilities – other than financial liabilities at fair value through profit or loss – are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing liabilities are stated at amortised cost using the effective interest method. Gains and losses are recognised in the statement of profit or loss when the liabilities are derecognised as well as through the amortisation process.

Financial liabilities at fair value through profit or loss are measured at fair value through the statement of profit or loss.

(iii) Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of profit or loss.

Note 2 – Significant accounting policies (continued)

Derivative financial instruments

(i) Classification

Derivatives, including separated embedded derivatives, are classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains and losses on investments held for trading are recognised in the statement of profit or loss.

(ii) Initial recognition and subsequent measurement

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are restated at fair value. The method of recognising the resulting fair value gain or loss depends on whether the derivatives are designated as a hedging instrument, and if so, the nature of the risk being hedged.

Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

(iii) Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a host contract). The Bank accounts for an embedded derivative separately from the host contract when:

- The host contract is not in the scope of IFRS 9;
- The host contract is not itself carried at FVTPL;
- The terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract; and
- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form a part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contact.

(iv) Trading

Derivatives that do not qualify for hedge accounting are accounted for as trading instruments. The gain or loss on remeasurement to fair value of trading derivatives is recognised immediately in the statement of profit and loss.

(v) Hedge accounting

The Bank may use derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. Where there is a hedging relationship between a derivative instrument and a related item being hedged, the hedging instrument is measured at fair value. The treatment of any resulting gains and losses is set out below.

Note 2 – Significant accounting policies (continued)

As permitted by IFRS 9, the Bank has elected to continue to apply the hedge accounting requirements of IAS 39.

On initial designation of the hedge, the Bank formally documents:

- the relationship between the hedging instruments and the hedged items;
- the risk management objectives and strategies in undertaking the hedge;
- the method that will be used to assess the effectiveness of the hedging relationship.

The Bank makes an assessment, both at inception of the hedge relationship and on an on-going basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within the range of 80%-125%.

For the purpose of hedge accounting, the Bank has classified hedges as fair value hedges.

<u>Fair value hedges</u>

The change in the fair value of a hedging derivative is recognised in the statement of profit or loss. The change in the fair value of the hedged item attributable to the hedged risk is recorded as a part of the carrying value of the hedged item and is also recognised in the statement of profit or loss.

For fair value hedges relating to items carried at amortised cost, the adjustment to carrying value is amortised through the statement of profit or loss over the remaining term to maturity. Any adjustment to the carrying amount of a hedged financial instrument for which the effective interest rate method is used, is amortised through the statement of profit or loss.

Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. If the hedged item is derecognised, the unamortised fair value is recognised immediately in the statement of profit or loss.

When an unrecognised firm commitment is designated as a hedged item, the subsequent cumulative changes in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability with a corresponding gain or loss recognised in the statement of profit or loss. The changes in the fair value of the hedging instrument are also recognised in the statement of profit or loss.

(vi) Derecognition

Derivatives are derecognised when the rights and obligations under the instrument are discharged, cancelled or expired.

Financial guarantee contracts and loan commitment

Financial guarantee contracts issued by the Bank are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of a debt instrument.

Note 2 – Significant accounting policies (continued)

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:
- The amount of the loss allowance;
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Loan commitments provided by the Banks are firm commitments to provide loans or advances under pre-specified terms and conditions and are measured as the amount of the loss allowance. The Bank has not provided any commitment to provide loans at a below-market interest rate.

Financial guarantee contracts and loan commitments are recognised in off balance sheet.

The Bank recognises loan commitments when it has fulfilled all its obligations and related contracts have been duly signed by all the counterparties involved.

The Bank recognises a loss allowance in compliance with IFRS 9.

Repurchase agreements and reverse repurchase agreements

The Bank enters into purchases (sales) of investments under agreements to resell (repurchase) substantially identical investments at a certain date in the future at a fixed price. Investments purchased subject to commitments to resell them at future dates are not recognised. The amounts paid are recognised in loans to either banks or customers. The advances are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy of the category to which they relate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers.

The difference between the sale and repurchase considerations is recognised on an accrual basis over the period of the transaction and is included in interest.

Impairment of financial assets

The Bank recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:
- Financial assets that are debt instruments;
- Financial guarantee contracts issued; and
- Loan commitments issued.

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:
- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

Note 2 – Significant accounting policies (continued)

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of "investment grade". The Bank does not apply the low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as "Stage 1 financial instruments".

Lifetime ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as "Stage 2 financial instruments".

Measurement of ECL
ECL are a probability-weighted estimate of credit losses. They are measured as follows:
- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Restructured financial assets
If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows:
- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset;
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets
At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVTOCI are credit impaired (referred to as "Stage 3 financial assets"). A financial asset is "credit impaired" when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.
Evidence that a financial asset is credit-impaired includes the following observable data:
- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;

Note 2 – Significant accounting policies (continued)

- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered credit-impaired even when the regulatory definition of default is different.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors:
- The market's assessment of creditworthiness as reflected in the bond yields;
- The rating agencies' assessments of creditworthiness;
- The country's ability to access the capital markets for new debt issuance;
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness;
- The international support mechanisms in place to provide the necessary support as "lender of last resort" to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the statement of financial position:
Loss allowances for ECL are presented in the statement of financial position as follows:
- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVTOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

Write-off
Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in "Net impairment result" in the statement of profit or loss and OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

Note 2 – Significant accounting policies (continued)

Non-integral financial guarantee contracts
The Bank assesses whether a financial guarantee contract held is an integral element of a financial asset that is accounted for as a component of that instrument or is a contract that is accounted for separately. The factors that the Bank considers when making this assessment include whether:

- the guarantee is implicitly part of the contractual terms of the debt instrument;
- the guarantee is required by laws and regulations that govern the contract of the debt instrument;
- the guarantee is entered into at the same time as and in contemplation of the debt instrument; and
- the guarantee is given by the parent of the borrower or another company within the borrower's group.

If the Bank determines that the guarantee is an integral element of the financial asset, then any premium payable in connection with the initial recognition of the financial asset is treated as a transaction cost of acquiring it. The Bank considers the effect of the protection when measuring the fair value of the debt instrument and when measuring ECL.

If the Bank determines that the guarantee is not an integral element of the debt instrument, then it recognises an asset representing any prepayment of guarantee premium and a right to compensation for credit losses. A prepaid premium asset is recognised only if the guaranteed exposure neither is credit-impaired nor has undergone a significant increase in credit risk when the guarantee is acquired. These assets are recognised in "other assets". The Bank presents gains or losses on a compensation right in profit or loss in the line item "Net impairment result".

In addition, the Bank proceeds with an estimation of a potential collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration factors such as deterioration in country risk, industry and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

When financial instruments are grouped if expected credit losses is measured on a collective basis, parameters are modelled taking into consideration four options based on the information available:

- An ECL percentage is calculated on each contract the Bank has with a customer. It represents the most precise calculation it is possible to perform because it means that the Bank is able to define a specific PD and LGD for that specific transactions with a customer.
- An ECL percentage is calculated on a specific customer. It represents a less accurate calculation, because the Bank has the information to perform a PD and an LGD for that customer and the ECL% out-coming from the procedure is applied to each transaction with that customer.
- An ECL percentage might also be calculated on a specific product. When it is not possible to calculate a proper PD and LGD for a client, the Bank identifies an ECL based on the type of product concluded with that client.
- A residual ECL percentage. It represents the last and most conservative category where a specific ECL% has been identified to be applied to all transactions which cannot be classified in one of the previous categories.

Note 2 – Significant accounting policies (continued)

Tangible and intangible fixed assets

Items of plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads.

Intangible assets are included at purchase price or production cost, less accumulated amortisation.

Depreciation is charged to the statement of profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows (on a straight line basis):

- buildings 40 years
- transformation costs 5-10 years
- fixtures and fittings 5 years
- softwares 3 years

An item of plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is included in the statement of profit or loss in the year the asset is derecognised. The asset's residual value, if not insignificant, and useful lives and methods of depreciation are reviewed and adjusted, if appropriate, at each financial year-end.

The Bank recognises the cost of replacing part of a plant and equipment item at incurrence in the carrying amount of this item if that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. All other costs are recognised in the statement of profit or loss as an expense as incurred.

Other assets

This caption includes assets such as prepaid charges, accrued income or unearned income.
Other assets are stated at cost less impairment.

Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets.

Note 2 – Significant accounting policies (continued)

Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

Impairment losses of continuing operations are recognised in the statement of profit or loss in those expense categories consistent with the function of the impaired asset.

For assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank makes an estimate of the recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of profit or loss unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase.

Cash and cash equivalents

Cash and short-term deposits in the statement of financial position comprise cash at banks and on hand and short-term deposits with an original maturity of three months or less.

Cash and cash equivalents include the following reserves:

- Credit institutions established in Luxembourg are required to hold minimum reserves with the Luxembourg Central Bank. These deposits represent 2% of some of their liabilities and are considered as not available. Compliance with the reserve requirement is determined on the basis of the institutions' average daily reserve holdings over the maintenance period, thus reserves of credit institutions can vary from one day to another following their treasury management, the money market or their expectations in interest rates.
- Concerning the branch of the Bank located in Amsterdam, a minimum reserves has also to be hold at De Nederlandsche Bank (DNB). The amount of minimum reserves to be held by each institution is determined in relation to its reserve base, which is defined in relation to elements of its balance sheet. The balance sheet data are calculated by the institutions themselves and reported to DNB within the general framework of the ECB's money and banking statistics.

Employee benefits

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.

Short-term employee benefits are employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service. They include:

Note 2 – Significant accounting policies (continued)

- wages, salaries and social security contributions;
- paid annual leave and paid sick leave;
- profit-sharing and bonus; and
- non-monetary benefits (such as medical care, housing or cars) for current employees.

Post-employment benefits are employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment. The Bank contributes to a defined contribution retirement plan located with an external insurance company. The Bank does not grant any other employee benefits.

Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when a reliable estimate can be made of the amount of the obligation. Where the Bank expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of profit or loss net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risk specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as an interest expense.

Other liabilities

This caption includes liabilities such as income perceived in advance, accrued expenses and expenses due but not yet paid. Other liabilities are stated at cost.

Discontinued operations

A discontinued operation is a component of the Bank's business, the operations and the cash flows of which can be clearly distinguished from the rest of the Bank and which:
- represents a separate major line of business or geographical area of operations;
- is a part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to re-sale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held for sale.

When an operation is classified as a discontinued operation, the statement of comprehensive income is re-presented as of the operation has been discontinued from the start of the comparative year.

Interest income and expense

Effective interest rate
Interest income and expense are recognised in profit or loss using the effective interest method.

Note 2 – Significant accounting policies (continued)

The "effective interest rate" is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments to:

- the gross carrying amount of the financial asset; or
- the amortized cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instruments, but not ECL. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using the estimated future cash flows including ECL.

The calculation of effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or a financial liability.

Amortised cost and gross carrying amount

The "amortised cost" of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The "gross carrying amount of a financial asset" is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date on which amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

Note 2 – Significant accounting policies (continued)

Presentation
Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:
- interest on financial assets and financial liabilities measured at amortised cost;
- interest on debt instruments measured at FVTOCI; and
- interest in relation with derivatives designated in fair value hedges of interest rate risk.

Interest expense presented in the statement of profit or loss and OCI includes:
- financial liabilities measured at amortised cost; and
- interest in relation with hedging derivatives designated in fair value hedges of interest rate risk.

Fee and commission income

Fee and commission income arises on financial services provided by the Bank including cash management services, brokerage services, investment advice and financial planning, investment banking services, project and structured finance transactions, and asset management services. Fee and commission income is recognised when the corresponding service is provided.

The Bank recognises the whole amount of fees and commissions income into the statement of profit or loss when their purpose is to reimburse specific or general costs incurred by the Bank in preparing and completing a transaction and they do not represent additional return on a loan or receivable.

If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment period.

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and the applies IFRS 15 to the residual.

For more details on fee and commission income see Note 19.

Net (un) realised gains and losses on financial assets and liabilities at fair value through profit or loss

Net trading income comprises gains and losses related to trading assets and liabilities, and includes all fair value changes, interests and foreign exchange differences.

Net realised gains and losses on financial assets and liabilities not at fair value through profit and loss

Gains and losses on financial assets and liabilities are recognised in the statement of profit or loss at the date of sale, based on difference between the consideration paid or collected and the carrying amount of such instruments.

In case of financial assets measured at FVTOCI, gains and losses are adjusted to take into consideration premiums and discounts accrued as at the date of sale.

Note 2 – Significant accounting policies (continued)

Dividend income

Dividend income is recognised in the statement of profit or loss when the Bank's right to receive the payment is established.

Income Tax

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in OCI.

Current income tax
Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted by the statement of financial position date.

In accordance to the local law (article 164 LIR) a company can neutralise its current income taxes thanks to the consolidation of taxable results with the taxable losses generated by its Parent Company located in Luxembourg.

Deferred income tax
Deferred income tax is provided using the liability method on temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:
- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry forward and unused tax credits and unused tax losses, to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each statement of financial position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the statement of financial position date.

Note 2 – Significant accounting policies (continued)

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses relating to transactions with any of the Bank's other components, whose operating results are regularly reviewed by the Bank's management to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Operating leases

Policy before 1 Janaury 2019
Assets held under operating leases are not recognised in the Bank's statement of financial position. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of lease. Lease incentives received are recognised as an integral part of the total lease expense over the term of the lease.

Policy after 1 Janaury 2019
Please refer to the section "*Changes in accounting policies – IFRS 16*".

Note 3 – Financial risk management

(a) Introduction and overview

The Parent Company governing body (Board of Directors), supported by specific Committees, defines the "risk profile" at Group level for all the Group entities. The Group risk profile definition considers risk management and control as key factors to guarantee a solid and sustainable creation of value in a risk controlled environment in order to assure financial stability and reputation of the Group and to provide a transparent portfolio risk representation. The risk policy is consequently aimed to achieve an appropriate balance between risk and return.

The local Risk Management unit operates under the direction of the Chief Risk Officer and applies the Group business strategies and objectives, defines scopes and methods to manage risks:

- assures different types of risk measurement and control i.e. market, interest rate, liquidity and operational risks following specific policies;
- revaluates the Bank assets according to mark-to-market and fair value principle defined in a "Fair Value Policy" issued at Group level;
- measures financial risks in the banking book and assures that the local limits stated by the Parent Company are respected. A periodic reporting is made to the Parent Company;
- provides the relevant reports to the Parent Company, the Audit Committee, the Board of Directors, the General Management and to the Asset/Liabilities Committee.

Note 3 – Financial risk management (continued)

The Risk Management function supports the risk identification and measurement processes by providing details and own assessments, proposes risk management policies and approaches compliant with regulatory and the ultimate Parent Company requirements.

The Credit function provides details, own assessments and complies with regulatory and ultimate Parent Company requirements with regards to credit risk, and coordinates the decisions taken by the Credit and Asset Quality Committee.

The Accounting department provides the capital data details and supports the reconciliation with the supervisory capital.

The Compliance function encompasses all measures aiming to avoid that the Bank incurs any loss, financial or not, due to the fact it does not comply with applicable laws and regulations. It is an independent function that identifies, assesses, advises, monitors and reports on the Bank's compliance risk.

The Organization & Human Resources Division assures adequate organizational framework and clear lines of responsibilities, with relevant documentation.

The Internal Audit provides an independent, periodic and comprehensive review of the processes and of the compliance with regulatory and Group requirements.

Roles and responsibilities of the Bank's bodies and departments/functions have been defined in coordination with the ultimate Parent Company.

(b) Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations.

Credit risk arises due to:
- exposure to corporate and private clients;
- exposure to institutional counterparties.

The Bank's credit risk management is based on the commercial and risk strategy drawn up by the Management and validated by the Board of Directors. The main principles are as follows:
- the Bank grants credits in priority to corporate clients who are often also clients of the Group or are part of the Group;
- calculation of the impact on capital requirements is made for all new credit transactions. The objective is to maintain the adequate ratio of the own funds beyond the 10.5% required by local regulation;
- each new customer relation must be approved by the "Client Control Committee" and where applicable by the "Committee of acceptance of new customers and operations";
- the main exposures are toward the ultimate Parent Company;
- the Bank does not systematically require a 100% collateral as a guarantee. It depends on the reputation of the borrower.

Note 3 – Financial risk management (continued)

Credit risk is assessed by reviewing:

- large exposure;
- credit limits and collaterals;
- credit lines;
- financial analysis;
- ratings.

The Bank has in place a manual of procedures, which describes the controls, review and reports regarding credit risk. The Bank has a regular Credit Committee which reviews major transactions and risk situations. Periodic reporting on credit risk is made to the Audit Committee.

(i) Credit quality analysis

The following table sets out information about the credit quality of financial assets measured at amortised cost, financial assets measured at FVTOCI. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantees contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Explanation of the terms “Stage 1”, “Stage 2” and “Stage 3” is also included in Note 2.

The table below details the amount of loss allowances by stage and type of exposure as at 31 December 2019 and 2018 :

	2019			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances	9,231,484	6,325,632	11,936,964	**27,494,080**
Off balance sheet exposures	1,146,515	1,483,259	-	**2,629,774**
Financial assets at FVTOCI	612,636	464,150	-	**1,076,786**
IFRS 9 Loss allowance	**10,990,635**	**8,273,041**	**11,936,964**	**31,200,640**

	2018			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances	7,982,815	1,419,499	11,785,770	**21,188,084**
Off balance sheet exposures	958,682	351,445	-	**1,310,127**
Financial assets at FVTOCI	620,935	17,900	-	**638,835**
IFRS 9 Loss allowance	**9,562,432**	**1,788,844**	**11,785,770**	**23,137,046**

Note 3 – Financial risk management (continued)

The following table shows the distribution of loss allowance calculated on loans and advances as at 31 December 2019 and 2018 by level of risk and stages, specifying the amount of impairment calculated in relation to each bucket.

	2019			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to credit institutions at AC				
Grades A: Low-fair risk	8,561,916,901	24,933	-	**8,561,941,834**
Grades B: Higher risk	-	3,632	-	**3,632**
Grades C: UTP ("Unlikely To Pay")	-	28,209	-	**28,209**
Grades C: UR ("Unrated")	3,780	235,344	-	**239,124**
Loss allowance	(3,776,206)	(909)	-	**(3,777,115)**
Carrying amount	**8,558,144,475**	**291,209**	-	**8,558,435,684**

	2019			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to customers at AC				
Grades A: Low-fair risk	7,771,275,055	358,530,616	-	**8,129,805,671**
Grades B: Higher risk	810,197,723	306,309,947	-	**1,116,507,670**
Grades C: UTP ("Unlikely To Pay")	-	202	44,341,058	**44,341,260**
Grades C: UR ("Unrated")	476,962,694	842,994,199	281	**1,319,957,174**
Loss allowance	(5,455,278)	(6,324,723)	(11,936,964)	**(23,716,965)**
Carrying amount	**9,052,980,194**	**1,501,510,241**	**32,404,375**	**10,586,894,810**
Total amount loans and advances				**19,145,330,494**
Including loss allowances:				*(27,494,080)*

	2018			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to credit institutions at AC				
Grades A: Low-fair risk	7,978,511,180	71,961	-	**7,978,583,141**
Grades B: Higher risk	10,041,030	32,883	-	**10,073,913**
Grades C: UTP ("Unlikely To Pay")	-	-	-	**-**
Grades C: UR ("Unrated")	6,985,185	235,010	-	**7,220,195**
Loss allowance	(3,883,961)	(647)	-	**(3,884,608)**
Carrying amount	**7,991,653,434**	**339,207**	-	**7,991,992,641**

Note 3 – Financial risk management (continued)

	2018			
(in EUR)	Stage 1	Stage 2	Stage 3	Total
Loans and advances to customers at AC				
Grades A: Low-fair risk	6,316,249,020	20,022,361	-	**6,336,271,381**
Grades B: Higher risk	1,040,453,803	118,905,745	-	**1,159,359,548**
Grades C: UTP ("Unlikely To Pay")	305	1,141	43,891,293	**43,892,739**
Grades C: UR ("Unrated")	197,303,492	2,670,755,410	66,845	**2,868,125,747**
Loss allowance	(4,098,854)	(1,418,852)	(11,785,770)	**(17,303,476)**
Carrying amount	**7,549,907,766**	**2,808,265,805**	**32,172,368**	**10,390,345,939**
Total amount loans and advances				**18,382,338,580**
Including loss allowances:				*(21,188,084)*

The following table shows the distribution of loss allowances calculated on guarantees, loan commitments and uncommitted off balance sheet items as at 31 December 2019 and 2018 by level of risk and stages, specifying the amount of impairment calculated in relation to each bucket.

	2019			
(in EUR)	Stage 1	Stage 2	Stage 3	Total
Financial guarantees, loan commitments and uncommitted credit lines				
Grades A: Low-fair risk	5,853,246,300	557,944,622	-	**6,411,190,922**
Grades B: Higher risk	459,711,341	12,130,915	-	**471,842,256**
Grades C: UTP ("Unlikely To Pay")	-	5,004,601	2	**5,004,603**
Grades C: UR ("Unrated")	749,971,999	409,456,232	-	**1,159,428,231**
Loss allowance	(1,146,515)	(1,483,259)	-	**(2,629,774)**
Carrying amount	**7,061,783,125**	**983,053,111**	**2**	**8,044,836,238**
Financial guarantees, loan commitments and uncommitted credit lines				**8,047,466,012**
Uncommitted off balance sheet items				(3,091,695,513)
Financial guarantees and loan commitments				**4,955,770,499**

Note 3 – Financial risk management (continued)

	2018			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Financial guarantees, loan commitments and uncommitted credit lines				
Grades A: Low-fair risk	10,545,968,082	116,829	-	**10,546,084,911**
Grades B: Higher risk	491,037,784	89,004,693	-	**580,042,477**
Grades C: UTP ("Unlikely To Pay")	-	4,547	-	**4,547**
Grades C: UR ("Unrated")	868,357,270	336,068,157	-	**1,204,425,427**
Loss allowance	(958,682)	(351,445)	-	**(1,310,127)**
Carrying amount	**11,904,404,454**	**424,842,781**	**-**	**12,329,247,235**

Financial guarantees, loan commitments and uncommitted credit lines	**12,330,557,362**
Uncommitted off balance sheet items	(5,369,784,399)
Financial guarantees and loan commitments	**6,960,772,963**

The following table sets out the credit quality of financial assets at FVTOCI. The analysis has been based on external ratings.

	2019			
(in EUR)	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Financial assets at FVTOCI				
A-	424,671,057	-	-	**424,671,057**
A+	26,358,268	-	-	**26,358,268**
AA	73,740,222	-	-	**73,740,222**
AA-	55,277,575	-	-	**55,277,575**
Aa2	20,245,127	-	-	**20,245,127**
Aa3	26,773,314	-	-	**26,773,314**
Aaa	32,738,255	-	-	**32,738,255**
AAA	438,744,849	41,579,961	-	**480,324,810**
Baa1	12,374,898	10,156,972	-	**22,531,870**
BB	14,983,554	-	-	**14,983,554**
BBB	952,437,327	94,133,848	-	**1,046,571,175**
BBB+	11,399,221	-	-	**11,399,221**
BBB-	22,499,464	-	-	**22,499,464**
Loss allowance	(609,882)	(464,150)	-	**(1,074,032)**
	2,111,633,249	**145,406,631**	-	**2,257,039,880**

Note 3 – Financial risk management (continued)

Loss allowance calculated on loan at FVTOCI amounted to EUR 2,754 as at 31 December 2019 and its fair value amounted to EUR 7,040,755.

	2018			
(in EUR)	Stage 1	Stage 2	Stage 3	Total
Financial assets at FVTOCI				
A	31,419,383	-	-	**31,419,383**
A-	353,978,291	-	-	**353,978,291**
A+	17,939,179	-	-	**17,939,179**
A3	11,458,217	-	-	**11,458,217**
AA	196,893,927	-	-	**196,893,927**
AA-	30,125,004	-	-	**30,125,004**
Aa1	-	10,353,500	-	**10,353,500**
Aa2	19,873,042	-	-	**19,873,042**
AAA	403,169,067	-	-	**403,169,067**
Baa1	5,023,318	-	-	**5,023,318**
BB	7,864,841	7,059,690	-	**14,924,531**
BBB	1,213,309,800	-	-	**1,213,309,800**
BBB-	26,827,458	-	-	**26,827,458**
BBB+	15,664,615	-	-	**15,664,615**
Loss allowance	(620,935)	(17,900)	-	**(638,835)**
	2,332,925,207	**17,395,290**	-	**2,350,320,497**

Note 3 – Financial risk management (continued)

The following table shows the reconciliation from the opening to the closing balance of the loss allowance concerning:

	Transfers between Stage 1 & 2		Transfers between Stage 2 & 3		Transfers between Stage 1 & 3		No transfers	Total
	To 2 From 1	To 1 From 2	To 3 From 2	To 2 From 3	To 3 From 1	To 1 From 3		
Balance at 1 January 2019								**23,137,046**
New financial assets originated or purchased	-	-	-	-	-	-	14,615,257	**14,615,257**
Remeasurement of loss allowance – increase	1,345,268	1,412	-	440	-	-	634,030	**1,981,150**
Remeasurement of loss allowance – decrease	(525)	(3,909)	-	-	-	-	(1,234,790)	**(1,239,224)**
Write offs and assets derecognized	-	-	-	-	-	-	(7,293,589)	**(7,293,589)**
Balance at 31 December 2019								**31,200,640**

During the year there was no significant change in carrying amount value that contributed to a significant change in loss allowance.

Note 3 – Financial risk management (continued)

	Transfers between Stage 1 & 2		Transfers between Stage 2 & 3		Transfers between Stage 1 & 3		No transfers	Total
	To 2 From 1	To 1 From 2	To 3 From 2	To 2 From 3	To 3 From 1	To 1 From 3		
Balance at 1 January 2018								**20,900,485**
New financial assets originated or purchased	-	-	-	-	-	-	19,479,256	**19,479,256**
Remeasurement of loss allowance – increase	9,082	-	-	-	-	-	234,831	**243,913**
Remeasurement of loss allowance – decrease	(173,326)	(632,954)	(2)	-	(4,922)	-	(1,130,215)	**(1,941,419)**
Write offs and assets derecognized	-	-	-	-	-	-	(15,545,189)	**(15,545,189)**
Balance at 31 December 2018								**23,137,046**

During the year there was no significant change in carrying value that contributed to a significant change in loss allowance.

Note 3 – Financial risk management (continued)

Inputs, assumptions and methodology used for estimating impairment

With respect to impairment, a model developed at Intesa Sanpaolo Group level has been introduced for instruments measured at amortised cost and fair value through other comprehensive income (other than equity instruments) based on the concept of "expected loss", aimed at recognising losses in a more timely manner. IFRS 9 requires that entities recognise expected credit losses over the next 12 months (stage 1) starting from initial recognition of the financial instrument. The time horizon for calculating expected losses is the entire residual life of the asset being measured if credit risk has increased "significantly" since initial recognition (stage 2) or if it is impaired (stage 3). More specifically, the introduction of the new impairment rules involves the:

- allocation of performing financial assets to different credit risk stages (staging), which correspond to value adjustments based on 12-month Expected Credit Losses (ECL) (Stage 1), or lifetime ECL over the remaining duration of the instrument (Stage 2), if there is a significant increase in the credit risk (SICR) determined by comparing the Probabilities of Default at the initial recognition date and at the reporting date;
- allocation of the non-performing financial assets to Stage 3, again with value adjustments based on the lifetime ECL;
- inclusion of forward-looking information in the calculation of the ECL, also consisting of information on the evolution of the macroeconomic scenario.

In particular:

- the new impairment model methodology has been established for the tracking of the credit quality of the positions included in the portfolios of financial assets measured at amortised cost and at fair value through other comprehensive income;
- the parameters have been established for determining the significant increase in credit risk, for the correct allocation of performing exposures to stage 1 or stage 2. With regard to impaired exposures, on the other hand, the alignment of the definitions of accounting and regulatory default – already currently present – means that the current criteria for the classification of exposures as "non-performing/impaired" can be considered the same as the classification criteria for exposures within stage 3;
- the models have been produced – which include the forward-looking information – to be used for the stage allocation (based on the lifetime PD) and for the calculation of the 12-month expected credit loss (ECL) (to be applied to stage 1 exposures) and the lifetime ECL (to be applied to stage 2 and stage 3 exposures). To take into account forward-looking information and the macroeconomic scenarios in which the Bank may have to operate, it was decided to adopt, as reported in greater detail below, the so-called "most likely scenario + Add-on" approach.

With regard to the tracking of credit quality – in line with the regulatory content of the standard and the instructions from the Supervisory Authorities regarding the methods for applying the reporting standard for larger sized banks – the policy has been established to be applied for the specific analysis of the credit quality of each individual relationship (both in the form of securitised exposure and the form of lending). This is aimed at identifying any "significant deterioration in credit risk" between the initial recognition date and the reporting date, with the consequent need for classification to stage 2, as well as, vice versa, the conditions for returning to stage 1. In other words, this operational choice involves, case-by-case and at each reporting date, the comparison – for the purposes of staging – between the credit quality of the financial instrument at the time of measurement and at the time of initial disbursement or purchase.

Note 3 – Financial risk management (continued)

With regard to the above, the factors that – in accordance with the standard and its operational implementation by the Bank – constitute the main drivers to be taken into consideration regarding the "transfers" between the different stages are the following:

- the variation (beyond set thresholds) of the lifetime probabilities of default compared to the time of initial recognition of the financial instrument. This is therefore an assessment made on a "relative" basis, which constitutes the main driver;
- the presence of a past due position that – subject to the materiality thresholds identified by the regulations – has been in that status for at least 30 days. If these circumstances apply, the credit risk of the exposure is considered to have "significantly increased" and, the exposure is therefore transferred to stage 2 (when the exposure was previously included in stage 1);
- the presence of forbearance measures, which – again on a presumption basis – result in the classification of the exposures under those whose credit risk has "significantly increased" since initial recognition;
- lastly, for banks belonging to the international scope, some of the indicators from the credit monitoring systems specifically used by each bank are considered for the purposes of the transfer between "stages" where appropriate;
- this refers in particular to the watch lists, i.e. the credit monitoring systems that, based on the current credit quality of the borrower, identify performing exposures above a certain level of risk.

Focusing on the main trigger out of those referred to above (i.e. the change in the lifetime probability of default), the significant increase in credit risk ("SICR") is determined by comparing the relative change in the lifetime probability of default recorded between the initial recognition date of the relationship and the observation date (Lifetime PD Change) with predetermined significance thresholds. The assignment of a Lifetime PD to the individual relationships is carried out by allocating the ratings for each segment according to the masterscale at both the initial recognition date and the observation date. Ratings are determined based on internal models, where available, or on business models. If there are no ratings, the Benchmark PDs are assigned to the type of counterparty being assessed.

The significant deterioration is therefore based on the increase in the lifetime PD caused by downgrades of the position, measured in terms of notches, from its origination to the reporting (observation) date, as well as the change in the forecast of the future macro-economic factors. The above-mentioned "relative" change in lifetime PD is an indicator of the increase or decrease in credit risk during the reporting period. To establish whether, in accordance with IFRS 9, any increase in credit risk can be considered "significant" (and therefore entail a transition between stages), it is necessary to set specific thresholds. Increases in lifetime PD below these thresholds are not considered significant and, consequently, do not result in the transfer of individual credit lines/tranches of debt securities from stage 1 to stage 2. However, this transfer is required if there are relative increases in PD above these thresholds. The thresholds used are determined based on a process of simulations and optimisations of forecast performance, carried out using granular historical portfolio data. Specific thresholds are set for the Corporate, Retail, Large Corporate and Retail SME models and extended to the other models based on methodological affinity. The thresholds differ according to residual maturity, annual granularity and rating class at the time of disbursement/purchase of each individual financial instrument. The determination of the thresholds has been calibrated to find a suitable balance between the performance indicators relating to the ability of the thresholds to:

- detect stage 2 positions before their transition to default;
- identify positions for which a return to stage 1 is due to an actual improvement in credit rating.

Note 3 – Financial risk management (continued)

Some specific considerations apply for the "staging" of the debt securities. Unlike loans, for this type of exposure, sales and purchases after initial recognition (made using the same ISIN) may form part of the ordinary management of the positions (with the consequent need to identify methods to be adopted for identifying the sales and repayments in order to determine the remaining quantities of the individual transactions that need to be allocated a credit quality/rating upon origination to be compared with that parameter at the reporting date). In this regard, the use of the "first-in-first-out" or "FIFO" method (for the recognition of the recorded ECL in the statement of profit or loss, in the event of sales or repayments) was considered to help in providing a more transparent management of the portfolio, also for the front office operators, while also enabling the continued updating of the credit rating based on new purchases.

Lastly, solely with regard to the first-time adoption of the standard, for certain categories of exposures (specifically identified and mainly related to performing debt securities measured at fair value through other comprehensive income, held by the Parent Company and the Italian bank subsidiaries), the low credit risk exemption established by IFRS 9 has been used. Based on the exemption, exposures which, at the date of transition to the new standard, had a credit rating equivalent to investment grade have been considered to have a low credit risk and therefore as stage 1.

Once the allocation to the various credit risk stages has been established, the expected credit losses (ECL) are determined at individual transaction or securities tranche level, using the IRB/Business models, based on the parameters of Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD), to which appropriate corrections are made to ensure compliance with the specific requirements of IFRS 9. These corrections include the adoption of a Point in Time (PIT) PD compared to the Through the Cycle (TTC) PD used for Basel purposes, the estimate of the PDs and, where necessary, of the multi-period LGDs to determine the lifetime expected credit loss for the financial instrument, and the removal of the economic downturn component from the LGD calculation, as well as the use of the effective interest rate of the individual transactions in the discounting process.

The measurement of the financial assets – both performing and stage 3 – also reflects the best estimate of the effects of future conditions and in particular the economic conditions that affect the forward-looking PDs and LGDs. Information on future macroeconomic scenarios in which the Bank may find itself clearly influence the situation of the debtors, with regard both to the "risk" of migration of exposures to lower quality classes (and therefore concerning the staging) and to the recoverable amounts (and therefore concerning the determination of the expected loss on the exposures).

In terms of method, various possible alternative approaches designed to take account of these elements have been analysed.

Of the various alternatives considered, the Bank has decided to adopt the "Most likely scenario+Add-on" approach. According to this approach, the macroeconomic conditioning of PD and LGD is carried out through a baseline scenario ("Most Likely", in line with the approach used for other business purposes such as, for example, the budget and business plan) and then corrected with an Add-On to include any differences compared to downside and upside scenarios. If the overall impact of the Add-On on the risk parameters is positive, the decision has been made to neutralise the effect for both staging and ECL calculation purposes.

Note 3 – Financial risk management (continued)

The design of the most-likely scenario is performed using a set of analytical and stand-alone forecasting instruments that determine the forecast path for several blocks of variables, namely:

- national accounts and inflation of the top 6 Eurozone countries, the United States and Japan;
- official rates (ECB, Fed, BoJ), EUR and USD swap rate curves, and several points of the government curves;
- exchange rates for EUR, USD, JPY and GBP;
- some specific data for the Italian economy (industrial production, employment, public finance balances).

These forecasts are then entered in the Oxford Economics multi-country structural model (Global Economic Model), where they replace the forecast paths of the baseline scenario provided by the company with the periodic updating of the database.

The model is then solved to derive a consistent global forecasting framework, including variables for which no specific models have been developed, and to obtain a simulation environment that can be used to generate alternative scenarios. This step may require some iterations, particularly if the forecasting framework generated internally is significantly different from the one provided by Oxford Economics. If this is the case, further fine-tuning may be needed for specific secondary variables that the analysts consider to be inconsistent with the forecast scenario or that have an unexplainable quarterly volatility.

The construction of the most-likely scenario is accompanied by the identification of alternative paths, used as inputs in the calculation of the Add-On using the Oxford Economics "Global Model" simulation environment. For some variables, alternative paths are set with respect to those in the most-likely scenario, which are used to solve the model to obtain consistent simulated paths for the other variables used in this process.

The assessments made take account of the fact that the consensus estimates may include forecasts that already incorporate the total or partial realisation of one or more risk factors in their estimates, which means that the alternative paths may already incorporate these additional factors to some extent. Specific considerations apply to “stage 3” exposures (consisting, as reported above, of the current scope of non-performing assets). With regard to non-performing loans in particular, it should be noted that, despite the fact that the definition of “credit impaired” financial assets contained in IFRS 9 compared to the previous standard is substantially the same, the methods of calculation of the lifetime ECL have methodological repercussions also for the purposes of the measurements to be carried out in this segment, mainly in relation to the following aspects:

- the inclusion of forward-looking information, such as the information on the macroeconomic scenarios, on the recovery estimates and times, and on the likelihood of migration into worse classes, as well as information that can have an influence on the value of the collateral or the expected recovery time;
- the consideration of alternative recovery scenarios, such as the sale of the credit assets, in connection with possible disposals of parts of the non-performing portfolio, in relation to company objectives of reduction of the non-performing assets, to which a probability of realisation must be assigned, to be considered within the overall measurement.

With regard to the inclusion of forward looking information, it should be noted that, also in relation to non-performing exposures, in addition to a component linked to current economic conditions, a component linked to the most-likely and downside scenarios expected over the period of the next three years has been considered, according to the criteria already described.

Note 3 – Financial risk management (continued)

As required by IFRS 9, the effects of the forward-looking scenario on LGD estimates pegged to the current conditions must also be considered using the above-mentioned component. As already stated, the forward-looking scenario component is aimed at capturing the non-linearity of the relationship between the macroeconomic variables and ECL measurement, by analysing the forecast uncertainty of the variables used for the preparation of the most-likely scenario. It is based on the methodological framework that is used for performing loans, but ignores the upside scenario from a prudential perspective and only considers the average downside and most-likely scenarios over the period of the next three years.

Including "forward-looking" information

The Bank has decided to consider – among the various possible approaches identified for inclusion of information on future macroeconomic trends in the countries in which the Group operates – the "most likely scenario + add-on" approach.

The elements that determined this choice are briefly summarised as follows:
- consistency with the other corporate processes (e.g. business plan/budget/ICAAP);
- greater comprehensibility and comparability of results over time;
- greater governance and control over process metrics;
- possibility of calculating the add-on outside the accounting cycle/calendar hence within a time frame compatible with fast closing, as required by Regulators;
- ability to monitor more closely the natural volatility of expected losses;
- greater possibility of performing back-testing with period-end data to progressively improve the accuracy of estimates.

Briefly stated, this methodology provides that:
- each exposure (credit line/tranche of a security) is classified in one stage only;
- both stage assignment and ECL calculation are defined by considering a single reference forward-looking macroeconomic scenario (the one considered to be most likely and clearly used for other internal purposes by the Bank). The risk parameters of the scenario are corrected by an ad hoc "add-on" that takes into account the presence of non-linear effects in the relationship between the risk parameters themselves and the macroeconomic variables. Indeed, in reality, only rarely there are a direct correlation between the forward-looking macroeconomic trends implicit in the scenario used, on the one hand, and the magnitude of credit losses, on the other, and consequently the impacts of the single scenario identified must be "corrected" by a specific factor ("add-on"), which is modelled separately. In the absence of such "correction factor", in other words, the use of a single scenario in the absence of a linear correlation between "scenarios" and "losses" would not be considered to be compliant with the provisions of IFRS 9 which seems to rule out the use of just one reference forward-looking scenario.

The processes for determining such "add-on", and the methods for its validation and inclusion in stage assignment and in calculation of the expected loss of the exposures shown in the accounts, are detailed in the following paragraph. Here, we shall only mention that application of the add-on is also determined by means of managerial adjustment, in line with IFRS 9 to limit any benefits arising from its use that are inconsistent with other information available on the future scenarios considered.

Note 3 – Financial risk management (continued)

For completeness, we provide below a table summarising the key features of the "Most likely scenario + Add-on" approach adopted by the Bank (in line with Intesa Sanpaolo Group decision).

Approach chosen	Stage Assignment	Definition of ECL	Main characteristics
Most likely scenario + Add-on	Each exposure is classified in one stage (1, 2 or 3); the change in credit risk, between the date of initial recognition and the measurement date, is defined by reference to a single forward-looking scenario, (considered to be the most likely), plus a possible add-on in the presence of non-linear correlations.	ECL is calculated by reference to only one forward-looking economic scenario (considered the most likely), to which however a separately modelled adjustment is made (add-on), designed to reflect the effects of other less likely scenarios and the associated non-linear impacts.	This approach is compliant with the standard (by introducing an add-on to account for the impacts of the non-linear correlation between the different forward-looking scenarios and the associated credit losses, as in the case of the ISP Group's portfolios). Simpler representation and explanation of impairment dynamics between periods compared to possible alternative solutions.

Determination of forward-looking scenarios

<u>Definition of the Most-likely + Add-on model</u>

To determine value adjustments, the Standard requires consideration of all the information that is available at the reporting date concerning past events, current conditions and forecasts of future economic conditions ("forward-looking"). In particular, to determine expected credit losses (at one year and lifetime), it is necessary to determine "an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes". To this end, as described earlier, the Group adopts an approach ("Most-likely scenario+Add-on") that starts from the determination of the parameters in a base scenario, considered more plausible ("Most-likely"), to which an adjustment is applied ("Add-on") to reflect the effects of alternative scenarios and the associated non-linear impacts due to the changes in the macroeconomic variables determined. Indeed, only on occurrence of (i) linear links between scenario and risk parameters and (ii) symmetry of the alternative macroeconomic trends, would the Most-likely scenario alone cover all possibilities.

The "Most-likely scenario+Add-on" approach is consistent with the other projection-based corporate processes since it uses the same baseline macroeconomic scenario as the basis for building the alternative scenarios.

The implementation adopted, which includes calculation of one Add-on at lifetime PD level and one at LGD level, also makes it possible to ensure, for construction, consistency between the parameters used for Staging and those used to calculate ECL. Furthermore, incorporation of the effects of the alternative scenarios at the level of risk parameters makes it possible to assign the exposure to one Stage directly and uniquely and to make one calculation of the corresponding ECL for each exposure.

Forward looking – quantitative analysis

The methodology for estimating Expected Credit Loss (ECL) adopted for the purpose of determining impairment losses on loans in accordance with IFRS 9 is carried out, at the level of individual transactions or tranches of securities, starting from the IRB modeling of the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD) parameters, on which appropriate corrective actions are done to ensure coherence with the specific requirements of the principle.

Note 3 – Financial risk management (continued)

A detailed description of the methods adopted by the Intesa Sanpaolo Group is included in the Group Accounting Policies and, in particular, provided in Section "*A. 2 - Part relating to the main items of the Balance Sheet*" – paragraph "*Methods for determining impairment losses*" to which reference is made.

In particular, the valuation of financial assets reflects the best estimation of the effects of future conditions, first of all those relating to the economic context, on the basis of which PD and LGD forward looking are conditioned. In the context of IFRS 9, also on the basis of the guidelines of the international Regulators, informations on future macroeconomic scenarios in which the Bank may find itself operating and which significantly have an influence on the situation of debtors with reference to both the "risk" of migration of exposures to lower quality classes (i.e. staging) and the recoverable amounts (i.e. the determination of the expected loss on exposures) are to become particularly important.

From a methodological point of view, several possible alternative approaches have been analysed in order to take these elements into account. With respect to the various alternatives considered, the approach that the Intesa Sanpaolo Group has decided to adopt is the so-called "Most likely scenario + Add-on". According to this approach, the macroeconomic conditioning of PD and LGD is carried out through a base scenario ("Most Likely", consistent with what is used for other business purposes such as, for example, budgets and business plans) and then adjusted with an Add-On aimed at including any differences with respect to worst and best scenarios. If the impact of the Add-On is positive overall on the risk parameters, it has been chosen to sterilize its effect both for staging and ECL calculation purposes.

The macroeconomic scenario is determined by the Bank's Studies and Research Department using forecasting models also taking into account the forecasts of the main national and international bodies and institutions. The alternative improving and worsening scenarios are determined by stressing the input variables in the forecast models.

In the period 2019-22, the macroeconomic variables most relevant for the determination of the ECL and used for the Most likely scenario have compound annual growth rates for the period (CAGR) of +0.46% for Real GDP Italy and +1.03% for Real Estate Prices Italy. The unemployment rate for Italy is expected to be 10.0% on average for the period. Forecasts for the financial markets show compound annual growth rates for the period of +2.62% for the DJ Eurostoxx50 and +1.12% for the S&P500, while the Spread BTP-Bund is expected to be 178 b.p. on average for the period.

The table below shows these variables together with estimations according to the improving and worsening scenarios described above:

Note 3 – Financial risk management (continued)

Macroeconomic variable	Most likely Scenario	Improving Scenario	Worsening Scenario
Real GDP Italy growth rate *(CAGR 2019-2022)*	0.46%	0.67%	-0.48%
Real Estate Prices Italy growth rate *(CAGR 2019-2022)*	1.03%	1.66%	-1.39%
DJ Eurostoxx 50 index growth rate *(CAGR 2019-2022)*	2.62%	4.72%	-7.45%
S&P 500 index growth rate *(CAGR 2019-2022)*	1.12%	5.64%	-5.67%
Italy unemployment rate avg value *(Avg 2019-2022)*	10.0%	9.8%	10.2%
Avg value Spread vs. Bund *(Avg 2019-2022)*	178bps	160bps	268bps

The estimations of the prospective improving and worsening scenarios compared with the most Likely scenario show the following differences: Real GDP Italy +21 b.p. for the improving scenario and -94 b.p. for the worsening scenario, Price of real estate Italy +63 b.p. for the improving scenario and -242 b.p. for the worsening scenario, Unemployment rate Italy -20 b.p for the improving scenario and +20 b.p. for the worsening scenario, DJ Eurostoxx stock index 50 +210 b.p. for the improving scenario and -1007 b.p. for the worsening scenario, S&P stock index 500 +452 b.p. for the improving scenario and -679 b.p. for the worsening scenario and Spread BTP-Bund -18 b.p. for the improving scenario and +90 b.p. for the worsening scenario.

The Bank's Expected Credit Loss (ECL) for 2019, determined in accordance with IFRS 9, was subject to sensitivity analysis in order to analyse the variability with regard to the individual alternative scenarios. This analysis was carried out on the performing loans portfolio (Stage 1 & Stage 2) in relation to the Group's representative perimeter (Parent Company and banks in the CIB Division, which account for approximately 90% of the Group's total exposure), taking as a reference scenario the worsening scenario which, together with the improving scenario, contributes to the determination of the Add-on. The sensitivity of the portfolio to the worsening scenario shows an increase in ECL 2019 of approximately 0.06%.

For the Group companies included in the roll-out plan, the internal rating models, EAD and LGD components are subject to an independent validation process carried out by the Validation function and to third level control by the Internal Audit function. At the end of the activities, a report on the compliance of the models with the supervisory regulations is produced for the Supervisory Authorities, which also verifies the effective deviation between the assumptions made ex-ante and the actual values realised ex-post. The report, approved by the Board of Directors of Intesa Sanpaolo S.p.A., certifies the on-going/perpetual compliance requirements.

The effectiveness of IFRS 9 models is also monitored by the Validation function at least once a year on risk parameters (staging criteria, PD, LGD and haircut models), both through model performance tests and in terms of model design and data treatment and code review activities. The results are shown, similarly to what described above, in the annual report on internal models for management purposes. With regard to the analyses carried out during 2019, no particular critical issues emerged and an opinion of general adequacy was expressed with respect to the areas under analysis.

Note 3 – Financial risk management (continued)

Definition of the Most-likely macroeconomic scenario

The baseline scenario is built every six months at the following times, unless significant changes require a mid-term update:

- March scenario, which includes largely complete historical data on the previous year and it usually allows significant improvements to the forecasts for the current year, to be used to condition the calculation parameters for preparing the half-year report and the third quarter report;
- September scenario, used to support other corporate processes (i.e. budget, business plan) and to determine other balance sheet parameters (e.g. goodwill), to be used to condition the calculation parameters for preparation of the year-end financial statements and the first quarter report.

The global macroeconomic scenario is designed using a set of stand-alone analytical and forecasting instruments, which determine the forecasting process using certain clusters of variables, specifically:

- countries economic indicators and inflation rate of the top six countries in the Eurozone, of the United States and of Japan;
- official rates (ECB, Fed, BoJ), EUR and USD swap rate curves, some points of the government curves;
- exchange rates for EUR, USD, JPY and GBP;
- some detailed data on the Italian economy (industrial output, employment, public finance balances).

These forecasts are then applied to the multi-country structural model (Global Economic Model) of Oxford Economics, where they replace the forecasts of the baseline scenario provided by the company with the periodic updating of the database. The model is then resolved to obtain a coherent overall forecast, inclusive of variables for which no ad hoc models have been developed, and to have a simulation environment that can be used to generate possible alternative scenarios. This step may require several iterations, especially if the forecast based on internally processed data diverges significantly from the one produced by Oxford Economics. In this case, additional fine-tuning might be required on specific secondary variables that the analysts consider not consistent with the forward-looking scenario or which display an unexplained quarterly volatility.

Definition of alternative paths to calculate Add-on

At the same time intervals used to prepare the Most-likely scenario, alternative paths are identified; they are used as inputs to calculate the Add-on, using the Oxford Economics' Global Model simulation environment. For certain variables, alternative paths to that provided for in the Most-likely scenario are imposed. These are used as the basis to resolve the model in order to obtain coherent simulated paths for the other variables used in the process in question.
The key variables are the following:

- average annual GDP growth rates in certain countries (Italy, United States, Germany, France, Spain and United Kingdom);
- European stock exchange index (DJ Eurostoxx 50);
- US stock exchange index (S&P500);
- price of residential real estate (United States);
- price of residential real estate (Italy).

Note 3 – Financial risk management (continued)

To select the alternative paths external information is used. More specifically:

- average annual GDP growth rates of certain countries: this is a key driver of the simulation; deviations are determined so as to replicate the dispersion of the growth estimates published by Consensus Economics in the latest report available at the date of the simulation, considering the minimum and maximum forecast (after applying a Grubbs filter to identify and remove any outliers). In the presence of outliers, the abnormal data is removed and the maximum and minimum of the remaining values are considered. Since consensus estimates are available only for the first two years of the simulation timeframe, for the third year an extrapolation is made of the deviations identified for the first two years;
- Stock market indices (DJ Eurostoxx 50, S&P500) and indices of US residential property prices: the minimum and maximum forecast of the Thomson Reuters panel are used;
- Italian residential property prices: since no consensus estimates are currently available, the alternative paths rely on the distribution of past quarterly variations available from 1980 to the current quarter.

For each quarter, the percentile relating to the variation of the quarter present in the Most-likely scenario with respect to the historical distribution of the changes in the above-mentioned indicators is identified. Starting from the identified percentile value, the variations corresponding to probability deviation $\pm\Delta p$ are identified; they are calculated by means of statistical analysis of the historical distribution of the observations. The new values identified are then used as input to determine the negative Add-on factor (lowest value) and the input for the positive Add-on (highest value). The two changes (positive and negative) compared to the Most-likely scenario, are then used to calculate the level of the individual indices identified, reconstructing, for each, two alternative paths (one positive and one negative) which constitute the input for determining the Add-on factor. The probability deviation adopted is identified on the basis of the variability characteristics of the series, so as to obtain a significantly large deviation from the Most-likely scenario.

When applying the annual changes to the quarterly profile of the variables, each deviation from the annual average is distributed, within that year's forecast quarters, according to a standardised levelling methodology that minimises the overall variability of the variable's profile.

The two sets of alternative variables thus obtained are used as inputs in the above-mentioned Global Model of Oxford Economics, which is then resolved to obtain coherent paths for all the remaining variables and countries. The output of the model consists in two datasets of variables that reflect, through the model's equations, the two shocks applied (respectively adverse and positive). The datasets are checked to detect any excessive quarterly volatility and/or inconsistencies in the path of the secondary variables. If necessary, the results are fine-tuned. From these datasets, another set of variables is extracted; these are the narrower datasets supplied to produce the alternative Add-on scenarios in the next stages of the process.

Note 3 – Financial risk management (continued)

(ii) Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including derivatives. The maximum exposure is shown before the effect of mitigation through the use of collateral agreements but after deduction of impairments.

	Maximum exposure	
(in EUR)	**2019**	**2018**
Cash and cash balances with central banks	726,382,833	109,032,333
Financial assets held for trading	30,193,047	48,445,482
Financial assets designated at fair value	-	10,365,456
Financial assets mandatorily measured at FVTPL	613,898	789,701
Financial assets measured at FVTOCI	2,265,365,852	2,351,170,517
Loans and advances	19,145,330,494	18,382,338,580
Derivatives held for hedging	2,111,798	210,014
Other assets	35,638,829	25,473,149
Total	**22,205,636,751**	**20,927,825,232**
Guarantees	316,141,594	479,967,237
Commitments	4,639,628,905	6,480,805,726
Total	**4,955,770,499**	**6,960,772,963**

Where financial instruments are recorded at fair value, the amounts shown above represent the maximum risk exposure that could arise in the future as a result of change in values.

For more detail on the maximum credit exposure to credit risk for each class of financial instruments, references shall be made to the specific notes.

Note 3 – Financial risk management (continued)

(iii) Credit quality per class of financial assets

For classification of non-performing exposures in the various risk categories (doubtful loans, substandard exposures and past due exposures), the Bank rules laid down by its ultimate Parent Company.

The table below gives a breakdown by categories of gross financial assets and credit quality (except for cash balances with central banks) before impairment:

(in EUR)	Performing assets 2019	Doubtful assets 2019	Unlikely to Pay 2019	Past due exposures 2019	Total 2019
Financial assets held for trading	30,193,047	-	-	-	**30,193,047**
Financial assets designated at fair value	-	-	-	-	-
Financial assets mandatorily measured at FVTPL	613,898	-	-	-	**613,898**
Financial assets at FVTOCI	2,265,365,852	-	-	-	**2,265,365,852**
Loans and advances	19,128,483,235	-	44,341,339	-	**19,172,824,574**
Total	**21,424,656,032**	**-**	**44,341,339**	**-**	**21,468,997,371**

(in EUR)	Performing assets 2018	Doubtful assets 2018	Unlikely to Pay 2018	Past due exposures 2018	Total 2018
Financial assets held for trading	48,445,482	-	-	-	**48,445,482**
Financial assets designated at fair value	10,365,456	-	-	-	**10,365,456**
Financial assets mandatorily measured at FVTPL	789,701	-	-	-	**789,701**
Financial assets at FVTOCI	2,351,170,517	-	-	-	**2,351,170,517**
Loans and advances	18,359,635,371	-	43,891,293	-	**18,403,526,664**
Total	**20,770,406,527**	**-**	**43,891,293**	**-**	**20,814,297,820**

(iv) Credit quality per class of financial assets

The gross and net exposures of loans and advances are as follows:

(in EUR)	Gross exposure 2019	Individual impairment 2019	Collective impairment 2019	Total 2019
Performing loans	19,128,483,235	-	(15,557,116)	**19,112,926,119**
Doubtful loans	-	-	-	-
Unlikely to Pay	44,341,339	(11,936,964)	-	**32,404,375**
Total	**19,172,824,574**	**(11,936,964)**	**(15,557,116)**	**19,145,330,494**

Note 3 – Financial risk management (continued)

(in EUR)	Gross exposure 2018	Individual impairment 2018	Collective impairment 2018	Total 2018
Performing loans	18,359,635,371	-	(9,402,314)	**18,350,233,057**
Doubtful loans	-	-	-	**-**
Unlikely to Pay	43,891,293	(11,785,770)	-	**32,105,523**
Total	**18,403,526,664**	**(11,785,770)**	**(9,402,314)**	**18,382,338,580**

As at 31 December 2018 and 2019, there is no credit position that could qualify for loan forbearance as defined by the ESMA (European Security and Market Authority).

(v) Concentration of risks

In order to avoid a too high concentration of risks, the Bank has to respect the following limit on a permanent basis:

- the total risk exposure toward a single client or group of connected clients must not exceed 25% of the own funds of the Bank.

As at 31 December 2019, the lending limit amounted to EUR 631 million (2018: EUR 622 million) and no borrower exceeded this amount after the application of credit risk mitigation. The main exposures relates to 105 borrowers or group of borrowers (2018: 92 borrowers or group of borrowers) with financing between EUR 12 billion and EUR 15 million each (2018: between EUR 8 billion and EUR 15 million).

The Bank produces large exposures reports, which are the main tests of exposure concentration, as they include exposures to individual clients as well as group of counterparties and banking counterparties. They are communicated to the Management on a regular basis.

Following the Bank's request, the CSSF has approved an exemption from including in its calculation of the large risk exposures, in accordance with point 24, part XVI of CSSF circular 06/273 as subsequently amended and article 400.2 of the EU Regulation No 575/2013, the risks to which the Bank is exposed with the Intesa Sanpaolo Group. The exposures on related parties are disclosed in Note 27.

(vi) Geographical allocation of risks

As at 31 December 2019 and 2018, the distribution by geographical area of the risks held in securities (except for trading positions and derivatives held for hedging) and loans and advances before taking into account collateral held and other credit enhancements can be summarized as follows:

Note 3 – Financial risk management (continued)

(in EUR)	2019		2018	
	Investment Securities (FVTOCI, FVTPL)	**Loans and advances**	**Securities (FVTOCI, FVTPL)**	**Loans and advances**
Italy	1,057,344,024	8,885,426,471	1,271,871,969	11,143,277,724
USA	-	84,287,344	-	83,959,305
Japan	-	23,231	-	669,239
France	133,098,898	3,798,009	217,423,749	21,544,385
Spain	431,105,112	133,680,344	364,948,047	210,892,051
Luxembourg	132,426,544	1,533,592,629	97,154,426	1,274,178,524
Belgium	26,773,314	136,813,862	25,159,254	111,446,296
Germany	95,138,248	326,573,589	55,874,337	400,978,818
United Kingdom	16,379,620	315,202,388	10,030,655	381,458,938
Switzerland	-	273,467,849	-	161,264,324
The Netherlands	118,974,132	590,181,612	52,914,321	828,296,462
Poland	-	11,722	-	3,702,743
Qatar	-	429,482,907	-	382,702,947
Russia	-	4,753,253,244	-	2,203,621,629
Croatia	-	-	-	507,992
Hungary	-	154,814	-	196,411
Romania	-	120,342,733	-	123,286,073
Supranational	187,403,846	-	226,111,159	-
Slovenia	-	-	-	2,246,663
Portugal	-	-	-	180,172
South Africa	-	282,581,478	-	317,060,369
Ireland	10,310,603	29,314,783	10,035,944	64,346,535
Czech Republic	-	4	-	724,067
Denmark	-	10,321	-	48,722
Norway	2,549,733	45,697	10,430,116	20,176
Canada	37,456,273	1,059,235	15,043,319	355,579
Austria	-	32,404,235	-	33,750,689
Sweden	-	40,170	5,045,741	39,609
Cyprus	-	151,300,878	-	157,964,063
Azerbaijan	-	147,575,869	-	264,727,975
Man Island	9,978,648	-	-	-
India	7,040,755	136,381,591	-	-
Saudi Arabia	-	613,178,560	-	-
Other	-	165,144,925	-	208,890,100
Total	**2,265,979,750**	**19,145,330,494**	**2,362,043,037**	**18,382,338,580**

Note 3 – Financial risk management (continued)

(in EUR)	2019		2018	
	Guarantees	**Commitments**	**Guarantees**	**Commitments**
Belgium	111,269,361	414,801,937	106,986,900	400,151,990
Cyprus	90,000	-	60,000	25,437,741
France	70,000	-	70,000	-
Germany	-	66,497,287	-	127,768,339
Tunisia	10,000	-	10,000	-
Ghana	-	1	-	1
Hungary	110,000	-	-	-
Italy	49,533,233	119,078,150	49,539,078	378,640,497
Luxembourg	52,289,825	484,934,897	46,093,814	496,882,202
The Netherlands	18,967,112	1,321,121,311	4,403,111	949,634,256
Kuwait	-	133,523,233	-	131,004,367
Principato di Monaco	80,000	-	30,000	-
Qatar	-	724,249,504	-	801,129,228
Spain	-	40,778,200	-	-
Switzerland	585,758	28,648,834	574,707	38,071,483
Turkey	10,000	-	15,000	-
USA	2,655,305	1	7,802,101	192,610,895
United Kingdom	80,292,000	51,467,137	264,342,526	129,327,189
Venezuela	40,000	-	10,000	-
Congo Dem. Republic	30,000	-	30,000	-
South Africa	-	78,161,748	-	78,338,768
Russia	-	654,228,237	-	2,731,808,770
Azerbaijan	-	1	-	-
India	-	522,138,427	-	-
Israel	9,000	-	-	-
Brazil	10,000	-	-	-
British Virgin Isl.	50,000	-	-	-
Lebanon	40,000	-	-	-
Total	**316,141,594**	**4,639,628,905**	**479,967,237**	**6,480,805,726**

Significant concerns about creditworthiness of certain Eurozone countries persisted during the year leading to speculation as to the long-term sustainability of the Eurozone.

Note 3 – Financial risk management (continued)

The Bank is exposed to such risk mainly through the Italian sovereign debt securities held in its securities portfolio.

Maturing On	Fair Value (Eur)
2020	175,123,200
2021	50,430,817
2022	186,032,271
2023	161,039,297
2024	130,693,894
2025	85,649,231
2026	52,379,710
2027	53,928,655
2028	80,773,216
	976,050,291

(vii) Industry sector allocation of risks

As at 31 December 2019 and 2018, the breakdown by industry sector of the risks held in securities (except for trading positions and derivatives held for hedging) and loans and advances before taking into account collateral held and other credit enhancements can be summarized as follows:

(in EUR)	2019		2018	
	Investment Securities (FVTPL, FVTOCI)	**Loans and advances**	**Securities (FVTOCI, FVTPL)**	**Loans and advances**
Financial institutions	369,352,846	8,558,435,684	353,060,971	7,991,992,641
Public sector	1,888,972,251	921,794,790	1,998,405,425	312,023,770
Other industries	7,654,653	9,655,017,330	10,576,641	8,159,400,224
Individuals	-	10,082,690	-	1,918,921,945
Total	**2,265,979,750**	**19,145,330,494**	**2,362,043,037**	**18,382,338,580**

(in EUR)	2019		2018	
	Guarantees	**Commitments**	**Guarantees**	**Commitments**
Financial institutions	195,775,496	5,000,000	380,536,858	-
Public sector	-	724,249,505	-	801,129,228
Other industries	119,559,251	3,910,379,400	98,808,926	5,602,145,908
Individuals	806,847	-	621,453	77,530,590
Total	**316,141,594**	**4,639,628,905**	**479,967,237**	**6,480,805,726**

Note 3 – Financial risk management (continued)

(c) Liquidity risk

Liquidity risk is defined as the risk that the Bank is not able to meet its payment obligations when they fall due (funding liquidity risk). Normally, the Bank is able to cover cash outflows with inflows of cash, readily marketable assets and its own capacity to obtain credit. With regards to readily liquid assets in particular, market turmoil may occur which makes their sale or use of guarantee in exchange for funds extremely difficult (or even impossible); from this point of view, the Bank's liquidity is closely tied to the market liquidity conditions (market liquidity risk). The Liquidity Risk Management policy of the Bank is intended to define the guidelines for prudent management of this risk, outlining all the control processes and standards designed to prevent situations of liquidity crisis for the Bank. The policy defines the rules, measurement methodologies, behavioural parameters for the Bank, according to the Intesa Sanpaolo Group Guidelines. Liquidity risk is subject to supervisory requirements in compliance with the applicable regulation and to internal limits as set in the Bank's Risk Appetite Framework (RAF).

In accordance with the guidelines and with the aim of guaranteeing a sufficient and balanced level of liquidity to ensure on-going availability of sufficient funds to meet its day-to-day payment commitments:

- the Bank developed a prudent approach to liquidity management, so as to maintain an overall risk profile at extremely contained levels;
- the liquidity risk management policy is clearly communicated to the whole organisation;
- all the Bank's operational units which carry out activities which have an impact on the liquidity are familiar with the liquidity management strategy and with the corresponding costs and should act within the framework of approved policies and limits;
- the units responsible for managing the liquidity risk operate within the approved limits;
- the Bank maintains a sufficient level of readily liquid assets to enable business-as-usual and overcome the initial stages of any shock to its own liquidity or that of the system.

The Bank also complies with Group regulations that from time to time may be imposed on the Bank as part of the Intesa Sanpaolo Group, such as occasional limitation of the access to the market by concentrating with the Parent Company any excess of liquidity.

As at 31 December 2019, the Liquidity Coverage Ratio of the Bank as defined in the article 416 of EU Regulation No 575/2013 and Delegated Regulation EU No 2015/61 was 277% (2018: 193%).

Note 3 – Financial risk management (continued)

The tables below present the cash flows payable by the Bank under non-derivative and derivative financial liabilities held for managing liquidity risk by remaining contractual maturities at the date of the statement of financial position.

31 December 2019 (in million EUR)	**< 1 month**	**≥ 1 month < 3 months**	**≥3 months < 6 months**	**≥6 months < 1 year**	**≥1 year < 2 years**	**≥2 years < 5 years**	**≥ 5 years**	**Total**
Deposit from central banks	-	-	810	-	-	-	-	**810**
Financial liabilities at FVTPL and derivatives held for hedging	4,131	570	969	433	768	1,615	954	**9,440**
Financial liabilities at fair value through profit or loss	-	-	-	-	-	-	-	**-**
Financial liabilities measured at amortised cost	2,959	2,199	3,238	2,627	4,372	3,159	215	**18,769**
Total	**7,090**	**2,769**	**5,017**	**3,060**	**5,140**	**4,774**	**1,169**	**29,019**

31 December 2018 (in million EUR)	**< 1 month**	**≥ 1 month < 3 months**	**≥3 months < 6 months**	**≥6 months < 1 year**	**≥1 year < 2 years**	**≥2 years < 5 years**	**≥ 5 years**	**Total**
Deposit from central banks	-	-	-	-	812	-	-	**812**
Financial liabilities held for trading and derivatives held for hedging	299	13	4,833	126	163	909	33	**6,376**
Financial liabilities at fair value through profit or loss	-	1	-	1	3	5	-	**10**
Financial liabilities measured at amortised cost	3,095	3,682	1,826	2,145	2,948	3,640	216	**17,552**
Total	**3,394**	**3,696**	**6,659**	**2,272**	**3,926**	**4,554**	**249**	**24,750**

Note 3 – Financial risk management (continued)

The breakdown by sector of financial liabilities is as follows (in EUR):

2019	**Government and central banks**	**Other public entities**	**Financial institutions**	**Non financial companies**	**Other**	**Total**
Deposits from central banks	809,894,291	-	-	-	-	**809,894,291**
Financial liabilities held for trading and for hedging	-	-	163,566,999	1,361	15,374,355	**178,942,715**
Financial liabilities at fair value through profit or loss	-	-	-	-	-	**-**
Financial liabilities measured at amortised cost	-	153,458,317	3,916,727,803	1,206,255,562	13,492,614,705	**18,769,056,387**
Total	**809,894,291**	**153,458,317**	**4,080,294,802**	**1,206,256,923**	**13,507,989,060**	**19,757,893,393**

Note 3 – Financial risk management (continued)

2018	Government and central banks	Other public entities	Financial institutions	Non financial companies	Other	Total
Deposits from central banks	812,487,716	-	-	-	-	**812,487,716**
Financial liabilities held for trading and for hedging	-	-	119,445,466	-	16,941,817	**136,387,283**
Financial liabilities at fair value through profit or loss	-	-	10,240,794	-	-	**10,240,794**
Financial liabilities measured at amortised cost	-	138,127,304	1,072,688,424	559,660,454	15,781,433,247	**17,551,909,429**
Total	**812,487,716**	**138,127,304**	**1,202,374,684**	**559,660,454**	**15,798,375,064**	**18,511,025,222**

Note 3 – Financial risk management (continued)

2019	Zone EURO	Other European countries	Other	Total
Deposits from central banks	809,894,291	-	-	**809,894,291**
Financial liabilities held for trading and for hedging	178,732,504	180,389	29,822	**178,942,715**
Financial liabilities at fair value through profit or loss	-	-	-	**-**
Financial liabilities measured at amortised cost	17,788,852,353	691,508,262	288,695,772	**18,769,056,387**
Total	**18,777,479,148**	**691,688,651**	**288,725,594**	**19,757,893,393**

2018	Zone EURO	Other European countries	Other	Total
Deposits from central banks	812,487,716	-	-	**812,487,716**
Financial liabilities held for trading and for hedging	135,730,009	130,193	527,081	**136,387,283**
Financial liabilities at fair value through profit or loss	10,240,794	-	-	**10,240,794**
Financial liabilities measured at amortised cost	16,852,491,535	479,158,739	220,259,155	**17,551,909,429**
Total	**17,810,950,054**	**479,288,932**	**220,786,236**	**18,511,025,222**

(d) Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices.

The Bank's primary financial instruments comprise money markets assets and liabilities, some cash and liquid resources and various other items that arise directly from its operations.

The Bank enters into derivatives transactions, which are mainly interest rate swaps ("IRS") and forward foreign currency contracts. Those derivatives are held from an economic point of view for the purpose of monitoring the Bank's interest rate risk and currency risk respectively.

The Treasury Department is part of Dealing Room and is responsible for managing the interest rate risk and foreign exchange risk generated within the Bank and for maintaining them within risk limits validated by the Board of Directors of the Bank.

To assess market risk, the Bank has put in place a reporting addressed to the Authorized Management, the Internal Audit, the Financial Markets Division and any other operational service responsible.

The Risk Control Function carries out their own analyses and assessments and the results are communicated periodically to the members of Authorized Management of the Bank, to the Financial Markets Division, to the ALCO Committee and to the Board of Directors, through the Audit Committee.

The Risk Management conducts daily controls of positions in foreign exchange, securities trading and interest rate. The result of these checks and any overruns positions are communicated through a daily report to the Management of the Bank.

The Bank has in place Policies and a manual of procedures for the Treasury department and Risk Management, which describe limits, rules and controls.

Note 3 – Financial risk management (continued)

Risk measurements

A Value at Risk (VaR) measurement of the proprietary portfolio is computed by the Parent Company Risk Management on a weekly basis and communicated to the Bank Risk Control Function in charge of the analysis.

The VaR model used by the Group and applied to the Bank is based on simulations where calculations of risk is made through the construction of "n" scenarios possible variations compared to the initial value of the risk factors: the scenarios are applied to the initial value of the risk positions in order to estimate the theoretical distribution of profit and loss on which to calculate the VaR at a predetermined percentile.

The approach used for the VaR computation is characterised by:
- a model of historical simulation using the platform Mark-to-Future (Algorithmics);
- a confidence interval of 99-th percentile;
- a considered holding period of 1 day;
- a full revaluation of positions.

A daily VaR limit is fixed at EUR 15 million.

Interest rate risk

Average interest rates

The average effective interest rates on financial instruments by main currencies for the year ended 31 December 2019 and 2018 are as follows:

	2019		**2018**	
	Assets	**Liabilities**	**Assets**	**Liabilities**
EUR	0.4804%	0.2604%	0.4881%	0.2695%
USD	3.0374%	2.2539%	4.0516%	3.1808%

Interest rate risk is the risk arising from potential changes in interest rates that have an impact on the Bank's assets and liabilities other than those that are present in the trading portfolio.

In general, the interest rate risk is covered as follows:
- concerning client deposits in Euro as well as credit, investment and interbank loans, the Bank generally uses floating rates, which sustain profit margin. Euro bonds that pay fixed rate are hedged by interest rate swaps.
- concerning loan and credit operations held in foreign currencies, the Bank uses a roll over interest rates with a pre-agreed fixed margin.

Note 3 – Financial risk management (continued)

The interest rate risk is mainly represented by treasury operations which are not perfectly hedged at maturity or risk of maturity transformation.

The interest rate risk is analysed based on the maturity of claims and liabilities, which also gives a measure of average margins and durations for treasury operations in given currencies. In order to optimise treasury activities, a mismatch is authorised either through cash positions, off balance sheet positions short term IRS, FRS or Futures. It is subject to certain limits in terms of interest rate positions, liquidity and concentration of client deposits.

The set of "Shift sensitivity +100bps" limits for the Bank have been approved by the Group Financial Risk Committee and by the Bank Board on 15 December 2017 and updated on September 2019:

	Limit per time bucket		
Limits	**Short term**	**Medium term**	**Long term**
Total	0 – 18 months	18 months– 5 years	> 5 years
+18 / -24 million	+8 / -17 million	+14 / -14 million	+8 / -10 million

In addition a shift sensitivity +100bps limit for USD currency has been introduced and equal to +/- 3.5 million.

In order to measure interest rate risk, the Risk Management Department uses on a daily basis the "shift sensitivity of Fair Value" (EVE) indicator which measures the changes in economic value of a financial portfolio resulting from a parallel shift (+/- 100bps) in the discount curves (yield curve) related to currencies. To calculate the present value, discount curves which are suitable for measuring individual financial instruments are applied. The total value of shift sensitivity is broken down by time bucket (bucket analysis), in order to identify the distribution of risk over the time axis.

At year end, the values of shift sensitivity +/- 100bps (EVE) have been as follows:

Bucket	**Shift +100p per bucket**	**Shift -100p per bucket**	**Limits**
Short term	(3,514,846)	2,086,376	+8/-17 mln
Medium term	(535,811)	798,192	+14/-14 mln
Long term	(2,969,281)	2,124,775	+8/-10 mln
Total	**(7,019,938)**	**5,009,343**	**+18/-24 mln**

Note 3 – Financial risk management (continued)

At 31 December 2019, the Net Interest Income Sensitivity (NII), which measures the impact on net interest income of a parallel and instantaneous shock in the interest rate curve of +/- 50 bps, over a period of 12 months, has been as follows:

-50 bps	+50 bps
(14,277,897)	8,475,582

The tables below present the financial assets and liabilities by repricing dates. Interest rate sensitive assets and liabilities are classified in the respective categories according to the interest rate repricing dates. For derivatives, the fair value of the instruments is used.

Note 3 – Financial risk management (continued)

31 December 2019 (in million of EUR)	**< 1 month**	**≥ 1 month < 3 months**	**≥ 3 months < 6 months**	**≥ 6 months < 1 year**	**≥ 1 year < 2 years**	**≥ 2 years < 5 years**	**≥ 5 years**	**Total**
Cash and cash balances with central banks	726	-	-	-	-	-	-	**726**
Financial assets held for trading derivatives held for hedging and financial assets mandatorily at FVTPL	-	-	-	-	-	-	33	**33**
Financial assets at fair value through profit or loss	-	-	-	-	-	-	-	**-**
Financial assets at FVTOCI	14	175	25	91	131	992	837	**2,265**
Loans and advances	2,543	1,875	2,537	1,775	4,654	4,265	1,496	**19,145**
Total financial assets	**3,283**	**2,050**	**2,562**	**1,866**	**4,785**	**5,257**	**2,366**	**22,169**
Deposits from central banks	-	-	810	-	-	-	-	**810**
Financial liabilities held for trading and derivatives held for hedging	-	-	-	-	-	-	179	**179**
Financial liabilities at fair value through profit or loss	-	-	-	-	-	-	-	**-**
Financial liabilities measured at amortised cost	2,960	2,200	3,236	2,627	4,372	3,159	215	**18,769**
Total financial liabilities	**2,960**	**2,200**	**4,046**	**2,627**	**4,372**	**3,159**	**394**	**19,758**

Under the assumptions as defined here above taking into account assets and liabilities as at 31 December 2019, a 100 bp increase or decrease in market interest rates would influence the interest income before tax by EUR (7,019,938) and EUR 5,009,343 respectively.

Note 3 – Financial risk management (continued)

31 December 2018 (in million of EUR)	**< 1 month**	**≥ 1 month < 3 months**	**≥ 3 months < 6 months**	**≥ 6 months < 1 year**	**≥ 1 year < 2 years**	**≥ 2 years < 5 years**	**≥ 5 years**	**Total**
Cash and cash balances with central banks	109	-	-	-	-	-	-	**109**
Financial assets held for trading derivatives held for hedging and financial assets mandatorily at FVTPL	-	-	-	-	-	-	49	**49**
Financial assets at fair value through profit or loss	-	-	-	-	-	10	-	**10**
Financial assets at FVTOCI	-	50	50	225	313	717	996	**2,351**
Loans and advances	3,646	4,081	610	2,581	1,102	5,206	1,156	**18,382**
Total financial assets	**3,755**	**4,131**	**660**	**2,806**	**1,415**	**5,933**	**2,201**	**20,901**
Deposits from central banks	-	-	-	-	812	-	-	**812**
Financial liabilities held for trading and derivatives held for hedging	-	-	-	-	-	-	136	**136**
Financial liabilities at fair value through profit or loss	-	-	-	-	-	10	-	**10**
Financial liabilities measured at amortised cost	3,095	3,682	1,826	2,145	2,948	3,640	216	**17,552**
Total financial liabilities	**3,095**	**3,682**	**1,826**	**2,145**	**3,760**	**3,650**	**352**	**18,510**

Under the assumptions as defined here above taking into account assets and liabilities as at 31 December 2018, a 100 bp increase or decrease in market interest rates would influence the interest income before tax by EUR (9,151,355) and EUR 540,356 respectively.

Note 3 – Financial risk management (continued)

(e) Foreign exchange rate risk

Foreign exchange rate risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Specific limits are set-up based on the open positions in foreign currencies. In particular, for transactions involving derivative instruments, ad hoc limits are established.

As at 31 December 2019 and 2018, the financial assets and liabilities denominated in EUR, in USD and in other currencies are as follows (in EUR):

31 December 2019	**EUR**	**USD**	**Other**	**Total**
Cash and cash balances with central banks	726,365,857	3,805	13,171	**726,382,833**
Financial assets at fair value through profit or loss and held for trading	-	27,147,799	3,045,248	**30,193,047**
Financial assets at FVTOCI	2,258,325,097	7,040,755	-	**2,265,365,852**
Loans and advances	16,065,207,311	2,650,018,509	430,104,674	**19,145,330,494**
Total financial assets	**19,049,898,265**	**2,684,210,868**	**433,163,093**	**22,167,272,226**
Deposits from central banks	809,894,291	-	-	**809,894,291**
Financial liabilities held for trading and held for hedging	96,451,824	75,916,358	6,574,533	**178,942,715**
Financial liabilities at fair value through profit or loss	-	-	-	-
Financial liabilities measured at amortised cost	17,255,412,950	1,175,996,234	337,647,203	**18,769,056,387**
Total financial liabilities	**18,161,759,065**	**1,251,912,592**	**344,221,736**	**19,757,893,393**

31 December 2018	**EUR**	**USD**	**Other**	**Total**
Cash and cash balances with central banks	109,018,906	5,917	7,510	**109,032,333**
Financial assets at fair value through profit or loss and held for trading	789,701	41,561,416	17,249,522	**59,600,639**
Financial assets at FVTOCI	2,351,170,517	-	-	**2,351,170,517**
Loans and advances	15,798,612,329	2,457,647,095	126,079,156	**18,382,338,580**
Total financial assets	**18,259,591,453**	**2,499,214,428**	**143,336,188**	**20,902,142,069**
Deposits from central banks	812,487,716	-	-	**812,487,716**
Financial liabilities held for trading and held for hedging	69,947,022	57,906,471	8,533,790	**136,387,283**
Financial liabilities at fair value through profit or loss	-	-	10,240,794	**10,240,794**
Financial liabilities measured at amortised cost	16,611,292,787	789,547,469	151,069,173	**17,551,909,429**
Total financial liabilities	**17,493,727,525**	**847,453,940**	**169,843,757**	**18,511,025,222**

Note 3 – Financial risk management (continued)

(f) Capital management and capital adequacy

Regulatory capital

The Bank is required to comply with the Luxembourg prudential regulations that transpose the European Directive on "Capital adequacy for credit institutions" into national law.

During the past years the Bank has complied with its entire externally imposed capital requirement.

The Bank regulatory capital is determined in compliance with CSSF circulars, which adopted the Basel III capital requirements with effect from 1 January 2014.

The Bank regulatory capital consists of the sum of the following elements:
- Tier 1 capital (all qualifies as Common Equity Tier 1 – CET 1 – capital), which includes ordinary share capital, related share premiums, retained earnings, reserves and NCI after adjustment for foreseeable dividends and deductions for goodwill, intangible assets and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes;
- Tier 2 capital, which includes qualifying subordinated liabilities and certain provisions for loans losses that are presently unidentified on an individual basis.

Banking operations are categorised as either trading book or non-trading book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying level of risk attached to assets and exposures not recognised in the statement of financial position.

The Bank's aim is to maintain a strong capital base so as to maintain investors, creditors and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognised the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

Note 3 – Financial risk management (continued)

The Bank's regulatory position under Basel III at 31 December 2019, excluding income for the current year, is as follows:

	2019	**2018**
Tier 1 Capital		
Ordinary share capital	1,389,370,555	1,389,370,555
Share premium	7,720,692	7,720,692
Other reserves and retained earnings	934,051,636	895,709,492
less 50% of holdings in other credit and financial institutions amounting to more than 10% of their capital	-	-
Others deductions	(5,533,853)	(23,400,273)
Total Tier 1	**2,325,609,030**	**2,269,400,466**
Tier 2 Capital		
General credit risk adjustments	-	-
Subordinated loan	200,000,000	200,000,000
Total Tier 2	**200,000,000**	**200,000,000**
Total own fund eligible for solvency purposes	**2,525,609,030**	**2,469,400,466**

Note 3 – Financial risk management (continued)

Capital requirements and risk weights

The following table summarises the risks broken down by Basel regulatory class. These risks serve as a reference for calculating the solvency ratio of the Bank within the framework of regulatory reports filed with the CSSF.

	2019 Amount of risk weighted assets	**2018 Amount of risk weighted assets**
Credit and couterparty risk	**8,173,661,171**	**9,065,433,489**
Central governments and central banks	13,788,761	57,439,997
Public Sector Entities	266,181,945	-
Corporates	4,404,058,244	5,036,477,865
Institutions	3,233,233,294	3,767,875,731
Retail	1,502,204	2,428,184
Exposures in default	140	33,385
Equity exposures	38,214,814	35,724,886
Other items	48,722,842	37,407,503
Covered bonds	135,052,187	86,215,772
Collective investments undertakings (CIU)	32,906,740	41,830,166
Market risk	**-**	**-**
Operational risk	**377,498,367**	**351,189,200**
Credit Valuation Adjustment	**4,247,864**	**5,382,489**
Total risk weighted assets and capital requirements	**8,555,407,402**	**9,422,005,178**
Tier 1 capital ratio	*27.18%*	*24.09%*
Total capital ratio	*29.52%*	*26.21%*

Capital adequacy

Under the European regulation transposed into national law by the CSSF circulars as amended, the Bank is required to comply with the regulatory ratios at all times meaning minimum common equity capital ratio at least equal to 4.5%, a minimum Tier 1 Capital ratio at least equal to 6% and a minimum Total Capital plus Conservation buffer of 10.5%.

As at 31 December 2019, the solvency ratio of the Bank is 29.52% (2018: 26.21%), above the regulatory limit of 8% and above the regulatory limit including conservation buffer limit of 10.5%. Over the year 2019, the higher solvency ratio amounted to 29.52% (December) and the lower amounted to 24.74% (September).

Note 3 – Financial risk management (continued)

Capital management and planning

The primary objectives of the Bank's capital management policy are to ensure that the Bank complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise the shareholder value.

The Bank manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. No changes have been made to the objectives, policies and processes from the previous years.

As part of the internal assessment process for its capital adequacy (relative to Basel III Pillar 2), the Bank considers that the Pillar 1 risks (credit, market and operational risks) are sufficiently covered by the regulatory capital under Pillar 1 as at 31 December 2019 and going forward.

The ICAAP (Internal Capital Assessment Process)

The second Pillar of Basel III capital framework describes how supervisory authorities and the Bank can effectively assess the appropriate level of regulatory capital. This assessment must cover all risks incurred by the Bank, their sensitivity to crises scenarios and how they are expected to evolve in light of development projects.

This internal assessment system is regularly integrated into the Bank's decision-making and the management processes and supported, where appropriate, by impact analyses of crises scenarios on business plans and by models that reflect concentrations and diversifications in an economic manner.

(g) Operational risk

The operational risk is the risk of loss resulting from inadequate or failed processes, people and systems or from external events. This definition includes legal risk.

Segregation of duties, internal procedures, and technological systems in force mitigate the risk of losses due to errors or inadequacies.

(h) Derivative financial instruments

During 2019 and 2018, in order to manage efficiently its treasury position, the Bank used mainly foreign exchange transactions and interest rate swaps.

Note 3 – Financial risk management (continued)

As at 31 December 2019 and 2018, the notional amount and fair value of the derivatives held for trading are as follows (in EUR):

	2019		**2018**	
	Notional amount	**Fair value**	**Notional amount**	**Fair value**
Assets				
Interest rate instruments	-	-	-	-
Currency instruments	2,870,722,666	30,193,047	2,846,361,067	48,445,482
	2,870,722,666	**30,193,047**	**2,846,361,067**	**48,445,482**
Liabilities				
Interest rate instruments	35,000,000	660,551	65,000,000	1,464,664
Currency instruments	3,544,863,548	80,040,342	3,410,238,045	65,878,843
	3,579,863,548	**80,700,893**	**3,475,238,045**	**67,343,507**

As mentioned in Note 2, as far as interest rate risk is concerned, only fair value hedge is applied by the Bank.

(i) Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of financial assets and liabilities measured at amortised cost (excluding cash balances with central banks) in the statement of financial position (in millions of EUR):

	Carrying amount		**Fair value**	
	2019	**2018**	**2019**	**2018**
Assets				
Loans and advances	19,145	18,382	18,903	18,398
Liabilities				
Financial liabilities measured at amortised cost	18,769	17,552	19,723	18,224

The fair value of the financial assets and liabilities corresponds to the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The fair values of financial assets and financial liabilities measured at amortised cost have been determined through the present value of future cash flows: the value of a financial instrument held to maturity at the year-end analysis is equal to the sum at that date of all the discounted cash inflows and outflows expected.

The cash flows are discounted with reference to the zero-coupon curve associated with currency in which the instrument is denominated and translated, where applicable, to the reference currency using the exchange rate applying on the analysis date.

Note 3 – Financial risk management (continued)

Fair value hierarchy

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair values using other valuation techniques.

(i) Valuation models

As at 31 December 2019 and 2018, the Bank uses the following fair value hierarchy for determining and disclosing the fair value of financial instruments, which reflects the significance of the inputs used in making the measurements:

Level 1: inputs that are quoted prices (unadjusted) in active markets for identical assets and liabilities. This level includes listed equity securities and debt instruments on exchanges (for example: London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and exchanges traded derivatives like futures (for example: Nasdaq, S&P 500).

Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, such as interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices or model inputs are usually available in the market for listed debt and equity securities, exchanged-traded derivatives and simple over-the-counter derivatives such as interest rate swaps. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

Note 3 – Financial risk management (continued)

(ii) Valuation framework

The Bank has adopted and applied a specific policy issued by the Group, denominated "Fair Value Policy", which states principles and methodologies to calculate financial instruments fair value.
In relation to controls and procedures put in place concerning valuation framework, please refer to Note 3.d "Market risk".

(iii) Financial instruments measured at fair value – fair value hierarchy

The following table analyses financial instruments measured at fair value at year-end, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position.

31 December 2019 (in EUR)	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value through profit or loss (FVTPL):				
- Financial assets held for trading	-	30,193,047	-	**30,193,047**
- Financial assets mandatorily measured at fair value	613,898	-	-	**613,898**
- Financial assets designated at fair value	-	-	-	**-**
Financial assets measured at FVTOCI				
- Equity instruments (other than investments in subsidiaries)	-	211,185	-	**211,185**
- Debt instruments	2,258,113,912	-	-	**2,258,113,912**
- Loans	-	-	7,040,755	**7,040,755**
Derivatives held for hedging	-	2,111,798	-	**2,111,798**
Total financial assets	**2,258,727,810**	**32,516,030**	**7,040,755**	**2,298,284,595**
Financial liabilities held for trading				
- Derivatives held for trading	-	80,700,893	-	**80,700,893**
- Short positions	-	-	-	-
Financial liabilities at fair value through profit or loss	-	-	-	-
Derivatives held for hedging	-	98,241,822	-	**98,241,822**
Total financial liabilities	**-**	**178,942,715**	**-**	**178,942,715**

Note 3 – Financial risk management (continued)

31 December 2018 (in EUR)	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value through profit or loss (FVTPL):				
- Financial assets held for trading	-	48,445,482	-	**48,445,482**
- Financial assets mandatorily measured at fair value	789,701	-	-	**789,701**
- Financial assets designated at fair value	-	10,365,456	-	**10,365,456**
Financial assets measured at FVTOCI:				
- Equity instruments (other than investments in subsidiaries)	-	211,185	-	**211,185**
- Debt instruments	2,350,959,332	-	-	**2,350,959,332**
Derivatives held for hedging	-	210,014	-	**210,014**
Total financial assets	**2,351,749,033**	**59,232,137**	**-**	**2,410,981,170**
Financial liabilities held for trading				
- Derivatives held for trading	-	67,343,507	-	**67,343,507**
- Short positions	-	-	-	**-**
Financial liabilities at fair value through profit or loss	-	10,240,794	-	**10,240,794**
Derivatives held for hedging	-	69,043,776	-	**69,043,776**
Total financial liabilities	**-**	**146,628,077**	**-**	**146,628,077**

During the reporting years ending 31 December 2019 and 31 December 2018, there were no transfers between Level 1 and Level 2 categories, and no transfers into and out of Level 3 category.

(j) Operating segments

The Bank has four reportable operating segments which are the Bank's strategic divisions. The Bank's Management reviews the divisions internal management reports on a monthly basis while the Bank's Board of Directors reviews these internal management reports on a quarterly basis.

Alongside these strategic divisions the Bank has also governance and administration divisions. The strategic divisions include: the Corporate Banking division which operates on loans, deposits, securities trading and other transactions with corporate customers. The Wealth Management division operates on loans, deposits, securities trading and other transactions with private customers. The Financial Markets division undertakes the Bank's funding and centralised risk management activities through borrowings, issue of debt securities, use of derivatives for risk management purposes and investing in debt or equity securities.

Note 3 – Financial risk management (continued)

Results by strategic divisions in EUR '000	**2019**					
	Corporate & Financial Institutions	**Wealth Management**	**Financial Markets**	**Others Financial Institutions**	**Governance**	**Total revenues**
Net interest margin	81,569	1,746	80,776	(10,010)	-	**154,081**
Dividends	-	-	51	-	-	**51**
Net commission margin	23,003	2,909	9,281	157	-	**35,350**
Net trading income	(1,355)	369	(30,952)	(1,966)	-	**(33,904)**
Net other expenses	(18)	(312)	(1)	(1,335)	-	**(1,666)**
Impairment on financial assets	(6,316)	(22)	(987)	734	-	**(6,591)**
Total area results	**96,883**	**4,690**	**58,168**	**(12,420)**	**-**	**147,321**
Depreciation					(2,236)	**(2,236)**
Provision					(1,172)	**(1,172)**
Staff and operating expenses					(43,204)	**(43,204)**
Tax expenses					(6,626)	**(6,626)**
Total operating & extraordinary expenses					**(53,238)**	**(53,238)**
RESULTS FOR THE YEAR						**94,083**

Results by strategic divisions in EUR '000	**2018**					
	Corporate & Financial Institutions	**Wealth Management**	**Financial Markets**	**Others Financial Institutions**	**Governance**	**Total revenues**
Net interest margin	67,837	1,981	84,576	(11,383)	-	**143,011**
Dividends	-	620	52	-	-	**672**
Net commission margin	29,590	4,238	8,607	101	-	**42,536**
Net trading income	2,121	476	(36,580)	(858)	-	**(34,841)**
Net other operating expenses	(137)	(270)	(46)	(2,404)	-	**(2,857)**
Impairment on financial assets	(4,027)	(79)	1,413	76	-	**(2,617)**
Total area results	**95,384**	**6,966**	**58,022**	**(14,468)**	**-**	**145,904**
Depreciation					(960)	**(960)**
Provision					179	**179**
Staff and operating expenses					(38,841)	**(38,841)**
Tax expenses					(2,285)	**(2,285)**
Total operating & extraordinary expenses					**(41,907)**	**(41,907)**
RESULTS FOR THE YEAR						**103,997**

Note 3 – Financial risk management (continued)

Assets by strategic division in EUR'000	**2019**				
	Corporate & Financial Institutions	**Wealth Management**	**Financial Markets**	**Others Financial Institutions**	**Total**
Cash and cash balances with central banks	-	-	725,910	473	**726,383**
Financial assets held for trading	-	117	29,497	579	**30,193**
Financial assets designated at fair value through profit or loss	-	-	-	-	**-**
Financial assets mandatorily measured at fair value	-	-	614	-	**614**
Financial assets measured at FVTOCI	7,041	-	2,258,114	211	**2,265,366**
Loans and advances	10,715,284	12,794	8,089,738	327,514	**19,145,330**
Loans and advances to credit institutions	*142,263*	-	*8,088,691*	*327,481*	***8,558,435***
Loans and advances to customers	*10,573,021*	*12,794*	*1,047*	*33*	***10,586,895***
Derivatives held for hedging	-	-	2,112	-	**2,112**
Tangible fixed assets	556	-	-	4,053	**4,609**
Intangible assets	-	-	-	-	**-**
Tax assets	8,969	-	-	5,755	**14,724**
Other assets	11,751	84	8,072	15,732	**35,639**
Total assets	**10,743,601**	**12,995**	**11,114,057**	**354,317**	**22,224,970**

Assets by strategic division in EUR'000	**2018**				
	Corporate & Financial Institutions	**Wealth Management**	**Financial Markets**	**Others Financial Institutions**	**Total**
Cash and cash balances with central banks	-	-	108,551	481	**109,032**
Financial assets held for trading	-	83	47,197	1,165	**48,445**
Financial assets designated at fair value through profit or loss	-	-	10,365	-	**10,365**
Financial assets mandatorily measured at fair value	-	-	790	-	**790**
Financial assets measured at FVTOCI	-	-	2,350,960	211	**2,351,171**
Loans and advances	10,390,228	22,442	6,217,547	1,752,122	**18,382,339**
Loans and advances to credit institutions	*53,630*	-	*6,216,349*	*1,722,014*	***7,991,993***
Loans and advances to customers	*10,336,598*	*22,442*	*1,198*	*30,108*	***10,390,346***
Derivatives held for hedging	-	-	210	-	**210**
Tangible fixed assets	236	-	-	546	**782**
Intangible assets	-	-	-	2	**2**
Tax assets	6,202	-	-	22,976	**29,178**
Other assets	3,335	179	1,970	19,989	**25,473**
Total assets	**10,400,001**	**22,704**	**8,737,590**	**1,797,492**	**20,957,787**

Note 3 – Financial risk management (continued)

Liabilities & Equity by strategic division in EUR'000 **2019**

Liabilities	**Corporate & Financial Institutions**	**Wealth Management**	**Financial Markets**	**Others Financial Institutions**	**Total**
Deposits from central banks	-	-	809,894	-	**809,894**
Financial liabilities held for trading	-	247	80,454	-	**80,701**
Financial liabilities designated at fair value through profit or loss	-	-	-	-	-
Financial liabilities measured at amortised cost	**1,296,378**	**819,836**	**16,440,172**	**212,670**	**18,769,056**
Deposits from credit institutions	*158,172*	-	*2,716,690*	-	***2,874,862***
Deposits from customers	*1,136,533*	*819,836*	*995,585*	*212,082*	***3,164,036***
Debts evidenced by certificates	*1,673*	-	*12,727,897*	*588*	***12,730,158***
Derivatives held for hedging	-	-	95,791	2,451	**98,242**
Provisions	2,576	53	1	1,748	**4,378**
Tax liabilities	6,704	-	-	3,581	**10,285**
Other liabilities	10,746	115	5,915	22,846	**39,622**
Total liabilities	**1,316,404**	**820,251**	**17,432,227**	**243,296**	**19,812,178**
Equity					
Share capital and share premium	-	-	-	1,397,091	**1,397,091**
Revaluation reserve	18	-	(6,913)	1,724	**(5,171)**
Other reserves and retained earnings	398	273	(14,747)	940,865	**926,789**
Net profit for the year	183,287	(551)	(65,046)	(23,607)	**94,083**
Total equity	**183,703**	**(278)**	**(86,706)**	**2,316,073**	**2,412,792**
Total liabilities and equity	**1,500,107**	**819,973**	**17,345,521**	**2,559,369**	**22,224,970**

Liabilities & Equity by strategic division in EUR'000 **2018**

Liabilities	**Corporate & Financial Institutions**	**Wealth Management**	**Financial Markets**	**Others Financial Institutions**	**Total**
Deposits from central banks	-	-	812,488	-	**812,488**
Financial liabilities held for trading	-	735	66,608	-	**67,343**
Financial liabilities designated at fair value through profit or loss	10,241	-	-	-	**10,241**
Financial liabilities measured at amortised cost	**3,804,691**	**798,171**	**12,704,919**	**244,128**	**17,551,909**
Deposits from credit institutions	*65,441*	-	*967,552*	*39,695*	***1,072,688***
Deposits from customers	*3,736,327*	*798,171*	*1,557,429*	*203,856*	***6,295,783***
Debts evidenced by certificates	*2,923*	-	*10,179,938*	*577*	***10,183,438***
Derivatives held for hedging	-	-	68,482	562	**69,044**
Provisions	1,277	48	8	1,727	**3,060**
Tax liabilities	9,175	-	-	3,176	**12,351**
Other liabilities	7,394	151	1,560	40,024	**49,129**
Total liabilities	**3,832,778**	**799,105**	**13,654,065**	**289,617**	**18,575,565**
Equity					
Share capital and share premium	-	-	-	1,397,091	**1,397,091**
Revaluation reserve	-	-	(40,545)	-	**(40,545)**
Other reserves and retained earnings	399	273	6,241	914,766	**921,679**
Net profit for the year	159,463	769	(63,007)	6,772	**103,997**
Total equity	**159,862**	**1,042**	**(97,311)**	**2,318,629**	**2,382,222**
Total liabilities and equity	**3,992,640**	**800,147**	**13,556,754**	**2,608,426**	**20,957,787**

Note 3 – Financial risk management (continued)

(k) Return on assets ("ROA")

The Bank return on asset is as follow:

	2019	2018
Total assets	22,224,969,767	20,957,787,120
Net profit for the year	94,082,728	103,997,153
Return on assets	**0.42%**	**0.50%**

(l) Pillar III disclosures requirements

As part of Intesa Sanpaolo Group, proper Pillar III disclosures are provided in a dedicated and specific document the Parent Company elaborates and publishes on a quarterly basis on its web site.

The document, denominated "Third pillar of Basel 2 and Basel 3 ("Pillar 3")" is available at the following web address:
"http://www.group.intesasanpaolo.com/scriptIsir0/si09/governance/eng_terzo_pilastro_basilea.jsp"

The ICAAP (Internal Capital Assessment Process)

The revised disclosure requirements will enable market participants to better compare banks' disclosures of risk-weighted assets. The revisions notably focus on improving the transparency of the internal model-based approaches that banks use to calculate minimum regulatory capital requirements. This assessment must cover all risks incurred by the Bank, their sensitivity to crises scenarios and how they are expected to evolve in light of development projects.

This internal assessment system is regularly integrated into the Bank's decision-making and the management processes and supported, where appropriate, by impact analyses of crises scenarios on business plans and by models that reflect concentrations and diversifications in an economic manner.

The Benchmark Regulation

On 29 June 2016, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the "Regulation") was published in the Official Journal of the European Union (OJEU) and entered into force on 30 June 2016.

The Regulation sets out to establish a common regulatory framework at the EU level under which benchmarks are provided, produced and used, and to restore trust in indices used as financial benchmarks. The aim of this Regulation is to enhance the benchmark-setting process, improve transparency and prevent conflicts of interest in order to enhance the robustness and reliability of benchmarks, thereby strengthening confidence in financial markets.

According to the Regulation, a benchmark is any index by reference to which the amount payable under a financial instrument or a financial contract, or the value of financial instrument is determined, or an index that is used to measure the performance of an investment fund with the purpose of tracking the return of such index, of defining the asset allocation of a portfolio or of computing the performance fee.

Note 3 – Financial risk management (continued)

The Regulation has the following objectives:

- Improving governance and controls over the benchmark process, in particular to ensure that administrators avoid conflicts of interest, or at least manage them appropriately;
- Improving the quality of input data and methodologies used by benchmark administrators;
- Ensuring that contributors to benchmarks and the data they provide are subject to adequate controls, in particular to avoid conflicts of interest. Therefore, a legally-binding code of conduct is introduced to contributors specifying their responsibilities with respect to the contribution of input data;
- Protecting consumers and investors through greater transparency and adequate rights of redress.

Benchmarks have been classified in three categories:

- Critical Benchmarks;
- Significant Benchmarks;
- Non-significant Benchmarks.

And they are subjected to requirements appropriate to their size and nature, while at the same time respecting a core set of minimum requirements in line with the internationally agreed principles of the International Organization of Securities Commission (IOSCO).

With reference to those Benchmarks for European short term rates classified as “Critical”, it has been necessary to issue new rules concerning:

- **Euribor**: the EMMI (European Money Market Institute) has reviewed the method to fix the Euribor during 2019, introducing a new hybrid methodology, which uses a hierarchical approach consisting of three levels, applied progressively.
    - Under level 1, panel bank contributions are based solely on eligible transactions for that particular tenor.
    - Level 2 looks at contributions based on transactions across the maturity spectrum using a calculation technique provided by EMMI.
    - Finally, under level 3, contributions are based on transactions and/or data from a range of markets closely related to the unsecured euro money market, using a combination of modelling techniques and/or panel bank judgment.

- **Eonia**: stating from October 2019 EONIA has been replaced as Euro risk-free rate benchmark for all products and contracts by the €STR (Euro short-term rate), which is calculated by the European Central Bank (ECB) and is based on the money market statistical reporting of the Eurosystem. Eonian fixing will be published until the end of 2021 and then it will definitively be replaced by the €STR.

- **Libor USD**: LIBOR is an indicative measure of the average interest rate at which major global banks could borrow from one another. LIBOR is quoted in multiple currencies and multiple time frames using data reported by private-sector banks. LIBOR is used extensively in the U.S. and globally as a “benchmark” or “reference rate” for various commercial and financial contracts, including corporate and municipal bonds and loans, floating rate mortgages, asset-backed securities, consumer loans, and interest rate swaps and other derivatives. It is expected that a number of private-sector banks currently reporting information used to set LIBOR will stop doing so after 2021 when their current reporting commitment ends, which could either cause LIBOR to stop publication immediately or cause

Note 3 – Financial risk management (continued)

LIBOR's regulator to determine that its quality has degraded to the degree that it is no longer representative of its underlying market. As regulators and market participants seek to avoid business and market disruptions resulting from the expected discontinuation of LIBOR, implementing alternative reference rates in advance of the discontinuation has taken on urgency. The U.S. and other countries are currently working to replace LIBOR with alternative reference rates.

The Benchmarks Project in Intesa Sanpaolo Group

The Group paid a lot of attention on the evolution in terms of Benchmarks Regulation, starting a dedicated project since 2016 involving many functions. Several updates have been provided to the Group Risk Committee, Board of Directors, Italian Regulators and the topic has been also discussed with the JST during their periodical meetings with the Chief Financial Officer and the Chief Risk Officer of the Group.

The Group was also involved actively in some working groups organized by EMMI and European Central Bank.

With specific reference to the last one, being voting member, the Group participated to the Working Group on risk free rates, where among the main tasks it appointed the €STR as new benchmark for the short term money market and published recommendations to manage the transition period from Eonia to €STR.

The main interventions covered by the Benckmark project at Group level can be summarized as follows:

- Risk and Valuation Assessment:
    - Of the main impacts generated by transition from Eonia to €STR;
    - On risk valuation on trading and banking book financial instruments;
    - On impacts given by the new Benchmarks fixing methodology on NII and EVE;
    - Of the impacts on counterparty risks, operational one and liquidity;
- Screening of the existing contracts based on Euribor, Eonia and Libor, analysing terms and conditions and updating/adding fallback conditions; updates issued by ISDA have been also analysed and external legal opinions have been required if necessary;
- Contributions to benchmarks with methodology update, processes and procedures update to fix Euribor and blocking the contribution to Eonia;
- Organization of internal training seminars;
- Internal newsletters and external communication to inform customers on Euribor new regulation when issuing their 31 December 2019 bank account statement;
- Accounting impacts analysis in terms of hedge accounting and involvement on dedicated meetings organized by the IASB Committee;
- Screening of the Operation and IT impacts on the whole procedures following the adoption of the new benchmarks, issuing updates concerning Eonia/€STR/Euribor since 2019 and planning further actions on Libor in 2020-2021;
- Foreign branches and subsidiaries involvement in the project.

Benckmark Regulation: focus on Intesa Sanpaolo Bank Luxembourg S.A.

Intesa Sanpaolo Bank Luxembourg S.A. has analyzed its financial instruments to identifiy connections with the above mentioned rates. The outcomes are presented as follows in dedicated tables where data as at 31 December 2019 are presented.

Note 3 – Financial risk management (continued)

Hedging derivatives (€ mio - nominal) Benchmark	Hedging type	Maturity 2020	2021	2022 2024	2025 & more	Total
EURIBOR	FVH	650	285	1,022	731	**2,688**
	Macro FVH	-	-	-	-	-
	CFH	-	-	-	-	-
	Macro CFH	-	-	-	-	-
Total EURIBOR		**650**	**285**	**1,022**	**731**	**2,688**
Libor USD	FVH	-	-	-	36	**36**
	Macro FVH	-	-	-	-	-
	CFH	-	-	-	-	-
	Macro CFH	-	-	-	-	-
Total LIBOR USD		-	-	-	**36**	**36**
Libor GBP	FVH	-	-	-	-	-
	Macro FVH	-	-	-	-	-
	CFH	-	-	-	-	-
	MacroCFH	-	-	-	-	-
Total LIBOR GBP		-	-	-	-	-
Other benchmarks affected by the reform	FVH	-	-	-	275	**275**
	Macro FVH	-	-	-	-	-
	CFH	-	-	-	-	-
	MacroCFH	-	-	-	-	-
Total other benchmarks		-	-	-	**275**	**275**
Total		**650**	**285**	**1,022**	**1,042**	**2,999**

Trading derivatives (€ mio - nominal) Benchmark	Leg type	Maturity 2020	2021	2022 2024	2025 & more	Total
EURIBOR	Placement	1,033	791	390	-	**2,214**
	Deposit	-	-	-	-	-
Libor USD	Placement	-	-	-	-	-
	Deposit	1,015	801	125	-	**1,941**
Other benchmarks	Placement	-	-	-	-	-
	Deposit	-	-	275	-	**275**
Fix rates	Placement	-	-	-	-	-
	Deposit	35	-	-	-	**35**
Total	**Placement**	**1,033**	**791**	**390**	-	**2,214**
	Deposit	**1,050**	**801**	**400**	-	**2,251**

Note 3 – Financial risk management (continued)

Financial assets valued at amortized cost (€ mio)	**Rate type**		**Total**
	Floating	**Fix**	
Loans and advances to credit institutions	2,564	5,994	**8,558**
Euribor	*2,453*		***2,453***
Libor USD	*102*		***102***
Libor GBP	*5*		***5***
Other	*4*		***4***
Loans and advances to customers	9,217	1,370	**10,587**
Euribor	*6,865*		***6,865***
Libor USD	*2,302*		***2,302***
Libor GBP	*10*		***10***
Other	*40*		***40***
Financial assets valued at amortized cost	**11,781**	**7,364**	**19,145**

Financial assets measured at FVTOCI (€ mio)	**Rate type**			**Total**
	Floating	**Fix**	**Zero C.**	
Debt securities	235	1,823	200	**2,258**
Euribor	*235*			***235***
Loans and receivables	7	-	-	**7**
Euribor	*7*			*7*
Financial assets measured at FVTOCI	**242**	**1,823**	**200**	**2,265**

Financial liabilities measured at amortized cost (€ mio)	**Rate type**		**Total**
	Floating	**Fix**	
Deposits from credit institutions	2,098	777	**2,875**
Euribor	*2,041*		***2,041***
Libor USD	*56*		***56***
Libor GBP	-		-
Other	*1*		***1***
Deposits from customers	1,548	1,616	**3,164**
Euribor	*1,340*		***1,340***
Libor USD	*164*		***164***
Libor GBP	*23*		***23***
Other	*21*		***21***
Debts evidenced by certificates	7,366	5,364	**12,730**
Euribor	*7,365*		***7,365***
Libor USD	*1*		***1***
Libor GBP	-		-
Other	-		-
Financial liabilities measured at amortized cost	**11,012**	**7,757**	**18,769**

Cash balances with Central Banks and Deposits from Central Banks are not influenced by the Benchmark Regulation being regulated on a fixed rate basis.

Note 4 – Cash and cash equivalents measured at amortized cost

Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

	Net carrying amount	
(in EUR)	**2019**	**2018**
Cash and cash balances with central banks	726,382,833	109,032,333
Loans and advances to credit institutions with maturity <= 3 months	3,618,873,691	4,158,192,064
	4,345,256,524	**4,267,224,397**

In accordance with the requirements of the European Central Bank, the Luxembourg Central Bank implemented effective on 1 January 1999, a system of mandatory minimum reserves applicable to all Luxembourg credit institutions. The amount outstanding as at 31 December 2019 is EUR 719,612,098 (2018: EUR 105,999,996).

Concerning the branch of the Bank in Amsterdam, the mandatory reserve as at 31 December 2019 at De Nederlandsche Bank amounts to EUR 6,297,698 (2018: EUR 2,551,806).

Note 5 – Financial assets at fair value through profit or loss ("FVTPL")

	Net carrying amount	
(in EUR)	**2019**	**2018**
Financial assets at fair value through profit or loss ("FVTPL")	**30,193,047**	**48,445,482**
Derivatives held for trading	30,193,047	48,445,482
Investment securities mandatorily measured at fair value through profit or loss ("FVTPL")	**613,898**	**789,701**
Mutual funds shares	-	282,637
Securities	613,898	507,064
	30,806,945	**49,235,183**
Investment securities designated at fair value through profit or loss ("FVTPL")		
Securities	-	10,365,456
	-	**10,365,456**

The position designated at fair value through profit or loss was represented by a unique structured corporate bond issued in JPY, maturing in February 2021, and it has been disposed in February 2019. It was funded by a deposit in the same currency from the Bank's ultimate Parent Company. Designation at FVTPL eliminated accounting mismatches.

Note 6 – Financial assets measured at Fair Value through Other Comprehensive Income ("FVTOCI")

As at end of the year, investment securities measured at Fair Value through Other Comprehensive Income portfolio was composed as follows:

Financial assets measured at Fair Value through Other Comprehensive Income with recycling:

	Net carrying amount	
(in EUR)	**2019**	**2018**
Quoted debt instruments issued by:		
Financial institutions	369,141,661	352,553,907
Public sector	1,888,972,251	1,998,405,425
	2,258,113,912	**2,350,959,332**

	Net carrying amount	
(in EUR)	**2019**	**2018**
Loans and receivables granted to:		
Non Financial companies	7,040,755	-
	7,040,755	**-**

During the last part of 2019 the Bank concluded one *originate to share* deal, which belongs to the Hold to Collect and Sale business model and classified in the FVTOCI portfolio for the part of the loan designated to be sold.

The loan has been valued for the first time at its fair value at the end of December 2019 and the NPV adjustment booked amounts to EUR 18,452.

Given that the mentioned deal was still in the primary syndication phase, the fair value has been kept at par plus accrued interests.

The Luxembourg Central Bank's long-term refinancing operation (LTRO) is a process by which the Luxembourg Central Bank provides financing to local banks in exchange of a deposit with the former of eligible bonds as collateral for that purposes.

The Bank started participating in the program in 2012, obtaining a financing of EUR 1,200,000, maturing in 2015. As at the end of 2014, the LTRO transactions were again available by auctions and the Bank decided to participate obtaining a new financing for an amount of EUR 90,000,000 maturing in 2018, which has been increased by EUR 500,000,000 during 2015 reaching the total amount of EUR 591,259,790 as at end of December 2015.

During 2016, EUR 90,000,000 has been reimbursed and a new TLTRO mechanism has been subscribed for an amount equal to EUR 821,440,000.

Note 6 – Financial assets measured at Fair Value through Other Comprehensive Income (continued)

The last deposit received has been hedged entering in a hedge accounting relationship where an Interest Rate Swap has been used as hedging instrument: as a consequence of the hedge accounting, the TLTRO mechanism carrying amount of EUR 809,748,171, of which negative accrued interests amount to EUR 11,691,829 and negative NPV adjustment amounts to EUR 146,120 as at 31 December 2019.

During 2018, the TLTRO deposit amounting to EUR 500,000,000 has been reimbursed.

The last deposit still alive is collateralised by eligible securities for an amount of EUR 842,023,178.

Financial assets measured at Fair Value through Other Comprehensive Income without recycling:

	Net carrying amount	
(in EUR)	**2019**	**2018**
Quoted & not quoted shares issued by:		
Corporates	211,185	211,185
	211,185	**211,185**

As at 31 December 2019, shares in affiliated undertakings, which are classified in this category, where the Bank held at least 20% are as follows:

	Registered Office	Percentage Owned	Net equity (in EUR)*	Of which Profit of the year (in EUR)*
Company:				
Lux Gest Asset Management S.A.	Luxembourg	100%	464,252	15,283

* Based on unaudited figures

At 1 January 2018, the Bank designated the investment shown in the table above as equity security at FVTOCI and designation was made because the investment is expected to be held for the long term for strategic purposes.

Equity instruments elected to present changes in value in other comprehensive income will never recycle to profit or loss, even in the event of disposal of the financial instrument (Financial assets measured at fair value through other comprehensive income without "recycling").

The below table describes the movements on the revaluation reserve related to the investment securities and loans measured at FVTOCI per type of financial asset:

Note 6 – Financial assets measured at Fair Value through Other Comprehensive Income (continued)

(in EUR)	Fixed Inc. securities	Floating Inc. securities	Loans HTCS	Total
Balance as at 31 December 2018	**(31,982,975)**	**(8,562,391)**	**-**	**(40,545,366)**
Increase (decrease) of unrealised gain	(474,602)	(115,231)	18,452	(571,381)
(Increase) decrease of unrealised gain	35,124,252	9,804,978	-	44,929,230
Amount reclassified from equity to profit or loss for the year	3,772,956	-	-	3,772,956
Unrealised fair value gain made on assets bought during the year	(661,461)	-	-	(661,461)
Loss allowance movement	319,966	115,231	2,754	437,951
Deferred taxes	(9,959,828)	(2,568,199)	(4,601)	(12,532,628)
Balance as at 31 December 2019	**(3,861,692)**	**(1,325,612)**	**16,605**	**(5,170,699)**

Note 7 – Loans and advances

(in EUR)	2019		2018	
	Total Net carrying amount	Of which: Impairment	Total Net carrying amount	Of which: Impairment
Unquoted loans and advances to:				
Financial institutions and public sector	9,480,231,094	5,142,088	8,304,016,411	3,871,909
Private customers	10,082,070	27,741	1,918,921,945	118,145
Corporate customers	9,655,017,330	22,324,251	8,159,400,224	17,198,030
Total	**19,145,330,494**	**27,494,080**	**18,382,338,580**	**21,188,084**

Impairment allowance for loans and advances

As at 31 December 2019, the Bank has determined its individual impairment at EUR 11,936,964 (2018: EUR 11,785,770) and a collective provision amounting to EUR 15,557,116 (2018: EUR 9,402,314).

A reconciliation of the allowance for impairment losses for loans and advances is as follows (in EUR):

(in EUR)	2019	2018
Impairment as at 1st January	21,188,084	242,884
Charge of the year/First Time Adoption of IFRS 9	13,099,161	36,244,149
Recoveries/amounts written off	(6,793,165)	(15,298,949)
Impairment as at 31 December	**27,494,080**	**21,188,084**
of which:		
Individual impairment	11,936,964	11,785,770
Collective impairment	15,557,116	9,402,314

Note 7 – Loans and advances (continued)

Guarantees received as collateral

Loans and advances are secured by the following guarantees received by the Bank:

(in EUR)	2019		2018	
	Loans and advances to customers	**Loans and advances to credit institutions**	**Loans and advances to customers**	**Loans and advances to credit institutions**
Net carrying amounts	**10,586,894,810**	**8,558,435,684**	**10,390,345,939**	**7,991,992,641**
Real guarantees				
Securities	400,000,000	-	5,210,387	-
Other real guarantees	224,797,713	38,062,077	2,576,932,145	45,294,306
Other guarantees				
Government guarantees	1,641,882,285	-	1,698,890,101	-
Credit institutions guarantees	2,971,384,136	-	929,812,227	-
Total guarantees	**5,238,064,134**	**38,062,077**	**5,210,844,860**	**45,294,306**

Note 8 – Property and equipment

(in EUR)	**Land & building**	**Office equipment**	**Other equipment**	**Total**
Carrying value before depreciation as at 31 december 2018	**210,631**	**1,419,774**	**2,038,730**	**3,669,135**
Recognition of right-of-use asset on initial application of IFRS 16	5,310,466	-	261,904	**5,572,370**
Carrying value before depreciation as at 1st January 2019	**5,521,097**	**1,419,774**	**2,300,634**	**9,241,505**
Additions	154,940	834	332,620	**488,394**
Disposals/Transfers	-	(6,786)	(45,065)	**(51,851)**
Cost as at 31 December 2019	5,676,037	1,413,822	2,588,189	**9,678,048**
Accumulated depreciation as at 1st January 2019	(155,091)	(1,234,472)	(1,497,181)	**(2,886,744)**
Depreciation charge	(1,795,441)	(35,536)	(403,574)	**(2,234,551)**
Depreciation reversal	-	6,786	45,065	**51,851**
Accumulated depreciation as at 31 December 2019	(1,950,532)	(1,263,222)	(1,855,690)	**(5,069,444)**
Net carrying amount as at 31 December 2019	**3,725,505**	**150,600**	**732,499**	**4,608,604**

(in EUR)	**Land & building**	**Office equipment**	**Other equipment**	**Total**
Carrying value before depreciation as at 1st January 2018	**49,550,706**	**1,551,678**	**8,141,863**	**59,244,247**
Additions	-	23,532	326,478	**350,010**
Disposals/Transfers	(49,340,075)	(155,436)	(5,776,655)	**(55,272,166)**
Cost as at 31 December 2018	210,631	1,419,774	2,038,730	**3,669,135**
Accumulated depreciation as at 1st January 2018	(17,841,212)	(1,349,408)	(7,239,486)	**(26,430,106)**
Depreciation charge	(883,845)	(40,500)	(35,350)	**(959,695)**
Depreciation reversal	18,569,966	155,436	5,777,655	**24,503,057**
Accumulated depreciation as at 31 December 2018	(155,091)	(1,234,472)	(1,497,181)	**(2,886,744)**
Net carrying amount as at 31 December 2018	**55,540**	**185,302**	**541,549**	**782,391**

Note 9 – Intangible assets

(in EUR)	2019
Cost as at 1st January 2019	**4,968**
Additions	-
Disposals/Transfers	-
Cost as at 31 December 2019	4,968
Accumulated depreciation as at 1st January 2019	(3,375)
Depreciation charge	(1,124)
Accumulated depreciation as at 31 December 2019	(4,499)
Net carrying amount as at 31 December 2019	**469**

Note 10 – Tax expense, current and deferred tax assets and liabilities

Current taxes recorded are related to the Amsterdam branch of the Bank; they comprise tax payable on the taxable income realised by the branch and they represent the best estimate of the tax amount expected to be paid.

(in EUR)	2019	2018
Current tax assets	8,969,210	6,201,905
Current tax liabilities	(6,760,165)	(9,174,660)
Net current tax assets (liabilities)	**2,209,045**	**(2,972,755)**

In relation to the Luxembourg entity, instead, no current taxes are recorded considering the tax integration since 2002 with the Luxembourg Bank's local shareholder Intesa Sanpaolo Holding International S.A.. The income from the Branch in the Netherlands is subject to the local income tax (25% as at 31 December 2019).

Deferred tax assets and liabilities

	2019	2018
Deferred tax assets	5,754,733	22,975,999
Deferred tax liabilities	(3,524,440)	(3,176,749)
Tax assets (liabilities)	**2,230,293**	**19,799,250**

Note 10 – Tax expense, current and deferred tax assets and liabilities (continued)

Recognised deferred tax assets and liabilities are attributable to the following:

(in EUR)	**1 January 2019**	**Statement of profit or loss**	**Equity**	**31 December 2019**
Financial assets held for trading	(24,227,224)	466,437	-	**(23,760,787)**
Instruments held for trading	57,417	80,658	-	**138,075**
Financial assets designated at fair value through profit or loss	128,673	(128,673)	-	**-**
Financial assets measured at FVTOCI	14,202,825	-	(12,532,628)	**1,670,197**
Financial liabilities held for trading	23,947,624	(480,582)	-	**23,467,042**
Financial liabilities designated at fair value through profit or loss	(76,213)	76,213	-	**-**
Provisions and value adjustments	208,674	-	-	**208,674**
IFRS 9 – FTA	5,557,474	(5,050,382)	-	**507,092**
Net deferred income tax assets/(liabilities)	**19,799,250**	**(5,036,329)**	**(12,532,628)**	**2,230,293**

A deferred tax amount has been booked even if the Bank calculates current income in relation to the tax integration with the Bank's local shareholder.

The deferred tax expenses presented in profit or loss are related to temporary differences generated by financial instruments fair value changes booked through profit or loss.

Deferred taxes amount as at 1 January 2019 have been restated to correctly present amounts related to Financial assets designated at fair value through profit or loss and financial liabilities designated at fair value through profit or loss, which were related respectively to one financial asset and one financial liability classified in those caption to avoid any accounting mismatch. Amount related to financial liabilities has been consequently restated accordingly, presenting an amount in line with financial assets held for trading.

The deferred tax assets calculated on financial assets at fair value through other comprehensive income are showing a net deferred tax asset balance. The deferred tax amount has been consequently shown in deduction of the relative comprehensive income.

The deferred tax assets calculated on the IFRS 9 First Time Adoption contributing to the other comprehensive income have been reversed for an amount related to underlying assets arrived at maturity during 2019 and no more part of financial assets at 31 December 2019.

Note 11 – Other assets and other liabilities

(in EUR)	2019	2018
Prepaid charges	3,013,032	2,486,745
Taxes	12,574,711	16,293,566
Accrued commission income	7,305,977	590,552
Other	12,745,109	6,102,286
Other assets	**35,638,829**	**25,473,149**

(in EUR)	2019	2018
Social security charges	680,913	677,296
Withholding taxes and VAT	13,014,673	30,142,879
Administrative expenses to be paid	18,525,725	11,091,781
Accrued commission expenses	5,255,804	5,110,782
Short term payable and other sundry accounts	2,144,866	2,106,206
Other liabilities	**39,621,981**	**49,128,944**

Note 12 – Deposits from central banks

The Luxembourg Central Bank's long-term refinancing operation (LTRO) is a process by which the Luxembourg Central Bank provides financing to local banks in exchange of a deposit with the former of eligible bonds as collateral for that purposes.

The Bank started participating in the program in 2012, obtaining a financing of EUR 1,200,000, maturing in 2015. As at the end of 2014, the LTRO transactions were again available by auctions and the Bank decided to participate obtaining a new financing for an amount of EUR 90,000,000 maturing in 2018, which has been increased by EUR 500,000,000 during 2015 reaching the total amount of EUR 591,259,790 as at end of December 2015.

During 2016, EUR 90,000,000 has been reimbursed and a new TLTRO mechanism has been subscribed for an amount equal to EUR 821,440,000.

The last deposit received has been hedged entering in a hedge accounting relationship where an Interest Rate Swap has been used as hedging instrument: as a consequence of the hedge accounting, the TLTRO mechanism carrying amount of EUR 809,748,171, of which negative accrued interests amount to EUR 11,691,829 and negative NPV adjustment amounts to EUR 146,120 as at 31 December 2019.

During 2018, the TLTRO deposit amounting to EUR 500,000,000 has been reimbursed.

The last deposit still alive is collateralised by eligible securities for an amount of EUR 842,023,178.

Note 13 – Financial liabilities designated at FVTPL

The caption included until February 2019 a financial liability which was eligible, according to IFRS 9 to fair value option, with a fair value based on the discounted cash flows method. That financial liability has been reimbursed in February 2019. The value of this financial liability amounted to EUR 10,240,794 at 31 December 2018.

Note 14 – Financial liabilities measured at amortised cost

(in EUR)	2019 Carrying amount	2018 Carrying amount	Variation in EUR	in %
Deposits from credit institutions				
Current accounts and amounts with period of notice	615,198,776	228,808,275	386,390,501	169%
Term deposits	2,259,663,547	843,880,149	1,415,783,398	168%
Total	**2,874,862,323**	**1,072,688,424**	**1,802,173,899**	**168%**
Corporate customers				
Current accounts and amounts with period of notice	1,253,110,243	1,058,338,112	194,772,131	18%
Term deposits	1,755,041,294	4,402,432,879	(2,647,391,585)	(60%)
Total	**3,008,151,537**	**5,460,770,991**	**(2,452,619,454)**	**(45%)**
Private customers				
Current accounts and amounts with period of notice	97,743,760	489,716,555	(391,972,795)	(80%)
Term deposits	58,140,721	345,295,764	(287,155,043)	(83%)
Total	**155,884,481**	**835,012,319**	**(679,127,838)**	**(81%)**
Debts evidenced by certificates				
Certificates of deposits	5,454,880,667	4,844,685,272	610,195,395	13%
Term notes	3,533,001,234	3,772,365,418	(239,364,184)	(6%)
Commercial paper	3,742,276,145	1,566,387,005	2,175,889,140	139%
Total	**12,730,158,046**	**10,183,437,695**	**2,546,720,351**	**25%**
Financial liabilities measured at amortised cost	**18,769,056,387**	**17,551,909,429**	**1,217,146,958**	**7%**

European Medium Term Notes :
Since November 2011, the Bank participates as an additional issuer in a EUR 70 billion Euro Medium Term Notes (EMTN) Programme, developed by its ultimate Parent Company, alongside Intesa Sanpaolo Bank Ireland (INSPIRE). The programme is guaranteed by Intesa Sanpaolo S.p.A.. The EMTN (the "bonds") issued under this programme bear a maturity date of maximum 5 years. The maximum aggregate principal amount of notes from time to time outstanding in respect of all issuers will not exceed EUR 70 billion or the equivalent thereof in other currencies. The notes are denominated in any currency subject to compliance with any applicable legal and or regulatory and or central bank requirements. As at 31 December 2019, such notes issued by the Bank amount to EUR 3,533 million (2018: EUR 3,772 million).

Commercial Paper:
Since March 2011, the Bank participates as an additional issuer in a EUR 30 billion Euro Commercial Paper (ECP) Programme, developed by its ultimate Parent Company, alongside Intesa Sanpaolo Bank Ireland (INSPIRE). The ECP (further the "notes") issued under this programme bear a maturity date under 1 year (short term notes) and are denominated in Euro, US Dollars or any other currency subject to compliance with any applicable legal and regulatory requirements. The maximum aggregate principal amount of notes from time to time outstanding in respect of all issuers will not exceed EUR 30 billion or the equivalent thereof in other currencies. As at 31 December 2019, such ECP issued by the Bank amount to EUR 3,742 million (2018: EUR 1,566 million).

Note 15 – Derivatives held for hedging

The Bank mainly uses interest rate swaps to hedge its exposure to changes in the fair values of certain fixed-rate bonds classified as financial assets measured at FVTOCI due to adverse changes in interest rates. In more details, the risk investment strategy is to invest in fixed rate securities carried at FVTOCI. The exposure of the fixed interest rate hedged item to interest rate risk is converted to floating rates with an interest rate swap in order to mitigate a potential fall in its value. The investment in the hedged assets and the completion of the covering hedging instrument are done simultaneously (Asset Swaps).

Each interest rate swap is matched with a specific bond subscribed and each hedging relationship is formally documented at inception. The documentation describes the hedging strategy, identifies the hedged item and the hedging instrument and the nature of the hedged risk.

For each hedging relationship, ex-ante and ex-post hedge effectiveness is measured by ensuring that fair value changes of the hedged items match with fair value changes of the hedging instruments.

The fair values of derivatives designed as fair value hedges are as follows:

(in EUR)	2019		2018	
	Notional amount	**Fair value**	**Notional amount**	**Fair value**
Assets				
Interest rate instruments	1,050,474,479	2,111,798	155,000,000	210,014
	1,050,474,479	**2,111,798**	**155,000,000**	**210,014**
Liabilities				
Interest rate instruments	1,948,906,195	98,241,822	2,342,734,498	69,043,776
	1,948,906,195	**98,241,822**	**2,342,734,498**	**69,043,776**

Hedged items are as follows (in EUR):

	2019	**2018**
	Carrying value	**Carrying value**
Financial assets at fair value through other comprehensive income	1,807,492,881	1,515,661,025
Loans and advances	522,080,675	245,934,498
Deposits from central banks	821,440,000	821,440,000
Deposits from customers	155,000,000	155,000,000
Total	**3,306,013,556**	**2,738,035,523**

Note 16 – Provisions

(in EUR)	**2019**	**2018**
Financial guarantee contracts issued	264,227	382,690
Loan commitments issued and uncommitted credit lines	2,365,547	927,437
Other provisions	1,748,185	1,749,385
Total	**4,377,959**	**3,059,512**

Note 16 – Provisions (continued)

Financial guarantee contracts, loan commitments issued and uncommitted credit lines
As at 31 December 2019, the amount in respect of financial guarantee contracts issued, loan commitments issued and uncommitted credit lines represent the sum of ECL provisions calculated following IFRS 9 implementation.

Other provisions
The following table sets out other provisions.

(in EUR)	**2019**
Provision as at 1st January 2019	1,749,385
Reduction	-
Forex impact	22,170
Provision reversed during the year	(23,370)
Provisions as at 31 December 2019	**1,748,185**

(in EUR)	**2018**
Provision as at 1st January 2018	1,679,138
Reductions	-
Forex impact	70,247
Provision reversed during the year	-
Provisions as at 31 December 2018	**1,749,385**

The above table shows provisions movements from 31 December 2018 to 31 December 2019. Increase has been generated by foreign exchange movements (linked to some provisions in foreign currency).

Note 17 – Equity

Share capital

As at 31 December 2011, the Bank's subscribed and paid-up capital amounts to EUR 280,000,000, represented by 1,750,000 shares with no par value.

On 29 June 2012, the Bank transferred the ownership of its subsidiary Intesa Sanpaolo Private Bank (Suisse), S.A., Lugano (ISPB) to its shareholder Intesa Sanpaolo Holding International S.A., Luxembourg through a partial demerger without dissolution. Consequently, ISPB is ultimately controlled by the same party both before and after the partial demerger.

In a partial demerger without dissolution, both assets and liabilities are transferred, this implied the Bank transferring an equivalent portion of own funds equal to the book value of the transferred asset.

Note 17 – Equity (continued)

According to the demerger contract concluded between the Bank and its sole shareholder, as published in the draft demerger project in the Luxembourg official newspaper (Mémorial), dated 26 May 2012, the book value of the subsidiary was fixed at EUR 16,605,170 and the Bank reduced its paid-up capital by EUR 4,908,480 cancelling 30,678 shares without par value and reduced its retained earnings and other reserves by an amount of EUR 11,696,690, drawing back its shares capital from EUR 280,000,000 to EUR 275,091,520 represented by 1,719,322 shares with no par value.

On 10 December 2012, the Bank increased its subscribed and paid-up capital by EUR 260,000,000.

On 1 February 2016 the Bank purchased the Branch from the Group through a contribution in kind. For that purpose, 13,750 shares have been issued to Intesa Sanpaolo S.p.A. consisting of EUR 4,279,308.01 to share capital and EUR 7,720,691.99 to share premium in exchange of the Branch.

On 22 September 2016, the Bank performed a capital increase of EUR 449,999,892.27 through the issuance of 1,445,911 shares integrally subscribed by Intesa Sanpaolo Holding International S.A..

The Board of Directors of the Bank during the last meeting held on 25 October 2017 resolved to increase – within the limit of the statutory authorized capital - the share capital by an amount of EUR 399,999,835.08 to raise it from EUR 989,370,720.28 to the amount of EUR 1,389,370,555.36 by creation and issue of 1,285,254 new shares without any nominal value.

These new shares all subscribed by the sole shareholder Intesa Sanpaolo Holding International S.A, fully paid off, benefit from the same rights and privileges as the existing shares.

As at 31 December 2019, the subscribed capital was therefore EUR 1,389,370,555.36 represented by 4,464,237 shares (integrally subscribed).

Revaluation reserve

Revaluation reserve caption is composed of the cumulative net change in fair value of debt securities measured at FVTOCI until the assets are derecognised or reclassified and it amounts to EUR (5,170,699). This amount includes the ECL loss allowance equal to EUR 1,076,786 (gross of deferred taxes equal to EUR 268,550). FTA revaluation reserve calculated as at 1 January 2018 following the IFRS 9 implementation has been recorded in Retained Earnings.
These revaluation reserves are not distributable.

Legal reserve

Under Luxembourg Law, the Bank must appropriate to a legal reserve an amount equivalent to 5% of the annual net profit until such reserve is equal to 10% of the share capital. This appropriation is made in the following year.

Distribution of the legal reserve is restricted. As at 31 December 2019, the legal reserve amounts to EUR 71,615,139 (2018: EUR 66,415,281). As a consequence of the share capital increase the Bank had during 2017, it has been increased by EUR 5,199,858 during 2019.

Note 17 – Equity (continued)

Net Wealth Tax

As at 31 December 2019, the Bank allocated to the Net Wealth tax reserve an amount equal to EUR 17,000,000, which constitutes an unavailable reserve.

Other reserves

As at 31 December 2019, other reserves amount to EUR 841,268,027 (2018: EUR 841,268,027).

Retained earnings

As at 31 December 2019, retained earnings amount to EUR 13,905,387 (2018: EUR 13,995,691) and mainly include :

- the impact of the implementation (FTA) of IFRS 9 as adopted by the European Union (EUR -15,430,609);
- the impact of the first time adoption (FTA) of IAS/IFRS standards as adopted by the European Union (EUR 4,850,848);
- the impact of the disposal of the functional property carried at fair value (EUR 24,513,535);
- the impact of other retained earnings (EUR -28,387).

Profit allocation proposal

The amount attributable to shareholders, including earnings profit from previous financial years but excluding the impact of the first time application of IFRS as adopted by European Union, totals EUR 94,094,546, which corresponds to a return on equity of circa 4.06% (2018: 4.56%). It is proposed to the Annual General Shareholders' Meeting approving the financial statements as at 31 December 2019 to allocate the above mentioned amounts as follows (in EUR):

	2019
Net profit of 2019 financial year	94,082,728
Retained profit from previous year (excluding FTA and reclassification from revaluation reserves)	11,818
Amount attributable to Shareholders	**94,094,546**
Allocation to legal reserve (5% Net profit)	4,704,137
Allocation to the NWT reserve	17,256,550
Dividend for the financial year (77% rounded up)	72,100,000
Total	**94,060,687**
Retained profit carried forward to the next financial year	*33,859*

Note 18 – Net interest income

(in EUR)	2019	2018
Financial assets held for trading	424,434	746,917
Financial assets at fair value through profit or loss	44,487	353,910
Hedging derivatives	1,574,235	935,977
Financial assets at FVTOCI	19,870,233	23,997,338
Loans and advances	248,041,782	242,204,180
Interest income on liabilities	7,693,994	6,622,500
Other	-	12,862
Total interest and similar income	**277,649,165**	**274,873,684**

(in EUR)	2019	2018
Hedging derivatives	25,851,502	24,678,664
Financial liabilities held for trading	172,261	507
Financial liabilities measured at amortised cost	97,507,917	106,960,467
Financial liabilities at fair value through profit or loss	36,001	222,559
Interest expenses on assets	-	-
Total interest expenses and similar charges	**123,567,681**	**131,862,197**
Net interest income	**154,081,484**	**143,011,487**

Interest income and expenses from loans and advances, financial liabilities measured at amortised cost and financial assets at FVTOCI are recognized according to the effective interest rate methodology.

Note 19 – Net fee and commission income

A. Disaggregation of fee and commission income

In the following table, fee and commission income from contracts with customers in the scope of IFRS 15 is disaggregated by major type of services:

(in EUR)	2019	2018
Credit activities	71,008,020	47,291,488
Wealth management and Treasury activities	20,576,873	22,096,875
Corporate services	726,013	1,005,608
Other	2,744,270	4,205,581
Total fee and commission income	**95,055,176**	**74,599,552**
Credit activities	49,284,733	19,175,610
Brokerage and clearing fees	7,165,320	9,355,570
Other	3,254,854	3,532,639
Total fee and commission expenses	**59,704,907**	**32,063,819**
Net fee and commission income	**35,350,269**	**42,535,733**

Note 19 – Net fee and commission income (continued)

In the following table, fee and commission income from contracts with customers in the scope of IFRS 15 is disaggregated by nature:

(in EUR)	**2019**	**2018**
Wealth management and Treasury activities	20,576,873	22,097,604
Structuring fees	29,700,000	15,998,571
Commitment fees	14,006,274	11,028,688
Commission income on limited recourse transactions	1,864,386	5,023,575
Upfront fees	9,767,153	4,568,836
Arrangement fees	9,435,579	3,798,054
Cash management fees	733,032	2,408,512
Amendment fees	1,580,773	1,622,677
Participation fees	1,878,219	878,450
Corporate services fees	513,421	770,313
Credit activities – other	1,071,208	727,607
Commission income on guarantees	659,819	669,863
Buy out fees	212,592	162,546
Other	3,055,847	4,844,256
Total fee and commission income	**95,055,176**	**74,599,552**
Structuring fees	29,700,000	11,400,000
Brokerage and clearing fees	7,165,320	9,355,570
Servicing fees	8,319,838	2,784,710
Credit activities – other	4,774,545	2,167,448
Commitment fees	1,400,635	1,265,714
Upfront fees	3,545,866	987,520
Arrangement fees	2,096,413	570,218
Other	2,702,290	3,532,639
Total fee and commission expenses	**59,704,907**	**32,063,819**
Net fee and commission income	**35,350,269**	**42,535,733**

Note 19 – Net fee and commission income (continued)

In the following table, fee and commission income from contracts with customers in the scope of IFRS15 is disaggregated by origin:

(in EUR)	2019	2018
LUXEMBOURG	11,499,192	24,982,514
ITALY	6,218,029	10,745,246
NETHERLAND	6,870,710	6,661,489
QATAR	4,188,587	6,078,450
U.S.A.	3,344,318	4,700,990
FRANCE	1,320,437	2,494,000
UNITED KINGDOM	1,708,657	2,482,516
GERMANY	721,420	1,846,963
SOUTH AFRICA	1,856,675	1,751,378
SPAIN	2,759,095	1,244,331
BELGIUM	971,728	1,036,269
IRELAND	1,258,968	1,022,947
RUSSIA	38,004,764	919,172
CYPRUS REP.	76,394	860,955
HONG KONG	1,385,762	810,666
JAPAN	708,215	794,496
GHANA	548,611	664,669
SWITZERLAND	844,339	616,432
SOUTH KOREA	395,875	536,656
CHINA	433,463	399,350
KUWAIT	521,219	395,802
CAYMAN ISL	509,687	360,835
TAIWAN	235,426	266,279
AUSTRIA	57,568	265,324
CANADA	225,402	257,111
INDIA	6,130,389	218,036
PAKISTAN	31,217	147,468
NIGERIA	69,877	133,383
MONACO	86,783	124,681
BRAZIL	481,339	113,025
SAUDI ARABIA	104,010	106,673
OTHER COUNTRIES	1,487,020	1,561,446
Total fee and commission income	**95,055,176**	**74,599,552**

Note 19 – Net fee and commission income (continued)

(in EUR)	2019	2018
UNITED KINGDOM	33,762,093	13,701,853
ITALY	16,573,779	7,565,127
U.S.A.	1,180,058	2,349,258
LUXEMBOURG	3,813,466	2,005,866
FRANCE	861,372	1,874,411
RUSSIA	517,246	576,641
CYPRUS REP.	267,369	452,605
GERMANY	163,181	324,441
JAPAN	231,816	313,844
SOUTH KOREA	199,090	279,504
IRELAND	182,362	243,780
CHINA	228,246	211,610
SWITZERLAND	44,356	163,633
INDIA	152,194	152,669
TAIWAN	143,210	152,135
CAYMAN ISL	219,476	148,721
SOUTH AFRICA	100,987	147,986
HONG KONG	199,287	119,819
NETHERLAND	90,480	105,288
CANADA	83,573	100,882
OTHER COUNTRIES	691,266	1,073,746
Total fee and commission expenses	**59,704,907**	**32,063,819**
Net fee and commission income	**35,350,269**	**42,535,733**

B. Contract balances
Revenues are mainly recognised at a specific point in time, when the Bank satisfies a performance obligation by transferring a promised service to the customer.
As at 31 December 2019 the Bank recognised a receivable amounting to EUR 6,800,000 in relation to a transaction finalized at the end of the year and concerning up-front fees to be received during the first quarter of 2020.

C. Performance obligations and revenue recognition policies
Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer.

The following table provides information about the nature and timing of satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Note 19 – Net fee and commission income (continued)

Type of service	Nature and timing of satisfaction of performance obligations, including significant payment terms	Revenue recognition under IFRS 9 and 15 (applicable from 1 January 2018)
Corporate banking service	The Bank provides banking services to corporate customers. Fees for ongoing account management are charged to the customers' account on a monthly basis. Transaction-based fees are charged when the transaction takes place.	Revenue from account service is recognised over time as the services are provided. Revenue related to transactions is recognised at the point in time when the transaction takes place.
Asset management service	The Bank provides asset management services. Fees for asset management services are calculated based on a fixed percentage of the value of assets managed and deducted from the customers' account balance on a monthly basis.	Revenue from asset management services is recognised over time as the services are provided.

Note 20 – Dividend income

As at 31 December 2019 dividend income relates to financial assets mandatorily measured at fair value; 2018 amount relates to financial assets mandatorily measured at fair value and to financial assets measured at FVTOCI.

Note 21 – Net (un)realised losses on financial assets and liabilities held for trading

As at 31 December 2019 and 2018, the net (un)realised (losses) on financial assets and liabilities held for trading are composed of:

(in EUR)	2019	2018
Equity instruments and linked derivatives	(116,727)	18,204
Interest rate instruments and linked derivatives	(8,886,285)	(18,978,087)
Foreign exchange transactions	(30,044,680)	(41,333,014)
	(39,047,692)	**(60,292,897)**

As at 31 December 2019 net (un)realised losses on financial assets and liabilities held for trading are mainly composed of :

- Losses realised on Interest rate swap contracts unwinded before their maturity for an amount of EUR -2.9 million (of which EUR -0.2 million paid in relation to their NPV and EUR -2.7 million paid in relation to interest rate differentials); as at 31 December 2018 corresponding figures were respectively EUR -12.6 million, EUR -15.2 million and EUR 2.6 million.
  Those contracts have been unwinded in relation to the sale of bond instruments disclosed in note 23;

Note 21 – Net (un)realised losses on financial assets and liabilities held for trading (continued)

- Losses unrealised on Cross Currency Interest rate swap contracts for an amount of EUR -48.5 million, of which EUR 3.9 million of gains linked to their NPV and EUR -52.4 million of losses linked to the interest rate differentials related to the hedging of forex exposures; as at 31 December 2018 corresponding figures were respectively EUR -56.4 million, EUR -7.6 million and EUR -48.8 million.
- Global positive impact generated by foreign translation differences for an amount of EUR 18 million.

Note 22 – Net (un)realised gains on financial assets and liabilities at fair value through profit or loss

As at 31 December 2019 the net (un)realised gains on financial assets and liabilities at fair value through profit or loss are mainly composed of realised losses on assets classified at fair value through profit or loss for an amount of EUR 251 thousands (2018: EUR 175 thousands) and of realised gains on deposits for an amount of EUR 296 thousands (2018: EUR 273 thousands). Those amounts have been realized following the disposal in February 2019 of a security classified as financial asset designated at fair value and the consequent reimbursement of the linked deposit in the liability side.

Note 23 – Net realised gains on financial assets and liabilities not at fair value through profit or loss

As at 31 December 2019 net realised gains on financial assets and liabilities not at fair value through profit or loss are mainly composed of net gains realised on the sale of bond instruments measured at FVTOCI for an amount of EUR 5.2 million (2018: EUR 25.9 million).

(in EUR)	2019			2018		
	Profits	**Losses**	**Net**	**Profits**	**Losses**	**Net**
Due from banks and customers	37,048	-	37,048	203,531	(948,000)	(744,469)
Financial assets measured at FVTOCI	6,381,243	(1,162,536)	5,218,707	28,512,359	(2,562,689)	25,949,670
Debt securities	*6,381,243*	*(1,158,543)*	*5,222,700*	*28,512,359*	*(2,562,689)*	*25,949,670*
Equities	-	*(3,993)*	*(3,993)*	-	-	-
Total assets	**6,418,291**	**(1,162,536)**	**5,255,755**	**28,715,890**	**(3,510,689)**	**25,205,201**
Securities issued	-	-	-	-	-	-
Total liabilities	-	-	-	-	-	-
Net realised gains and losses	**6,418,291**	**(1,162,536)**	**5,255,755**	**28,715,890**	**(3,510,689)**	**25,205,201**

Note 24 – Net other expenses

As at 31 December 2019 and 2018, net other expenses are mainly composed of withholding taxes, which are linked to the Bank's business activity.

Note 25 – Administrative expenses

(in EUR)	2019	2018
Wages and salaries	14,520,032	14,246,034
Social security charges	2,185,206	2,160,859
Legal pension and similar expenses	862,716	854,225
Employee benefits	1,776,381	1,632,146
Other	736,650	152,497
Total staff expenses	**20,080,985**	**19,045,761**
Operating expenses	8,145,257	5,982,750
Repair and maintenance	241,127	349,044
Training and moving	1,037,564	1,083,963
IT outsourcing costs	9,116,627	8,047,329
Legal and professional fees	1,499,188	1,524,454
Marketing and representation fees	1,551,815	1,582,330
Charges linked to Corporate activity and other charges	1,531,352	1,225,562
Total general and administrative expenses	**23,122,930**	**19,795,432**
Total administrative expenses	**43,203,915**	**38,841,193**

The average number of personnel employed by the Bank at the end of the financial year was as follows:

	2019	2018
Senior Management	4	4
Middle Management	53	59
Employees	112	109
	169	**172**

Note 26 – Net Impairment on financial assets

During the year, the Bank has recorded impairment on financial assets as follows:

(in EUR)	2019			2018
	Write-downs	Write-backs	Total	Total
Loans and advances	(13,472,723)	7,369,416	(6,103,307)	(3,076,196)
Debt securities	(642,324)	154,583	(487,741)	459,660
Impairment	**(14,115,047)**	**7,523,999**	**(6,591,048)**	**(2,616,536)**

Note 27 – Related party disclosures

Identity of related parties

The Bank has a related party relationship with its direct and non-direct parent companies, entities of its Group and with its directors (hereafter "administrative bodies") and executive officers (hereafter "other key management personnel"). All transactions made with related parties are concluded on an arm's length basis.

The amount of main assets, liabilities, income and expenses as at 31 December 2019 and 2018 concerning Group entities and the parent companies are as follows:

(in EUR)	2019	2018
Assets and liabilities		
Assets held for trading and assets carried at fair value through profit or loss	27,885,550	41,300,587
Investment securities mandatorily measured at FVTPL	613,898	507,064
Investment securities at FVTOCI	211,185	211,185
Loans and advances	8,410,988,691	7,955,946,319
Hedging derivatives – Assets	2,111,798	210,014
Tangible assets*	3,298,698	-
Financial liabilities held for trading and liabilities carried at fair value through profit or loss	65,084,904	60,304,445
Financial liabilities measured at amortised cost*	7,555,827,031	9,505,200,327
Hedging derivatives – Liabilities	98,241,822	69,043,776
Provisions	36,956	136,523

(in EUR)	2019	2018
Income and expenses		
Interest income*	51,214,474	46,799,881
Fees and commissions income	757,693	1,621,224
Dividend income	50,878	672,427
Net (un)realised losses on financial assets and liabilities held for trading	(84,549,073)	(185,547,082)
Net unrealised losses on financials assets and liabilities held for hedging	(33,643,116)	(54,268,176)
Net (un)realised losses on financials assets and liabilities at fair value through profit or loss	296,312	191,474
Net realized gains on financials assets and liabilities not at fair value through profit or loss	(2,896)	(1,151,622)
Interest expenses*	(75,800,052)	(84,732,473)
Fees and commissions expenses	(16,537,939)	(15,210,779)
Impairment	265,791	1,088,202
Administrative expenses	(12,081,912)	(11,249,070)
Other operating income and expenses	(1,446,823)	(1,949,352)
Depreciation*	(1,073,524)	-

**Tangible assets amount (and the related amount booked in caption "Depreciation") relates to real estate operating lease contract subscribed by the Bank with its parent company Intesa Sanpaolo Holding International S.A. (ISPH); concerning financial liabilities measured at AC, the amount includes EUR 221 mio of deposits and EUR 4,309 mio of debt certificates with ISPH. In relation to Income and expenses captions, interest expenses related to transactions with ISPH amounted to EUR 27 mio.*

Note 27 – Related party disclosures (continued)

Key management personnel

The Bank incurred expenses with respect to the remuneration of the members of the administrative, management and supervisory bodies as follows:

(in EUR)	**2019**	**2018**
Administrative bodies	200,946	131,392
Other key management personnel	1,317,188	1,506,370
	1,518,134	**1,637,762**

Administrative bodies are related to Directors composing the Bank's board. The amount relates to their participation to each board.

As at 31 December 2019 and 2018, the Bank has no obligations related to retirement pensions for former administrative bodies and key management personnel.

As at 31 December 2019 and 2018, the Bank has not granted advances and credits and has not entered into guarantee commitments for the above mentioned bodies and personnel.

During 2019 the Bank has paid bonuses to other key management personnel for an amount of EUR 280,000 (2018: EUR 331,940).

Note 28 – Commitments and contingent liabilities

The Bank's commitments and contingent liabilities may be analysed as follows:

(in EUR)	**2019**	**2018**
Unused confirmed credits	4,639,628,905	6,480,805,726
- out of which towards related parties	-	*25,065*
Guarantees and other direct substitutes for credit	316,141,594	479,967,237
- out of which towards related parties	*83,945,442*	*273,000,316*

Note 28 – Commitments and contingent liabilities (continued)

Guarantees received by the Bank:

Unused confirmed credits and contingent liabilities are secured by guarantees received by the Bank as follows:

(in EUR)	2019		2018	
	Contingent liabilities	**Unused confirmed credits**	**Contingent Liabilities**	**Unused confirmed credits**
Net carrying amounts	**316,141,594**	**4,639,628,905**	**479,967,237**	**6,480,805,726**
Real guarantees				
Securities	2,893,810	-	1,520,969	-
Other real guarantees	40,707,113	15,290,523	3,950,268	28,610,765
Personal guarantees				
Government guarantees	-	873,327,084	-	801,129,228
Credit institutions guarantees	-	2,999,970	12,153	2,650,000,000
Total guarantees	**43,600,923**	**891,617,577**	**5,473,390**	**3,479,739,993**

Note 29 – Deposit guarantee and investor compensation schemes

The law related to the resolution, reorganisation and winding-up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes ("the Law"), transposing into Luxembourgish law the directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms and the directive 2014/49/EU related to deposit guarantee and investor compensation schemes, was passed on 18 December 2015.

The deposit guarantee and investor compensation scheme "Association pour la Garantie des Dépôts Luxembourg" (AGDL) was replaced by a new contribution based system of deposit guarantee and investor compensation scheme. This new system covers eligible deposits of each depositor up to an amount of EUR 100,000 and investments up to an amount of EUR 20,000. The Law also provides that deposits resulting from specific transactions or fulfilling a specific social or other purpose are covered for an amount above EUR 100,000 for a period of 12 months.

The funded amount of the "Fonds de résolution Luxembourg" (FRL) shall reach by the end of 2026 at least 1% of covered deposits, as defined in article 1 number 36 of the Law, of all authorized credit institutions in all participating Member States. This amount will be collected from the credit institutions through annual contributions during the years 2015 to 2024.

The target level of funding of the "Fonds de Garantie des Dépôts Luxembourg" (FGDL) is set at 0.8% of covered deposits, as defined in article 163 number 8 of the Law, of the relevant credit institutions and was to be reached by the end of 2018 through annual contributions. The contributions were made in the form of annual payments during the years 2016 to 2018.

Note 29 – Deposit guarantee and investor compensation schemes (continued)

Since the level of 0.8% was reached, the Luxembourgish credit institutions are to continue to contribute for 8 additional years in order to constitute an additional safety buffer of 0.8% of covered deposits as defined in article 163 number 8 of the Law.

Note 30 – Investment management services and underwriting functions

The Bank provides its customers with, among others, the following services:

- Private Banking;
- Corporate services;
- Custody.

Assets managed on behalf of third parties are as follows:

(in EUR)	2019	2018
Custody and administration of transferable securities	8,838,417,094	8,766,001,222
Wealth Management	161,141,167	216,904,473

Note 31 – Audit fees

The audit fees and audit related fees for the years ended 31 December 2019 and 2018 are as follows:

(in EUR)	2019	2018
Audit fees	200,500	200,500
Audit related fees	350,500	350,500
Other	25,000	111,000
	576,000	**662,000**

Note 32 – Encumbered assets

In 2019 and 2018 the Bank participated to the Long Term Refinancing Operation mechanism organised by the Banque centrale du Luxembourg for an amount of EUR 812 million (2018: EUR 812 million). Those deposits are collateralised by eligible securities classified in the securities at fair value through OCI portfolio for an amount of EUR 842 million (2018: EUR 873 million).

Note 32 – Encumbered assets (continued)

ASSET ENCUMBRANCE

(in EUR)	ENCUMBERED Carrying amount	ENCUMBERED Fair value	UNENCUMBERED Carrying amount	UNENCUMBERED Fair value	CARRYING AMOUNT 2019	CARRYING AMOUNT 2018
Cash and cash equivalents	-	-	4,345,256,524	-	4,345,256,524	4,267,224,397
Debt securities	842,023,178	842,023,178	1,416,090,734	1,416,090,734	2,258,113,912	2,361,324,788
Equities	-	-	825,083	825,083	825,083	1,000,886
Loans and advances	148,720,000	-	15,384,777,558	-	15,533,497,558	14,224,146,516
Other financial assets	-	-	32,304,845	32,304,845	32,304,845	48,655,496
Non financial assets	-	-	54,971,845	-	54,971,845	55,435,037
Total 2019	**990,743,178**	**842,023,178**	**21,234,226,589**	**1,449,220,662**	**22,224,969,767**	**20,957,787,120**

Note 33 – Analysis of changes in financing during the year

In EUR	Liabilities Debt Securities	Liabilities Subordinated Liabilities	Equity Ordinary Shares	Equity Share Premium	Equity Retained Earnings	Total
Opening balance at 1 January 2019	**5,338,752,423**	**200,000,000**	**1,389,370,555**	**7,720,692**	**13,995,691**	**6,949,839,361**
Changes from financing cash flows						
Proceeds from issue of debt securities	6,596,197,971	-	-	-	-	6,596,197,971
Repayment of debt securities	(4,659,344,538)	-	-	-	-	(4,659,344,538)
Proceeds from issue of subordinated loans	-	-	-	-	-	-
Proceeds from disposal of assets	-	-	-	-	-	-
Total changes from financing cash flow	1,936,853,433	-	-	-	-	1,936,853,433
Other changes	(328,477)	-	-	-	-	(328,477)
Allocation of 2018 result	-	-	-	-	(2,705)	(2,705)
Balance at 31 December 2019	**7,275,277,379**	**200,000,000**	**1,389,370,555**	**7,720,692**	**13,992,986**	**8,886,361,612**

Note 33 – Analysis of changes in financing during the year (continued)

	Liabilities		Equity			
In EUR	Debt Securities	Subordinated Liabilities	Ordinary Shares	Share Premium	Retained Earnings	Total
Opening balance at 1 January 2018	**6,454,645,627**	**-**	**1,389,370,555**	**7,720,692**	**4,850,848**	**7,856,587,722**
Changes from financing cash flows						
Proceeds from issue of debt securities	3,276,013,564	-	-	-	-	3,276,013,564
Repayment of debt securities	(4,391,439,737)	-	-	-	-	(4,391,439,737)
Proceeds from issue of subordinated loans	-	200,000,000	-	-	-	200,000,000
Proceeds from disposal of assets	-	-	-	-	24,513,535	24,513,535
Total changes from financing cash flow	(1,115,426,173)	200,000,000	-	-	24,513,535	(890,912,638)
IFRS9 - First time adoption	-	-	-	-	(15,343,010)	(15,343,010)
Other changes	(467,031)	-	-	-	-	(467,031)
Allocation of 2017 result	-	-	-	-	(25,682)	(25,682)
Balance at 31 December 2018	**5,338,752,423**	**200,000,000**	**1,389,370,555**	**7,720,692**	**13,995,691**	**6,949,839,361**

Note 34 – Operating leases

The Bank leases cars and office premises under operating leases.

Right-of-use-assets
Right-of-use-assets mainly relate to leased branch and office premises that are presented within property and equipment (see Note 8).

(in EUR)	Right-of-use assets
Balance at 1 January 2019	**5,572,370**
Depreciation charge of the year	*(1,984,406)*
Additions	*446,783*
Balance at 31 December 2019	**4,034,747**

As at 31 December 2019, the future minimum lease payments under non-cancellable operating leases are mainly composed of Luxembourg real estate location contract, which will arrive at maturity at the end of December 2021.

Note 34 – Operating leases (continued)

Lease liabilities
Lease liabilities mainly relate to real estate operating leases of the branch and of the office premises.

(in EUR)	Lease liabilities
Balance at 1 January 2019	**5,572,370**
Reductions	*(1,932,928)*
Additions	*446,783*
Balance at 31 December 2019	**4,086,225**

Amounts recognised in profit or loss

(in EUR)	2019
Interest on lease liabilities	(19,409)
Depreciation charge of the year	(1,984,406)
Expenses relating to short-term leases	(16,487)
Expenses relating to leases of low-value assets	(22,676)
Total amount	**(2,042,978)**

As at 31 December 2018, the future minimum lease payments under non-cancellable operating leases were payable as follows:

In EUR	Motor vebicles	Real estate location contracts	Total
Within 1 year	74,964	1,768,750	1,843,714
1 to 5 years	179,169	3,537,500	3,716,669
Over 5 years	-	-	-
Total	**254,133**	**5,306,250**	**5,560,383**

Note 35 – Impacts of macroeconomic factors on the financial statements

The Bank does not expect a significant impact on its performance and financial stability due to the Brexit.

The above conclusion has been reached analysing the different types of risks Brexit shall generate.

Exchange rate volatility:
A fall in value of sterling and exchange rate volatility could be generated in the aftermath of the Brexit. Taking into consideration the structure of exchange rate risk of the Bank, no significant impacts are expected.

Note 35 – Impacts of macroeconomic factors on the financial statements (continued)

Industry sectors:
Probably companies operating in the real estate-related sectors cited uncertainty within the UK property market, deferred investment decisions, and increases in construction and labour costs as being potential risks. Companies operating in the travel industry have cited the availability of markets, for example, securing flying rights in Europe, as being a major concern. The Bank has analysed the type of activities performed by its clients, and no major issues related to Brexit have been identified.

Securities issued by the Bank:
Intesa Sanpaolo London S.p.A. acts as one of the dealers used by the Bank to place its issuance. Following the Brexit, the Bank may engage a new dealer without any impact to the ECP/EMTN issuance program.

Involvement of Group entities located in UK in the Bank corporate lending activity:
From time to time the Bank interacts with entities of the Group located in London (Banca IMI London Branch or ISP London Branch) to finalize its corporate lending activities. Following the Brexit, the Bank will interact with the Group to achieve the same goals and have no impacts.

Positive impact of Brexit:
Following the Brexit, Luxembourg market will benefit of a favourable impact following the transfer of activities and entities. As per consequence, the Bank will dialogue with the Group to develop a strategy to capture opportunities to go on developing its business.

Note 36 – Events after the reporting date

The Bank is not aware of any adjusting or non-adjusting event that would have occurred since 31 December 2019.