CASSA DI RISPARMIO
DI PISTOIA E DELLA LUCCHESIA

Annual Report 2018

A bank of the Group INTESA SANPAOLO

CASSA DI RISPARMIO DI PISTOIA E DELLA LUCCHESIA

2018 Report and Financial Statements of Cassa di Risparmio di Pistoia e della Lucchesia

Company subject to management and coordination
by the Parent Company Intesa Sanpaolo S.p.A.

This is an English translation of the original Italian document "Bilancio 2018". In cases of conflict between the English language document and the Italian document, the interpretation of the Italian language document prevails. The Italian original is available on group.intesasanpaolo.com.

Contents

Board of Directors, Board of Statutory Auditors and Independent Auditors **5**

Merger of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. with Intesa Sanpaolo S.p.A. **7**

Transition to IFRS 9 **8**

Main figures and alternative performance indicators **29**
Summary of operations 32

Report on operations **35**
Executive summary 37
Macroeconomic context and banking system 53
Income statement results 61
Balance sheet aggregates 68
Other information 73
Forecast for 2019 76

Proposal to approve the financial statements **78**

Board of Statutory Auditors Report **79**

Independent Auditors Report **81**

Financial statements **89**
Balance sheet 90
Income statement 92
Statement of comprehensive income 93
Statement of changes in shareholders' equity 94
Statement of cash flows 95

Explanatory Notes **97**
Part A – Accounting policies 99
Part B – Information on the balance sheet 147
Part C – Information on the income statement 188
Part D – Comprehensive income 202
Part E – Information on risks and relative hedging policies 203
Part F – Information on capital 253
Part G – Business combinations 260
Part H – Information on compensation and transactions with related parties 261
Part I – Share-based payments 266

Annexes to the financial statements **271**
Income statement reclassification criteria 273
Balance sheet reclassification criteria 273
Reconciliation between the reclassified income statement and the Bank of Italy income statement 275
Reconciliation between the reclassified balance sheet and the Bank of Italy balance sheet 276
Financial assets measured at fair value through other comprehensive income consisting +of minority shareholdings acquired for investment purposes held at the balance sheet date 277
List of the IAS/IFRS accounting standards endorsed by the European Commission as of the balance sheet date 278
Statement of property, equipment and financial assets subject to revaluation 279
Services provided by the independent auditors and by the entities belonging to the network of the independent auditors 280
Balance sheet and income statement of Intesa Sanpaolo S.p.A. 281
Territorial network 284

Report by the Management Control Committee of Intesa Sanpaolo S.p.A. to the Shareholders' Meeting on the activities carried out by the Board of Statutory Auditors of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. during the 2018 financial year pursuant to Article 2429 of the Italian Civil Code **287**

Board of Directors, Board of Statutory Auditors and Independent Auditors

Board of Directors

Chairman	Francesco Ciampi (*)
Deputy Chairman	Luciano Nebbia (*)
Directors	Antonio Di Zanni Nicola Lattanzi Luca Severini Vannino Vannucci Stefano Visone (**)

Board of Statutory Auditors

Chairman	Sandro Venturi
Standing auditors	Marco Dell'Acqua Marco Petreni
Substitute auditors	Angela Paganelli Enrico Terzani

Management

General Manager	Umberto Alunni

Independent auditors

KPMG S.p.A.

(*) in office since 7 February 2018
(**) appointed on 7 February 2018

Merger of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. with Intesa Sanpaolo S.p.A.

On 12 October 2018, the extraordinary shareholders' meeting of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. approved the merger plan of Cassa di Risparmio di Firenze S.p.A. (direct parent company of the Bank) and of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. with the Parent Company Intesa Sanpaolo S.p.A. resolved by the Bank's Board of Directors on 6 March 2018 and authorised by the European Central Bank with Decision of 25 June 2018, a plan falling within the expected objectives of the Intesa Sanpaolo Group 2018-2021 Business Plan, which provides for the simplification of the corporate structure of the Banca dei Territori Division; in view of this plan, the Shareholders' Meeting held on 26 March 2018, in relation to the renewal of the expiring Board of Directors, resolved to maintain the Board in office as a prorogation pursuant to art. 2385, paragraph 2 of the Italian Civil Code - with full powers and with the current internal structure and the same remuneration structure - until the planned integration of the Bank with the Parent Company Intesa Sanpaolo, or until new and different determinations of a subsequent Shareholders Meeting.

At the time of approval of the merger plan, the share capital of Cassa di Risparmio di Pistoia e della Lucchesia was divided between: Cassa di Risparmio di Firenze (74.883%), Intesa Sanpaolo (25.017%) and Minority Shareholders (0.100% overall). The merger of Cassa di Risparmio di Pistoia e della Lucchesia provides for the issue, by the merging company, of new Intesa Sanpaolo ordinary shares based on the exchange ratio established as 0.639 Intesa Sanpaolo ordinary shares for each ordinary share of Cassa di Risparmio di Pistoia e della Lucchesia held by shareholders other than Intesa Sanpaolo itself and Cassa di Risparmio di Firenze[1].

Due to the planned simultaneous execution of the merger of Cassa di Risparmio di Firenze, to which the merger of the Bank is subordinated, the simplified regime pursuant to art. 2505-bis of the Italian Civil Code applies and, therefore, the expert report on the adequacy of the exchange ratio pursuant to art. 2501- sexies of the Italian Civil Code has not been prepared since the Minority Shareholders have been granted the right to purchase from Intesa Sanpaolo, in whole or in part, their ordinary shares at the price of 1.89 euros for each ordinary share held, a price determined on the basis of the criteria envisaged for withdrawal; this right of sale was exercised by 8 shareholders of the Bank, for a total of 80,100 ordinary shares. The settlement of the sale took place on 10 December 2018 and consequently Intesa Sanpaolo will issue, to service of the merger, 124,061 new ordinary shares, for a total amount of 64,511.72 euros.

The legally effective date of the merger of the Bank was set as 25 February 2019, with accounting and tax effects from 1 January 2019; consequently, taking into account the timescales envisaged for the preparation of the financial statements as at 31 December 2018 and the related obligations of the Corporate Bodies, the following procedure was established, in agreement with the competent functions of the Parent Company:

- approval of the 2018 draft financial statements by the Bank's Board of Directors before the legally effective date of the merger (25 February 2019);
- the independent auditors Kpmg S.p.A. issue their report on the Bank's 2018 financial statements before the legally effective date of the merger;
- the Board of Statutory Auditors, not being able to carry out the formalities related to the calling of the Shareholders' Meeting for approval of the 2018 financial statements before the date indicated above, within the deadlines set by the Italian Civil Code, does not issue its Report on such financial statements but transmits a document containing, in substance, that required by current legislation to the Management Control Committee of the Parent Company;
- the 2018 financial statements are submitted for approval to the Shareholders' Meeting of Intesa Sanpaolo, together with the financial statements of the Parent Company.

[1] *Intesa Sanpaolo may issue a maximum of 175,245 new ordinary shares, without nominal value, and the share capital may increase by 0.52 euros for each of these new ordinary shares and, therefore, by a maximum of 91,127.40 euros, with the consequent modification of art. 5 of the by-laws.*

Transition to IFRS 9

IFRS 9: the new accounting standard on financial instruments

In this paragraph, to be considered an integral part of section A.1 of the Explanatory Notes Part A - of the 2018 financial statements, the impacts of the first-time adoption of IFRS 9 are illustrated, including the transition between the schemes published in the 2017 financial statements and those represented as a comparison year in the 2018 financial statements.

The regulatory provisions

The new IFRS 9 accounting standard, issued by the IASB in July 2014 and approved by the European Commission through Regulation no. 2067/2016, as of 1 January 2018, replaced IAS 39, which until 31 December 2017 governed the classification and measurement of financial instruments.

IFRS 9 is divided into three different areas of classification and measurement of financial instruments, impairment and hedge accounting.

With regard to the first area, IFRS 9 requires that the classification of financial assets be guided, on the one hand, by the characteristics of the related contractual cash flows and, on the other, by the business model for which such activities are held. Instead of the previous four accounting categories, financial assets according to IFRS 9 can be classified - according to the two drivers indicated above - into three categories: Financial assets measured at amortised cost, Financial assets measured at fair value through comprehensive income (for debt instruments, the reserve is transferred to the income statement in the event of disposal of the instrument) and, finally, Financial assets measured at fair value through the income statement. Financial assets can be recognised in the first two categories and can therefore be measured at amortised cost or at fair value with recognition in shareholders' equity only if it is demonstrated that they give rise to cash flows that are represented exclusively by payments of principal and interest (so-called "solely payment of principal and interest" - "SPPI test”). Equity securities are always recorded in the third category and measured at fair value through profit or loss, unless the entity (irrevocably, at the time of initial recognition), for shares not held for trading purposes, presents the changes in value in a shareholders' equity reserve, which will never be transferred to the income statement, even in the event of disposal of the financial instrument (Financial assets measured at fair value with impacts on comprehensive income without “recycling”).

With regard to financial liabilities, no substantial changes are introduced with respect to IAS 39 regarding their classification and measurement. The only change is the accounting treatment of the current credit risk: for financial liabilities designated at fair value (so-called fair value option liabilities), the standard requires that changes in fair value attributable to changes in credit risk be recognised in shareholders' equity, unless such treatment creates or extends accounting asymmetry in the profit for the year, while the residual amount of the changes in the fair value of the liabilities must be recognised in the income statement.

With reference to the impairment test, for instruments measured at amortised cost and at fair value with a balancing entry in shareholders' equity (other than equity instruments), a model is introduced based on the concept of "expected loss", instead of "Incurred loss" envisaged by IAS 39, so as to recognise losses in a more timely manner. IFRS 9 requires companies to account expected losses in the 12 months following (stage 1) initial recognition of the financial instrument. The time horizon for calculating the expected loss, on the other hand, becomes the entire residual life of the asset being measured, where the credit quality of the financial instrument has undergone a "significant" deterioration with respect to the initial measurement (stage 2) or if it is "impaired" (stage 3). More in detail, the introduction of the new impairment rules entails:

- allocation of performing financial assets to different credit risk stages (staging), corresponding to value adjustments based on expected losses in the following 12 months (“Stage 1”), or "lifetime", for the entire residual duration of the instrument ("Stage 2"), in the presence of a significant increase in credit risk ("SICR") determined by comparing the Probabilities of Default at the date of initial recognition and at the balance sheet date;
- allocation of impaired financial assets in "Stage 3", again with value adjustments based on expected "lifetime" losses;
- inclusion of forward-looking information linked, among other things, to the evolution of the macroeconomic scenario in the calculation of "Expected Credit Losses" - "ECL").

Finally, with reference to hedge accounting, the new model relating to hedges - which however does not concern so-called “macro hedges” - tends to align the accounting representation with risk management activities and to strengthen the disclosure on the risk management activities put in place by the entity that prepares the financial statements.

The choices of the Intesa Sanpaolo Group

It is appropriate to make a premise with regard to the "general" choices made by the Intesa Sanpaolo Group regarding the corporate scope of application of the new standard, to recognition of the impacts deriving from adoption of the new impairment rules on own funds, according to the recent changes introduced in the prudential regulations, and to representation of the comparative balances in the year of first adoption of the standard:

- on 12 December 2017, the European Parliament and the Council issued Regulation (EU) 2017/2395 "Transitional provisions aimed at mitigating the impact of the introduction of IFRS 9 on own funds" which updates Regulation 575/2013 CRR, introducing the new article 473 bis "Introduction of IFRS 9", which offers banks the possibility of mitigating the impacts on own funds deriving from the introduction of IFRS 9 in a 5-year transitional period (from March 2018 to December 2022) sterilising in CET1 the impact with the application of decreasing percentages over time. The Intesa Sanpaolo Group has chosen to adopt the so-called “static approach”, to be applied to the impact resulting from the comparison between the IAS 39 value adjustments as at 31/12/2017 and those of IFRS 9 as at 1/1/2018;
- with reference to the methods of representing the effects of first-time adoption of the standard, the Group exercised the option provided for in paragraph 7.2.15 of IFRS 9 and in paragraphs E1 and E2 of IFRS 1 “First-Time Adoption of International Financial Reporting Standards", according to which - without prejudice to the retrospective application of the new measurement and representation rules required by the standard - there is no mandatory requirement for restatement on a consistent basis of the comparison data in the financial statements for the first adoption of the new standard. According to the indications contained in the issue document of the 5th update of Circular 262 “ Bank balance sheets: compilation schemes and rules", banks that make recourse to exemption from the obligation of redetermination of the comparative values must, in any case, include, in the first financial statements drawn up on the basis of the new Circular 262, a reconciliation statement that highlights the methodology used and provides a reconciliation between the data of the last approved financial statements and the first financial statements prepared on the basis of the new provisions. The form and content of this disclosure are also left to the discretion of the competent corporate bodies.

Below is a brief review of the main impact areas of the new accounting standard as previously defined, as well as the main choices made in this regard by the Intesa Sanpaolo Group.

Classification and Measurement

In order to comply with the provisions of IFRS 9, according to which the classification of financial assets is guided, on the one hand, by the contractual characteristics of the cash flows of the instruments and, on the other, by the business model according to which they are held, the methods for carrying out the test on the contractual characteristics of the cash flows (SPPI Test) were defined and the business models adopted by the various Structures through which the Group operates were formalised.

As regards the SPPI test on financial assets, based on the defined methodology, an analysis was carried out on the composition of the securities and loan portfolios outstanding as at 31 December 2017, in order to determine the correct classification at the time of First Time Adoption (FTA) of the new standard.

In particular, with regard to debt securities, a detailed examination was made of the characteristics of the cash flows of instruments classified at amortised cost and in the category of financial assets available for sale according to IAS 39, identifying the assets which, not passing the SPPI test, were classified as assets to be measured at fair value through the income statement according to IFRS 9. Only a non-significant portion of debt securities - with respect to the entire Group portfolio - did not pass the SPPI test, mainly attributable to instruments that create concentrations of credit risk (tranches) and structured securities. It should also be noted that, based on the investigations conducted and the clarifications provided by the IFRS Interpretation Committee, UCI units (open-end funds and closed-end funds) were classified among assets to be measured at fair value with an impact on the income statement.

For the credit segment, the IFRS 9 implementation project carried out modular analyses, taking into account the significance of the portfolios, their homogeneity and the Business Division. In this regard, different approaches were used for retail and corporate loan portfolios and, in this context, only marginal cases emerged which, due to specific contractual clauses or the nature of the loan, determined failure of the SPPI test. Therefore, also for the credit sector, no significant impacts were identified in the FTA stage.

With regard to the second driver of financial assets classification (business model), the reference business models for each Business Division were defined. For Hold to Collect portfolios, the admissibility thresholds for sales not affecting the classification were defined (frequent but not significant, individually and in aggregate, or infrequent even if significant) and, at the same time, the parameters to identify sales consistent with this business model since attributable to an increase in credit risk were established.
More in detail, sales are allowed within the scope of an HTC business model:

- in the event of an increase in credit risk, which occurs:
    - for securities, when there is a downgrade of predetermined notches with respect to the origination rating. The approach adopted envisages that the number of notches is differentiated according to the origination rating, in line with the methodology in use for identification of "significant deterioration", i.e. to pass the staging;
    - for loans, in the case of disposal of impaired loans or loans classified in stage 2;
- when frequent but not significant in terms of value or occasional even significant in terms of value.
  In order to determine these aspects, frequency and significance thresholds were defined:
    - frequency is defined as the percentage ratio between the number of positions sold (ISINs or transactions) during the observation period and the total number of positions in the portfolio during the observation period;
    - significance is defined as the percentage ratio between the nominal value of the sales and the total nominal value of the instruments in the portfolio during the period considered.

  In the event of simultaneously exceeding both frequency and significance thresholds, a further assessment is envisaged in order to confirm the consistency of the HTC business model (for example, to assess whether sales are made near the deadline).

On the basis of the analyses carried out, it emerged that debt security portfolios measured at amortised cost pursuant to IAS 39 generally had limited movements, consistent with the management strategy of a Hold to Collect business model.
With reference, on the other hand, to debt securities classified - again in accordance with IAS 39 - among assets available for sale, a Hold to Collect business model was defined for most of the portfolios.
With regard to loans, their current management model, both for retail and corporate counterparties, is essentially attributable to a Hold to Collect business model.
Finally, in more general terms, in relation to the business model according to which the financial assets are held, it should be noted that a specific Business Model Rules document - approved by the competent governance levels - was finalised with the aim of defining and outlining the constituent elements of the business model, specifying their role with reference to the classification model regulated by the IFRS 9 standard.

With regard to equity securities, instruments (classified in the category of financial assets available for sale pursuant to IAS 39) to be subjected to the option of classification at fair value through comprehensive income in FTA were identified (without recycling to the income statement); furthermore, the general criteria that must guide the choice "in the steady state" were defined and the related organisational process was formalised.

Finally, it should be noted that, at the end of a specific analysis process, it was decided, as regards the banking Group, not to use the Fair Value Option (with separate recognition in shareholders' equity of the fair value changes attributable to one's creditworthiness) in relation to the stock of financial liabilities outstanding as at 1 January 2018.

Impairment

As regards the new impairment model:

- the tracking methods of the credit quality of the positions present in the portfolios of financial assets measured at amortised cost and at fair with balancing item in shareholders' equity were defined;
- parameters for determination of the significant increase in credit risk were established, for the purposes of correct allocation of performing exposures in stage 1 or stage 2. With reference, on the other hand, to impaired exposures, alignment of the definitions of accounting and regulatory defaults - already present today - makes it possible to consider the current classification logic of exposures in the "deteriorated/impaired" category compared to the classification logic of exposures in stage 3 to be identical;
- models were prepared - including forward-looking information - to be used for the purposes of both stage allocation (based on use of the lifetime PD) and of calculation of the one year (to be applied to stage 1 exposures) and lifetime (to be applied to stage 2 and stage 3 exposures) expected credit loss (ECL). In order to take into account the forward looking information and the macroeconomic scenarios in which the Group may find itself operating, it was decided to adopt, as analysed in more detailed below, the so-called. “Most likely scenario + add on” approach.

With reference to credit quality tracking - in line with the regulatory content of the standard and with the indications of the Supervisory Authorities concerning application of the accounting standard for larger institutions - the policy to be applied for a precise analysis of the credit quality tracking of each individual relationship (in both securitised exposure and credit form) was defined. This for the purpose of identifying both the possible "significant increase in credit risk" from the date of initial recognition to the balance sheet date, with the consequent need to classify the exposure in stage 2, and, vice vers, the prerequisites for returning it to stage 1. In other words, the choice made envisages, on a case-by-case basis and at each reporting date, the comparison - for "staging" purposes - between the credit quality of the financial instrument at the time of the measurement and that at the moment of initial issue or purchase.

In relation to the above, the elements that - pursuant to the standard and its operational application made by the Intesa Sanpaolo Group - constitute the main determinants to be taken into consideration for the purposes of the assessments on the "switches" between different stages are the following:

- the change (beyond certain thresholds) in the lifetime probability of default with respect to the time of initial recognition of the financial instrument in the financial statements. It is therefore an assessment made by adopting a "relative" criterion, which constitutes the main "driver";
- the possible presence of overdue amounts that - without prejudice to the significance thresholds identified by the law - are so since at least 30 days. In this case, in other words, the credit risk of the exposure is presumed to be "significantly increased" and, therefore, it "switches" to stage 2 (where the exposure was previously included in stage 1);
- the possible presence of forbearance measures, which - again on a presumptive basis - involve the classification of exposures among those whose credit risk is "significantly increased" compared to initial recognition;
- finally, for banks belonging to the foreign perimeter, some of the indicators of the credit monitoring systems specifically used by each bank are considered - for the purposes of switching between “stages” and where appropriate;. In particular, the reference is to the so-called "watch-lists", i.e. to those credit monitoring systems which, based on the current creditworthiness of the debtor counterparty, highlight performing exposures above a certain risk level.

By focusing on the main triggers highlighted above (the change in the probability of lifetime default), the significant increase in credit risk (SICR) is determined by comparing the relative change in the lifetime Probability of Default recorded between the date of first recognition of the relationship and that of observation (Lifetime PD Delta) with predetermined significance thresholds. The allocation of a Lifetime PD to the individual relationships is carried out by referring to the rating masterscale by single segment both at the date of initial recognition and observation. The ratings are determined based on internal models where available or managed. In the absence of a rating, the Benchmark PDs are allocated on the type of counterparty assessed.
The determination of a significant deterioration is therefore given by the increase in lifetime PD caused by the downgrade of the position, measured in terms of "notches", between the origination of the same and the reporting ("observation") date, as well as the change in the forecast of future macro-economic factors.
The aforementioned "relative" change in lifetime PD is the indicator of the increase or decrease in credit risk identified in the reference period. In order to establish whether, in accordance with the requirements of IFRS 9, a possible increase in credit risk can be considered "significant" (and therefore entail the switch between stages), it is necessary to define specific thresholds. Increases in lifetime PD less than these thresholds are not considered significant and, consequently, do not involve the transfer of individual credit lines/tranches of debt securities from stage 1 to stage 2; this transfer is, on the other hand, necessary in the presence of relative increases of PD greater than the thresholds in question. The thresholds used are determined on the basis of a process of simulations and optimisations of predictive performance, developed using granular historical portfolio data. Specific thresholds are defined for the Corporate, Retail, Large Corporate and SME Retail models and extended by methodological affinity to other models. The thresholds differ in terms of residual duration, annual granularity and rating class at the time of issue/purchase of each individual financial instrument.
The determination of the thresholds was calibrated in order to find a correct balance between the performance indicators related to the capacity of such thresholds to:

- intercept positions in stage 2 before their transition to default;
- identify positions for which the return to stage 1 is synonymous with an effective improvement in creditworthiness.

Once the allocation to the various stages of credit risk has been defined, the determination of the expected losses (ECL) is carried out, at the level of the individual security transaction or tranche, starting from the IRB/Management model, based on the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD) parameters, on which appropriate corrective actions are performed, so as to ensure compliance with the specific provisions of IFRS 9. We recall that these actions include, in particular, adoption of a Point in Time (PIT) PD against the Through the Cycle (TTC) PD used for Basel purposes, estimate of PD and, where appropriate, of multi-period LGD to determine, where necessary, the expected loss for the entire residual life of the financial instrument, removal from the calculation of the LGD of the component linked to the adverse economic cycle (so-called Downturn), as well as use, in the discounting process, of the actual interest rate of the individual positions.

The measurement of financial assets - both those performing and those included in stage 3 - also reflects the best estimate of the effects of future conditions, first of all those in the economic context, on the basis of which the forward looking PD and LGD are influenced. With reference to the incorporation of this information in determining the impairment of a loan, a useful indication came from the TRG[2]. The TRG addressed, among other things, the following issues: (i) whether it is sufficient to use a single scenario, or whether it is necessary to incorporate a plurality of scenarios within the scope of the impairment estimates; (ii) if it is necessary to incorporate a plurality of scenarios, which methodology must be adopted for this purpose. With regard to point (i), the TRG observed that, when there is a non-linear relationship between macroeconomic variables and impairment losses, only one macroeconomic scenario is not representative of the entire distribution of possible scenarios; therefore, the estimate of the impairment losses must necessarily be based on a plurality of scenarios. With regard to point (ii), the TRG showed that one of two methods can be used:

[2] The TRG or "IFRS Transition Resource Group for impairment of financial instruments (ITG)" is a discussion forum with the aim of supporting the implementation of certain issues related to the new impairment requirements introduced by IFRS 9.

a) estimate of losses in each scenario considered and calculation of the average of the losses thus obtained, weighted by the probabilities of occurrence of each scenario;

b) estimate of losses based on the "most-likely" scenario and subsequent correction of the amount thus obtained through the application of an "add-on" (also called "overlay adjustment") to take into account the less likely scenarios[3].

The information on the future macroeconomic scenarios in which the Bank may find itself operating influences the situation of debtors with reference both to the "risk" of migration of exposures to lower quality classes (thus concerning the "staging") and to the amounts recoverable (thus relating to the determination of the expected loss on exposures).
From a methodological point of view, several possible alternative approaches were analysed in order to take these elements into consideration. With respect to the various alternatives considered, the approach that the Intesa Sanpaolo Group decided to adopt is represented by the so-called "Most likely scenario + Add-on". According to this approach, the macroeconomic conditioning of PD and LGD is carried out through a basic "Most Likely" scenario, consistent with that used for other business purposes such as, for example, budget and business plan, and then corrected with an Add-On aimed at including any differences with respect to worse and better scenarios. If the impact of the Add-On on the risk parameters is on the whole positive, it was decided to sterilise the effect both for the purpose of staging and calculating the ECL.
The design of the "most-likely" scenario takes place using a set of stand-alone analytical and forecasting tools that determine the forecast path for certain blocks of variables, in particular:
- national accounts and inflation in the first 6 countries of the Eurozone, the United States and Japan;
- official rates (ECB, Fed, BoJ), EUR and USD swap rate curves, certain points of government curves;
- exchange rates for EUR, USD, JPY and GBP;
- certain detailed data for the Italian economy (industrial production, employment, public finance balances).

These forecasts are then imposed on the multi-country structural model (Global Economic Model) of Oxford Economics, where they replace the forecasts of the base scenario provided by the company with the periodic updating of the database. The model is then solved to derive a coherent global forecast, including variables for which ad hoc models have not been developed, and to have a simulation environment that can be used to generate any alternative scenarios. This step may require a number of iterations, especially if the forecast framework expected through internal processing deviates significantly from that of Oxford Economics. In this case, it may be necessary to carry out further fine-tuning interventions on specific secondary variables that analysts consider to be inconsistent with the forecast scenario or which are characterised by unexplained quarterly volatility.

Simultaneously with the preparation of the Most-Likely scenario, alternative paths are identified, used as input in the calculation of the Add-On using the Oxford Economics "Global Model" simulation environment. For certain variables, alternative paths are imposed with respect to the one foreseen in the Most-Likely scenario, on the basis of which the model is solved in order to obtain consistent simulated paths for the other variables used in the context of the process in question.
The guiding variables are the following:
- annual average GDP growth rates of certain countries (Italy, the United States, Germany, France, Spain and the United Kingdom);
- European stock exchange index (DJ Eurostoxx 50);
- US stock exchange index (S&P500);
- residential real estate prices (United States);
- residential real estate prices (Italy).

The selection of alternative paths is carried out using external information. In particular:
- annual average GDP growth rates of certain countries: represents the fundamental driver of the simulation; the deviations are determined in order to replicate the dispersion of the growth estimates published by Consensus Economics in the most recent report available at the date of the simulation, considering the minimum and maximum forecasts (after applying a filter for the identification and elimination of any outliers). In the presence of outliers, the anomalous data is discarded and the maximum and minimum of the remaining values are considered. Since the consensus estimates are available only for the first two years of the simulation horizon, for the third year an extrapolation of the deviations identified for the first two years is made;
- US stock exchange indices (DJ Eurostoxx 50, S&P500) and residential real estate prices: the minimum and maximum forecasts of the Thomson Reuters panel are used as a reference;
- Italian residential real estate prices: since there are no consensus estimates currently available, the alternative paths start from the distribution of quarterly historical variations available from 1980 to the current quarter.

For each quarter, the percentile relating to the change in the quarter in the Most Likely scenario is identified with respect to the historical distribution of the variations referring to the above indicators. Starting from the identified

[3] These alternative methodologies are also envisaged in the document of the Global Public Policy Committee of representatives of six largest accounting networks of 17 June 2016, entitled "The implementation of IFRS 9 impairment requirements by banks. Considerations for those charged with governance of systematically important banks".

percentile value, the variations corresponding to a probability difference are identified, calculated through the statistical analysis of the historical distribution of the observations. The new values identified are used as input for the determination of the negative Add-On factor (lowest value) and as input for the positive Add-On (highest value). The two variations (positive and negative) with respect to the Most-Likely scenario are then used to calculate the level of the individual indices identified, reconstructing for each the two alternative paths (one positive and one negative) which represent the input for determination of the Add-On factor. The probability difference adopted is identified on the basis of the variability characteristics of the series, so as to obtain a deviation from the Most-Likely scenario of significant amplitude.
In applying the annual variations in the quarterly profile of the variables, each deviation from the annual average is distributed, within the forecast quarters for that year, following a standardised levelling method that minimises the overall variability of the variable profile.
The two sets of alternative variables thus obtained are used as input in the aforementioned Oxford Economics Global Model, which is then solved to derive consistent paths for all the remaining variables and countries. The output of the model consists of two variable datasets that reflect, through the equations of the model, the two shocks applied (worse and better, respectively). The datasets are checked to verify the presence of excessive quarterly volatilities and/or inconsistencies in the path of the secondary variables. If necessary, a fine tuning of the results is performed. The set of variables that constitute the most restricted datasets provided to elaborate the alternative Add-On scenarios in the subsequent stages of the process is then extracted from these datasets.
In addition to definition of the alternative routes, a map of possible additional factors, i.e. adverse events or idiosyncratic scenarios (e.g. Brexit, etc.), not explicitly incorporated in the time series used to define the Most-Likely scenario or in the alternative routes, which can generate further significant effects on expected losses, is maintained.
Of these events/scenarios, the following are assessed:

- the possible occurrence time frame;
- the degree of inclusion in the Most Likely scenario or in the alternative routes;
- the potential impact, measured in qualitative terms.

The additional factors map also draws on the lists of risk factors contained in the IMF (World Economic Outlook) and European Commission forecast reports and may change over time.
In the assessment of the additional factors time-frame, it is highlighted whether the factor is impossible to place in a specific time horizon, a characteristic that makes its incorporation into the Most-Likely scenario or into the alternative paths impractical.
The assessments carried out take into account the fact that the consensus estimates could include forecasts that already incorporate the total or partial occurrence of one or more risk factors in their estimates, so the alternative routes could already incorporate these additional factors.

Special considerations apply to exposures classified as "stage 3" (those corresponding - as indicated above - to the current perimeter of impaired assets). With regard more specifically to impaired loans, it should be noted that, despite the fact that the definition of impaired credit (credit-impaired financial asset) present in IFRS 9 with respect to the previous accounting standard is substantially the same, the methods for calculating the lifetime ECL have led to methodological reflections, also for the purposes of the assessments to be carried out in this area, mainly in relation to:

- the inclusion of forward-looking information, such as that relating to macroeconomic scenarios, estimates and recovery times, the likelihood of migration into worse classes, as well as that which may influence the value of the collateral or the expected duration of the related recovery;
- the consideration of alternative recovery scenarios, such as those of the sale of credit assets, in connection with possible disposals of portions of the impaired portfolio, in relation to the corporate objectives for the reduction of non-performing assets, to which a probability of occurrence must be attributed, to be considered in the context of the overall assessment.

As regards the inclusion of forward looking information, it should be noted that, also in relation to impaired exposures, in addition to a component linked to current economic conditions, a component linked to the most likely and worst-case scenarios envisaged in the next three years was considered, according to the criteria already described. In fact, as required by IFRS 9, the effects of the forward looking scenario must also be considered with respect to the LGD estimates anchored to the "current conditions" through the aforementioned component. As already mentioned, the forward looking scenario component is aimed at capturing the non-linearity of the relationship between the macroeconomic variables and the ECL measurement, by analysing the forecast uncertainties of the variables used to prepare the most-likely scenario. It is based on the same methodological framework used for performing loans, but ignores the improvement scenario from a prudential standpoint, considering only the average worst-case and most-likely scenarios over the three following years.

Moving on to analyse the alternative recovery scenarios, the Intesa Sanpaolo Group, in relation to the objectives of reducing the stock of outstanding non-performing loans, included in the business plans, and to the commitments undertaken with the Supervisory Bodies, with specific reference to the so-called NPL Strategy, considers the sale of certain portfolios as the strategy that can, under certain conditions, maximise the recovery of cash flows, also in consideration of recovery times.
In particular, the ECB, with the "NPL Guidance" published in March 2017, requested Banks with an incidence of impaired loans higher than the average of European Banks, to define a strategy aimed at achieving a progressive reduction of the same. During 2017, Intesa Sanpaolo submitted to the ECB an impaired loans reduction plan, mainly focused on recovery activities through internal management, and which envisaged the achievement of an NPL ratio of 10.5% at the end of 2019.
In the latter part of 2017 - in the light of regulatory developments, with the publication, in October, of the draft of the Addendum to the "NPL Guidance" aimed at determining minimum levels of prudential allocation for impaired loans, and of the indications provided by the Supervisory Authority to banks with above-average impaired exposures, regarding the need to proceed with greater incisiveness in the reduction of non-performing loans - Intesa Sanpaolo, as part of the preparation of the 2018-2021 Business Plan, approved by the Board of Directors on 6 February, identified a significant de-risking among the priority points, aimed at allowing the Group - in 2021 - to reduce the incidence of gross impaired loans to approx. 6% of the loan portfolio. To this end, a new "NPL Plan" was sent to the ECB, which envisages, in addition to the strengthening of the activities aimed at the internal recovery of positions, the sale of a significant portfolio of non-performing loans. The flanking of the sales scenario alongside the ordinary recovery scenario through internal management therefore meets the requests received from the Supervisory Authorities.

The aforementioned change in strategy envisaged by the new plan was taken into consideration when first adopting IFRS 9, a standard which, as already highlighted, has significant innovations with respect to IAS 39. In particular, IAS 39 stated (see par. 59): “An asset or group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment following one or more events that occur after the initial recognition of the asset…. omissis…. The expected losses as a result of future events, regardless of their probability, are not recognized”.
The approach envisaged by IFRS 9 is significantly different; par. 5.5.17, in fact, establishes that “an entity shall measure expected credit losses of a financial instrument in a way that reflects:

a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
b) the time value of money; and

c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions”.

In particular, IFRS 9 defines the loss as the difference between all the contractual cash flows due and the cash flows that the entity expects to receive. Therefore, while for IAS 39 the source of the cash flows is limited to the cash flows from the debtor or the guarantee as envisaged by the contractual terms, according to IFRS 9 the source of the cash flows is not limited to the cash flows based on the contractual terms, but includes all the cash flows that will flow to the creditor.
It follows that, if the entity expects to sell a "non-performing" loan to a third party, both in order to maximise the cash flows, as well as in relation to a specific non-performing loan management strategy, the ECL estimate will also reflect the presence of the sales scenario and therefore of the cash flows deriving from this sale.
IFRS 9 makes it possible to consider sales scenarios that are even only possible, which therefore must be averaged with the others considered more likely; on the other hand, in the context of IAS 39, realisation through the disposal of a loan can be considered (as a single scenario) only if it is reasonably certain at the balance sheet date, being an expression of a managerial orientation already formalised at that date.
In addition to the above, it is noted that the TRG - on the impairment of financial instruments - also confirmed that the cash flows deriving from the sale of a loan in default must be considered in the estimate of impairment losses provided that:

- sale of the loan is one of the methods of recovery that the entity expects to implement;
- the entity has no legal or operational limitations that affect the ability to sell the loan;
- the entity has reasonable and adequate information to support the disposal scenario.

The TRG also notes that:

- in order to support the entity's expectations about the assumption that disposals to third parties represent a recovery method in the event of default, both past conduct of the entity and future expectations must be assessed, and that the latter may deviate from conduct previously observed;
- to determine the recoverable amount, the relevant market information on loan exchange prices must be considered;
- the inclusion of the amounts recoverable through sale for the purposes of estimating expected losses is applicable to financial instruments classified in all Stages (1, 2 and 3); this because, in measuring expected losses, IFRS 9 requires all possible scenarios to be considered, regardless of the Stage in which the loan is classified.

That said, according to the IFRS 9 impairment model, the Group has reflected the various recovery strategies hypothesised in the assessment of loans, in order to align them in a proportional manner with a probability of disposal defined in accordance with the Group's NPL Plan.

Consequently, the "ordinary" scenario, which assumes a recovery strategy based on collection of the credit typically through legal actions, mandates to collection companies and excussion of mortgage guarantees, has been accompanied - as a recovery strategy - also by the scenario of the sale of the loan itself. In the light of this, for a defined perimeter of non-performing loans with the characteristics of disposability, in order to determine the overall expected loss of the exposures, the recoverable values based on the ordinary internal recovery process and the amounts recoverable from the sale, estimated based on market valuations carried out by an external expert, were weighted according to the portion of the portfolio held for sale, envisaged by the NPL strategy, with respect to the total of the disposable portfolio.
In this context, the perimeter of disposable non-performing loans (equal to approx. 24 billion, in terms of gross exposure, out of a total of 34 billion) was identified in the positions managed by the Credit Collection Department, taking into consideration the following exclusion criteria:
- positions in relation to which disputes or litigation are in progress (situations in which the debtor has taken legal action against the bank to dispute its credit position or its classification as non-performing);
- positions guaranteed by Consorzi Fidi, since it is burdensome to precisely identify the guarantees that support the individual credit lines;
- positions issued by Italian banks to companies resident abroad, in consideration of the operational complexities deriving from the regulatory and operational differences with respect to the debtor jurisdictions;

- securitised positions, since the securitisation structure should be dismantled, involving the various stakeholders;
- positions vis-a-vis entities other than normal families and manufacturing companies (for example, non-profit organisations);
- syndicated loans, to avoid the involvement of third parties in the disposal process, and positions with third-party funds or special facilities such as to render the disposal process operationally burdensome.

In particular, the recoverable value of disposable non-performing loans was quantified as an average value between (i) the "value in the event of disposal" (fair value) and (ii) the "value in the event of collection", assuming as weightings the percentage of disposable loans that management expects to sell, as defined in the "NPL plan" approved by the Board of Directors, and that which it plans to keep in its portfolio, respectively. It should be noted that the "value in the event of collection" was determined according to the ordinary logic followed by the Group for the impairment of non-performing loans, i.e. based on an analytical assessment for exposures above a defined threshold (equal to 2 million euros) and on an analytical-statistical assessment for the others. The analytical-statistical assessment of "below-threshold" exposures provides for their grouping into homogeneous clusters by credit risk. As illustrated above, it should be noted that the measurement of the value in the event of sale was carried out by an external expert.

It should be noted, for the sake of completeness, that, as regards impairment, a specific “Impairment Policy” document in compliance with the provisions of IFRS 9 was prepared, approved by the competent levels of governance.

Hedge Accounting

With regard to Hedge Accounting, the regulatory changes concern exclusively the General Hedge and are closely linked to the choice of the Group to make use of the opt-in/opt-out option (i.e. the possibility of implementing the criteria envisaged by the new IFRS 9 standard rather than maintaining the previous provisions of IAS 39). Based on the analyses carried out on the current management of hedging transactions, it was decided to exercise the opt-out option at the time of IFRS 9 FTA. In the light of this indication, all types of hedging transactions continue to be managed in continuity with the past, in line with the provisions of IAS 39 (carve-out). The Group will assess whether or not to confirm this choice for reporting periods subsequent to 2018.

Governance of transition to the new Standard

The Intesa Sanpaolo Group has initiated and conducted the implementation process of the new Standard on the basis of a strong and solid Project Governance. The responsibility for the Project was shared by the Risk and Accounting functions and involved, thanks to the establishment of a Steering Committee and a Business Committee with responsibility for approving the main project decisions, representatives of all the affected areas.
Furthermore, the Board of Directors, the Risk Committee and the Management Control Committee were involved, during the duration of the project, as part of the implementation process of the standard.
The value adjustments determination and reporting process is governed by two sets of company regulations: the Impairment Policy (approved by the Risk Committee and Board of Directors) which, in joint reading with the Group Accounting Rules, defines the metrics and algorithms for estimating expected impairment losses and the Process Guides, which define the actions, behaviours and controls of the organisational units involved in the process.
The activities to determine the ECL on performing and non-performing loans have been modified and supplemented in compliance with the current Group Governance framework which sees the area of the Chief Lending Officer and the Capital Light Bank responsible for determination of the analytical impairment losses on non-performing loans, and the area of the Chief Risk Officer responsible for measurement, with statistical methods, of the expected losses on performing loans, as well as the additional non-analytical measurements of non-performing loans (e.g. scenario add-on).
The expected loss calculation activities see the definition of the expected scenarios as a fundamental step; the definition of the basic assumptions is the responsibility of the Studies and Research Department in analogy to that done for other balance sheet items (e.g. impairment of intangible assets) and in line with the assumptions of the Business Plan and the Budget.

As mentioned, the CRO Area is responsible for developing and implementing the models necessary for calculating losses on loans; these models and methods are then subject to validation by the Validation Department, a function independent with respect to both the Business structures as well as the model development and implementation structures. The analyses of the Validation Department include the review of the documentation concerning the design and development of the models, data validation and repetition of the calculations.

The process of classifying financial instruments was regulated by updating existing policies and by preparing the Rules on Business Models, approved by the Risk Committee and the Board of Directors. These Rules define and outline the constituent elements of the various business models with which the Intesa Sanpaolo Group operates and, together with the SPPI test methodology described in the Group Accounting Rules, allow determination of the correct financial asset measurement approach. The Process Guides, on the other hand, define the processes, actions, behaviours and controls of the organisational units involved in the process.
In particular, with reference to loans, it should be noted that the credit disbursement processes have been supplemented to (i) manage execution of the SPPI test, carried out based on the methodology developed internally and provided in the specific tool available to the business structures and (ii) define the business model associated with each credit disbursement. The method for determining the fair value of loans (input data, models, etc.) has been integrated in the Fair Value Policy, in compliance with the current Group Governance framework.
Finally, with reference to investments in equity instruments, which the standard includes by default among financial assets valued at fair value through the income statement, the general criteria that must guide possible exercise of the option of classification at fair value through comprehensive income (without recycling to the income statement) have been defined and consequently the reference framework has been aligned (processes, limits and decision-making autonomy, etc.).

Effects of first-time adoption (FTA) of IFRS 9

As indicated in the paragraph Criteria for Preparation of the Financial Statements, the Group has chosen to make recourse to the option, established by IFRS 9, not to restate the comparative figures of the IFRS 9 first-time adoption financial statements. In order to align the 2017 comparative data with the accounting items envisaged by the new official formats of Circular 262, the necessary adjustments were made, without changing the values, based on the criteria indicated in the aforementioned paragraph Criteria for Preparation of the Report, to which reference is made. On the other hand, this section illustrates the reconciliations of the accounting balances as at 1 January 2018 due to adoption of the new classification and measurement rules required by IFRS 9.

Reconciliation between the accounting statements published in the 2017 financial statements and the IFRS 9 accounting statements (new Circular 262) as of 1 January 2018 (reclassification of IAS 39 balances)

The reconciliation statements between the Accounting Schemes as per the 2017 Financial Statements and the Accounting Schemes introduced by the new Circular 262 of the Bank of Italy are shown below, which incorporates the adoption of the presentation criteria required by IFRS 9. In these statements, the accounting balances as at 31.12.2017 (values determined according to IAS 39) are reallocated to the new accounting items, according to the reclassifications made necessary in relation to the new classification criteria introduced by IFRS 9 and based on the analyses carried out (already described above), but without applying new measurement criteria and, therefore, with the same total assets and total liabilities.

Assets

IAS 39 / IFRS 9	10. Cash and cash equivalents	20. Financial assets held for trading	30. Financial assets designated at fair value	40. Financial assets available for sale	50. Investments held to maturity	60. Due from banks	70. Loans to customers	80. Hedging derivatives	90. Fair value change of financial assets in hedged portfolios (+/-)	100. Equity investments	110. Property and equipment	120. Intangible assets	130. Tax assets	140. Non-current assets held for sale and discontinued operations	150. Other assets	**TOTAL ASSETS**
10. Cash and cash equivalents	29,620															**29,620**
20. Financial assets measured at fair value through profit or loss		9,409	24	589												**10,022**
30. Financial assets measured at fair value through other comprehensive income				33,796												**33,796**
40. Financial assets measured at amortised cost						343,366	2,568,905									**2,912,271**
50. Hedging derivatives								5,057								**5,057**
60. Fair value change of financial assets in hedged portfolios (+/-)									-2,881							**-2,881**
70. Equity investments										10						**10**
80. Property and equipment											59,923					**59,923**
90. Intangible assets												17,100				**17,100**
100 Tax assets													66,501			**66,501**
110 Non-current assets held for sale and discontinued operations														3,433		**3,433**
120 Other assets															46,762	**46,762**
TOTAL ASSETS	**29,620**	**9,409**	**24**	**34,385**	**-**	**343,366**	**2,568,905**	**5,057**	**-2,881**	**10**	**59,923**	**17,100**	**66,501**	**3,433**	**46,762**	**3,181,614**

Focusing attention on the most significant reclassifications as regards the Bank, application of the new classification and measurement rules for financial assets determined, in particular, the reclassification of UCITS units classified under financial instruments available for sale pursuant to IAS 39 which, for an amount of approximately 589 thousand euros, were included under assets to be measured at fair value through the income statement pursuant to IFRS 9.

In addition to the reclassifications due to adoption of IFRS 9 (i.e. for Business Model and SPPI Test), it is considered appropriate to recall here, also those attributable to the introduction of new official schemes through the update of Circular no. 262 of the Bank of Italy of December 2017; in this regard, the different method of stating financial assets which, rather than the previously existing items Customer Receivables, Receivables from banks, Financial assets held to maturity, Financial assets available for sale, Financial assets valued at fair value and Financial assets held for trading, are now classified under the new items Financial assets measured at fair value through the income statement, Financial assets measured at fair value through comprehensive income and Financial assets valued at amortised cost.

Liabilities

IAS 39 / IFRS 9	10. Due to banks	20. Due to customers	30. Securities issued	40. Financial liabilities held for trading	50. Financial liabilities designated at fair value	60. Hedging derivatives	70. Fair value change of financial liabilities in hedged portfolios (+/-)	80. Tax liabilities	90. Liabilities associated with assets held for sale and discontinued operations	100. Other liabilities	110. Employee termination indemnities	120. Provisions for risks and charges	TOTAL
10. Financial liabilities measured at amortised cost (IFRS 7(8)(g))	557,238	2,210,953	1,300										**2,769,491**
15. Passività finanziarie di pertinenza delle imprese di assicurazione valutate al costo ammortizzato ai sensi dello IAS 39													**-**
20. Financial liabilities held for trading				9,514									**9,514**
30. Financial liabilities designated at fair value (IFRS 7(8)(e))													**-**
40. Hedging derivatives						2,136							**2,136**
50. Fair value change of financial liabilities in hedged portfolios (+/-)							1,432						**1,432**
60. Tax liabilities								8,304					**8,304**
70. Liabilities associated with assets held for sale and discontinued operations													**-**
80. Other liabilities										63,388			**63,388**
90. Employee termination indemnities											19,526		**19,526**
100 Provisions for risks and charges										423		23,768	**24,191**
TOTAL	**557,238**	**2,210,953**	**1,300**	**9,514**	**-**	**2,136**	**1,432**	**8,304**	**-**	**63,811**	**19,526**	**23,768**	

Shareholders' Equity

IAS 39 / IFRS 9	130. Valuation reserves	150. Redeemable shares	160. Equity instruments	170. Riserves	180. Issue premium	190. Share capital	200. Treasury shares (-)	220. Profit (loss) for the period	TOTAL
110. Valuation reserves	10,421								**10,421**
120. Redeemable shares									**-**
130. Equity instruments									**-**
140. Riserves	20			33,527					**33,547**
150. Issue premium					73,578				**73,578**
160. Share capital						171,846			**171,846**
170. Treasury shares (-)									**-**
180. Profit (Loss) for the year (+/-)								-5,760	**-5,760**
TOTAL	**10,441**	**-**	**-**	**33,527**	**73,578**	**171,846**	**-**	**-5,760**	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY									**3,181,614**

With reference to financial liabilities, no significant reclassification impacts arising from transition to IFRS 9 were recorded. For the sake of completeness, only the reclassification of the credit risk provisions for commitments to disburse funds and financial guarantees provided is highlighted which, pursuant to the previous version of Bank of Italy Circular 262, were allocated to Other liabilities and which, according to the new instructions, must be included under Provisions for risks and charges.

Also for Liabilities and Shareholders' Equity items, however, it is considered appropriate to recall the reclassifications due to the new official schemes introduced by the aforementioned Circular no. 262; in this regard, in addition to the innovation in terms of representation of cumulative adjustments to the guarantees provided and commitments to disburse funds mentioned above, it should be noted that the previous items relating to amounts due to banks, amounts due to customers and outstanding securities are all included in item 10. Financial liabilities measured at amortised cost.

Reconciliation between the Balance Sheet as at 31 December 2017 (which incorporates the new IFRS 9 presentation rules) and the Balance Sheet as at 1 January 2018 (which incorporates the new IFRS 9 measurement and impairment rules)

The following are the reconciliation statements between the Balance Sheet as at 31 December 2017 (pursuant to IAS 39), which incorporates the reclassifications determined by the new classification rules provided for by IFRS 9, previously illustrated, and the Balance as at 1 January 2018 (IFRS 9). In these statements, the accounting balances as at 31.12.2017 (values determined pursuant to IAS 39) are modified due to adoption of the new measurement and impairment approach, in order to determine IFRS 9 compliant opening balances.

(thousands of euros)

Captions	31.12.2017 (a)	IFRS9 transition effect(b)		01.01.2018 (c) = (a) + (b)
		Classification and measurement	Impairment	
10. Cash and cash equivalents	29,620			29,620
20. Financial assets measured at fair value through profit or loss	10,022			10,022
30. Financial assets measured at fair value through other comprehensive income	33,796			33,796
40. Financial assets measured at amortised cost	2,912,271		-47,440	2,864,831
50. Hedging derivatives	5,057			5,057
60. Fair value change of financial assets in hedged portfolios (+/-)	-2,881			-2,881
70. Equity investments	10			10
80. Property and equipment	59,923			59,923
90. Intangible assets	17,100			17,100
100. Tax assets	66,501		13,331	79,832
110. Non-current assets held for sale and discontinued operations	3,433			3,433
120. Other assets	46,762			46,762
TOTAL ASSETS	**3,181,614**	**-**	**-34,109**	**3,147,505**

Classification and measurement

The different classification of financial assets in the new categories envisaged by IFRS 9 and the consequent different measurement metrics did not determine impacts on Shareholders' Equity.

Impairment

Adoption of the new impairment rules ("expected credit losses") on Financial assets measured at amortised cost (cash exposures) determined a negative impact of 47,440 thousand euros, as detailed below:

- higher value adjustments on performing cash loans of approximately 7,807 thousand euros, attributable (i) to allocation of part of the performing portfolio to Stage 2, based on defined stage allocation criteria, with the consequent need to calculate the expected loss for the entire remaining duration of the financial assets and (ii) inclusion in the calculation of expected losses of forward looking parameters deriving from future macroeconomic scenarios. The first-time adoption impact is almost entirely attributable to the increase in adjustments to positions classified in Stage 2;
- higher value adjustments on impaired loans of approx. 39,633 thousand euros, mainly due to inclusion in the calculation of expected losses of forward looking parameters, deriving from the consideration of future macroeconomic scenarios for all categories of NPLs and inclusion of the sale scenario - foreseen by the corporate objectives of reducing non-performing assets - for part of the non-performing portfolio with disposability characteristics. Approx. 30,376 thousand euros of the impact of the higher adjustments is due to non-performing loans and approx. 9,257 thousand euros to positions classified as probable defaults and overdue loans.

Liabilities and shareholders' equity

(thousands of euros)

	Captions	31.12.2017 (a)	IFRS9 transition effect (b)	01.01.2018 (c) = (a) + (b)
10.	Financial liabilities measured at amortised cost	2,769,491		2,769,491
20.	Financial liabilities held for trading	9,514		9,514
30.	Financial liabilities designated at fair value	-		-
40.	Hedging derivatives	2,136		2,136
50.	Fair value change of financial liabilities in hedged portfolios (+/-)	1,432		1,432
60.	Tax liabilities	8,304		8,304
70.	Liabilities associated with assets held for sale and discontinued operations	-		-
80.	Other liabilities	63,388		63,388
90.	Employee termination indemnities	19,526		19,526
100.	Provisions for risks and charges	24,191	858	25,049
110.	Valuation reserves	10,421	5	10,426
120.	Redeemable shares	-		-
130.	Equity instruments	-		-
140.	Reserves	33,547	-34,972	-1,425
150.	Issue premium	73,578		73,578
160.	Share capital	171,846		171,846
170.	Treasury shares (-)	-		-
180.	Profit (Loss) for the year (+/-)	-5,760		-5,760
	TOTAL LIABILITIES	**3,181,614**	**-34,109**	**3,147,505**

With regard to liabilities, there are higher value adjustments for guarantees provided and (irrevocable and revocable) commitments to disburse funds of approx. 858 thousand euros recognised under provisions for risks and charges. This increase derives from adoption of the new rules on impairment (including the forward looking component) and extension of the scope of application, which also includes revocable commitments.

Finally, Shareholders' Equity includes the recognition of a negative profit reserve (so-called FTA reserve) of 48,298 thousand euros, with an overall negative effect - including the tax impact of 13,331 thousand euros - on the Bank's Shareholders' Equity of approx. 34,967 thousand euros.

Below is the reconciliation scheme between Shareholders' Equity as at 31.12.2017, as reported in the 2017 Financial Statements, and the opening Shareholders' Equity as at 1.1.2018, after transition to IFRS 9, which reflects the effects previously commented on.

	IFRS9 transition effect
IAS 39 Shareholders' Equity - 31.12.2017	**283,632**
CLASSIFICATION AND MEASUREMENT	
Adjustment of the carrying value of financial assets deriving from modification of the "Business Model"	**-**
Fair value adjustment of financial assets following failure of the SPPI test	**-**
Reclassification from valuation reserves to profit reserves:	**-**
net change in valuation reserves for adoption of new classification and measurement rules	5
net change in profit reserves for adoption of new classification and measurement rules	-5
IMPAIRMENT	
Application of the new impairment model (ECL) to loans valued at amortised cost:	**-47,440**
performing (Stage 1 and 2)	-7,807
non performing (Stage 3)	-39,633
Application of the new impairment model (ECL) to guarantees provided and (irrevocable and revocable) commitments to disburse funds	**-858**
Application of the new impairment model (ECL) to debt securities valued at amortised cost:	**-**
performing (Stage 1 and 2)	-
non performing (Stage 3)	-
Reclassification from valuation reserves to profit reserves:	**-**
net change in valuation reserves for impairment on financial assets measured at fair value with impact on comprehensive income	20
net change in profit reserves for impairment on financial assets measured at fair value with impact on comprehensive income	-20
Tax effect	**13,331**
Total IFRS9 transition effects 01.01.2018	**-34,967**
IFRS 9 Shareholders' Equity - 01.01.2018	**248,665**

The effects regard both the amount and the composition of shareholders' equity and mainly derive:

- from the obligation to recalculate value adjustments on financial assets in the portfolio (both performing and impaired) using the "expected credit losses" model - including forward looking components - instead of the previous “incurred credit losses” model; in particular, as regards performing exposures, the increase in value adjustments is attributable (i) to allocation of part of the performing portfolio to Stage 2, based on defined stage allocation criteria, with the consequent need to calculate the expected loss for the entire remaining duration of the financial assets and (ii) inclusion in the calculation of expected losses of forward looking parameters deriving from future macroeconomic scenarios. As regards impaired loans, the impact is essentially due to inclusion in the calculation of expected losses of forward looking parameters, deriving from the consideration of future macroeconomic scenarios for all categories of NPLs and inclusion of the sale scenario - foreseen by the corporate objectives of reducing non-performing assets - for part of the non-performing portfolio with disposability characteristics.
- from the allocation of additional liabilities to cover guarantees provided and commitments and of new liabilities to cover risks concerning revocable and irrevocable margins;
- from application of an adjustment for impairment on debt securities measured at fair value through comprehensive income; this adjustment is recognised in the IFRS 9 first-time adoption reserve as a balancing entry - de facto - for the change in the dedicated Measurement reserve and consequently the shareholders' equity effect is zero;
- from determination of the tax effects on the aforementioned components.

Financial statements - Balance Sheet

Asset items	01.01.2018
10. Cash and cash equivalents	29,620
20. Financial assets measured at fair value through profit or loss	10,022
a) financial assets held for trading	*9,409*
b) financial assets designated at fair value	-
c) other financial assets mandatorily measured at fair value	*613*
30. Financial assets measured at fair value through other comprehensive income	33,796
40. Financial assets measured at amortised cost	2,864,831
a) Due from banks	*343,195*
b) Loans to customers	*2,521,636*
50. Hedging derivatives	5,057
60. Fair value change of financial assets in hedged portfolios (+/-)	-2,881
70. Equity investments	10
80. Property and equipment	59,923
90. Intangible assets	17,100
Of which:	
- goodwill	17,100
100. Tax assets	79,832
a) current	*12,485*
b) prepaid	*67,347*
110. Non-current assets held for sale and discontinued operations	3,433
120. Other assets	46,762
Total assets	**3,147,505**

Liability and shareholders' equity items	01.01.2018
10. Financial liabilities measured at amortised cost	2,769,491
a) due to banks	*557,238*
b) due to customers	*2,210,953*
c) securities issued	*1,300*
20. Financial liabilities held for trading	9,514
30. Financial liabilities designated at fair value	-
40. Hedging derivatives	2,136
50. Fair value change of financial liabilities in hedged portfolios (+/-)	1,432
60. Tax liabilities	8,304
a) current	*880*
b) deferred	*7,424*
70. Liabilities associated with assets held for sale and discontinued operations	-
80. Other liabilities	63,388
90. Employee termination indemnities	19,526
100. Provisions for risks and charges	25,049
a) commitments and guarantees provided	*1,281*
b) pensions and similar obligations	*2,227*
c) other provisions for risks and charges	*21,541*
110. Valuation reserves	10,426
120. Redeemable shares	-
130. Equity instruments	-
140. Reserves	-1,425
150. Issue premium	73,578
160. Share capital	171,846
170. Treasury shares (-)	-
200. Profit (loss) for the period (+/-)	-5,760
Total liabilities and shareholders' equity	**3,147,505**

The following is an analysis of the credit quality of exposures at amortised cost, before and after adoption of IFRS 9.

Composition and stage allocation of the exposures at amortised cost subject to IFRS 9 impairment testing and related ECL

(millions of euro)

On-balance sheet exposures (Amortised cost)	IFRS 9											
	Gross exposure				Total adjustments				Net exposure			
	STAGE				STAGE				STAGE			
	1	2	3	TOTAL	1	2	3	TOTAL	1	2	3	TOTAL
Loans to Customers	1.903.430	353.624	670.077	2.927.131	3.936	10.408	391.151	405.495	1.899.494	343.216	278.926	2.521.636
Due from Banks	343.366	-	-	343.366	172	-	-	172	343.195	-	-	343.195
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL	**2.246.796**	**353.624**	**670.077**	**3.270.497**	**4.107**	**10.408**	**391.151**	**405.667**	**2.242.689**	**343.216**	**278.926**	**2.864.831**

	IAS 39								
	Gross exposure			Total adjustments			Net exposure		
	Performing	Non-performing	TOTAL	Performing	Non-performing	TOTAL	Performing	Non-performing	TOTAL
Loans to Customers	2.257.054	670.077	2.927.131	6.708	351.518	358.226	2.250.346	318.559	2.568.905
Due from Banks	343.366	-	343.366	-	-	-	343.366	-	343.366
Debt securities	-	-	-	-	-	-	-	-	-
TOTAL	**2.600.420**	**670.077**	**3.270.497**	**6.708**	**351.518**	**358.226**	**2.593.712**	**318.559**	**2.912.271**

Reclassified balance sheet

Assets	**01.01.2018**
Loans to banks	343,219
Loans to customers	2,521,636
Financial assets measured at fair value through profit or loss	9,998
Financial assets measured at fair value through other comprehensive income	33,796
Equity investments	10
Tangible and intangible assets	77,023
Tax assets	79,832
Non-current assets held for sale and discontinued operations	3,433
Other asset items	78,558
Total assets	**3,147,505**

Liabilities	**01.01.2018**
Amounts due to banks at amortised cost	557,238
Amounts due to customers at amortised cost and securities issued	2,212,253
Financial liabilities held for trading	9,514
Tax liabilities	8,304
Other liability items	66,956
Provisions for risks and charges	44,575
of which provisions for commitments and financial guarantees provided	*1,281*
Share capital	171,846
Reserves	72,152
Valuation reserves	10,426
Net result	-5,760
Total liabilities and shareholders' equity	**3,147,505**

Below are the reconciliation between the financial statements relating to the balance sheet items (Assets and Liabilities) provided for by the new Bank of Italy Circular 262 and the corresponding reclassified statements, the reclassified Balance Sheet, as well as the new credit quality table referring to the item of the reclassified schedule.

Reconciliation between Balance Sheet (Circular 262) and reclassified balance sheet

(thousands of euros)

Assets		1.1.2018
Loans to banks		343,219
Item 40a (partial)	Financial assets measured at amortised cost - Loans to Banks	343,195
Item 20a (partial)	Financial assets held for trading - Loans to banks	
Item 20b (partial)	Financial assets designated at fair value - Loans to banks	
Item 20c (partial)	Other financial assets mandatorily measured at fair value - Loans to banks	24
Item 30 (partial)	Financial assets measured at fair value through other comprehensive income - Loans to banks	
Loans to customers		**2,521,636**
Loans to customers measured at amortised cost		2,521,636
Item 40b (partial)	Financial assets measured at amortised cost - Loans to customers	2,521,636
Item 40b (partial)	Financial assets measured at amortised cost - Debt securities (public bodies, non-financial companies and others)	
Loans to customers measured at fair value with impact on comprehensive income and with impact on the income		-
Item 20a (partial)	Financial assets held for trading - Non-bank loans	
Item 20b (partial)	Financial assets designated at fair value - Non-bank loans	
Item 20c (partial)	Other financial assets mandatorily measured at fair value - Non-bank loans	
Item 30 (partial)	Financial assets measured at fair value through other comprehensive income - Non-bank loans	
Financial assets measured at amortised cost that are not loans		-
Item 40a (partial)	Financial assets measured at amortised cost - Debt securities to Banks	
Item 40b (partial)	Financial assets measured at amortised cost - Debt securities (governments, financial and insurance companies)	
Financial assets measured at fair value through profit or loss		9,998
Item 20a (partial)	Financial assets held for trading	9,409
Item 20b (partial)	Financial assets designated at fair value - Debt securities	-
Item 20c (partial)	Other financial assets mandatorily measured at fair value	589
Financial assets measured at fair value through other comprehensive income		33,796
Item 30 (partial)	Financial assets measured at fair value through other comprehensive income	33,796
Equity investments		10
Item 70	Equity investments	10
Tangible and intangible assets		77,023
Item 80	Property and equipment	59,923
Item 90	Intangible assets	17,100
Tax assets		79,832
Item 100	Tax assets	79,832
Non-current assets held for sale and discontinued operations		3,433
Item 110	Non-current assets held for sale and discontinued operations	3,433
Other asset items		78,558
Item 10	Cash and cash equivalents	29,620
Item 50	Hedging derivatives	5,057
Item 60	Fair value change of financial assets in hedged portfolios (+/-)	-2,881
Item 120	Other assets	46,762
Total assets		**3,147,505**

(thousands of euros)

Liabilities		1.1.2018
Amounts due to banks at amortised cost		557,238
Item 10 a)	Financial liabilities measured at amortised cost - Amounts due to banks	557,238
Amounts due to customers at amortised cost and securities issued		2,212,253
Item 10 b)	Financial liabilities measured at amortised cost - Amounts due to customers	2,210,953
Item 10 c)	Financial liabilities measured at amortised cost - Securities issued	1,300
Financial liabilities held for trading		9,514
Item 20	Financial liabilities held for trading	9,514
Financial liabilities designated at fair value		-
Item 30	Financial liabilities designated at fair value	
Tax liabilities		8,304
Item 60	Tax liabilities	8,304
Liabilities associated with assets held for sale and discontinued operations		-
Item 70	Liabilities associated with assets held for sale and discontinued operations	
Other liability items		66,956
Item 40	Hedging derivatives	2,136
Item 50	Fair value change of financial liabilities in hedged portfolios (+/-)	1,432
Item 80	Other liabilities	63,388
Provisions for risks and charges		44,575
Item 90	Employee termination indemnities	19,526
Item 100 a)	Provisions for risks and charges - commitments and guarantees provided	1,281
Item 100 b)	Provisions for risks and charges - pensions and similar obligations	2,227
Item 100 c)	Provisions for risks and charges - other provisions for risks and charges	21,541
Share capital		171,846
Item 160	Share capital	171,846
Reserves		72,152
Item 120	Redeemable shares	-
Item 140	Reserves	-1,425
Item 150	Issue premium	73,578
- Item 170	Treasury shares	-
Valuation reserves		10,426
Item 110	Valuation reserves	10,426
Equity instruments		-
Item 130	Equity instruments	
Net result		-5,760
Item 180	Profit (Loss) for the year (+/-)	-5,760
Total liabilities and shareholders' equity		**3,147,505**

Credit quality

(amounts in thousands of EUR)

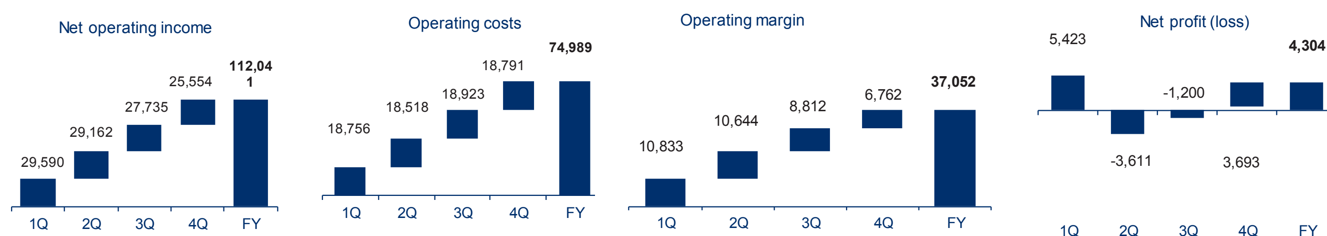
Items	31/12/2017				Reclassifications and adjustments			01/01/2018			
	Gross exposure	*Total value adjustments*	*Net exposure*	*Hedging %*	*Reclassification of gross exposure*	*Reclassifications of value adjustments*	*FTA adjustments*	*Gross exposure*	*Total value adjustments*	*Net exposure*	*% of coverage*
Non-performing loans	489,798	307,618	182,180	62.81%	-	-	30,376	489,798	337,994	151,804	69.01%
Unlikely to pay	174,240	42,833	131,407	24.58%	-	-	9,137	174,240	51,970	122,270	29.83%
Receivables past due /over limit	6,039	1,067	4,972	17.67%	-	-	120	6,039	1,187	4,852	19.66%
Impaired loans	**670,077**	**351,518**	**318,559**	**52.46%**	**-**	**-**	**39,633**	**670,077**	**391,151**	**278,926**	**58.37%**
Impaired loans in stage 3 (subject to impairment)	xxxxx	xxxxx	xxxxx		-	-	-	-	-	-	
Non-performing loans measured at fair valuewith a balancing entry in the income statement	xxxxx	xxxxx	xxxxx		-	-	-	-	-	-	
Performing loans	**2,257,054**	**6,708**	**2,250,346**	**0.30%**	**2,257,054**	**6,708**	**7,636**	**2,257,054**	**14,344**	**2,242,710**	**0.64%**
Stage 2	xxxxx	xxxxx	xxxxx		353,624	2,954	7,454	353,624	10,408	343,216	2.94%
Stage 1	xxxxx	xxxxx	xxxxx		1,903,430	3,754	181	1,903,430	3,936	1,899,494	0.21%
Performing loans measured at fair valuewith a balancing entry in the income statement	xxxxx	xxxxx	xxxxx		-	-	-				
Performing loans represented by securities	**-**	**-**	**-**		**-**	**-**	**-**	-	-	-	-
Stage 2	xxxxx	xxxxx	xxxxx		-	-	-	-	-	-	
Stage 1	xxxxx	xxxxx	xxxxx		-	-	-	-	-	-	
Receivables held for trading	xxxxx	xxxxx	xxxxx		-	-	-	-	-	-	
Total loans to customers	**2,927,131**	**358,226**	**2,568,905**	**-12.24%**	**2,257,054**	**6,708**	**47,269**	**2,927,131**	**405,495**	**2,521,636**	**-13.85%**

Main figures and alternative performance indicators

It should be noted that following entry into force, starting from 1 January 2018, of the IFRS 9 accounting standard, the comparative balance sheet data have been restated as at 1/1/2018 based on the provisions of this new standard (First Time Adoption). On the other hand, the economic data referring to previous periods have not been restated, but are determined on the basis of the previous IAS 39 standard, since the mandatory restatement of the comparative data is not required by the specific provisions of IFRS 9 and IFRS 1 in the year of first-time adoption of the new Standard.

Income statement figures (thousands of euro)	31 December 2018	31 December 2017	absolute changes	%
Net interest income	52,861	57,014	-4,153	-7.3
Net fee and commission income	59,240	61,059	-1,820	-3.0
Profits (Losses) on trading	914	1,059	-145	-13.7
Net operating income	112,041	119,773	-7,732	-6.5
Operating costs	-74,989	-80,159	-5,170	-6.4
Profit (loss) from operations	37,052	39,614	-2,563	-6.5
Net adjustments to loans and receivables	-31,832	-45,459	-13,627	-30.0
Net profit (loss)	4,304	-5,760	+10,065	

Quarterly development of main income statement figures (thousands of euro)



Balance sheet figures (thousands of euro)	31 December 2018	01 January 2018	absolute changes	%
Financial assets	5,133,041	5,398,185	-265,144	-4.9
Loans to customers	2,427,070	2,521,636	-94,566	-3.8
Total assets	3,084,138	3,147,505	-63,368	-2.0
Direct deposits	2,126,825	2,212,253	-85,428	-3.9
Indirect deposits:	3,006,216	3,185,932	-179,716	-5.6
of which: Assets under management	2,307,858	[VALORE]	*-152,922*	*-6.2*
Shareholders' equity	253,609	248,665	+4,945	+2.0

Operational structure	31.12.2018	31.12.2017	absolute changes
Number of employees	656	704	-48
Italy	656	704	-48
Abroad	-	-	-
Number of financial promoters	-	-	-
Number of bank branches (a)	65	66	-1
Italy	65	66	-1
Abroad	-	-	-

[a] The figure includes Retail Branches, Business Branches and Entities and Treasuries Branches .

Profitability ratios (%)	31.12.2018	31.12.2017
Cost / Income	66.9	66.9
Net profit (loss) / Average shareholders' equity (ROE)	1.6	-2.0

Risk ratios (%)	31.12.2018	01.01.2018
Net non-performing loans / Loans to customers	**7.69**	**11.06**
Net bad debts / Loans to customers	*3.29*	*6.02*
Net unlikely to pay/ Loans to customers	*4.34*	*4.85*
Net past due and overdrawn / Loans to customers	*0.06*	*0.19*
Accumulated adjustments on bad loans / Gross bad loans to customers	72.2	69.0

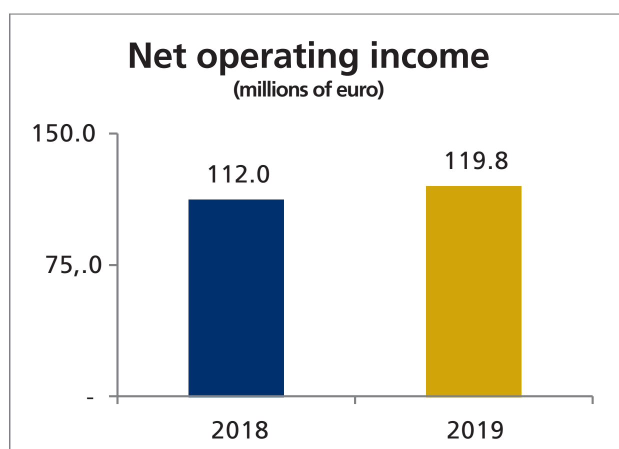
Capital ratios (%)	31.12.2018	31.12.2017 (*)
TIER 1 capital / Risk-weighted assets	18.81	18.88
Total own funds / Risk-weighted assets (Total capital ratio)	18.81	19.26
Risk-weighted assets (thousands of euro)	1,409,414	1,396,137

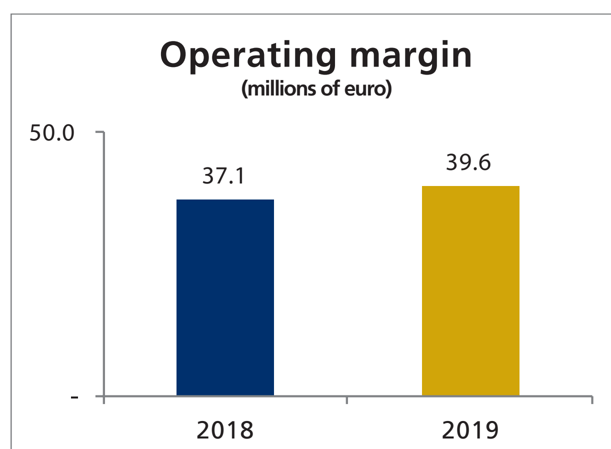
(*) Data calculated according to IAS 39 standard.

Summary of operations

The 2018 financial year closed with a net profit of 4.3 million euros, a very clear improvement compared to the loss of 5.8 million in 2017. **Net operating income** recorded a decrease of 6.5% (-7.7 million), due to contraction of net interest of 4.2 million, commission margin of 1.8 million, other operating income of 1.6 million and the trading result of 0.1 million; at the same time, operating costs fell by 5.2 million and consequently **operating profit, which amounted to 37.1 million euros, fell by 2.6 million euros (-6.5%) compared to 2017**. The lower part of the income statement opened with a significant reduction in net adjustments to loans (-13.6 million, equal to -30.0%), while net provisions for risks and charges and adjustments to other assets worsened by 0.3 million and other net income decreased by the same amount; this performance led to a **gross profit** of 5.7 million (-4.7 million for the comparison figure). This led to a **net profit of 4.3 million euros** after direct taxes, integration charges and taxes and charges relating to the banking system (both net of taxes), with the last two items recording values substantially in line with those of the previous year. For more details on the cost and revenue components that characterised the 2018 financial year, please refer to the "Operating profit/loss" chapter, as well as to the Explanatory Notes.

The comprehensive income of the Bank, which constitutes the integration of the profit for the period with the income components not transferred to the income statement, shows a decrease (-3.4 million), from 8.1 million in 2017 to 4.6 million as at 31 December 2018; this decrease derives from the fact that, in the past year, a positive component of approximately 14.4 million euros was recognised, relating to the portion not transferred to the income statement of the overall revaluation of buildings and works of art deriving from the change in the measurement criterion of the same from cost to fair value, whose absence in 2018 was only partially offset by the improvement in the net profit (+10.1 million), in the impacts of actuarial gains (losses) on defined-benefit pension schemes (+0.5 million) and in the measurement of financial assets measured at fair value (+0.2 million).

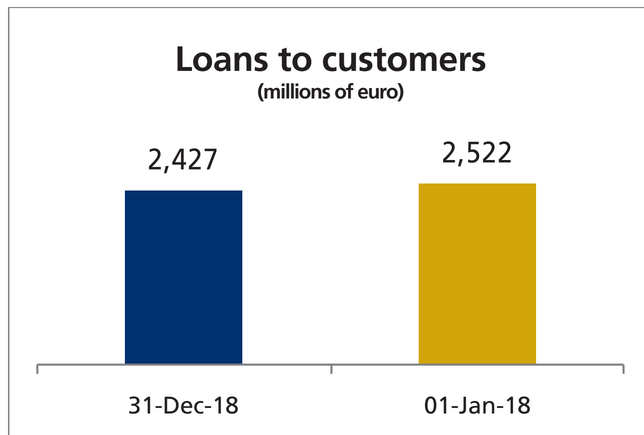


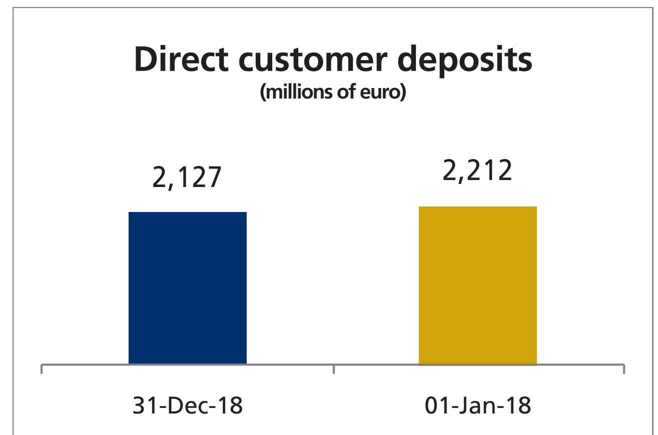


Customer financial assets amounted to 5,133 million euros, recording a decrease of 265 million euros compared to 31 December 2017, broken down as follows:

- Direct collection: down by 85 million euros (-3.9%), due to the contraction in current accounts and customer deposits;
- Indirect collection: down by 180 million (-5.6%), due to the contraction of 153 million in the managed segment and 27 million in assets under administration;
- **Loans to customers:** these amounted to 2,427 million euros, a decrease of 95 million (-3.8%) compared to the end of the previous year.

Shareholders' Equity strengthened, from 249 million euros at the end of 2017 to 254 million euros, essentially thanks to the net profit achieved in 2018.





Report on operations

Executive summary

Significant events

Strategic agreement concerning NPLs

During 2018, in line with the 2018-2021 business plan, which provides for a strong acceleration of de-risking at the Group level, Cassa di Risparmio di Pistoia e della Lucchesia, as well as the other Group banks, resolved to assign to the external Servicer Intrum, Europe's leading group in the collection of impaired loans, a significant part of the stock and the new credit flows classified as non-performing.

In particular, the operation involved:

- disposal of a portfolio of loans deriving from unsecured and mortgage loans, credit facility agreements and other financial transactions of different nature and technical form and classified as non-performing, by disposal without recourse pursuant to articles 7.1 and 4 of the Securitization Law to a special purpose securitisation company called Penelope SPV Srl for the purpose of subsequent securitisation;
- conferral on the Servicer of an outsourcing mandate for the management and collection of all loans owned by Italian companies belonging to the Intesa Sanpaolo Group at the date of signing the mandate, including Cassa di Risparmio di Pistoia e della Lucchesia, classified at the time as "non-performing" - not subject to assignment in the aforementioned securitisation - for a period of ten years.

The loan portfolio owned by the Bank disposed of as part of the securitisation transaction consists of positions whose Total Due Amount amounts to approximately 182 million euros; the financial structure of the vehicle Penelope SPV Srl allowed full accounting and regulatory deconsolidation of the portfolio at the closing date (November 2018).

Incorporation of the Intesa Sanpaolo VAT Group

On 30 October 2018, the Intesa Sanpaolo VAT Group was established by submitting to the Revenue Agency the declaration required by current legislation.

Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. and another 47 companies adhered to the Intesa Sanpaolo VAT Group - effective from 1 January 2019.

Sale of Palazzo dei Vescovi

On 21 December 2018, in execution of the Preliminary Sale Agreement signed on 26 October 2017, the Deed of Sale was signed with which Palazzo dei Vescovi was sold to Cultural Events Scrl, a vehicle company of the Cassa di Risparmio di Pistoia and Pescia Foundation. The sale is subject to a negative suspensive condition in relation to exercise of the right of first refusal by the Ministry of Cultural Heritage and Activities in accordance with articles 60 et seq. of Legislative Decree 42/2004.

Interventions in support of the banking system

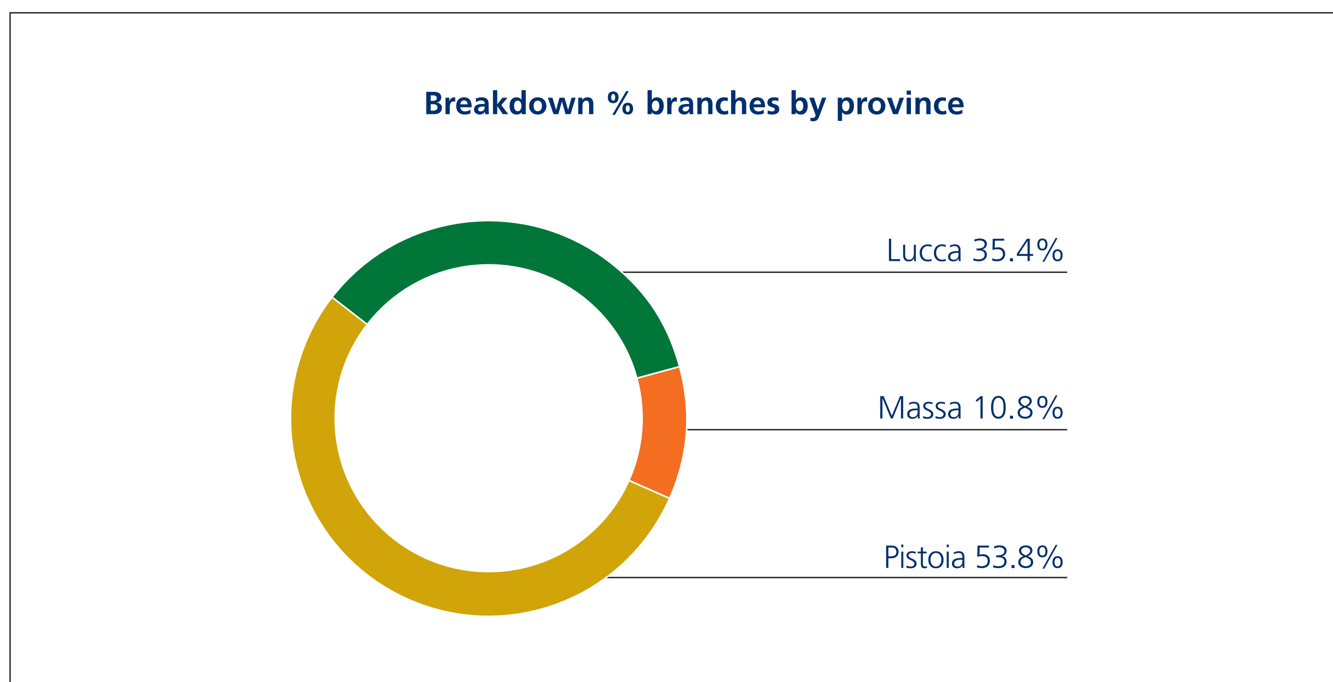
The shareholders' meeting of the Voluntary Scheme of the Interbank Deposit Protection Fund (FITD), held on 30 November 2018, resolved a maximum intervention of 320 million euros by the Scheme itself - which the Group adheres to - in a complex recapitalisation of Banca Carige aimed at enabling compliance with the prudential requirements and contributing to the reorganisation of said bank. The transaction entailed the subscription of subordinated bonds, "converted" into shares upon the fulfilment of certain conditions, by the Voluntary Scheme, which constitutes a structure interposed between the Scheme itself and the participating banks.

The extraordinary shareholders' meeting of Carige, held on 22 December 2018, did not approve the aforementioned conversion of the subordinated bond subscribed by the banking system through the FITD Voluntary Scheme. The portion attributable to Cassa di Risparmio di Pistoia e della Lucchesia for the intervention, calculated on the basis of the data as at 30 September 2018, amounts to approximately 0.832 million euros, with the simultaneous subscription of subordinated bonds which were entirely written down as at 31 December 2018.

Human resources and distribution network

As at 31 December 2018, the Bank's workforce amounted to 656 resources, a decrease of 48 compared to the end of 2017; presence in the reference area is guaranteed by 59 Retail Branches, 5 Business Branches and an Entity and Treasury Branch, broken down as follows by province:

PROVINCE	Retail Branches	Business Branches	Entity and Treasury Branch	TOTAL
Lucca	21	2		23
Massa	6	1		7
Pistoia	32	2	1	35
TOTAL	59	5	1	65



During the reporting period, the closure of the retail branch of Castellare was completed.

Commercial performance

In order to ensure greater focus on the market and on the customer relationship, at the beginning of 2015 the new Banca dei Territori Service Model was implemented, which involved the specialisation of the commercial network in three "commercial areas", in order to ensure a better level of service, while enhancing the specific skills of Personnel. The commercial areas defined in this manner are:

- Retail (that serves Basic Customers, Families and Retail Companies);
- Personal;
- Business (for Small Businesses, Companies and Top Companies).

Each Operational Point is therefore part of a single commercial area and serves only the Customers that belong to it, with the exception of transactional operations, which remained under the responsibility of the Retail Branches.

The principles underlying the new Service Model are the centrality of the area and of the Manager-Customer approach, organisational and competence segmentation, exploitation of synergies between business segments and support of the specialised corporate finance, wealth management and bankinsurance hubs.

Furthermore, bankinsurance, in line with the guidelines of the 2018-21 Business Plan, was one of the most focused and growing activities, through innovation of the product range and identification of a team of specialists dedicated to the Protection world to support Branches in the development of skills and knowledge in this important area of business, in order to facilitate marketing of the products developed in the non-life insurance field.

Based on the principles of attention to the customer relationship through the products, services and specialised skills of the Network indicated above, the 2018 Business Plan was also prepared, which was divided into focus areas specific to the different types of customers served by each of the three commercial areas detailed above

PRIVATE CUSTOMERS (RETAIL AND PERSONAL)

The main offer areas of the bank's products and services for private customers concerned:

- asset management;
- protection products (bankinsurance);
- mortgages and loans;
- transactional products (accounts and credit and debit cards).

With regard to asset management, the activity was directed, in full compliance with the financial profile of individual customers and their spending needs, with the reinvestment of maturities, conversion of direct deposits which exceeded reserve needs (also through low-risk managed deposit products), upgrading of under-performing products and portfolio diversification with a view to optimising the risk/return ratio, in a market context which, especially in the second half of the year, showed greater volatility. To this end, products with a high protection and guarantee profile, such as segment I certificates and policies, were made available to the sales network.

In this context, “Valore Insieme”, the innovative 360° consulting service to provide the customer with an integrated view of the financial and non-financial assets of the family nucleus, addressing the related consultancy needs, was expanded with additional contents and functionalities aimed at increasing the level of consultancy and covering the different areas of customer needs, adding to the non-property component: the property component, the protection and safety component and the inheritance component. Furthermore, in order to expand the range of offerings for customers adhering to the platform, through further distinctive and value-added elements, in December a range of “best expertise” fund portfolios, designed for every customer risk profile (conservative, moderate or dynamic) was included.

The protection area was certainly that of greater development of commercial activity during 2018, through a review of the product range, extensive use of the "insurance questionnaire" with a view to checking the customer's risk coverage needs and strengthening the specialist network support. As regards the first point, the main innovation was represented by the inclusion in the product range of “XME Protezione”, a multi-guarantee, flexible and modular policy that aims to cover the insurance needs of the customer in the Family, Health and Assets field, building a "customised protection", suitable for each customer, which can be modified over time in a lifecycle approach, in order to adapt to any changes in life.

With regard to the loans sector, the Bank worked to support customers in meeting all spending needs, by proposing loan solutions making it possible to avoid disinvestment of their savings in the current market context. The favorable interest rate scenario in fact allowed the offer of particularly advantageous conditions to specific customer targets which, on the basis of a statistical model, might be inclined to take out a loan. In addition to the various interest rate promotions that were provided to support the growth of personal loans, among the products that characterised the Bank's offer, worthy of mention in particular were Mutuo Up, to manage unplanned expenses and draw on an additional amount, up to 10% of the loan amount, without any additional document to be submitted, and Mutuo In Tasca, addressed to those who have not yet identified a property, but need to know the amount that the Bank is willing to grant them, with the opportunity to take advantage of an advance (credit line) of the amount of the loan to meet the expenses related to payment of the deposit or notary and/or property brokerage fees.

In the field of credit and debit cards, the activity was directed towards increasing cross-selling on non-holders and upselling on holders. Particular attention was paid to the youth segment, promoting the acquisition of minors through the proposal of XME Conto Up, at advantageous conditions and through highly visible initiatives, such as the partnership with Panini.

CORPORATE, RETAIL AND BUSINESS CUSTOMERS

The main offer areas of the bank's products and services for business customers concerned:

- loans;
- financial and insurance risk hedging;
- welfare and social security solutions;
- transactionality.

With regard to the financial sector, the bank focused primarily on customers classified as “without risk” based on the evidence of their rating systems, with margins for growth for the part to be included in the short term and, where appropriate, of credit lines, in accordance with the credit and risk management policies defined at the Group level. In this context, attention was paid to the growth of short-term loans, to support the management of working capital and the liquidity of receivables, of operations abroad and, above all, on medium-long term loans, which had a strong boost, also thanks to the fiscal incentives provided for by the Stability Law (Industry 4.0 Protocol).

In terms of risk hedging, the areas of need related to the management of interest rate risk on MLT loans, of exchange rate risk or on commodities and CPI policies were monitored. Without forgetting the Protection world, in which specific products are present for the various sectors of customer activity, which have been well-received by Customers: Trade Policy, Agriculture Policy and Manufacturing Policy.

In the welfare and social security area, agreements were developed with local companies for their employees to adhere to the forms of collective pensions made available by the Bank (Il Mio Domani open pension fund) and Welfare Hub, an innovative platform for managing corporate welfare programs was marketed, in accordance with current tax legislation: by signing the Welfare Hub service, companies provide their employees with access to a digital multi-channel platform (browsable from a PC, tablet or smartphone) in which they can find goods and services for spending their welfare credit (so-called flexible benefits) on multiple areas of need (home and family, health and well-being, savings and leisure, travel and mobility).

As regards transactionality, in addition to the activity related to the dissemination of the most traditional products in the catalogue and the increase in POS penetration, to digitise customer collection activity, an effort was made to increase the proportion of transactional operations of Customers abroad, which represents one of the growth drivers for local businesses and, in view of mandatory electronic invoicing starting from 1 January 2019, on the dissemination of the dedicated Digifatttura platform.

A further growth driver of the masses and strengthening of relations with the local area was represented by the Filiere Program, through which the Bank identifies primary industry leaders to conclude an agreement with, aimed at supporting Supply Chain suppliers (customers and non-customers), through greater provision of credit, at more advantageous conditions and with a dedicated commercial offer, such as Confirming, the innovative factoring product that allows the supplier to discount receivables due from the main supply chain company, through a non-recourse factoring operation carried out through an online platform.

With particular regard to Retail Companies, the “Best Retail Companies” program, launched in 2016, continued, with the aim of fully developing a segment with high potential and increasing profitability, through a dedicated commercial offer structured by product bundles by economic segment, a particular focus on credit, an engine of growth and development, a new focus on commercial campaigns, prioritised and supported by dedicated offers, the absolute centrality of relationship managers and strengthening of the acquisition engine to consolidate a leadership position in the segment.

A further offer area on which intense activity was carried out is that dedicated to tobacconists, for signing dedicated agreements, in order to facilitate the sale of "Bank 5" products in tobacconists, with the aim of acquiring new customer segments (lower mass, new Italians and young people), creating a proximity Network Bank - focused on "instant banking" - to complement the current Branch Network which will increasingly focus on consultancy and value-added services.

With more specific regard to Businesses, to cover areas of need complementary to those more typical of the banking business, the activity of Intesa Sanpaolo Forvalue, a company of the Intesa Sanpaolo Group that offers a wide range of services and products to support business, designed to promote innovation and growth and to simplify business management, continued. The Company offers a consultancy and assistance service to businesses, including individuals, including the analysis, design and creation of customised solutions (for example: digital solutions, customer loyalty programs, training courses), making recourse to the collaboration of qualified partners and selecting the best skills and experiences on the national and international market.

INTEGRATED MULTI-CHANNEL APPROACH AND NEW BRANCH MODEL

The Multichannel Bank Project aims, on the one hand, to provide customers with a simple, convenient and affordable service and, on the other, to free managers from the most repetitive tasks so that they can spend more time talking to customers. The goal is not to create an alternative channel to the Branch, but to achieve a true integration between the Branch and all the other channels of the Bank, meeting the ever-increasing "digital" needs of customers and facilitating administrative and contractual documentation filing activities.

The Group's multi-channel strategy aims, in a broader sense, to redefine the so-called "customer experience", giving the Customer the possibility to choose between multiple channels in order to interact with the Bank, making them simple, immediate and interconnected. The main objectives of the Integrated Multichannel Approach are in fact:

- redefinition of the role of channels, distinguishing them between “assisted” (Branch and Contact Unit) and self-service (home banking, tablet, mobile, ATM);
- enabling multichannel routes, in line with customer preferences, on selected priority products;
- exploitation of Customer contact points and the data available to the bank to generate and exploit new business opportunities and monitor customer satisfaction.

Finally, as regards the “physical” Branch, the New Branch Model is already present in 13 Bank Branches, which have been reorganised according to the new layout, created with the aim of optimising space and allowing a better reception and commercial relationship with the Customer. The "New Concept" branches were structured to integrate multi-channel strategies in the branch experience, to direct cash activities towards self-service systems, to create spaces for "new jobs" (for example the network of real estate agencies of ISP Casa, which has two units in Florence) and allows the organisation of events. In New Concept branches, the gradual replacement of traditional tills with so-called CSA (self-service assisted tills) is also planned. CSAs, 47 units currently installed in 40 branches, are automatic machines that, in addition to traditional services, allow the payment and booking of F24s, MAV and RAV slips, through the optical reading of documents, in addition to cash payments with management of any change.

Cassa di Risparmio di Pistoia e della Lucchesia operates through four Retail Areas, two Personal Areas and one Business Area, broken down as follows:

RETAIL AREA

Pistoia Area

During 2018, the Pistoia Retail Area, with regard to the Operating Income Statement, showed an increase of +3.3% in Interest Margin and of 0.50% in Gross Intermediation Margin. With regard to Total Loans, growth stood at +4% (2% on spot balances) and AFIs recorded +0.7% (1.1% on spot balances).

Services recorded 2.7% and Other Protection Products recorded +55.8%.

The year was characterised by the integration of two branches coming from the Vivaldi Project, Agliana Via Magni and Pistoia Via Fermi, in the area. Undoubtedly these two realities contributed positively in the Placements field, but proved problematic from a credit point of view. The credit costs of these two realities certainly did not benefit the overall data of the Area. Finally, the Area recorded 87.2% of the annual budget and 96.4% of the period budget.

As regards the overall quality of operations, it is important to underline that all branches are over the 100 point threshold on the SEIOK Excellence detector.

Montecatini - Quarrata Area

During the year, the Area maintained a positive trend in the private mortgages market, concentrated almost exclusively on real estate sales and also in consumer loans, certainly thanks to a very competitive price policy on the part of the institution that allowed us to acquire higher market shares.

The asset management sector performed less well, especially in terms of gross flow, with a modest increase in net flow compared to the previous year and increasingly favouring products with protection of invested capital, also in consideration of the negative market trend. Unfortunately, also for this year, the trend of disbursements to retail companies remains below expectations, where a certain reluctance of operators in the sector to new investments continues, due to the uncertainty of the economic cycle.

On the credit front, during 2018, containment of the cost of credit continued, thanks to a lower entry of past-due and probable default customers and also to renegotiation of existing mortgage and/or unsecured transactions.

The protection sector, especially the private sector, performed particularly well during 2018, thus guaranteeing the customer ever greater protection, also in light of the presence of XME Protection in the price list, i.e. a modular policy with which the customer is truly able to adopt the most appropriate form or forms of protection. The adoption of the questionnaire certainly helped the manager to understand and evaluate with customers their shortcomings in terms of insurance coverage.

The multichannel performance with increasingly frequent use of automatic tellers and the smartphone application was also very good, with peaks of excellence in the branches of Montecatini Terme and Monsummano Terme. The overall level in terms of service perceived by the customer was also positive.

Lucca Area

2018 saw the Lucca Retail Area continued its growth trend, even though to a lesser extent than in the previous year. The performance in financial assets was again very positive, marking an increase in spot balances close to 6%, reflecting the significant attractiveness of our bank. The volatility of the financial markets, however, affected the performance of the portfolios and negatively influenced the managed assets flow and revenues from the related commissions. However, this effect was almost entirely offset by the placement of third-party issuer bonds.

Loans grew on average by approx. 4.9%, mainly due to the increase of almost 5.4% in the MLT segment. Mortgage growth rates were lower than in previous years due to contraction in the subrogation market and MT corporate retail disbursements suffered from a slowdown in investments.

2018 was characterised above all by the significant growth of the insurance sector, in line with the indications of the Parent Company's Business Plan. The Area increased collected premiums by approx. 50% thanks to the placement of non-life insurance policies available for both families and companies.

Also in 2018, the experience of collaboration with Lucca Crea, which saw us actively participate in the Lucca Comics&Games event, was repeated. Once again, our people were able to communicate to the thousands of people contacted how much our bank is able to be close to the needs and passions of its customers, also through absolutely innovative channels.

Massa Carrara – Versilia Area

Revenue growth, which stood at over 2% (excluding the figure of the new branches coming from the acquisition of the “former Venetian banks”) continued in 2018.

In terms of volumes, the growth in loans continued, above all thanks to the positive trend in private mortgages; the increase in the balances of loans compared to 31 December 2017 exceeded 25 million euros (equal to 7.3%).

As for financial assets, growth was equally positive: the increase amounted to approx. 29 million euros and in percentage terms the increase exceeded 7%; in qualitative terms, this flow was mainly addressed to direct deposits, while managed deposits increased by only 3.7 million (approx. 2.8%).

Indeed, 2018 was characterised, above all in the second part, by significant market volatility, which made wealth management more difficult than in previous years.

There were decidedly positive notes in the protection and bank insurance market, where the area moved in line with the business plan, growing significantly; the competence of the commercial network developed significantly, also aided by the launch of new products and improvement of the sales process.

Finally, the number of operating units remained unchanged during the year, but work continued to reduce costs, taking advantage of the use of self-service devices and remote channels; it was thus possible to reduce the number of people employed in the area, maintaining the very high level of service.

Treasuries

The Bank, continuing the Single Treasury system, also in 2018 continued the policy of participation in those tenders that, in the event of award of the service, can guarantee profitability considered to be of interest. In compliance with the principle of preserving the local presence, we participated in tenders called in the Province of Pistoia, confirming us as Treasurers of the Municipality of Ponte Buggianese and of a number of schools. The conditions for continuation of cash service management were also renegotiated with a number of positions for which the cash service was performed on the basis of contracts that did not guarantee adequate profitability.

Other tenders called in the Province of Lucca, such as the Municipality of Capannori and the Municipality of Camaiore, were carefully evaluated, not only with regards to the economic aspects, but also in relation to the possible critical issues linked to operations and particularities deemed not compliant with Intesa Sanpaolo standards and therefore we preferred not to participate in these tenders.

During 2018, a new method of communicating with the State General Accounting Office for the communication of SIOPE codes was introduced, which involved a complete review of the procedures for sending digitally signed orders for all public entities subject to this regulation. Intesa Sanpaolo, with a view to increasing revenues deriving from the management of treasury services, proposed itself to institutions as an intermediary for sending orders to the General State Accounting Office. 8 of the most important local authorities, including the Municipalities of Pistoia and Viareggio and the Province of Pistoia, chose Intesa Sanpaolo as the intermediary against payment of a fee.

During 2018, the computerisation of minor authorities continued, which will continue in 2019. 68 authorities are currently managed by the Bank, divided as follows:

- 20 with Treasury service (17 Municipalities, 1 Province, 1 Union of Municipalities, 1 Other);
- 46 with Cash service;
- 2 Pool services (Tuscany Region and Tuscany Central LHA).

With a territorial position that sees 48 authorities in the Province of Pistoia, 10 in the Province of Lucca, 8 in the Province of Massa Carrara and 2 in the Province of Florence.

PERSONAL AREA

Pistoia and Province Personal Area

In an extremely complex context, such as the one that characterised 2018, with significant volatility in the financial, stock and bond markets, and with often negative performance, the Pistoia and Province Personal Area, thanks to the professionalism, determination and constant commitment of managers and operators, once again demonstrated dynamism, pro-activity and attention to application of the method, positioning itself in the top places among the areas of the Tuscany and Umbria Commercial Personal Department in terms of achieving economic and commercial objectives. In 2018, total gross placements amounted to approx. 239 million euros, of which 235 in Asset Management, Certificates and Third Party Bonds. Damage protection, in particular Non-Motor policies, such as for example family, home, accident and health coverage, was an area of excellence at the Banca dei Territori level with the achievement of 208% of the target assigned with over 132,000 euros in premiums, net of renewals, concretely interpreting one of the main pillars of the 2018-2021 Business Plan. Also in terms of advanced consultancy and multi-channel approach, during 2018 substantial progress was made on the path towards change, with the development of skills and with greater extensiveness and continuity in the proposition.

Lucca - Massa Carrara Personal Area

In 2018, financial markets were very volatile and with negative performance in almost all bond and stock market indicators, leading to a considerable slowdown in the "core" activity of the personal market, which managed to recover somewhat in the second part of the year, thanks to the issue of bond products and Segment I insurance policies. In this far from easy scenario, a large contribution was provided by the work of our people who, thanks to their professionalism, managed to reassure and help customers in their investment decisions.

However, 2018 was characterised by the significant increase in sales of Motor and Non-Motor insurance policies marketed by the Group in line with the objectives of the new business plan. On the other hand, the loan and mortgage market was stable.

Also for 2018, a significant contribution in achieving the objectives was provided by the choral and precise application of the commercial method, which allowed us to address all our customers.

BUSINESS AREA

CR Pistoia e Lucchesia Business Area

The Business Area continued to provide adequate financial support to customer companies, both in terms of working capital requirements typically resolved with short-term loans, also in instalments, and in medium-long term forms. The collaboration with Mediocredito Italiano was significant, with increases in factoring turnover (good results also for capital goods leases and medium-long loans), as well as with Banca IMI for typical corporate finance transactions.

The year was characterised by the affirmation on many customers of the Protection segment, where the Area was particularly highlighted, together with Welfare issues - another distinctive sign.

The contributions of foreign transactions was very positive, referring both to cash management issues (collections/payments) as well as to more specialised transactions to support every contractual phase of customers with international clients.

The fruitful collaboration with Intesa Sanpaolo Formazione continued, with the activation of 2 classroom courses (one in Pistoia and one in Lucca) which recorded a significant level of attendance: the topics dealt with, of particular significance, were Internationalisation and Digitisation, respectively.

At the end of the year, the collaboration with ISP FOR VALUE was launched in a business branch, with good synergy prospects.

Communication activity

Sponsorships

Also in 2018, the sponsorship activity continued through the strengthening of the collaboration with specific structures and entrepreneurial excellences in the area - cultural associations, sports clubs, foundations, etc. - addressed by the Bank, placing particular attention so that the initiatives put in place were aimed at achieving precise objectives, both of a commercial as well as relational and image nature.

Museums of the Antico Palazzo dei Vescovi of Pistoia

Considering the extensive museum program of 2017 - the year of Pistoia as Italian Capital of Culture - and the planned sale in 2018 of the Antico Palazzo dei Vescovi and the Museums contained therein to the Cassa di Risparmio di Pistoia and Pescia Foundation, the planning of events was extremely limited and concentrated exclusively in the first part of the year.

The planning work was oriented so as to focus on important and authoritative collaborations that guaranteed the scientific level of the events, choosing high-level communication methods, consolidating the role of the Museum of the Antico Palazzo dei Vescovi as a qualified interlocutor in the cultural planning of the city and an integral part of the Pistoia museum system.

In continuity with the work of last year and in consideration of the sales operations of the Antico Palazzo dei Vescovi and the loan agreement relating to over five hundred works belonging to the Bank's Collections, the aim was to effectively and productively consolidate the collaboration with all the structures of the Cultural Activities Department of the Parent Company.

The programme of activities implemented during the year was the subject of various forms of advertising: each initiative was promoted with press releases sent to the most important local and national media and supported by the production of printed materials such as leaflets, invitations and posters. During the year, the Museum implemented its mailing list and opened its Facebook profile.

In consideration of their high scientific level, in order that the contents presented in the cycles of meetings could become a concrete contribution to the investigations on the history, art and culture of the city of Pistoia, the conferences were published as part of a collection of small volumes: Meeting at the Palazzo - Notebooks.

In the tradition of the Antico Palazzo dei Vescovi, the speeches of the scholars and the meetings were followed by thematic aperitifs and tastings which, in addition to creating a pleasant and convivial atmosphere, contributed to restoring, on a sensorial level, perceptive associations with the topics covered.

There were numerous visits designed specifically for families with children: a way to share, while having fun, a visit to the Museum. This activity was supplemented by the teaching activity carried out for kindergartens, primary, lower and upper secondary schools and universities, which saw the participation in the laboratories of more than 600 students belonging to 32 different classes.

Overall, the Museum of the Antico Palazzo dei Vescovi, in its five versions, recorded approx. 5,000 visitors during the year, with attendance figures equal to those of the period prior to 2017.

Business Continuity and Cyber Security

The reference context

The Cybersecurity and Business Continuity Department, established on 10 May 2018 as an evolution of the previous Information Security and Business Continuity Service, was given responsibility to:
- contribute, in line with corporate strategies and objectives, to the definition of policies and guidelines on cyber security, IT security and business continuity for the Group.
- ensure implementation of these policies and guidelines, guaranteeing the service levels agreed with users and verifying implementation on the Group of all the defined guidelines.
- carry out all the tasks assigned to the Specialist Functions for managing the risk of non-compliance with legislation, as set out in the Group Compliance Guidelines, with reference to the regulatory areas on IT security and business continuity.
- contribute to the overall management of operational and reputational risk, developing a dynamic risk analysis logic and risk-based approach to security.
- support the digitisation of the Group's services and products and develop testing activities aimed at adopting innovative technological paradigms.

In this context, the attention paid to the fight against cyber crime committed in particular to the detriment of customers through direct channels (Internet banking, phone banking, mobile banking, payment cards and ATMs) is confirmed. At the banking system level, the continuous increase in cybercrime is highlighted, implemented with increasingly sophisticated and innovative tools.
In particular:
- the attacks are focusing on customer workstations since, while the infrastructure protection solutions of financial institutions have reached a greater level of maturity and effectiveness, end users are still lacking the appropriate skills and technologies necessary to address the threats to their security;
- cyber crime has evolved towards complex organisations and, at the same time, the level of sophistication of malware (infected software) is increasing, in certain cases capable of overcoming OTP-based (One Time Password) security measures;
- the growing use of smartphones, tablets and other devices to connect to online banking services is making the new channels an increasingly attractive target for cyber criminals;
- the spread of new real-time phishing campaigns aimed at Internet Banking service customers is emerging;
- the widespread use of social networks by customers and bank employees increases the risk of incurring theft of confidential information through "social engineering" techniques conveyed on these channels;
- national and European legislators, in the face of growing information security risks, have in recent years issued specific regulations that came into force or were implemented in the first half of 2018 (the main ones being Payment Services Directive 2 - PSD2, Network and Information Security Directive - NIS, General Data Protection Regulation - GDPR).

In the reference framework outlined above, projects and activities that guarantee both the confidentiality and integrity of the company's information assets (IT security) and its constant availability (operational continuity) are in fact integrated.

Main activities carried out by ISGS - Cybersecurity and Business Continuity Management

The main activities carried out during the year were aimed at implementing the Intesa Sanpaolo Group's strategy in the area of Cybersecurity and Business Continuity.

Following the closure, at the end of 2017, of the Cyber Security Program and in line with the new Security Regulatory System, the 2018 Intesa Sanpaolo Security Plan was defined which includes not only the activities carried out in 2017 and the 2018 plan, but also details on the Cybersecurity Business Plan for the period 2018-2021, the related strategy and the investments necessary to support it.

The 2018 IT Security Plan was presented to the Board Committees on 22 March 2018 and submitted for approval by the Board of Directors of Intesa Sanpaolo on 4 April 2018 and by the ISGS of 26 July 2018. This Plan is consistent with the Group Business Plan and in particular envisages implementation of the Group Cybersecurity Strategy, with some priority objectives: (i) reinforce and innovate security measures to ensure “digitisation” of Group services (ii) extend to Group entities the controls already implemented at the Parent Company level, (iii) manage Cyber Risks in an integrated manner consistent with that defined at the Group Risk Appetite Framework (RAF) level, (iv) systematically resort to the most innovative technologies and (v) take a proactive and influential role on the international scene on Cybersecurity issues. This strategy is broken down into four main topics (Single Digital Identity, IT Security Model and Stakeholder Networking, extension and evolution of the Group controls, reinforcement of internal skills) which allowed the definition of the operational projects and the related investments necessary for implementation of the initiatives defined in the Master Plan, starting part of the project activities.

In April 2018, a second opinion on the Cybersecurity Strategy was requested from an independent external advisor who, through the review of the three-year plan, confirmed the Cybersecurity objectives that had been identified, providing indications and suggestions for the correct implementation of the Plan itself. During the months of November/December, the same Advisor conducted a follow-up activity with respect to the verifications carried out in the first half of the year, with the aim of updating the strategy at the beginning of 2019.

On the subject of extending the safeguards to Group entities, a roll-out of the new IT Security Model was launched through the delivery of dedicated workshops. During the year, the meetings scheduled with the Legal Entities of the Group took place: to date, approx. 60% of the companies in scope have been involved.

The project envisages activities aimed at extending the cybersecurity capabilities to the Group by applying the target model to the individual companies in order to enable a holistic Cyber Governance.

The program to strengthen the Bank's national and international positioning in relation to cybersecurity issues continued through strategic and operational collaborations and active participation in various working groups. Specifically, this program made it possible to:
- strengthen institutional relations at a national (e.g. DIS, CERTFin) and international (e.g. ECB, ENISA, EUROPOL) level, also through participation in working groups such as: European Cyber Security Organisation (ECSO), European Banking Federation (EBF), Association for Financial Market in Europe (AFME);
- participate in the creation of the CyberSec4Europe Consortium to respond to the call of the European Commission which led to the allocation of funds dedicated to the development of the Common Application for mandatory incident reporting in the finance sector (BBVA, ISP, ATOS);
- create a Network of relationships of trust with some of the main operators in the Finance and Cross Industries sectors, at the national and European level.

During the year, the Security Regulatory System was updated, which needed to be updated with respect to the requirements of Regulation (EU) 2016/679 (GDPR) in force since 25 May 2018 and the Payment Services Directive (PSD2).

Furthermore, Process Guides and Rules were updated in order to implement the requirements of the EBA on Cloud Security, incorporating the organisational changes that occurred during the year, in accordance with the objectives of the Integrated Process Governance Project. Furthermore, in relation to the enhancement of the regulatory framework in the incident reporting area, a process was defined for the management of critical events valid for the entire Group, which also takes into consideration the regulatory aspects and requirements for incident reporting to Regulators.

With a view to strengthening the Group's security, a structure dedicated to Security by design and dynamic risk analysis was created. With regard to the latter, activities aimed at defining the Cyber Risk Framework are underway with the Chief Risk Officer, in order to carry out a more effective and dynamic cyber risk analysis. In particular, during the later half of 2018, the definition of the calculation model of the probability of occurrence of cyber risk scenarios was completed, and the models for estimating impacts and assessing vulnerabilities are being updated.

The 2018 - 2021 Awareness and Training Plan was defined with the aim of strengthening the security skills of all personnel.

Induction activities were carried out with the Corporate Bodies of the Parent Company and other Italian and foreign Group companies.

To date, approx. 100 new training courses have been released relating to Cyber Risk and Cybersecurity, Cyber Fraud, Phishing and Mobile Device Management, Operational Continuity.

Interventions were activated in the "Management School" and a survey was carried out for all managerial roles of Italian companies controlled directly by the Parent Company (approx. 10,000 colleagues). An innovative phishing test involving approx. 11,000 colleagues and a simulation of a crisis scenario related to a cyber incident ("Data Breach") were also implemented in order to increase the response capability of the Management Committee.
In December, a simulation was also carried out by CODISE to verify the effectiveness of the response capability of banks and systemic financial operators in the definition and application of a common strategy for customer communications.

On the subject of Single Digital Identity, the technological framework and target architecture were identified to support the new Group Identity & Access Management, with the aim of simplifying and rationalising access to services by customers and employees, ensuring adequate levels security through the use of Strong Authentication solutions. Some priority areas on which to intervene with infrastructural tactical solutions were identified, namely automation of the first group of processes through a Robot aimed at reducing operational risks.

Activities for the definition of the Global Fraud Management target model are in progress. In particular, development of the single Group fraud repository, the target technological solution, integration with Threat Intelligence processes, complete coverage of business processes and definition of synergies for coverage of internal (employees) and external (customers) areas are under consolidation. The level of operational continuity of the anti-fraud system of the new Internet Banking system was strengthened by migrating to a new technological architecture that guarantees greater levels of reliability and better performance and Machine Learning mechanisms are being evaluated to make the management of effectively fraudulent operations more efficient. In this regard, the evolution of the technological infrastructure of the Cyber Data Platform was started, currently used in the anti-fraud field and increasingly necessary to analyse significant amounts of information useful for identifying possible Cyber threats (Analytics), with the possible aid of Artificial Intelligence techniques.

The integration of Group banks aimed at centralising the activities of the Security Operation Center at Group level (Global SOC) continued. The integration to date has been completed for Alexbank, Banca 5 and CIB, while it is underway for ISP Albania, New York, Servitia, VUB and Romania.

The process of continuous strengthening of the safeguards, solutions and mechanisms for crisis management also ensured during 2018 continuity of services and the safeguard and protection of collaborators and customers during critical events for the Group's business continuity. In particular, worthy of mention are the management:
- of episodes of severe bad weather in areas where there are Italian local structures (Campania, Emilia Romagna, Abruzzo, Liguria, Triveneto, etc.);
- of IT technological and application problems with impacts on critical processes and settlement platforms on Italian systems (Target 2, Tigerz, Kondor+);
- of IT technological and application problems with impacts on payment processes on International Bank systems (VUB, PBZ and ISP Romania);
- of problems (also administrative) related to the non-compliant use of credentials: given to others or relating to colleagues who are no longer employees or consultants with expired contracts.

As for the main cyber threats that occurred during the year, some of which were also widely covered by the mass media (innovative social engineering techniques in terms of combining phishing, vishing and smishing, processor vulnerability called Meltdown and Specter, banking Trojans, Cobalt Group), a prompt and effective activation of the technical and organisational countermeasures for prevention and mitigation was coordinated by the Computer Security Incident Response Team, in collaboration with the competent corporate functions of Intesa Sanpaolo.

With regard to Business Continuity, a project was launched aimed at developing the Group Business Continuity Model, within which, following the completion of the feasibility study to carry out the Business Impact Analysis in line with the new corporate regulations of the Process Guides, said Model was integrated into the Risk Management processes (including third parties) and the Group is continuing with BIA harmonisation activities.

The updating and testing of business continuity solutions continued, reinforcing the existing safeguards with specific initiatives and envisaging new additional solutions aimed at increasing the level of effectiveness and resilience of these safeguards.

With reference to the tools supporting the activities, there were further implementations on the COOPE Portal to allow users a more complete management of activities pertaining to the BIA and the Group Business Continuity function more precise control.

During 2017, re-alignment of the I and II level Compliance checks with the control objectives of the Integrated CBCM NIST SP 800-53r4 based Model was completed. The periodic updating of the mapping of compliance monitoring and controls for the Cybersecurity and Business Continuity areas was completed and the first interventions to fill the gaps identified (e.g. Cisco ISE Network Access Control solution for identification of devices that are not in line with corporate security standards, adoption of strong authentication for access to a first subset of applications through the Citrix metaframe channel, etc.) were completed. Further initiatives will be implemented progressively in synergy with the ISP IT Security Plan for the three-year period 2018-2021.

Some of the activities aimed at strengthening the safeguards in terms of cybersecurity and monitoring of supplier performance were also launched. In particular, an initial classification was carried out for approx. 150 suppliers according to certain metrics of interest (which will be further extended) and feasibility studies are also being completed for implementation of the additional measures envisaged (e.g.: regulatory update, rationalisation of supplier management tools, third-party access management, etc.).

The minimum scope of verification and control sessions for Business Continuity and IT Security was identified. The 2018 Business Continuity Verification Plan initially envisaged 237 verification sessions, of which 13 were eliminated following organisational changes to the structures in scope; the 2018 Control Plan, based on the Integrated Control Model of the ISP Group, envisaged 23 control sessions, of which 15 documentary and 8 in audit-like mode.

For IT Security, 120 control sessions were envisaged, each of which was uniquely associated with a 2nd level control, of which 64 were documentary and 56 in audit-like mode.

In 2018, various initiatives were completed to fill the gaps identified in the "Compliance Monitoring and Control Mapping" project.

With regard to compliance with international regulations and standards, the following were renewed:
- "ISO 22301:2012 certification - Societal Security - Business Continuity Management Systems" with reference to systemically important processes pertaining to the provision, in the domestic sphere, of "Services connected with gross settlement systems in central bank money";
- ISO27001 certification, on all perimeters for which the Bank was already certified;

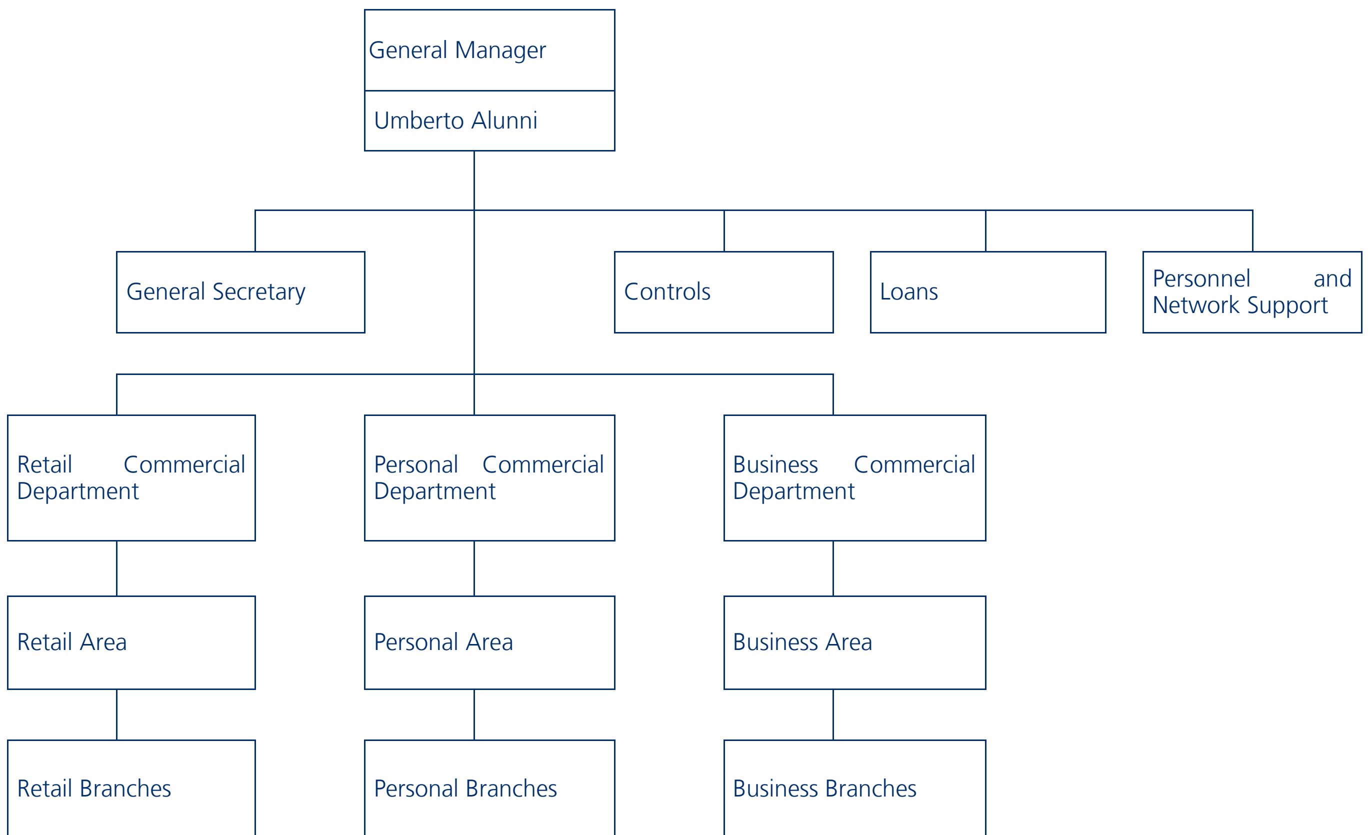
- PCI/DSS Service Provider Mercury Payments certification;
- ISO 20000 and ISO 9001 certifications, which certify the efficiency and quality of the services provided;
- compliance with the eIDAS Regulation;
- self-certification of compliance with ISO27001 for the Target 2 platform (europayments);
- CSCF self-certification for SWIFT and CAI compliance.

As envisaged by the Group Integrated Internal Control System regulation, in the first half of 2018, the information flows for the Corporate Bodies of the Parent Company, of the Banks and of direct Group subsidiaries were prepared. The "Group IT Security Plan" document and the 2018 Business Continuity Information Flows were brought to the attention of the Board of Directors of the Parent Company on 4 April 2018 and to the Board of Directors of ISGS on 26 July 2018 and approved in said meetings.

Finally, in line with the Group's Compliance Guidelines, compliance checks were carried out for the areas of competence of the IT Security Specialist Function and the Business Continuity Specialist Function.

Organisational Structure of the Bank

The Bank's organisation chart is as follows:



Reporting directly to the General Manager:
Financial Statement Audit Specialist
Service Control Specialist

Macroeconomic context and banking system

The macroeconomic context

The long period of expansion of the world economy continued at a moderate pace in 2018. In the second half of the year, however, the signs of a weakening of the cycle, which had already emerged from the economic indicators in the first quarter, became more marked. Concerns about the protectionist offensive launched by the United States have resulted in the imposition of duties on steel, aluminium and therefore on a wide range of Chinese products, followed by the adoption of countermeasures by China which have already reduced bilateral trade between the two countries. In China, economic growth has slowed, as has the demand for goods produced abroad.

For the time being, the US economy is experiencing robust growth. In 2018, the average annual rise in GDP was just under 3%. Domestic demand was underpinned by the short-term effects of the tax reform and still-favourable financial conditions. Unemployment fell to 3.9%, but signs of wage pressure are still limited. Inflation has returned to 2%, but is far from worrying for the Federal Reserve. The Central Bank continued to gradually increase official rates, raising the Fed funds target three times by a total of 75 basis points, and continued to reduce its securities portfolio, not reinvesting the entire amounts that were coming due.

The slowdown in growth, on the other hand, was very marked in the euro zone. In addition to the slowdown in foreign demand, the economy suffered from a sharp decline in demand for cars in the second half of the year, in part linked to the change in emissions standards. Trend growth decelerated in the third quarter to 1.6% YoY, and economic indicators indicate that a further slowdown occurred in the fourth quarter. Nevertheless, employment continued to rise, reducing unemployment to 7.9% of the labour force in November. Inflation remains modest and below the objectives of the European Central Bank. The latter announced in June its intention to cease net purchases of securities under the securities purchase programme at the end of December, after a reduction in the fourth quarter to €15 billion per month. The reinvestment of maturities, on the other hand, will continue in 2019. The ECB has also indicated that it expects official rates to remain unchanged until the end of summer 2019. For the time being, short-term rates remain negative and stable. The yield on the 10-year German Bund peaked at 0.76% in February, when the market was expecting official interest rate increases as early as spring 2019. Subsequently, medium and long-term market rates fell to below the lows of December 2017.

With regard to the negotiations for the United Kingdom's exit from the European Union (Brexit), the parties reached an agreement in November on the definition of the withdrawal treaty and on a political declaration on relations under way. However, the agreement is meeting with strong opposition in the UK Parliament, which has so far made it impossible to ratify it.

Important financial tensions characterised the Italian debt in the two-month period May-June, coinciding with the negotiations for the formation of the new government, and subsequently again between October and November, in connection with the definition of the Budget Law for 2019. In May, spreads with German debt rose rapidly on all maturities. On 29 May, coinciding with low demand end-of-month auctions, short-term spreads were even higher than long-term ones, a typical configuration of exceptional phases of financial stress. The state of tension reflected investors' doubts about the new government's willingness to keep public debt on a downward path, which also led them to face, in some phases, a significant risk of redenomination. At the end of the year, however, the draft budget law was significantly revised, with amendments considered sufficient by the European Commission to avoid the immediate opening of an infringement procedure for excessive deficit and such as to bring the deficit back to reassuring levels for investors. This was followed by a rapid descent of the BTP-Bund differential from peaks of more than 320 basis points back towards 280. However, yield spreads remain much higher than the average for the January-April period, and consistent with a risk of downgrading of creditworthiness.

The real Italian economy, like that of other European countries, has also lost momentum. GDP trend growth slowed to 0.7% YoY in the third quarter, with a negative variation (-0.1%) compared to the previous quarter. The slowdown reflects the fall to zero of the industrial sector's contribution to growth, as a result of the slowdown in exports, household consumption and, from the third quarter of 2018, fixed investments as well. In November, industrial production was down sharply on a trend basis. Business confidence indices continued to decline throughout the fourth quarter. However, while clearly slowing down, the pace of economic expansion was still sufficient to ensure modest employment growth and a further decline in the unemployment rate to 10.5% in November. The trend in the consumer price index was still modest (1.2% in December).

On the currency markets, the euro first strengthened against the US dollar, reaching a peak of 1.25 in February, then even returned below the levels of the beginning of the year, between 1.12 and 1.18. Between March and April, the euro also temporarily strengthened against the Swiss franc, almost reaching 1.20; then it returned to the levels of the beginning of the year, closing the year below 1.13.

The stock markets

The year 2018 showed generalised negative trends and a progressive increase in volatility on the international stock markets, in a context of greater risk aversion on the part of investors.

In the first part of the year, the stock markets initially found support in the performance of corporate profits; in particular, the announcements of the 4Q17 and 1Q18 results gave positive signals to investors, with numerous results above expectations, and the frequent confirmation, or improvement, of the guidance for the current year. Subsequently, the progressive exacerbation of tensions in international trade between the United States and China, and the consequent imposition of duties, represented a brake on cyclical expansion.

The second half of the year saw a combination of macroeconomic uncertainties (with numerous indicators indicating a slowdown in growth in Italy and, more generally, in the euro area), monetary uncertainties (linked to the exit from the ECB's quantitative easing programme), and political uncertainties (the growing tensions between Italy and the European Union linked to the approval of the 2019 Budget Law; uncertainties relating to Brexit). This triggered a strong and protracted correction in equity prices, which was more pronounced in the financial sector.

The Euro Stoxx index closed 2018 with a reduction of 14.8%; the CAC 40 fell by 11% at the end of the period; the Dax 30 underperformed the main Eurozone benchmarks (-18.3%), while IBEX 35 closed the year down by 15%. Outside the euro area, the Swiss market's SMI index fell by 10.2%, while the UK market's FTSE 100 index closed 2018 down by 12.5%.

With regard to the US stock market, the S&P 500 index closed the year in negative figures (-6.2%); the Nasdaq Composite technology stock index slightly outperformed it, closing at -3.9%. The performance of the major Asian stock markets was negative: the Nikkei 225 index closed 2018 with a 12.1% decline, while the decline in the Chinese SSE A-Share benchmark index was more pronounced (-24.6%).

The Italian stock market recorded negative performances in all its segments, in line with the other benchmarks of the euro area, but with high volatility during the year: the FTSE MIB index closed 2018 at -16.2%, after having first recorded an increase of +12.3% (7 May), and a subsequent decrease of 25.3% from the highs it had reached; the performance of the FTSE Italia All Share index was similar (-16.7%). Medium-cap stocks closed the year at -16.6%, in line with the main index, after closing the first half of the year at broadly the same level.

The Corporate Bond Market

European corporate bond markets closed 2018 negatively, with risk premiums (measured as asset swap spreads-ASW) rising sharply from their levels at the beginning of the year. The period was characterised by marked volatility, with markets negatively affected by the combination of a number of elements, including: signs of a slowdown in growth (especially in the euro area), trade tensions between China and the United States, new critical issues for some emerging countries. To these components were added the uncertainties linked to the future moves by the Fed, and above all the announced end of the European Central Bank's securities purchase programme. After a positive start to the year, and in line with the trend of 2017, starting in February the markets showed a progressive widening of the spreads, which continued until the end of the period, with high volatility and sporadic short phases of return to purchases by operators, which did not, however, change the negative tone of the fund. In the summer months, spreads were also affected by the sharp slowdown in ECB purchases, as well as by trade tensions and crises in some countries such as Turkey and Argentina.

In terms of sectors, 2018 ended with an underperformance of Investment Grade securities compared to the High Yield segment, which was also penalised by their greater sensitivity to risk-free interest rates. The highly compressed levels of spreads at the beginning of the year contributed to accentuating the negative performance. During the year, financial securities showed a greater weakness than industrial securities, probably due to a closer link between banks and country risk, especially in the Italian case, as well as to the lack of technical support provided by the corporate securities purchase programme. At the end of December 2018, the corporate (non-financial) securities held in the portfolio by the Frankfurt-based bank amounted to approximately €178 billion. Again according to data provided by the Central Bank, in October 2018, approximately 12% of the ECB's corporate portfolio consisted of securities issued by Italian issuers. At its last meeting of the year, the ECB confirmed the conclusion of the QE in December 2018, but also its intention to continue to reinvest maturing bonds for an extended period of time even after the first rate increase.

As regards the primary market, 2018 saw an overall decline in issues compared to 2017 (e.g. approximately -15% for non-financial corporate issues, source: Thompson One), also as a result of the pre-funding actions implemented by companies in previous years. The trend was characterised by high volumes in the first part of the year, with issuers intending to anticipate future moves by the ECB, while the subsequent increase in volatility and interest rates was reflected in a more wait-and-see approach, with issuers trying to exploit the sporadic phases of narrowing spreads.

Emerging countries

The economic cycle and inflation

In 2018, after a particularly strong first half of the year, the trend growth in GDP in emerging countries lost momentum. With reference to a sample of countries covering 75% of emerging countries' GDP, trend growth went from 5.1% in the first half of the year to 4.8% in the third quarter. For the whole of 2018, according to preliminary estimates by the IMF in January 2019, the GDP of emerging countries is expected to increase by 4.6%, compared to 4.7% in 2017. Despite a slowdown in the Chinese economy, Asia, thanks to greater growth in India, maintained an estimated growth rate of 6.5% (as in 2017), confirming itself as the most dynamic area in the world; the IMF estimates, on the other hand, see Latin America as the area with the weakest regional growth (+1.1%).

In countries with ISP subsidiaries, the economy as a whole remained robust in the first three quarters of 2018, at 3.1%, the same growth rate as in 2017. Growth accelerated again in the EEC countries (4.6% in the first three quarters of 2018 compared to 4.3% in the whole of 2017) but slowed down among the EEA countries (to 3.8% from 5.3%) as a result of the slowdown of the Romanian economy, which returned to a more sustainable path after the peak reached in 2017 (+6.9%). Among countries with an ISP presence, growth also slowed down, albeit to a limited extent, in Moldova, while it accelerated slightly in Russia and Ukraine and, to a significant extent, in Egypt, where in the financial year ended June 2018, it was among the most dynamic in the MENA region, with a rate above 5%.

In 2018, trend inflation, again with reference to the sample of 75% of emerging countries' GDP, after a peak of 4.4% in October, slowed in the final months, due to the fall in food and hydrocarbon prices, closing the year at 3.6%, substantially unchanged from the end of 2017.

Among countries with ISP subsidiaries, in EEC and EEA countries the most recent data on price dynamics, despite a positive output gap and a still sustained growth in wages, saw a slowdown in the last months of 2018 due to the decline in energy prices. In December, trend inflation ranged from 1.1% in Poland to 2.7% in Hungary in the EEC area and from 0.8% in Croatia to 3.3% in Romania in the EEA region. In most cases, inflation remained within the targets set by the respective Central Banks with the sole exception of Poland, where it fell below the lower limit of the target range. In the CIS area, inflation ended the year up to 4.3% in Russia, above the target value, while it ended the year down to one decimal place (9.8%) in Ukraine. Inflation slowed significantly in Egypt (12% at the end of 2018), with the effects of the large depreciation of the exchange rate and the revision of subsidies gradually fading away.

Monetary policy

In 2018, several Central Banks in emerging markets raised their reference interest rates. In some cases (Argentina and Turkey) the authorities have had to counteract a currency crisis with large increases in the cost of money. In others, as in some Asian countries (India, Indonesia, the Philippines and Malaysia), restrictive measures have been a response to rising inflation. Still in Asia, China’s Central Bank left interest rates unchanged, but cut the reserve requirement rate to support credit demand. In Latin America, the strength of the US dollar led the Central Banks (including Brazil and Peru) to close the bearish phase that began at the end of 2016 in the first half of the year.

Looking at countries with ISP subsidiaries, in EEC and EEA countries, rates rose in the Czech Republic and Romania, in response to rising inflation, while in the face of substantially stable inflationary conditions, and a still prudent monetary position by the ECB, monetary policy conditions remained accommodative elsewhere. Regarding CIS countries, in Russia the Central Bank cut the reference rate in the first part of the year by 50 bps, in the presence of inflation that fell below the target, but in the second half of the year, due to the weakening of the rouble and in order to counter inflationary pressures linked to the announced increase in VAT, it raised it by 25 bps, bringing it back up to 7.5%. In Ukraine, too, in order to counteract inflation above target, the Central Bank raised its reference rate by 350 bps in the year, bringing it up to 18%.

The financial markets

In 2018, the rise in interest rates on the dollar and the currency difficulties affecting some markets favoured an appreciation of the US dollar towards emerging countries (OITP Index 9.4%), in particular towards Argentina and Turkey, but also towards Brazil, South Africa, India and Indonesia. In countries with ISP subsidiaries, the major currencies followed the euro, which depreciated by 5% against the US dollar, with the Polish zloty and the Hungarian forint, however, also particularly weak against the common currency. In the CIS Area, the Russian rouble depreciated by 16.3%, penalised by the rebound in oil prices and additional sanctions. The new arrangement for financial support from the IMF finally favoured a moderate appreciation of Ukrainian hryvnia (+1.3%). The Egyptian pound also depreciated moderately (0.9%), despite still high inflation, supported by the high premium paid on interest rates.

Fears of a slowdown in the global economic cycle - together with uncertainties linked to the trade dispute between the United States and China and local geo-political tensions - have weighed on several stock markets. The composite MSCI index for emerging countries fell by 15.5%, following the fall in the indices for advanced countries. The falls were particularly large in Asian markets (Shanghai -24.5%) and in the Gulf oil countries (Dubai -24.9%). With regard to countries with ISP subsidiaries, several stock markets in Central and Eastern Europe outperformed EuroStoxx, in particular Serbia (+5%) and Slovakia (+2%). In the CIS area, the stock index in Russia fell by 7.6%, while the Ukrainian market was more resilient (-2.4%). In the MENA area, the Egyptian stock market also fell back (-13.2%), despite the sustained performance of the economy.

The political tensions affecting several countries, together with the greater financial risks linked to the rise in US rates, led to an increase in the EMBI+ spread (+116 bps was the average figure). The largest enlargement concerned the EMBI+ spread of Latin American countries (around 150 bps), which was affected by the crises in Argentina and Venezuela. With regard to countries with ISP subsidiaries, the spread rose by more than 150 bps in Ukraine (to 600 bps) and 40 bps in Russia (to 170 bps) and increased by 60 bps in Egypt (to 360 bps), while it fell slightly in Croatia and Serbia and remained at contained levels in the EEC area.

The improvement in the fiscal and external position has allowed Russia to regain investment grade (which it had lost between 2015 and 2016) by all three major rating agencies. Egypt also benefited from an increase in the valuation of sovereign debt (B for Fitch and S&P, B3 for Moody's). Also among ISP subsidiaries, upward rating revisions affected Ukraine (Caa1 for Moody's) after the new agreement with the IMF, the Czech Republic (now AA- for Fitch), Poland (now A+ for S&P) and Croatia (now BB+ or equivalent).

The Italian banking system

Rates and spreads

Bank rates also reached new record lows in 2018, but the summer saw the first increases in rates on new loans, due to the increase in the yield differential between Italian and German debt securities. On an annual average, corporate rates on large new loans remained broadly stable compared to 2017, while rates on smaller loans fell year-on-year. In the European comparison, Italian rates on new loans to businesses remained below the euro area average for both smaller operations and loans above €1 million. However, the negative differential narrowed in the second half of the year. Interest rates on mortgages to households also reached new lows and then showed a slight reversal of the trend, as a result of repricing actions. Given the still very low level of rates on new financing operations, the decline in rates on outstanding loans continued, alternating with phases of stability.

The average deposit rate remained viscous, marginally lower than the 2017 average. In the case of current accounts, the high liquidity in stock justifies the stability of interest rates at values close to zero, with at most slight downward adjustments. On the other hand, the average rate on new deposits with an agreed maturity was more variable, with signs of an upward trend towards the end of the year. The continuation of a moderate fall in the average rate on the stock of bonds contributed to a further reduction in the overall cost of funding from customers, also favoured by the re-composition of the aggregate into less costly forms.

However, as a result of the continued reduction in the average rate on the stock of loans, the spread between lending and borrowing rates narrowed slightly, especially in the first half of the year, but remained broadly stable in the second half of the year. For the seventh consecutive year, the mark-down on sight deposits was confirmed in negative territory, showing a marginal recovery in the latter part of the year. At the same time, the mark-up fell further due to the fall in short-term lending rates.

Loans

Moderate growth in bank lending continued. Lending to the private sector strengthened compared to 2017, reaching 3.0% YoY in April and then returning at a more moderate pace of 2.3% in November (adjusted for securitisations). The improvement was driven by a return to growth in loans to non-financial corporations, as well as a continuation of the positive trend in loans to households. Overall, the latter maintained an annual average growth rate of 2.8% YOY, the same as that recorded in the last quarter of 2017, thanks both to mortgages for the purchase of homes and to consumer credit. Mortgage lending continued at high volumes, rising again from July to October, with a rebound that could be linked to expectations of a rise in interest rates. Fixed-rate disbursements remained predominant, with interest rates still at a low level. The trend in mortgages to households appeared to be consistent with the more moderate pace of residential property purchases and sales, already observed in 2017 compared to the double-digit trend recorded in 2016. Consumer credit provided by banks continued to grow at a rate of between 8 and 9% YoY for the stock.

Loans to non-financial companies at the beginning of 2018 showed a jump in the growth rate to 2% YoY, after about two years of stagnation. Subsequently, the dynamics became more moderate on average. The most buoyant pace that emerged at the beginning of the year was also likely to be driven by the supply-side incentives provided by the Eurosystem's targeted refinancing operations. The evolution of loans continued to be characterised by different trends by sector and size of business. Loans to manufacturing and services continued to grow, while loans to construction companies continued to decline, albeit at a lower rate than in 2017. Loans to smaller companies have decreased further.

The development of corporate lending is the result of moderately rising demand and a still positive supply environment for most of the year, but has become slightly more cautious in recent months. According to the Bank of Italy's Credit Survey, until the third quarter banks continued their policy of cautiously reducing margins, accompanied by some improvements in other contractual terms and conditions, stimulated by competition and lower perceived risk. However, the tone became slightly restrictive in the latter part of the year, as a result of lower risk tolerance. Business reviews also confirmed favourable conditions for access to credit for most of the year and a slight restriction in the last quarter. On the other hand, throughout 2018, the increase in demand from businesses, especially for long-term loans, continued, driven mainly by the low level of interest rates. The liquidity environment remained broadly relaxed and was considered sufficient or more than sufficient by a large majority of companies. The reduction of corporate debt as a percentage of GDP has continued.

In 2018, Italian banks made much progress in reducing asset risks. Credit quality ratios have improved considerably, thanks to lower inflows of impaired exposures and the sale and securitisation transactions carried out by banks. The stock of net non-performing loans continued to fall, falling in November to €37.5 billion, a decrease of €26.5 billion compared to December 2017 and more than halved compared to the end of 2016 (-€49 billion or -57%). In relation to total loans, net non-performing loans fell to 2.2%, down 2.7 percentage points compared to December 2016. The rate of formation of new impaired loans continued at pre-crisis levels reached in the second half of 2017, with 1.7% in the third quarter of 2018, in terms of flow in relation to performing and annualised loans.

Direct deposits

In terms of customer deposits, 2018 also confirmed the trends already seen previously, i.e. the growth in deposits, driven by the trend in current accounts, which however showed a slight slowdown in the fourth quarter. At the same time, the double-digit decline in deposits with agreed maturity continued. The trend in customer deposits continued to benefit from the liveliness in the current accounts of non-financial corporations, although it slowed down in the last few months of the year, and from the solidity of household deposits. Once again, the growth in deposits from residents was offset by the collapse of the stock of bank bonds, whose performance was affected by the reallocation of customers' portfolios. Overall, funding from customers fluctuated between substantial stability and slight growth, averaging +0.6% YoY from January to November. Also taking into account the use of the Eurosystem, which has been slightly declining since March, total bank funding grew by an average of 0.5% YoY.

Indirect deposits and asset management

With regard to assets under administration, there was a marked decline in household debt securities held in custody by banks. The trend continues to be affected by the fall in bank bonds, while the decline in government bonds has slowed down. In particular, in the second and third quarters, ordinary Treasury bills (BOTs) increased again, for the first time after more than five years of reductions.

In the asset management market, the mutual fund and asset management industry experienced a sharp slowdown in 2018. In particular, the funds underwent net outflows in the last four months, closing the year with only marginally positive cumulative funding. The main reasons for this are the continuing tensions on the financial markets, uncertainty about economic policy in Italy and the increase in the risk premium on sovereign debt, and the gradual rise in American interest rates. In the last four months, outflows have been for long-term funds, including multi-assets (flexible and balanced). However, over the year as a whole, multi-assets achieved positive cumulative net inflows, together with equities and monetary assets, while, on the other hand, there were strong outflows from bond funds. In addition, the drive from Individual Savings Plans (PIRs) has gradually fallen away. A similar trend was recorded for portfolio management, which suffered a sharp weakening in funding from both the institutional component and the retail mandates.

In contrast, traditional life insurance products benefited from the adverse situation in the markets and their cumulative production increased again in 2018 after having declined for three consecutive years. On the other hand, the adverse market dynamics led to a decline in the production of unit-linked policies, which by their very nature reflect the performance of mutual funds. For both categories, the offer of multi-branch products played a fundamental role, which, above all, contained the drop in premium income with a higher financial content.

The Tuscan economy

Economic activity continued to expand in 2018, despite signs of a slowdown. One of the elements that had supported and contributed decisively to the 2017 results is foreign trade, which is showing signs of weakening in the current scenario. In the first nine months of 2018, Tuscany's exports grew at a slower rate than the national figure: Tuscan sales abroad increased by 2.3% compared to an overall average of 3.1%. In the period January-September 2018 Tuscany exported goods for €26.7 billion: the main sector confirmed its position in the leather sector with €4.5 billion, up by 4.1% compared to the same period of 2017. Extremely positive results were also confirmed for pharmaceuticals (+35%) and paper products (+12.3%), which offset the delays recorded in the mechanical (-13%) and clothing (-3.2%) sectors. The first market for Tuscan products abroad is confirmed by France with over €3 billion (+5.2%); Switzerland came second with €2.8 billion (+17.3%), thanks in particular to the fashion sector, while there was a drop in flows to the Russian Federation (-22.5%), which had shown signs of recovery in 2017.

Another driving force of the regional economy is represented by tourism, which for Tuscany is divided into different types: cities focused on art, the sea, thermal baths, hillsides and partly also mountains; over the years, the Tuscan offering has managed to develop different forms that are not purely location-based, such as the enhancement of food and wine tourism, "shopping tourism" offerings (presence of outlets, business museums, natural shopping centres) related to handicrafts and traditional manufacturing, luxury travel. After the particularly positive results of 2017 with arrivals up by 6.2%, 2018 is characterised by light and shadow: positive results for art cities with a growth of 8.6% in the first 5 months of 2018 of visitors to State Museums, while some seaside resorts have suffered from adverse weather conditions. Estimates currently available show total overnight stays of 47 million, up by 1.2%, in line with the national average. Passenger traffic through airports was also positive: in the period January-November, the airports of Florence and Pisa have racked up traffic of 7.7 million passengers with a growth of 3.7%.

After the weakness of the construction sector in 2017, there were signs of stabilisation in 2018: according to the evidence published in the Bank of Italy survey among companies with at least 10 employees, more than half of them expect a production trend in line with the previous year. These estimates are also supported by data from the National Association of Building Contractors in Tuscany: between January and August, the number of hours worked and workers remained broadly stable. The residential market continues to be supported by restructuring transactions. In the public works segment, in the first nine months of 2018, there was a significant increase in the value of calls for tenders (+92%), also thanks to the presence of the call for tenders by the Italian Highway Corporation (Autostrade per l'Italia) for the extension of the third lane on the Firenze Sud-Incisa section.

On the basis of a quarterly survey involving the Group's sales network that manages the business sector, the evaluations of the 2018 turnover trend are positive and in line with the data expressed at national level with greater optimism for the fashion system and for the provinces of Florence and Prato. The investment outlook has been progressively revised downwards, but has remained positive and more optimistic in high technology sectors.

With about 355,000 active companies, the Tuscan entrepreneurial fabric in the first half of 2018 confirms the levels of 2017: against an increase in the sectors of services (+815; +0.9%) and tourism (+363; +1.3%) there was a reduction in trade (-470; -0.5%), in agriculture (-126; -0.3%), in manufacturing (-160; -0.3%) and in construction (-263; -0.5%).

In the labour market, employment figures for the first half of 2018 show growth of 1.2%, linked to a more marked increase in female employment (+1.9%) and in line with the national figure. The regional unemployment rate in September 2018 was 6.1%, about 3 percentage points lower than the overall Italian figure. The first half of 2018 was characterised by a drop in extraordinary interventions to support businesses in crisis, which led to a reduction of 37% in the number of hours authorised by the CIG Redundancy Fund.

The credit market remained on a path of moderate growth, linked both to the component of credit to households (+3%) thanks to the increase in requests for mortgages for the purchase of housing and consumer credit, and to credit to businesses (+0.5%) to meet the need for financing of investment projects and for forms of support of working capital. It is important to note that this increase was accompanied in the first half by a further improvement in credit quality: in the ratio of deteriorated loans to early-stage loans, the percentage fell from 2.3% in 2017 to 2% in June 2018; this phenomenon is particularly present in the business sector, which has benefited from an improvement of about 0.5 percentage points (currently 2.7%) supported by the manufacturing and services sectors.

Income statement results

General aspects

On 1 January 2018 the IFRS 9 came into force which changed the criteria for the classification and measurement of financial instruments and resulted in new financial statement formats being adopted. However, since the specific IFRS 9 and IFRS 1 provisions do not require the mandatory restatement on a consistent basis of comparison data in the year of first application of the new standard, the income statement data for the previous periods have not been restated, but are determined according to the previously applicable IAS 39 standard.
The annexes to the financial statements include the reclassification criteria and the reconciliation statement between the income statement in the format required by the Bank of Italy and the reclassified income statement. Note, that due to the necessary rounding, some calculations could contain not material differences in terms of totals.

Reclassified income statement

(thousands of euro)

	31.12.2018	31.12.2017	absolute changes	%
Net interest income	52,861	57,014	-4,153	-7.3%
Net fee and commission income	59,240	61,059	-1,820	-3.0%
Net profit (loss) on financial assets and liabilities measured at fair value	914	1,059	-145	-13.7%
Other net operating income (expense)	-974	641	-1,615	n.s.
- Other net operating income / (Expense)	*-974*	*327*	*-1,301*	*n.s.*
- Dividends and Profits / (losses) from equity investments accounted for using the equity me	*0*	*314*	*-314*	*-100.0%*
NET OPERATING INCOME	112,041	119,773	-7,732	-6.5%
Personnel expenses	-44,975	-48,091	-3,116	-6.5%
Other administrative expenses	-28,438	-29,499	-1,061	-3.6%
Amortization and depreciation of intangible assets, property and equipment	-1,576	-2,569	-993	-38.6%
OPERATING COSTS	-74,989	-80,159	-5,170	-6.4%
OPERATING MARGIN	37,052	39,614	-2,563	-6.5%
Net adjustments to loans and receivables	-31,832	-45,459	-13,627	-30.0%
Net allowances and net adjustments to other assets	-820	-555	266	47.9%
- Net allowances for risks and charges	*-361*	*613*	*-974*	*n.s.*
- Net adjustments to other assets	*-459*	*-1,168*	*-708*	*-60.7%*
Other net income (expenses)	1,329	1,667	-338	-20.3%
GROSS INCOME (LOSS) FROM CURRENT OPERATIONS	5,729	-4,732	10,461	n.s.
Income taxes	1,160	1,680	-520	-31.0%
Charges (net of tax) for integration and exit incentives	-404	-443	-39	-8.8%
Levies and other charges concerning the banking industry (net of tax)	-2,181	-2,266	-85	-3.7%
NET PROFIT (LOSS)	4,304	-5,760	10,065	n.s.

Quarterly changes in the reclassified income statement

Quarterly development of the reclassified income statement

(thousands of euro)

Captions	2018				2017			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
Net interest income	11,563	13,751	13,955	13,592	13,937	14,707	14,055	14,315
Net fee and commission income	14,154	14,098	14,957	16,030	16,070	15,180	15,258	14,552
Net profit (loss) on financial assets and liabilities measured at fair value	44	282	399	189	269	266	204	321
Other net operating income (expense)	-208	-395	-149	-222	1,024	-185	-58	-139
- Other net operating income / (Expense)	*-208*	*-395*	*-149*	*-222*	*710*	*-185*	*-58*	*-139*
- Dividends and Profits / (losses) from equity investments accounted for using the equity methods	*0*	*0*	*0*	*0*	*314*	*0*	*0*	*0*
NET OPERATING INCOME	25,554	27,735	29,162	29,590	31,299	29,967	29,458	29,049
Personnel expenses	-11,144	-11,335	-11,193	-11,302	-12,439	-11,731	-12,313	-11,609
Other administrative expenses	-7,246	-7,197	-6,936	-7,059	-7,601	-7,119	-7,432	-7,348
Amortization and depreciation of intangible assets, property and equipment	-401	-391	-389	-395	-612	-650	-650	-658
OPERATING COSTS	-18,791	-18,923	-18,518	-18,756	-20,651	-19,499	-20,395	-19,614
OPERATING MARGIN	6,762	8,812	10,644	10,833	10,648	10,468	9,063	9,435
Net adjustments to loans and receivables	-5,438	-8,718	-14,749	-2,926	-19,547	-12,503	-7,935	-5,474
Net allowances and net adjustments to other assets	-679	-9	25	-157	-2,198	274	-974	2,343
Net provisions for risks and charges	*-220*	*-9*	*25*	*-157*	*-1,030*	*274*	*-974*	*2,343*
Net adjustments to other assets	*-458*	*-1*	*0*	*0*	*-1,167*	*0*	*0*	*0*
Other net income (expenses)	1,602	-273	0	0	1,654	13	0	0
GROSS INCOME (LOSS) FROM CURRENT OPERATIONS	2,248	-188	-4,080	7,750	-9,442	-1,749	154	6,304
Period taxes on income from current operations	2,406	-135	1,012	-2,123	3,725	329	-226	-2,147
Charges (net of tax) for integration and exit incentives	-344	18	-79	0	-18	0	-425	0
Levies and other charges concerning the banking industry (net of tax)	-618	-895	-463	-205	-56	-2,010	-16	-183
NET PROFIT (LOSS)	3,693	-1,200	-3,611	5,423	-5,791	-3,430	-513	3,974

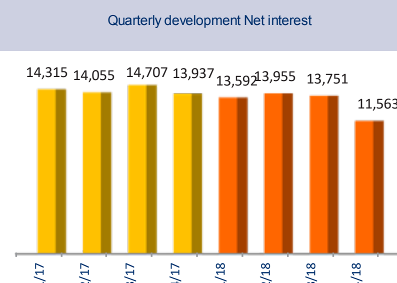
Net operating income

Net interest income

(thousands of euro)

Captions	31.12.2018	31.12.2017	absolute changes	%
Transactions with customers	45,028	45,414	-386	-0.8
Securities issued	-	-1	-1	
Differences on hedging derivatives	-3,240	-1,291	1,949	
Dealing with customers	**41,788**	**44,122**	**-2,334**	**-5.3**
Other financial assets measured at fair value through profit or loss	16	-	16	-
Other financial assets measured at fair value through other comprehensive income	17	7	10	
Financial assets	**33**	**7**	**26**	
Transactions with banks	-1,746	-2,003	-257	-12.8
Non-performing assets	12,949	15,119	-2,170	-14.4
Other net interest income	-163	-231	-68	-29.4
Net interest income	**52,861**	**57,014**	**-4,153**	**-7.3**

Quarterly development Net interest



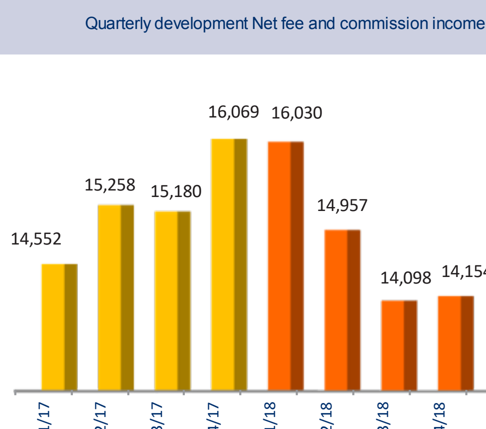
The segment of transactions with customer, which includes interest income on loans and interest expense on direct deposits, recorded a decrease of less than one percentage point (-0.8%); this reflected the fact that the average pricing reduction in loans was offset by an expansion in the average volumes, mostly in the medium / long-term category; more markedly negative were the changes in the contributions from the spreads on hedging derivatives (-1.9 million) and impaired assets (-2.2 million, consistent with the contraction in the underlying volumes occurred during the year) . Finally, results were less adverse with regard to transactions with banks (-0.3 million, thanks to the lower cost of funding) and net interest income, which declined slighlty.

Net fee and commission income

(thousands of euro)

Captions	31.12.2018	31.12.2017	absolute changes	%
Guarantees given	1,765	1,601	164	10.2
Collection and payment services	3,193	2,737	456	16.7
Current accounts	14,680	13,911	769	5.5
ATM and credit cards	3,367	3,091	276	8.9
Commercial banking activities	**23,005**	**21,340**	**1,665**	**7.8**
Securities dealing and placement	16,576	18,811	-2,235	-11.9
Currency dealing	672	547	125	22.9
Portfolio management	1,086	1,554	-468	-30.1
Distribution of insurance products	10,885	11,834	-949	-8.0
Other dealing / management commissions	4,102	3,857	245	6.4
Management, dealing and consulting activities	**33,321**	**36,603**	**-3,282**	**-9.0**
Other net fee and commission income	2,914	3,116	-203	-6.5
Net fee and commission income	**59,240**	**61,059**	**-1,820**	**-3.0**

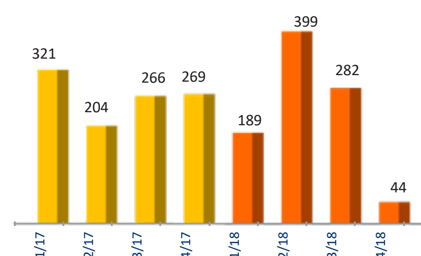
Quarterly development Net fee and commission income



Fee and commission income decreased by 1.8 million due to lower contribution from management, brokerage and advisory activities (-3.3 million), which declined with respect to mutual funds (-2.2 million), insurance products (-0.9 million) and asset management (-0.5 million); the decline was almost entirely due to lower placement commissions, while income from personal loans, for which demand remains robust, inceased by 0.3 million; in contrast, higher contributions came from all the commercial banking sectors: current accounts (+ €0.8 million, also due to changes in fees introduced in August 2017), collection and payment services (+ €0.5 million in relation to credit transfers, payment of bills and Telepass) and ATM and credit card services (+ €0.3 million, due to the growth in issued and uses of cards) and guarantees given (+ €0.2 million).

Profits (Losses) on trading

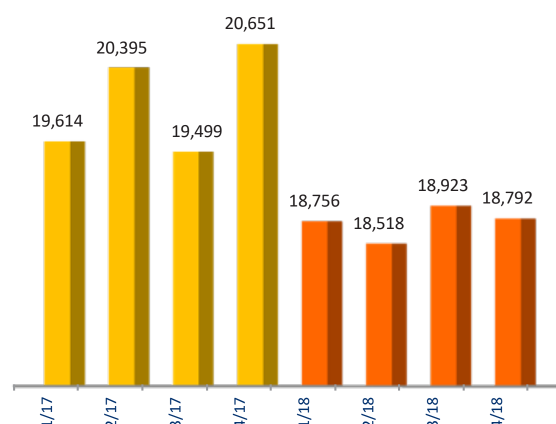
Captions	31.12.2018	31.12.2017	(thousands of euro) absolute changes	%
Profit (loss) on trading (securities and related income-generating derivatives, currencies, financial derivatives)	*253*	*634*	*-381*	*-60.1*
Other financial assets / liabilities: foreign exchange differences	*799*	*836*	*-37*	*-4.4*
Fair value adjustments in hedge accounting	*-245*	*-551*	*306*	*55.5*
Total profits (losses) on financial assets/ liabilities held for trading	**807**	**919**	**-112**	**-12.2**
Proifi (loss) on financial assets and liabilities at fair value through profit or loss	-43	-	-43	-
Dividend and similar income	150	140	10	7.1
Net profit (loss) on financial assets and liabilities measured at fair value	914	1,059	-145	-13.7



The 0.1 million euro decrease in the item in question was due to lower contribution from derivative transactions (-0.4 million, of which -0.2 relating to Credit-Risk Adjustments to contracts with customers), despite the improved net result of hedging activities (while the exchange gain was substantially stable).

Operating costs

Captions	31.12.2018	31.12.2017	(thousands of euro) absolute changes	%
Wages and salaries	31,336	33,086	-1,750	-5.3
Social security charges	8,197	8,979	-782	-8.7
Other personnel expenses	5,442	6,026	-584	-9.7
Personnel expenses	44,975	48,091	-3,116	-6.5
Information technology expenses	25	66	-41	-62.1
Management of real estate assets expenses	5,406	5,671	-265	-4.7
General structure costs	2,162	2,385	-223	-9.4
Professional and legal expenses	2,369	2,413	-44	-1.8
Advertising and promotional expenses	71	129	-58	-45.0
Indirect personnel costs	64	108	-44	-40.7
Other costs	17,810	18,675	-865	-4.6
Indirect taxes and duties	7,191	7,268	-77	-1.1
Recovery of expenses and charges	-6,660	-7,216	556	7.7
Administrative expenses	28,438	29,499	-1,061	-3.6
Property and equipment	1,576	2,569	-993	-38.6
Intangible assets			-	-
Amortisation and depreciation	1,576	2,569	-993	-38.6
Operating costs	74,989	80,159	-5,170	-6.4



The decrease in operating costs, of 5.2 million, referred to all cost components; in particular, personnel expenses benefited from a reduction of 51 in the average workforce (largely concentrated on seconded personnel), which resulted in a decrease in the items "Wages and salaries" and "Social security contributions" totaling 2.5 million, while "Other personnel expenses" were positively affected by the lower costs associated with the 2nd LECOIP Incentive Plan. The other administrative expenses also showed an appreciable reduction (-1.1 million, or -3.6%), due to lower real estate costs (-0.3 million, equally distributed across lease payments and energy consumption) general operating costs (-0.2 million, for postal savings) and for services received from ISGS (-0.5 million in the "Operations" area). Finally, depreciation and amortization fell sharply (-38.6%) due to a different approach in property valuation adopted at the end of 2017, which resulted in the separate indication of the non-depreciable «land» component and the «buildings» component, as part of the remeasurement of residual depreciable amounts.

Operating margin

The operating margin came to € 37.1 million, down 2.6 million compared to 2017 (-6.5%), while the cost / income ratio was unchanged at 66.9%.

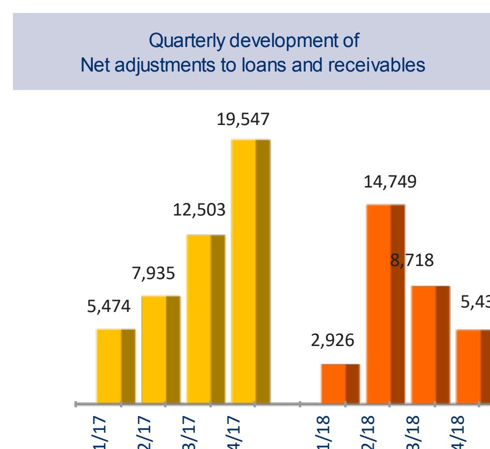
Net allowances and net adjustments to other assets

The item in question was negative by an additional 0.3 million, which resulted from a contrasting performance of the two components; the share attributable to allowances for risks and charges worsened by about one million euro, since in the comparative period a significant release was recorded in relation to a major legal dispute, while value adjustments to the other assets, linked to the fair value measurement of buildings and works of art, although still negative, improved by 0.7 million.

Net adjustments to loans and receivables

(thousands of euro)

Captions	31.12.2018	31.12.2017	absolute changes	%
Bad loans	20,252	32,104	-11,852	-36.9
Unlikely to pay	10,565	13,847	-3,282	-23.7
Past due / overdrawn loans	2,436	1,409	1,027	72.9
Performing loans	-1,227	-1,901	674	35.5
Net adjustments for impaired loans	32,026	45,459	-13,433	-29.5
Net adjustments for guarantees and commit	-194	-	-194	-
Net adjustments to loans and receivables	31,832	45,459	-13,627	-30.0



These adjustments, which were also affected by the «Savoy» loan sale transaction, decreased by 30.0%, due to lower write-downs of bad loans (-11.9 million) and of unlikely to pay (- € 3.3 million), which were only minimally mitigated by higher net adjustments to past due loans and by lower net recoveries on *performing loans*; as a result of this performance, credit cost decreased significantly from 180 b.p. in 2017 to 131 p.b ..

Other net income (expenses)

The item in question, which decreased by €0.3 million in 2018, mainly included the profit from the sale of a property to Fondazione Cassa di Risparmio di Pistoia and Pescia, previously classified under assets held for sale, while in 2017 its value almost entirely consisted of a capital gain on the sale of the stake held in Infogroup.

Gross income (loss) from current operations

Despite the reduction in operating margin by €2.6 million, gross income from current operations increased by 10.5 million, from a negative 4.7 million in 2017 to a positive 5.7 million in 2018, substantially due to the significant decrease in net adjustments to loans.

Charges (net of tax) for integration and exit incentives

(thousands of euro)

Income statement item according to Bank of Italy template	31.12.2018	31.12.2017	absolute change	% change
160a - Personnel expenses	-1,562	-14,389	-12,827	-89.1%
160b - Other administrative expenses	-94	-77	17	22.6%
170 - Allowances for risks and charges	-	-131	-131	-100.0%
200 Other operating income	1,045	9,327	-8,282	-88.8%
270 - Income taxes for the year	208	4,827	-4,619	-95.7%
Total charges (net of tax) for integration and exit incentives	**-404**	**-443**	**-39**	**-8.8%**

Personnel expenses in 2018, amounting to €1.6 million before taxes, consist of a further provision made pursuant to the agreement of 12 October 2017 on the "Protocol for harmonization following the integration of personnel from former Venetian Banks into Intesa Sanpaolo”; this had no impact on the net profit for the year as it was fully offset, net of direct taxation, by the recognition in item "200 -Other operating income” of income to be received from the Parent Company for the related charges incurred.
The components related to personnel expenses in 2017 were divided into two types of provisions:

- €0.6 million provision made pursuant to the agreement of February 2017 on the "Protocol for sustainable development", with an impact on net profit for the year;
- €13.8 million provision made pursuant to the agreement of 12 October 2017 on the "Protocol for harmonization resulting from the integration of personnel from former Venetian Banks into Intesa Sanpaolo” which had no impact on the net profit for the year as it was fully offset, net of direct taxation, by the recognition in item “190 -Other operating income” of income to be received from the Parent Company for the related charges incurred.

In addition to the aforementioned cost components, in 2017 other costs were recorded associated with the integration process of former Venetian Banks, namely administrative expenses for €77 thousand and provisions for risks and charges for €131 thousand; again, these costs had no impact on the net profit for the year as they were covered by the Parent Company through the arrangements mentioned above.

Levies and other charges concerning the banking industry (net of tax)

(thousands of euro)

Income statement item according to Bank of Italy template	31.12.2018	31.12.2017	absolute change	% change
100.b Loss on disposal of securities Voluntary Scheme	-	-1,398	-1,398	-100.0%
110 - Full write-down of CARIGE subordinated bond	-832	-	832	n.s.
130.b Write-down of securitization securities Voluntary Scheme	-	-399	-399	-100.0%
160.b Administrative expenses - Single Resolution Fund (*)	-990	-296	694	n.s.
160.b Administrative expenses - Deposit Guarantee Scheme	-1,422	-1,290	132	10.2%
270 - Income taxes for the year	1,063	1,117	-55	-4.9%
Total levies and other charges concerning the banking industry (net of tax)	**-2,181**	**-2,266**	**-85**	**-3.7%**

(*) The 2018 figure also includes the additional contributions for 2016.

Despite the impact on FY2018 of the full write-down of the CARIGE subordinated bond and of the additional contribution to the Resolution Fund for FY2016, the balance of the item slightly improved; this was due to the significant charges recognized in 2017 in relation to the bailout of Casse di Risparmio di Cesena, Rimini and San Miniato.

Net profit (loss) and ROE

The Bank reported a net profit of 4.3 million for FY2018, recording a marked improvement compared to the net loss of €5.8 million in the previous year. ROE, calculated as the ratio of net profit to the average share capital, share premium reserve, reserves and valuation reserves, amounted to 1.6% (-2.0% in 2017).

Balance sheet aggregates

General aspects

As already stated with reference to the income statement data, on 1 January 2018 the IFRS 9 came into force which changed the criteria for the classification and measurement of financial instruments and resulted in new financial statement formats being adopted also with regard to the balance sheet. To facilitate a comparison on a homogeneous basis, the reclassified balance sheet shown below compares the figures for the year with the December 2017 data restated as at 1/1/2018 in accordance with the provisions of IFRS 9 (First Time Adoption).
The annexes to the financial statements include the reclassification criteria and the reconciliation statement between the balance sheet in the format required by the Bank of Italy and the reclassified balance sheet.

Reclassified balance sheet

(thousands of euro)

Asset items	31.12.2018	01.01.2018	absolute changes	%
Loans to banks	368,476	343,219	25,257	7.4%
Loans to customers	2,427,070	2,521,636	(94,566)	-3.8%
Financial assets measured at fair value through profit or loss	11,209	9,998	1,211	12.1%
Financial assets measured at fair value through other comprehensive income	36,045	33,796	2,249	6.7%
Investments	10	10	0	0.0%
Property, equipment and intangible assets	75,670	77,023	(1,353)	-1.8%
Tax assets	83,961	79,832	4,129	5.2%
Non-current assets held for sale and discontinued operations	-	3,433	(3,433)	-100.0%
Other assets	81,698	78,558	3,140	4.0%
Total assets	3,084,138	3,147,505	-63,367	-2.0%

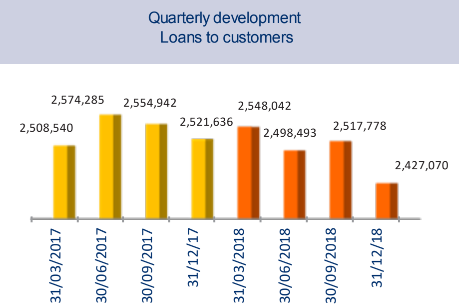
(thousands of euro)

Liabilities and shareholders' equity	31.12.2018	01.01.2018	absolute changes	%
Due to banks at amortized cost	548,137	557,238	(9,101)	-1.6%
Due to customers at amortized cost and securities issued	2,126,825	2,212,253	(85,428)	-3.9%
Financial liabilities held for trading	10,496	9,514	981	10.3%
Tax liabilities	9,721	8,304	1,417	17.1%
Other liabilities	96,851	66,956	29,895	44.6%
Allowances for risks and charges	38,499	44,575	(6,076)	-13.6%
of which allowances for commitments and financial guarantees given	16,774	1,281	15,493	n.s.
Share capital	171,846	171,846	-	0.0%
Reserves	66,675	72,152	(5,477)	-7.6%
Valuation reserves	10,784	10,426	357	3.4%
Net profit (loss)	4,304	(5,760)	10,064	n.s.
Total liabilities and shareholders' equity	3,084,138	3,147,505	-63,367	-2.0%

Loans to customers

(thousands of euro)

Captions	31.12.2018	% breakdown	01.01.2018	% breakdown	changes	%
Current accounts	151,826	6	180,209	7.1	-28,383	-15.8
Mortgages	1,688,426	70	1,643,626	65.2	44,800	2.7
Advances and other loans	400,162	16	418,875	16.6	-18,713	-4.5
Commercial banking loans	**2,240,414**	**92**	**2,242,710**	**88.9**	-2,296	**-0.1**
Non-performing loans	**186,656**	**8**	278,926	**11.1**	-92,270	**-33.1**
Loans to customers	**2,427,070**	**100**	**2,521,636**	**100.0**	**-94,566**	**-3.8**



Loans to customers fell back below the 2.5 billion threshold, recording a decrease of about 95 million, largely attributable to impaired positions (-92 million), also due to the "Savoy" sale transaction which involved the transfer of loans totalling 51 million; the performing share of the loans was substantially unchanged (-0.1%), since the contraction of short-term loans, for a total of 47 million, was almost entirely offset by the expansion of mortgages of 45 million, which, in turn, was driven by new disbursements for residential purposes amounting to around 190 million.

Loans to customers: credit quality

(thousands of euro)

Captions	31.12.2018					01.01.2018					Change	
	Gross exposure	Adjustments	Net exposure	% Coverage	% breakdown	Gross exposure	Adjustments	Net exposure	% Coverage	% breakdown	Net exposure	% Coverage
Bad loans	286,924	-207,075	79,849	72.2	3.3	489,796	-337,990	151,806	69.0	6.0	-71,957	3.2
Unlikely to pay	146,032	-40,767	105,265	27.9	4.3	174,238	-51,970	122,268	29.8	4.8	-17,003	-1.9
Past due / overdrawn loans	1,977	-435	1,542	22.0	0.1	6,039	-1,187	4,852	19.7	0.2	-3,310	2.3
Non-performing loans	**434,933**	**-248,277**	**186,656**	**57.1**	**7.7**	**670,073**	**-391,147**	**278,926**	**58.4**	**11.1**	**-92,270**	**-1.3**
Performing loans	**2,253,312**	**-12,898**	**2,240,414**	**0.6**	**92.3**	**2,257,053**	**-14,343**	**2,242,710**	**0.6**	**88.9**	**-2,296**	**-0.1**
Total loans to customers	**2,688,245**	**-261,175**	**2,427,070**	**9.7**	**100.0**	**2,927,126**	**-405,490**	**2,521,636**	**13.9**	**100.0**	**-94,566**	**-3.8**

Net non-performing loans decreased by over € 92 million, due to the lower exposure mainly recorded on bad loans (-72 million, of which 51 related to the aforementioned "Savoy" transaction) and on the unlikely to pay (-17 million); this performance, significantly affected by the sales of loans, resulted in a lower ratio of gross bad loans to total gross non-performing loans (from 73.1% to 66.0%), with consequent reduction in the overall coverage both of problem loans and total loans, taking also into account the substantial stability of performing loans.

Customer financial assets

(thousands of euro)

Captions	31.12.2018	% breakdown	01.01.2018	% breakdown	changes	%
Direct deposits	2,126,825	41.4	2,212,253	41.0	-85,428	-3.9
Indirect deposits	3,006,216	58.6	3,185,932	59.0	-179,716	-5.6
Customer financial assets	5,133,041	100.0	5,398,185	100.0	-265,144	-4.9

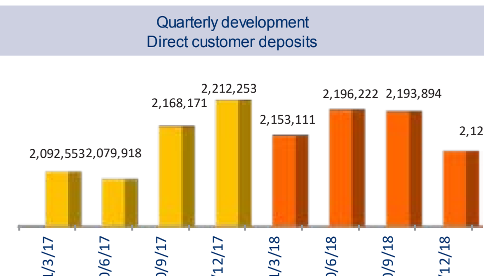
Customer financial assets recorded a decrease of €265 million, attributable to both direct and indirect deposits.

Direct deposits

(thousands of euro)

Captions	31.12.2018	% breakdown	01.01.2018	% breakdown	changes	%
Current accounts and deposits	2,092,570	98.4	2,180,623	98.6	-88,053	-4.0
Repurchase agreements and securities lending	-	-	-	-	-	-
Bonds	-	-	-	-	-	-
Certificates of deposit	758	0.0	1,300	0.1	-542	-41.7
Other deposits	33,497	1.6	30,330	1.4	3,167	10.4
Direct customer deposits	2,126,825	100.0	2,212,253	100.0	-85,428	-3.9

Quarterly development
Direct customer deposits



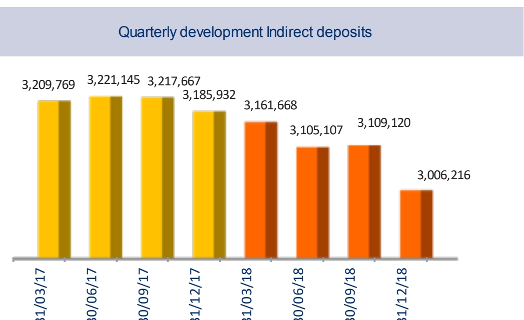
At 31 December 2018, direct deposits fell back to €2.2 billion, due to a contraction in current accounts and deposits of 88 million, which resulted from a decline in both demand deposits - for 35 million - and time deposits for 53 million.

Indirect deposits

(thousands of euro)

Captions	31.12.2018	% breakdown	01.01.2018	% breakdown	changes	%
Mutual funds	1,044,769	34.8	1,153,359	36.2	-108,590	-9.4
Supplementary pension funds	48,993	1.6	46,815	1.5	2,178	4.7
Portfolio management	86,687	2.9	121,308	3.8	-34,621	-28.5
Insurance	1,127,409	37.5	1,139,298	35.8	-11,889	-1.0
Assets under management	2,307,858	76.8	2,460,780	**77.2**	-152,922	-6.2
Assets under administration	698,358	23.2	725,152	**22.8**	-26,793	-3.7
Indirect deposits	3,006,216	100.0	3,185,932	100.0	-179,716	-5.6

Quarterly development Indirect deposits



Indirect deposits recorded a decline in volumes of 180 million, of which 153 attributable to assets management, which suffered a significant decline in respect of mutual funds, portfolio management and insurance products, against a slight increase in pension funds; the 6.2% decrease in asset management was moreover entirely due to a negative "market effect" (impact of -8.0%), which prevailed over the 1.8% increase in net flows. Finally, assets under administration fell by € 27 million.

Financial assets and liabilities

(thousands of euro)

	31.12.2018	01.01.2018	absolute changes	%
Financial assets held for trading	10,284	9,409	875	9.3
of which derivatives at fair value	*10,284*	*9,409*	*875*	9.3
Financial assets mandatorily measured at fair value	925	589	336	57.0
Other financial assets measured at fair value through profit or loss	**11,209**	**9,998**	**1,211**	**12.1**
Other financial assets measured at fair value through other comprehensive income	**36,045**	**33,796**	**2,249**	**6.7**
Total financial assets	**47,254**	**43,794**	**3,460**	**7.9**
Financial liabilities held for trading	**(10,496)**	**(9,514)**	**(982)**	**10.3**

The increase in financial assets manadatorily at fair value is mainly attributable to the UCITS segment, while the growth of financial assets at fair value through other comprehensive income (+2.2 million) originates from purchases of Government securities made during the year (CCT).

Financial assets measured at fair value through other comprehensive income

(thousands of euro)

	31.12.2018	01.01.2018	Absolute Change	%
Equity instruments at fair value through other comprehensive income	**29,803**	**30,127**	(324)	(1.1)
Debt securities measured at fair value through other comprehensive income	**6,242**	**3,669**	**2,573**	**70.1**
of which Stage 3	14	32	-18	(56.3)
of which Stage 2	0	30	-30	(100.0)
of which Stage 1	6,228	3,607	2,621	72.7
Other financial assets measured at fair value through other comprehensive income	**36,045**	**33,796**	**2,249**	**6.7**

The increase in the aggregate is attributable to the debt securities sub-item, up 2.6 million due to the combined effect of new purchases of Treasury Credit Certificates for 2.9 million and the sale of Ordinary Municipal Bonds for 0.3 million (issued by the Municipality of Pistoia).

Financial assets and liabilities measured at fair value through profit or loss

(millions of euro)

	31.12.2018	01.01.2018	Absolute Change	%
Bonds and other debt securities measured at fair value through profit or loss	*11*	*-*	*11*	
Equity instruments and units of UCI measured at fair value through profit or loss	*914*	*589*	*325*	*55.18*
Other financial assets measured at fair value through profit or loss (excluding derivatives)	**925**	**589**	**336**	**57.05**
Net value of trading derivatives	**-212**	**-105**	**-107**	
Financial assets and liabilities measured at fair value through profit or loss	**713**	**484**	**229**	**47.31**

In the presence of a slight deterioration in the net value of trading derivative contracts, the most significant change concerned UCITS units which increased by €0.3 million due to new subscriptions in 2018.

Investments

At 31 December 2018, the only residual investment held was that in Intesa Sanpaolo Group Services S.c.p.A. (which, moreover, was merged into Intesa Sanpaolo S.p.A. with effect from 21 January 2019) recognized at a value of €10 thousand.

Net interbank position

The interbank position at 31 December 2018 was a net debt of €180 million, a decrease from €214 million of the comparative period.

Shareholders' equity

(thousands of euro)

Captions	31.12.2018	01.01.2018	Absolute changes	%
Share capital	*171,846*	*171,846*	*-*	*-*
Valuation reserves	*10,784*	*10,426*	*357*	*3.4*
Other reserves	*66,675*	*72,152*	*-5,477*	*-7.6*
Share capital and reserves	249,305	254,425	-5,120	-2.0
Net profit (loss)	4,304	-5,760	10,064	
Shareholders' equity	253,609	248,665	4,945	2.0

Since the decrease in other reserves essentially arises from the coverage of the net loss reported in FY2017, the increase in shareholders' equity was mainly attributable to the net profit achieved in 2018 and, to a much lesser extent, to the increase in valuation reserves by 0.4 million, which reflects actuarial gains and losses on defined benefit pension plans.

Own funds and solvency ratios

(thousands of euro)

	31 December 2018	31 December 2017 (*)	change
Common Equity Tier 1 capital (CET1)	265,088	263,597	1,491
Additional Tier 1 Capital (AT1)			
TIER 1 CAPITAL	265,088	263,597	1,491
Tier 2 capital (T2)	**0**	**5,249**	**-5,249**
OWN FUNDS (Own funds)	265,088	268,846	-3,758
Credit risks	98,634	97,106	1,527
Market risks	0	1	-1
Operational risk	14,119	14,583	-464
Other regulatory requirements	0	0	0
Total regulatory requirements	**112,753**	**111,691**	**1,062**
Risk-weighted assets	1,409,414	1,396,137	13,277
CET 1 (Common Equity Tier 1 capital / risk weighted assets)	**18.81%**	**18.88%**	**-0.07%**
TOTAL CAPITAL (Own Funds / Risk-weighted Assets)	**18.81%**	**19.26%**	**-0.45%**

(*) Data calculated according to IAS 39 standard.

The nil value of the Tier 2 capital was determined by the cancellation of the component linked to the recognized adjustments to loans exceeding expected losses; these surpluses, which in the comparative period made up almost all of this capital tier, contribute to the formation of the T2 capital only to the extent of any surplus over the portion of IFRS9 first time application adjustments which are recovered in CET1 (95% in 2018). Given the decrease in loans to customers (- €94.6 million), the increase in risk-weighted assets (+ €13.3 million) was essentially due to end of the transitory period in the application of the relevant legislation, which provided for a less stringent weighting for transactions with financial counterparties.

Other information

The shareholders

At the end of FY2018, the share capital of Cassa di Risparmio di Pistoia e della Lucchesia amounted to €171,846,279.99; the shareholders at that date are listed below:

Shareholders	Number of ordinary shares held	% Holding
Banca CR Firenze S.p.A.	204,259,373	74.883%
Intesa Sanpaolo S.p.A.	68,318,350	25.046%
Other shareholders	194,150	0.071%
Total	272,771,873	100.000%

Information on transactions with related parties

As usual, in 2018 transactions with related parties were carefully monitored in compliance with the new Group related party transactions Regulation; in this regard, it is specified that transactions with Intesa Sanpaolo and its subsidiaries were carried out in compliance with criteria of substantial fairness and with the laws and regulations in force and were regulated at arm's length prices.

In general, in 2018 Cassa di Risparmio di Pistoia e della Lucchesia did not carry out any "atypical or unusual" transaction (with either related parties or other parties), which, due to their materiality or relevance, may have caused concerns regarding the integrity of company assets.

Transactions carried out in the period with corporate officers, close family members of corporate officers and parties controlled by them, fall within the normal operations of the Intesa Sanpaolo Group, in full compliance with the applicable legislation.

As regards transactions with the Parent Company and their effects on operations and on the income statement and balance-sheet results commented on in these financial statements, as well as transactions with subsidiaries, associates and other companies that are part of the Intesa Sanpaolo Group, reference is made to the comments below and, for more details, to the notes to the financial statements Part H "Information on compensation and transactions with related parties".

The table below contains a summary of the main transactions between the Bank and the Intesa Sanpaolo Group companies which are reflected in the balance sheet at 31 December 2018 and in the income statement for FY2018.

Amounts in thousands of euros	Assets	Liabilities	Income	Charges
Parent company *Transactions with Banks*				
INTESA SANPAOLO S.p.A.	382,582	452,173	7,256	-5,662
BANCA CR FIRENZE S.p.A.	302	491	0	-1,930
Total	382,884	452,664	7,256	-7,592
Group subsidiaries *Transactions with Banks*				
FIDEURAM - INTESA SANPAOLO PRIVATE BANKING S.p.A.	0	109	0	-233
CASSA DI RISPARMIO IN BOLOGNA S.p.A.	0	21	0	-57
BANCA IMI S.p.A.	6,210	10,744	5,112	-9,783
MEDIOCREDITO ITALIANO S.p.A.	2,676	10	522	-11
INTESA SANPAOLO PRIVATE BANKING S.p.A.	50	17	167	8
INTESA SANPAOLO BANK IRELAND PLC	0	100,191	0	-1,507
BANCA 5 S.p.A.	0	4	0	-1
Total transactions with Banks	8,936	111,096	5,801	-11,584
Transactions with financial institutions and other Group subsidiaries				
INTESA SANPAOLO GROUP SERVICES S.c.p.A.	139	1,793	31	-12,596
EURIZON CAPITAL S.A.	428	0	1,724	0
EURIZON CAPITAL SGR S.p.A.	2,080	0	12,142	0
INTESA SANPAOLO INVEST SIM	0	25	0	-36
INTESA SANPAOLO ASSICURA S.p.A.	255	10	1,308	-61
INTESA SANPAOLO VITA S.p.A.	1,510	1,684	6,220	-33
EPSILON SGR S.p.A.	177	0	781	0
INTESA SANPAOLO LIFE DAC	215	0	3,789	0
SOCIETA' ITALIANA DI REVISIONE E FIDUCIA	0	0	2	0
INTESA SANPAOLO SMART CARE S.R.L.	0	0	1	0
Total transactions with financial institutions and other Group subsidiaries	4,804	3,512	25,998	-12,726
Grand total	396,624	567,272	39,055	-31,902

Participation in the tax consolidation regime

With regard to existing relationships with the Parent Company, we inform that the Bank:
- participates in the National Tax Consolidation regulated by Articles 117 to 129 of Italian Legislative Decree 917/1986;
- is part of the Intesa Sanpaolo Group regulated by articles 70-bis to 70-duodecies of Italian Presidential Decree 633/72, starting from 1 January 2019.

Management and coordination

Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. is a subsidiary of Banca CR Firenze S.p.A. - of which Intesa Sanpaolo S.p..A is the Sole Shareholder - and is owned by Intesa Sanpaolo S.p.A. Therefore, the Parent Company Intesa Sanpaolo has an indirect control over the Bank.

Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. is therefore subject to management and coordination by the Parent Company Intesa Sanpaolo S.p.A. pursuant to art. 2497 et seq. of the Italian Civil Code and is required to comply with the provisions issued by the Parent Company within the framework of this management and coordination activity, including for the purpose of implementing the provisions issued by the regulatory authorities.

Research and development

Research and development activity (financial marketing, procedures, information systems, etc.) is carried out by the relevant units of the Parent Company with the involvement of various entities specialized in the different areas, which oversee their subsequent release.

Main risks and uncertainties

Information on the risks and uncertainties to which the Bank is exposed is discussed in detail in this Report on Operations and in the notes to the financial statements. More specifically, the risks associated with the performance of the world economy, of financial markets and with the choices that supranational bodies and governments will make to combat the crisis are set out in the introductory part of the Report on operations: the chapter on the economic scenario and the subsequent chapter on the business outlook specify the assumptions underlying the assessments and forecasts made.

The risks associated with the bank's capital stability and going concern were analysed whem discussing the income statement and balance sheet figures of this Report on operations, while further information is contained in Part F of the notes to the financial statements.

The information on financial risks and operational risks is described in detail in Part E of the notes to the financial statements.

Non-financial report pursuant to Italian Legislative Decree 254/2016

The company, although falling within the scope of application of art. 2 of Italian Legislative Decree 254/2016, did not prepare the non-financial statements as it made use of the exemption under art. 6 of the mentioned Decree, in its capacity as subsidiary included in the consolidated non-financial report drawn up by Intesa Sanpaolo S.p.A.

Significant events after the end of the reporting period

On 5 February 2019, the deed of merger by absorption of Cassa di Risparmio di Firenze Società per Azioni and Cassa di Risparmio di Pistoia and Lucchesia S.p.A. in Intesa Sanpaolo S.p.A., which, inter alia, set 25 February 2019 as the effective date of the transaction for legal purposes. For accounting and tax purposes, the merger shall take effect on 1 January 2019.

Forecast for 2019

The outlook for FY2019

The world economy growth cycle will extend to 2019, but with a further slowdown. Moreover, this time the outlook is marked by strong uncertainty, due to the synchronous slowdown in demand which has become apparent in all major economies, commercial tensions between United States and China, and other events that have caused economic data to become more volatile since the beginning of the year. Furthermore, both the Eurozone and Italy could suffer negative repercussions, via the trade channel, from a potential "no deal" exit of the United Kingdom from the European Union.

The urge to reduce monetary stimulus will weaken in the United States. Very short-term rates will remain unchanged and negative for the euro, as the European Central Bank has already indicated that no action will be taken on official rates until at least the end of the summer.

In general, the average annual growth in the Eurozone is expected to slow further, but the deterioration should come to an end during the year. GDP growth will also slow down in Italy, with consensus estimates that currently fluctuate around half a percentage point.

Uncertainty about Italian budgetary policies could fuel new turbulence on financial markets, especially on domestic markets, and a potential downgrade of sovereign ratings. The slowdown in economic growth will make it more difficult to achieve a decline in the debt / GDP ratio in 2019. A new increase in risk premiums on Italian debt cannot be ruled out, if the budget for 2020 were to fail to at least ensure a downward trend in the debt/GDP ratio. On the other hand, if the reduction in the debt/GDP ratio and fiscal consolidation were to be pursued by the government, risk premia could fall again, and concerns about a downgrade in ratings may not materialize after all.

Emerging economies are expected to continue to slow down slightly in 2019 compared to 2018, due to the decelaration in the advanced economies, especially in the United States and the Eurozone. The forecasts published in the IMF's World Economic Outlook update for January 2019 suggest an average real GDP growth of 4.5% in 2019 (compared to 4.6% in 2018), slowing down particularly in Asia and Emerging Europe only partly offset by an acceleration in Latin American and Sub-Saharan African commodity producing countries.

In countries where ISP subsidiaries are located, GDP growth is expected to slow down in both CEE and SEE countries, mainly due to a less favourable trend in exports towards euro area partners. We expect growth potential, estimated by the European Commission at around 3.3% in 2019, to be within close reach.

In the CIS area, growth in 2019 is expected to be only slightly more moderate, with domestic demand for consumer goods to be initially adversely affected by the announced increase in VAT and investment demand hindered by sanctions and by uncertainty surrounding the commodity market. Also in Ukraine, GDP growth is expected to slow down in 2019 due to the fiscal consolidation measures agreed with the IMF and still high borrowing costs. In the MENA region, in Egypt, economic growth for the current year is expected to remain at the same sustained pace of last year.

Downside risks for growth in emerging countries are fuelled by persistent geopolitical and commercial tensions in the international arena, the slowdown in the economic cycle of the advanced countries and a potentially less favorable scenario for the energy commodity market.

With regard to the Italian banking system, in 2019 the trend in loans to businesses will remain weak. It will be affected by economic weakness and a persistent climate of uncertainty which tend to stifle demand. Moreover, bank credit is supported by the still favorable rates applied by banks and the lesser appeal of corporate bond issues, given the higher returns requested by investors in light of high sovereign risk premiums. For households, the lending scenario remains positive but slowed down slightly in 2019. Residential mortgages will continue to benefit from very low rates for most of 2019 and the outlook for the housing market which is expected to hold up. On the other hand, peristently weak overall property prices will act as a brake on growth in the stock of mortgages.

In terms of funding, the net repayment of bonds in the retail segment and rising deposits will continue. Market yields that are still low, the climate of uncertainty and abundant liquidity will continue to fuel current account balances. However, in an overall picture that is still favorable for customer deposits, certain critical issues related to medium-term funding will become more evident, including the impact of the higher sovereign risk premium on the rates of new bond issues, which causes this type of wholesale funding to be more onerous and difficult. In any case, in 2019 the average cost of funding will continue to benefit from the shift in the aggregate composition towards less onerous types of funding and will likely rise very slowly. Rates on current accounts are still viewed at historic lows for most of 2019, with a weak recovery only in recent months. Despite a gradual repricing in loan rates already commenced in 2018,

credit conditions in 2019 will remain accommodative with modest increases. At the same time, competition for the best borrowers will continue.

Proposal to approve the financial statements

The financial statements of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. for the year ended 31 December 2018, accompanied by the Board of Directors' report on the company's operations and performance and consisting of the balance sheet and income statement, the statement of comprehensive income, the statement of changes in shareholders' equity, the cash flow statement, the notes to the financial statements and the related annexes, reported a profit of €4,304,119.91; given the merger deed executed on 5 February 2019 stipulating the merger of the Bank into Intesa Sanpaolo S.p.A., with accounting and tax effects as of 1 January 2019 and legal effect as of 25 February 2019, any decision regarding the approval of the aforementioned financial statements and the allocation of profit will be made by the competent corporate bodies of the absorbing company.

Pistoia, 18 February 2019

The Board of Directors of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A.

Report of the Board of Statutory Auditors

As noted in detail in other parts of this document, Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. will be absorbed by the Parent Company Intesa Sanpaolo S.p.A. and the financial statements for the year ended 31 December 2018 will be subject to the approval of the Shareholders' Meeting of the Parent Company, as it is not possible to comply with the deadline set by the Italian Civil Code for calling the Shareholders' Meeting of the Bank before the above-mentioned date; accordingly, the Board of Statutory Auditors will not issue its Report on the aforementioned financial statements, but in this regard it has sent a document to the Management Control Committee of the Parent Company, the content of which essentially complies with the requirements of the aforementioned regulation.

Independent auditors' report

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(Translation from the Italian original which remains the definitive version)

Independent auditors' report pursuant to article 14 of Legislative decree no. 39 of 27 January 2010 and article 10 of Regulation (EU) no. 537 of 16 April 2014

To the shareholders of
Cassa di Risparmio di Pistoia e della Lucchesia S.p.A.

Report on the audit of the financial statements

Opinion

We have audited the financial statements of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. (the "bank"), which comprise the balance sheet as at 31 December 2018, the income statement and the statements of comprehensive income, the statement of changes in shareholders' equity and the statement of cash flows for the year then ended and notes thereto, which include a summary of the significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. as at 31 December 2018 and of its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards endorsed by the European Union and the Italian regulations implementing article 43 of Legislative decree no. 136/15.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISA Italia). Our responsibilities under those standards are further described in the "*Auditors' responsibilities for the audit of the financial statements*" section of our report. We are independent of the bank in accordance with the ethics and independence rules and standards applicable in Italy to audits of financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

KPMG S.p.A. è una società per azioni di diritto italiano e fa parte del network KPMG di entità indipendenti affiliate a KPMG International Cooperative ("KPMG International"), entità di diritto svizzero.

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Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements of the current year. These matters were addressed in the context of our 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.

Transition to IFRS 9

Financial statements: "Transition to IFRS 9"

Notes to the financial statements "Part A - Accounting policies": paragraph A.2.1. "Financial assets measured at fair value through profit or loss (FVTPL)", paragraph A.2.2 "Financial assets measured at fair value through other comprehensive income (FVOCI)" and paragraph A.2.3 "Financial assets measured at amortised cost"

Key audit matter	Audit procedures addressing the key audit matter
The new IFRS 9 "Financial instruments", whose application became mandatory in 2018, modified the classification, measurement, impairment and hedge accounting rules for financial instruments compared to those provided for by IAS 39, which was applicable up to 31 December 2017. As a first-time adopter of the new standard, the bank restated its opening balances at 1 January 2018. Specifically, the directors: — reclassified financial assets into the new captions "Financial assets at fair value through profit or loss", "Financial assets at fair value through other comprehensive income" and "Financial assets at amortised cost"; — restated financial assets in accordance with the measurement requirements of IFRS 9; — retested financial assets for impairment, in particular loans and receivables with customers, using the rules of the new standard; — recognised the post-tax FTA effects under equity reserves;	Our audit procedures included: — gaining an understanding of the IFRS 9 transition processes and related IT environment of the bank's group in relation to the classification, measurement and impairment of financial instruments; — checking, on a sample basis, that financial assets had been correctly classified, by considering the group's and bank's transition procedures, obtaining evidence of the analyses carried out and assessing the consistency of the analyses carried out with the results obtained; — sample-based analysis of the application of the measurement model (amortised cost or fair value) to financial assets according to the classification adopted by the group and the bank; — assessing the consistency of the group's bank's staging rules for loans and receivables with the requirements of the new standard and checking, on a sample basis, that such rules had been applied correctly;

— disclosed the main changes introduced by the new standard, the transition process it followed, its and its group's key elections and the effects of FTA of IFRS 9. The application of the new standard led to a reduction of €35 million in equity at 1 January 2018, net of the related tax. It also required significant changes to the bank's processes, organisation and measurement of financial assets, which accounted for 92.4% of the bank's total assets at 1 January 2018. The IFRS 9 transition process required extremely complex estimates and factors of a subjective and uncertain nature. For the above reasons, we believe that the transition to IFRS 9 "Financial instruments" is a key audit matter.	— analysing the main estimates, assumptions and methods underlying the new impairment models, including checking the reasonableness of the main assumptions and variables included therein; we carried out these procedures with the assistance of experts of the KPMG network; — assessing the appropriateness of the disclosures on transition to the new standard in the financial statements.

Classification and measurement of loans and receivables with customers

Notes to the financial statements "Part A - Accounting policies": paragraph A.2.3 "Financial assets measured at amortised cost-b) loans and receivables with customers"

Notes to the financial statements "Part B - Information on the balance sheet - Assets": section 4 "Financial assets measured at amortised cost b) loans and receivables with customers".

Notes to the financial statements "Part C - Information about the income statement": Section 8 "Net value adjustment due to credit risk: a) to financial assets at amortised cost"

Notes to the financial statements "Part E – Information on risks and relative hedging policies": Section 1 "Credit risk"

Key audit matter	Audit procedures addressing the key audit matter
Lending to customers is the bank's core activity. Loans and receivables with customers, recognised under financial assets at amortised cost, totalled €2,427 million at 31 December 2018, accounting for 78.7% of total assets. Net impairment losses on financial assets at amortised cost recognised in profit or loss during the year totalled €32 million.	Our audit procedures included: — gaining an understanding of the bank's processes and IT environment in relation to the disbursement, monitoring, classification and measurement of loans and receivables with customers;

For classification purposes, the directors make analyses that are sometimes complex in order to identify those positions that show evidence of impairment after disbursement. To this end, they consider both internal information about the performance of exposures and external information about the reference sector and borrowers' overall exposure to banks.

Measuring loans and receivables with customers is a complex activity, with a high degree of uncertainty and subjectivity, with respect to which the directors apply internal valuation models that consider many quantitative and qualitative factors, including historical collection flows, expected cash flows and related estimated collection dates, the existence of any indicators of impairment, the borrower's estimated repayment ability, an assessment of any guarantees, the impact of macroeconomic variables and risks of the sectors in which the bank's customers operate.

For the above reasons, we believe that the classification and measurement of loans and receivables with customers are a key audit matter.

— assessing the design and implementation of controls and performing procedures to assess the operating effectiveness of material controls, especially in relation to the identification of exposures with indicators of impairment and the calculation of impairment losses;

— analysing the criteria used to classify loans and receivables with customers in the official categories and sample-based test of their classification, as well as analysing the criteria used to allocate loans and receivables with customers to the IFRS 9 categories (staging);

— analysing the individual and collective impairment assessment policies and models used and checking the reasonableness of the main assumptions and variables included therein; we carried out these procedures with the assistance of experts of the KPMG network;

— selecting a sample of exposures tested collectively, checking the application of the measurement models applied and checking that the impairment rates applied complied with those provided for in such models;

— selecting a sample of exposures tested individually and checking the reasonableness of the indicators of impairment identified and of the assumptions about their recoverability, including considering the guarantees received;

— analysing the significant changes in the official categories and in the related impairment rates compared to the previous years' figures and discussing the results with the relevant internal departments;

— assessing the appropriateness of the disclosures on loans and receivables with customers in the financial statements.

Other matters - Management and coordination

As required by the law, the bank's directors disclosed the key figures from the latest financial statements of the company that manages and coordinates it in the notes to its own financial statements. Our opinion on the financial statements of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. does not extend to such data.

Responsibilities of the bank's directors and board of statutory auditors ("Collegio Sindacale") for the financial statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with the International Financial Reporting Standards endorsed by the European Union and the Italian regulations implementing article 43 of Legislative decree no. 136/15 and, within the terms established by the Italian law, for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The directors are responsible for assessing the bank's ability to continue as a going concern and for the appropriate use of the going concern basis in the preparation of the financial statements and for the adequacy of the related disclosures. The use of this basis of accounting is appropriate unless the directors believe that the conditions for liquidating the bank or ceasing operations exist, or have no realistic alternative but to do so.

The *Collegio Sindacale* is responsible for overseeing, within the terms established by the Italian law, the bank's financial reporting process.

Auditors' responsibilities for the audit of the financial statements

Our objectives 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 an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISA Italia 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 ISA Italia, we exercise professional judgement and maintain professional scepticism 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 directors;
- conclude on the appropriateness of the 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 auditors' report 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 auditors' report. 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, identified at the appropriate level required by ISA Italia, 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.

We also provide those charged with governance with a statement that we have complied with the ethics and independence rules and standards applicable in Italy and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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 year and are, therefore, the key audit matters. We describe these matters in our auditors' report.

Other information required by article 10 of Regulation (EU) no. 537/14

On 12 December 2011, the bank's shareholders appointed us to perform the statutory audit of its financial statements as at and for the years ending from 31 December 2012 to 31 December 2020.

We declare that we did not provide the prohibited non-audit services referred to in article 5.1 of Regulation (EU) no. 537/14 and that we remained independent of the bank in conducting the statutory audit.

We confirm that the opinion on the financial statements expressed herein is consistent with the additional report to the *Collegio Sindacale*, in its capacity as audit committee, prepared in accordance with article 11 of the Regulation mentioned above.

Report on other legal and regulatory requirements

Opinion pursuant to article 14.2.e) of Legislative decree no. 39/10

The bank's directors are responsible for the preparation of a directors' report at 31 December 2018 and for the consistency of such report with the related financial statements and its compliance with the applicable law.

We have performed the procedures required by Standard on Auditing (SA Italia) 720B in order to express an opinion on the consistency of the directors' report with the bank's financial statements at 31 December 2018 and its compliance with the applicable law and to state whether we have identified material misstatements.

In our opinion, the directors' report is consistent with the bank's financial statements at 31 December 2018 and has been prepared in compliance with the applicable law.

With reference to the above statement required by article 14.2.e) of Legislative decree no. 39/10, based on our knowledge and understanding of the entity and its environment obtained through our audit, we have nothing to report.

Florence, 21 February 2019

KPMG S.p.A.

(signed on the original)

Andrea Rossi
Director of Audit

Financial statements

Balance sheet

(EUR)

Asset items		31/12/2018	31/12/2017
10.	Cash and cash equivalents	29,981,325	29,619,951
20.	Financial assets measured at fair value through profit or loss	11,218,315	9,433,252
	a) Financial assets held for trading;	10,284,287	9,408,915
	b) financial assets designated at fair value;	-	24,337
	c) other financial assets mandatorily measured at fair value	934,028	-
30.	Financial assets measured at fair value through other comprehensive income	36,044,557	34,384,891
40.	Financial assets measured at amortised cost	2,795,536,704	2,912,271,044
	a) receivables due from banks	368,466,848	343,366,344
	b) loans to customers	2,427,069,856	2,568,904,700
50.	Hedging derivatives	2,050,093	5,057,409
60.	Value adjustment of financial assets in hedged portfolios (+/-)	1,631,694	-2,881,443
70.	Equity investments	10,000	10,000
80.	Property and equipment	58,569,696	59,923,121
90.	Intangible assets	17,100,000	17,100,000
	Of which:		
	- goodwill	*17,100,000*	*17,100,000*
100.	Tax assets	83,960,904	66,500,423
	a) current	18,659,143	12,485,135
	b) prepaid	65,301,761	54,015,288
110.	Non-current assets and group assets/liabilities held for sale	0	3,433,481
120.	Other assets	48,034,982	46,762,229
Total assets		3,084,138,270	3,181,614,358

(EUR)

Liability and shareholders' equity items		31/12/2018	31/12/2017
10.	Financial liabilities measured at amortised cost	2,674,961,792	2,769,491,186
	a) payables due to banks	548,136,752	557,237,689
	b) payables due to customers	2,126,067,040	2,210,953,928
	c) securities in circulation	758,000	1,299,569
20.	Financial liabilities held for trading	10,495,869	9,514,408
30.	Financial liabilities designated at fair value	-	-
40.	Hedging derivatives	4,565,442	2,136,363
50.	Value adjustment of financial liabilities in hedged portfolios (+/-)	829,382	1,432,031
60.	Tax liabilities	9,721,422	8,303,941
	a) current	1,315,883	879,859
	b) deferred	8,405,539	7,424,082
70.	Liabilities associated with assets held for sale	-	0
80.	Other liabilities	91,455,874	63,386,800
90.	Employee termination indemnities	16,774,321	19,526,467
100.	Allowances for risks and charges:	21,724,743	24,191,300
	a) commitments and guarantees given	1,086,732	423,163
	b) pensions and similar obligations	755,461	2,227,423
	c) other provisions for risks and charges	19,882,550	21,540,714
110.	Revaluation reserves	10,783,804	10,440,881
120.	Redeemable shares	-	-
130.	Equity instruments	-	-
140.	Reserves	-6,902,666	33,527,042
150.	Share premium reserve	73,577,887	73,577,887
160.	Capital	171,846,280	171,846,280
170.	Treasury shares (-)	-	-
180.	Net income (loss) for the year (+/-)	4,304,120	-5,760,228
Total liabilities and shareholders' equity		3,084,138,270	3,181,614,358

Income statement

(EUR)

	Items	2018	2017
10.	Interest income and similar revenues	55,591,501	53,195,079
	Of which: interest income calculated using the effective interest method	*59,010,720*	-
20.	Interest expense and similar charges	-2,899,591	-5,205,637
30.	Net interest income	52,691,910	47,989,442
40.	Commission income	62,896,138	64,258,271
50.	Commission expense	-3,273,762	-2,952,198
60.	Net commissions	59,622,376	**61,306,073**
70.	Dividends and similar income	150,143	453,792
80.	Net result from trading activities	1,054,741	1,466,168
90.	Net profit (loss) from hedging activities	-245,116	-550,533
100.	Gains/losses on disposal or repurchase of:	-207,926	-2,308,981
	a) financial assets measured at amortised cost	-207,926	-911,511
	b) financial assets measured at fair value through other comprehensive income	-	-1,397,470
	c) financial liabilities	-	
110.	Net income from financial assets and liabilities at fair value through profit or loss	-877,549	3,532
	a) financial assets and liabilities designated at fair value	-1,798	3,532
	b) Other financial assets mandatorily measured at fair value	-875,751	-
120.	Net interest and other banking income	**112,188,579**	108,359,493
130.	Net impairment losses/reversals of impairment losses on credit risk of:	-31,818,816	-35,659,120
	a) financial assets measured at amortised cost	-31,817,886	-35,247,694
	b) financial assets measured at fair value through other comprehensive income	-930	-411,426
140.	Profits/losses from contractual changes without cancellation	-	-
150.	**Net result from financial management**	**80,369,763**	72,700,373
160.	Administrative expenses:	-84,406,347	-100,799,170
	a) personnel expenses	-46,740,184	-62,753,100
	b) other administrative expenses	-37,666,163	-38,046,070
170.	Net provisions for risks and charges	-166,485	479,398
	a) commitments and guarantees given	194,234	-
	b) other net provisions	-360,719	479,398
180.	Net impairment losses on property, plant and equipment	-1,576,123	-2,568,845
190.	Net impairment losses on intangible assets	-	-
200.	Other operating charges/income	6,409,971	16,292,363
210.	Operating costs	-79,738,984	-86,596,254
220.	Profits (Losses) from equity investments	-	1,654,441
230.	Net result of fair value measurement of property, plant and equipment and intangible assets	-459,000	-1,155,567
240.	Write-downs to goodwill	-	-
250.	Profits (Losses) on disposal of investments:	1,702,281	12,583
260.	Profit (loss) from continuing operations before tax	1,874,060	-13,384,424
270.	Taxes on income for the year from continuing operations	2,430,060	7,624,196
280.	Profit (loss) from continuing operations after tax	4,304,120	-5,760,228
290.	Profit (loss) from discontinued operations after tax	-	-
300.	Net income (loss) for the year	4,304,120	- 5,760,228

Statement of comprehensive income for the year

(EUR)

		31/12/2018	31/12/2017
10.	Profit (loss) for the period	4,304,120	-5,760,228
	Other income components net of taxes without reclassification to profit and loss	458,649	14,141,766
20.	Equities designated at fair value through other comprehensive income	-307,083	-
30.	Financial liabilities designated at fair value through profit or loss (changes in credit rating)	-	-
40.	Hedging of equity instruments designated at fair value through other comprehensive income	-	-
50.	Property and equipment	-380	14,373,254
60.	Intangible assets	-	-
70.	Defined benefit plans	766,112	-231,488
80.	Non-current assets and group assets/liabilities held for sale	-	-
90.	Share of valuation reserves of equity investments valued using the equity method	-	-
	Other income components net of taxes with reversal to income statement	-115,726	-315,119
100.	Hedging of foreign investments	-	-
110.	Exchange rate differences	-	-
120.	Cash flow hedges	-	-
130.	Hedging instruments (undesignated items)	-	-
140.	Financial assets (other than equity securities) measured at fair value through other comprehensive income	-115,726	-315,119
150.	Non-current assets and group assets/liabilities held for sale	-	-
160.	Share of valuation reserves of equity investments valued using the equity method	-	-
170.	Total other income components net of taxes	342,923	13,826,647
180.	Comprehensive income (Item 10 + 170)	4,647,043	8,066,419

In relation to the completion during the year of the capitalisation offer made to employees registered with the “Cassa di Previdenza Integrativa per il Personale dell'Istituto Bancario San Paolo di Torino” and the consequent extinction of the related obligation on the part of the Bank for the portion corresponding to the employees taking part in the offer, the related IAS 19 valuation reserve was realigned for a total net amount of €414,258 included in item 70 “Defined benefit plans” of the above-mentioned Statement of Comprehensive Profitability.

Statement of changes in shareholders' equity at 31 December 2018

(EUR)

	Capital		Share premium reserve	Reserves		Merger reserves	Valuation reserves	Equity instruments	Treasury shares	Net income (loss) for the year	Shareholders' equity
	ordinary shares	other shares		of profits	other						
INVENTORY AS AT 31/12/2017	171,846,280		73,577,887	31,679,294	1,847,748		10,440,881			-5,760,228	283,631,862
Change in opening balances				-34,952,621							-34,952,621
INVENTORY AS AT 1/1/2018	171,846,280		73,577,887	-3,273,327	1,847,748		10,440,881			-5,760,228	248,679,241
ALLOCATION OF THE RESULT FOR THE											-
PREVIOUS YEAR											-
Reserves				-5,760,228						5,760,228	-
Dividends and other allocations											-
CHANGES DURING THE YEAR											-
Changes to reserves				-418,322	701,463						283,141
Transactions on shareholders' equity											-
Issuance of new shares											-
Purchase of treasury shares											-
Extraordinary distribution of dividends											-
Change in equity instruments											-
Derivatives on treasury shares											-
Stock options											-
Other changes											-
Comprehensive income							342,923			4,304,120	4,647,043
SHAREHOLDERS' EQUITY AS AT 31/12/2018	171,846,280		73,577,887	(9,451,877)	2,549,211	0	10,783,804			4,304,120	253,609,425

It should be noted that the "Changes during the year" reported in the line "Comprehensive income for 2018" of the Valuation reserves includes the positive amount of €414,258 related to the realignment of the IAS 19 Reserve for the portion corresponding to the obligation extinguished following acceptance of the voluntary capitalisation offer formulated by the Bank during the year to the members of the "Cassa di Previdenza Integrativa per il Personale dell'Istituto Bancario San Paolo di Torino" Fund.
This change is also shown with a negative sign under "Changes in reserves" in the item "Reserves: of profits".

Changes in shareholders' equity as at 31 December 2017

(EUR)

	Capital		Share premium reserve	Reserves		Merger reserves	Revaluation reserves	Equity instruments	Treasury shares	Net income (loss) for the year	Shareholders' equity
	ordinary shares	other shares		of profits	other						
INVENTORY AS AT 1/1/2017	143,448,715	28,397,565	73,577,887	39,393,437	1,244,436		-3,385,766			-7,714,143	274,962,131
ALLOCATION OF THE RESULT FOR THE											-
PREVIOUS YEAR											-
Reserves				-7,714,143						7,714,143	-
Dividends and other allocations											-
CHANGES DURING THE YEAR											-
Changes to reserves					603,312						603,312
Transactions on shareholders' equity											-
Issuance of new shares											-
Purchase of treasury shares											-
Extraordinary distribution of dividends											-
Change in equity instruments											-
Derivatives on treasury shares											-
Stock options											-
Other changes	28,397,565	-28,397,565									-
Comprehensive income							13,826,647			-5,760,228	8,066,419
SHAREHOLDERS' EQUITY AS AT 31/12/2017	171,846,280	0	73,577,887	31,679,294	1,847,748	0	10,440,881	0	0	(5,760,228)	283,631,862

Statement of cash flows

(EUR)

	2018	2017
A. OPERATING ASSETS		
1. Management	**47,725,113**	**26,274,011**
- profit (loss) for the year (+/-)	4,304,120	-5,760,228
- gains/losses on Financial assets held for trading and on other assets/liabilities at fair value through profit or loss (-/+)	-2,324,290	-1,462,636
- gains/losses on hedging activities (-/+)	245,116	550,533
- net impairment losses/reversals of impairment losses on credit risk (+/-)	45,472,816	39,491,120
- net impairment losses/reversals to property, plant and equipment and intangible assets (+/-)	1,576,123	2,568,845
- net provisions for risks and charges and other costs/revenues (+/-)	166,485	-479,398
- unpaid taxes, duties and tax credits (+/-)	-2,430,060	-7,624,196
- net impairment losses on discontinued operations, net of tax effect (-/+)	-	-
- other adjustments (+/-)	714,803	-1,010,029
2. Liquidity generated/absorbed by financial assets	**32,811,586**	**-204,016,275**
- financial assets held for trading	571,369	3,014,844
- financial assets designated at fair value;	901,886	-
- other assets compulsorily measured at fair value	-934,028	-19,796
- financial assets measured at fair value through other comprehensive income	-1,237,786	680,842
- other assets compulsorily valued at amortised cost	71,262,454	-197,711,022
- other activities	-37,752,309	-9,981,143
3. Liquidity generated/absorbed by financial liabilities	**-83,600,489**	**168,603,546**
- financial liabilities measured at amortised cost	-94,529,394	142,966,396
- financial liabilities held for trading	981,461	-1,670,919
- financial liabilities designated at fair value	-	-
- other liabilities	9,947,444	27,308,069
Net liquidity generated/absorbed by operating activities	**-3,063,790**	**-9,138,718**
B. INVESTMENT ACTIVITIES		
1. Liquidity generated by	**3,425,164**	**2,146,806**
- sales of equity investments	-	1,693,014
- dividends received on equity investments	150,143	453,792
- sales of property, plant and equipment	3,275,021	-
- sales of intangible assets	-	-
- sales of intangible assets	-	-
- sales of business units	-	-
2. Liquidity absorbed by	**-**	**-201,439**
- acquisitions of property, plant and equipment	-	-201,439
- acquisitions of intangible assets	-	-
- sales of business units	-	-
Net liquidity generated/absorbed by investment activities	**3,425,164**	**1,945,367**
C. FINANCING ACTIVITIES		
- issue/purchase of own shares	-	-
- issue/purchase of equity instruments	-	-
- distribution of dividends and other purposes	-	-
Net liquidity generated/absorbed by funding activities	**0**	**0**
NET LIQUIDITY GENERATED/ABSORBED DURING THE YEAR	**361,374**	**-7,193,351**
RECONCILIATION		
Balance sheet items		
Cash and cash equivalents at the beginning of the year	29,619,951	36,813,302
Total net liquidity generated/absorbed during the year	361,374	-7,193,351
Cash and cash equivalents at the end of the year	**29,981,325**	**29,619,951**

Notes to the financial statements

Part A - Accounting policies

A.1 – GENERAL CRITERIA

SECTION 1 – DECLARATION OF COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

The financial statements of Cassa di Risparmio di Pistoia e della Lucchesia ("Bank"), in application of Legislative Decree no. 38 of 28 February 2005, have been prepared in accordance with the IAS/IFRS accounting standards issued by the International Accounting Standards Board (IASB) and the relative interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and approved by the European Commission, as established by EU Regulation no. 1606 of 19 July 2002.
The financial statements as at 31 December 2018 have been prepared on the basis of the "Instructions for the preparation of the financial statements of the company and the consolidated financial statements of banks and financial companies parent company of banking groups" issued by the Bank of Italy, in the exercise of the powers established by Article 43 of Legislative Decree no. 136/2015( ), by the Order of 22 December 2005 with which Circular no. 262/05 was issued, with subsequent updates of 18 November 2009, 21 January 2014, 22 December 2014, 15 December 2015 and 22 December 2017[4].
These Instructions set out compulsory financial statement forms and their means of preparation, as well as the contents of the Notes to the financial statements.
The financial statements have been prepared using the International Accounting Standards in force as at 31 December 2018 (including the SIC and IFRIC interpretation documents) as listed in the attachments to these financial statements.

The table below shows the new standards or amendments to existing ones, together with the related EU endorsement regulations, which came into force in 2018.

IFRS endorsed as at 31.12.2018 in force since 2018

Regulation endorsement	Title	Effective date
1905/2016	IFRS 15 Revenue from contracts with customers	01/01/2018 First financial year starting on or after 01/01/2018
2067/2016	IFRS 9 Financial instruments	01/01/2018 First financial year starting on or after 01/01/2018
1987/2017	Amendments to IFRS 15 Revenue from contracts with customers	01/01/2018 First financial year starting on or after 01/01/2018
1988/2017	Amendments to IFRS 4 Insurance contracts	01/01/2018 First financial year starting on or after 01/01/2018
182/2018	Amendments to IAS 28 Investments in associates and Joint ventures	01/01/2018 First financial year starting on or after 01/01/2018
	Amendments to IFRS 1 First-time adoption of International Financial Reporting	01/01/2018 First financial year starting on or after 01/01/2018
	Amendments to IFRS 12 Disclosure of interest in other entities	01/01/2018 First financial year starting on or after 01/01/2018
289/2018	Amendments to IFRS 2 Share-based payment	01/01/2018 First financial year starting on or after 01/01/2018
400/2018	Amendments to IAS 40 Investment property	01/01/2018 First financial year starting on or after 01/01/2018
519/2018	IFRIC 22 Foreign currency transactions and advance	01/01/2018 First financial year starting on or after 01/01/2018

(*) Article 43 of Legislative Decree no. 136/2015 confirmed powers for the Bank of Italy in relation to the technical forms of the financial statements already previously attributed to the same Authority by Legislative Decree no. 38/2005.
4 The new provisions introduced by IFRS 9 and IFRS 15 were incorporated with the 5th update of Circular 262, published on 22 December 2017. For the sake of completeness, it is noted that the Bank of Italy published the 6th update of Circular 262 on 30 November 2018. The update, which incorporates the new features introduced by the international accounting standard IFRS 16 "Leasing", will be applied starting from the financial statements closed on or in progress as at 31 December 2019

The applicable accounting standards, mandatorily and for the first time, from 2018, consist primarily of certain important accounting standards summarised in the table above - among which IFRS 9 Financial Instruments is cited primarily - which have a significant impact on the Bank.

The accounting principles adopted for the preparation of these financial statements, with reference to the phases of classification, recognition, measurement and derecognition of financial assets and liabilities, as well as the methods for recognising revenues and costs, have been modified with respect to those adopted for the preparation of the 2017 financial statements. These changes are essentially the result of the mandatory application, as from 1 January 2018, of the following international accounting standards:

- IFRS 9 “Financial Instruments”, issued by the IASB in July 2014 and approved by the European Commission through Regulation no. 2067/2016, which replaced IAS 39 with regard to the classification and measurement of financial instruments, as well as the related impairment process;
- IFRS 15 “Revenues from contracts with customers”, approved by the European Commission through Regulation no. 1905/2016, which led to the cancellation and replacement of IAS 18 “Revenues” and IAS 11 “Construction Contracts”.

Focusing its attention on IFRS 9, given the particular importance of its effects, with reference to the methods of representation of the effects of first-time application of the standard, the Intesa Sanpaolo Group has decided to adopt the option provided in paragraph 7.2.15 of IFRS 9 and paragraphs E1 and E2 of IFRS 1 “First-Time Adoption of International Financial Reporting Standards”, according to which - without prejudice to the retrospective application of the new rules of measurement and representation required by the standard - the mandatory restatement on a uniform basis of the comparison data in the financial statements of first-time application of the new standard is not envisaged. In order to bring the comparative figures as at 31 December 2017 into line with the new official formats provided for in the 5th update of Bank of Italy Circular 262, in force since 1 January 2018, the necessary adjustments have been made, without changing the values, to allow inclusion in the new items. It should be noted, in particular, that:

- the pre-existing captions relating to loans to customers, loans to banks and financial assets held to maturity are all included in caption “40. Financial assets measured at amortised cost”;
- those relating to financial assets held for trading and to financial assets measured at fair value are attributed to in caption “20. Financial assets measured at fair value through profit or loss”;
- those relating to available-for-sale financial assets are included in caption “30. Financial assets measured at fair value through other comprehensive income”;
- the pre-existing captions relating to amounts due to banks, amounts due to customers and securities issued are all included in caption “10. Financial liabilities measured at amortised cost.

Attached to these Financial Statements are the reconciliation statements that illustrate in detail the reclassifications made between the pre-existing captions of the official statements and those of the new official statements provided for in Circular 262.

An in-depth analysis of the impact of first-time adoption of IFRS 9, including the transition between the formats published in the 2017 Financial Statements and those presented as the comparative year in the 2018 Financial Statements, is provided on page 4 of this report in the section entitled “The transition to IFRS 9”, which should be understood as an integral part of these Notes to the Financial Statements, to which reference should be made for further details.

With regard to the introduction of IFRS 15, the analyses carried out have shown that the accounting treatment of the main types of revenues deriving from contracts with customers tends to be in line with the provisions of the new standard and, consequently, no significant impact on the accounting level has emerged.
These financial statements include the more detailed information required by the Standard and the forms envisaged by the Bank of Italy in the 5th update of Circular 262.

In addition to the above, which, as mentioned above, is of extreme importance for Cassa di Risparmio di Pistoia e della Lucchesia S.p.A., the applicable accounting regulations, obligatorily and for the first time, as from 2018, consist of the interpretation “IFRIC 22 Foreign currency transactions and certain amendments made to accounting standards already in force”, approved by the European Commission during 2018 and which are not of a particularly significant nature for the Bank.

The table below, conversely, shows the new standards or amendments to existing ones, together with the related EU endorsement regulations, which will become mandatory from 1 January 2019 - for financial statements reflecting the calendar year - or from a subsequent date.

International Accounting Standards approved as at 31/12/2018 and applicable subsequent to 31/12/2018

Settlement endorsement	Title	Date of entry into force
1986/2017	IFRS 16 Leasing	01/01/2019 First financial year starting on 01/01/2019 or later
498/2018	Amendments to IFRS 9 Financial instruments	01/01/2019 First financial year starting on 01/01/2019 or later
1595/2018	IFRIC 23 Uncertainty of income tax treatments	01/01/2019 First financial year starting on 01/01/2019 or later

With regard to the main changes that will be applied from 1 January 2019 and in particular IFRS 16 Leasing, it is estimated that the impacts for the Bank are not significant.

The following table shows the new international accounting standards or amendments to existing accounting standards not yet approved by the European Commission.

IFRS not endorsed as at 31.12.2018

Standard/ Interpretation	Title	Date of issue
IFRS 17	Insurance Contracts	18/05/2017
Standard/ Interpretation	**Amendments**	**Date of issue**
IAS 28	Long-term Interest in Associates and Joint Ventures	12/10/2017
IFRS 3	Business Combination	12/12/2017
IFRS 11	Joint Arrangement	12/12/2017
IAS 12	Income Taxes	12/12/2017
IAS 23	Borrowing Costs	12/12/2017
IAS 19	Plan Amendment, Curtailment or Settlement	7/2/2018
(*)	Amendments to References to the Conceptual framework in IFRS Standards	29/03/2018
IFRS 3	Definition of a Business	22/10/2018
IAS 1	Definition of Material	31/10/2018
IAS 8	Definition of Material	31/10/2018

(*) The document amends references to Conceptual Framework in IFRS2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22, SIC 32

SECTION 2 – GENERAL PREPARATION PRINCIPLES

The financial statements comprise the balance sheet, the income statement, the statement of comprehensive income, the statement of changes in equity, the cash flow statement, the notes to the financial statements and the related comparative information and are also accompanied by a report on operations, the economic results achieved and the financial position of Cassa di Risparmio di Pistoia e Lucchesia S.p.A. In compliance with the provisions of Article 5 of Legislative Decree 38/2005, the financial statements have been drawn up with the euro as the functional currency.
The amounts indicated in the financial statements are expressed in euro, while figures in the Notes to the financial statements as well as those in the Report on operations are expressed in thousands of euros, unless otherwise specified.
The financial statements are prepared with the application of the general principles set out by IAS 1 and the specific accounting principles endorsed by the European Commission and illustrated in Part A.2 of these Notes to the financial statements, as well as in compliance with the general assumptions set forth by the Framework for the Preparation and Presentation of Financial Statements issued by IASB. No exceptions to the application of IAS/IFRS have been made.
The Report on Operations and the Notes to the financial statements contain all information required by international accounting standards, by current regulations, by the Bank of Italy and by Consob (Italian Securities Exchange Commission), in addition to other information which is not compulsory but is nonetheless deemed to be necessary in order for the purposes of a true and fair presentation of the Bank's situation.

The financial statement and the Notes to the financial statements show, in addition to the figures for the reference period, the comparative figures as at 31 December 2017. As illustrated in more detail in section 1 of this paragraph, to which reference should be made for further details, the Bank has availed itself of the option provided for in paragraph 7.2.15 of IFRS 9 and in paragraphs E1 and E2 of IFRS 1, according to which, with regard to the effects of the first application of IFRS 9, the mandatory restatement of the comparison data on a uniform basis is not envisaged. Therefore, in order to bring the comparative data as at 31 December 2017 back into line with the new tables provided for by Circular 262, the necessary adjustments have been made, without changing the values, to make it possible to include them in the new items.
The Attachments include tables with the reconciliations between the balance sheet and income statement figures originally published in the 2017 Annual Report, together with specific reconciliations between the financial statements and the reclassified statements included in the Report on operations accompanying these financial statements.

Contents of financial statement forms

Balance sheet and income statement
The compulsory forms of the balance sheet and income statement are made up of captions, subcaptions and further detailed information (specified as the “of which” items in the captions and subcaptions). For the purposes of completeness with respect to the compulsory forms defined by the Bank of Italy, captions which do not include amounts for either the year to which the financial statements refer or the previous year are also shown. In the income statement revenues are indicated without sign, whereas costs are preceded by the minus sign.

Statement of comprehensive income
The Statement of comprehensive income shows, starting from the income/(loss) for the year, the income components recognised as a balancing entry in valuation reserves, net of the tax effect, in compliance with international accounting standards.
Comprehensive income is represented by providing separate evidence of the income components that will not be reversed to the income statement in the future and those that, otherwise, may subsequently be reclassified to profit (loss) for the year under certain conditions. As in the case of the balance sheet and the income statement, with respect to the compulsory forms defined by the Bank of Italy, captions which do not include amounts for either the year to which the financial statements refer or the previous year are also shown. Negative amounts are preceded by the minus sign.

Changes in shareholders' equity
The statement of changes in shareholders' equity shows shareholders' equity accounts and changes which occurred in the reference year and in the previous year, broken down into share capital (ordinary and savings shares), reserves, reserves from retained earnings, valuation reserves and net income. Treasury shares are deducted from shareholders' equity. The report is presented by inverting the lines and the columns with respect to the same form provided for by the updating of Bank of Italy Circular 262/2005.

Statement of cash flows
The statement of cash flows registered in the reference year and in the previous year is prepared using the indirect method, on the basis of which cash flows from operating activities are represented by net income adjusted for the effects of non-cash transactions.
Cash flows are broken down into flows from operating activities, from investing activities and from financing activities.
In the form, cash flows generated in the year are indicated without sign, whereas cash flows absorbed are preceded by the minus sign.

Contents of Notes to the financial statements
The Notes to the financial statements include the information required by international accounting standards and Bank of Italy Circular no. 262 issued on 22 December 2005 and subsequent amendments applicable to the preparation of these financial statements. It should be noted, in particular, that the initial existence of tables showing annual changes includes the effects of the first-time adoption of IFRS 9.

SECTION 3 – SIGNIFICANT EVENTS SUBSEQUENT TO FINANCIAL STATEMENT DATE

In the period between the end of the 2018 financial year and the date of approval of these financial statements, there were no events that were expected to have a significant impact on the bank's financial results.

SECTION 4 - OTHER ASPECTS

Option for the national fiscal consolidation provisions
Intesa Sanpaolo and the Italian companies of the Group, including Cassa di Risparmio di Pistoia e della Lucchesia S.p.A., have adopted the so-called "national consolidated tax mechanism", governed by Articles 117-129 of the Consolidated Income Tax Law, introduced into tax legislation by Legislative Decree no. 344/2003. It provides an option, based on which the total net income or fiscal loss of every controlled subsidiary taking part in the fiscal consolidation procedure – together with withholding tax, tax deductions and tax credits – is transferred to the parent company, which determines a single taxable income or loss carried forward (that is the result of the sum of its own income/loss and of the income/loss of the participating subsidiaries) and, consequently, a sole tax debit/credit.
Based on this option, Group companies which opted for the "national fiscal consolidation" determine the tax charge pertaining to them and the corresponding taxable income is transferred to the Parent Company.

Business continuity
In this regard, the Directors confirm that they have a reasonable assurance that the Company will continue to operate profitably in the foreseeable future and, consequently, the Financial Statements have been prepared with a view to continuity. The Directors have not detected in the asset and financial structure or in the performance of operations any uncertainties casting doubt on the specific issue of the going concern assumption.
It should be noted that the Board of Directors of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. resolved on 6 March 2018 to merge with Intesa Sanpaolo S.p.A. The merger, which is one of Intesa Sanpaolo's objectives under the 2018-2021 Business Plan, is aimed at simplifying and rationalising the organisational structure and corporate structure of the Banking Group.

Other aspects
The Bank's financial statements as at 31 December 2018 have been audited by the independent auditors KPMG S.p.A., in accordance with the resolution of the shareholders' meeting of 12 December 2011, which appointed KPMG S.p.A. for the period 2012-2020.

A.2 - MAIN FINANCIAL STATEMENT CAPTIONS

1. Financial assets measured at fair value through profit and loss (FVTPL*)*

Classification criteria
This category includes financial assets other than those classified as Financial assets measured at fair value through comprehensive profit or loss and as Financial assets measured at amortised cost. The caption, in particular, includes:
- financial assets held for trading, essentially represented by debt securities and equities and the positive value of derivative contracts held for trading;
- financial assets that must be measured at fair value, represented by financial assets that do not meet the requirements for measurement at amortised cost or at fair value, with an impact on comprehensive income. These are financial assets whose contractual terms do not exclusively provide for capital repayments and interest payments on the amount of capital to be repaid (the so-called "SPPI test" not passed) or which are not held within the framework of a business model whose objective is the possession of assets aimed at collecting contractual financial flows (the "Hold to Collect" business model) or whose objective is achieved both through the collection of contractual financial flows and through the sale of financial assets (the "Hold to Collect and Sell" business model);
- financial assets designated at fair value, i.e. the financial assets thus defined at the time of initial recognition and where the conditions are met. In this case, an entity may irrevocably designate a financial asset for recognition as measured at fair value through profit or loss if, and only if, by doing so, it eliminates or significantly reduces a measurement inconsistency.

They therefore find evidence in this caption:
- debt securities and loans that are included in an Other/Trading business model (i.e., not attributable to the "Hold to Collect" or "Hold to Collect and Sell" business models) or that do not pass the SPPI test, including units of syndicated loans subscribed or other types of loans that, from the outset, are intended for sale and that are not attributable to a "Hold to Collect and Sell" business model;
- equity instruments - not qualifying as control, connection or joint control - held for trading purposes or for which it was not decided, on initial recognition, to designate them at fair value through comprehensive income;
- UCI positions.

The caption also includes derivative contracts, recorded under financial assets held for trading, which are represented as assets if the fair value is positive and as liabilities if the fair value is negative. Positive and negative current values deriving from existing transactions with the same counterparty can only be offset if there is a current legal right to offset the amounts recorded in the accounts and the intention is to settle the positions to be offset on a net basis.
Derivatives also include those embedded in complex financial contracts - in which the primary contract is a financial liability - which have been recognised separately because:
- their characteristics and risks are not closely related to the characteristics of the host contract;
- embedded instruments, even though separate, fully meet the definition of derivative;
- combined instruments are not measured at fair value with changes in fair value recognised through profit and loss.

According to the general rules provided for by IFRS 9 on the reclassification of financial assets (with the exception of equity securities, for which no reclassification is permitted), reclassifications to other categories of financial assets are not permitted unless the entity modifies its business model for the management of financial assets. In such cases, which are expected to be highly infrequent, financial assets may be reclassified from the category measured at fair value through profit or loss into one of the other two categories provided for by IFRS 9 (Financial assets measured at amortised cost or Financial assets measured at fair value through comprehensive income). The transfer value is represented by the fair value at the time of reclassification and the effects of the reclassification operate prospectively from the date of reclassification. In this case, the effective interest rate of the reclassified financial asset is determined on the basis of its fair value at the reclassification date and this date is considered as the initial recognition date for allocation to the various stages of credit risk (stage assignment) for the purposes of impairment.
For further information on the criteria for the classification of financial instruments, reference should be made to the following paragraph "Criteria for the classification of financial assets".

Recognition criteria
Initial recognition of financial assets occurs at settlement date, for debt securities and equity securities, at the disbursement date for loans and at trade date for derivative contracts.
On initial recognition, financial assets measured at fair value through profit or loss are recognised at fair value, without considering transaction costs or revenues directly attributable to the instrument.

Measurement criteria
Subsequent to initial recognition, financial assets measured at fair value through profit or loss are measured at fair value. The effects of the application of this measurement criterion are recorded in the income statement.

For the determination of the fair value of financial instruments quoted on active markets, market quotations are used. If the market for a financial instrument is not active, standard practice estimation methods and valuation techniques are used which consider all the risk factors correlated to the instruments and that are based on market elements such as: measurement of quoted instruments with the same characteristics, calculation of discounted cash flows, option pricing models, recent comparable transactions, etc.. For equity securities and derivative instruments involving equity securities not listed on an active market, the cost criterion is used as a fair value estimate only in a residual way and limited to a few circumstances, i.e. in the case of non-applicability of all the measurement methods mentioned above, or in the presence of a wide range of possible measurements of fair value, in which the cost represents the most significant estimate.
For further information on the criteria for determining fair value, reference should be made to Section "A.4 Disclosure of Fair Value".

Derecognition criteria
Financial assets are derecognised solely if the sale leads to the substantial transfer of all the risks and rewards connected to the assets. Conversely, if a significant part of the risks and rewards relative to the sold financial assets is maintained, they continue to be recorded in assets, even though their title has been transferred.
When it is not possible to ascertain the substantial transfer of risks and rewards, the financial assets are derecognised where no control over the assets has been maintained. If this is not the case, when, even partial, control is maintained, the assets continue to be recognised for the entity's continuing involvement, measured by the exposure to changes in value of assets sold and to variations in the relevant cash flows.
Lastly, financial assets sold are derecognised if the entity retains the contractual rights to receive the cash flows of the asset, but signs a simultaneous obligation to pay such cash flows, and only such cash flows, without significant delay to third parties.

2. Financial assets measured at fair value through other comprehensive income (FVOCI)

Classification criteria
Financial assets that meet both the following conditions are included in this category:
- the financial asset is owned according to a business model whose objective is achieved both by the collection of contractually determined cash flows and by the sale of the financial asset ("Hold to Collect and Sell" business model); and
- the contractual terms of the financial asset provide, at certain dates, for cash flows consisting solely of payments of principal and interest on the amount of principal to be repaid (the so-called "SPPI test" passed).

The caption also includes equity instruments not held for trading purposes, for which, at the time of initial recognition, the option to be designated at fair value through comprehensive income was exercised.

In particular, they are included in this caption:
- debt securities that belong to a "Hold to Collect and Sell" business model and passed the SPPI test;
- equity interests, not qualifying as control, connection or joint control, which are not held for trading purposes, for which the option to be designated at fair value through comprehensive income has been exercised;
- loans that are linked to a "Hold to Collect and Sell" business model and that have passed the SPPI test, including the shares of syndicated loans subscribed or other types of loans that, from the outset, are intended for sale and that are linked to a "Hold to Collect and Sell" business model.

According to the general rules provided for by IFRS 9 on the reclassification of financial assets (with the exception of equity securities, for which no reclassification is permitted), reclassifications to other categories of financial assets are not permitted unless the entity modifies its business model for the management of financial assets.
In such cases, which are expected to be highly infrequent, financial assets may be reclassified from the category measured at fair value through comprehensive income into one of the other two categories provided for by IFRS 9 (Financial assets measured at amortised cost or Financial assets measured at fair value through profit or loss). The transfer value is represented by the fair value at the time of reclassification and the effects of the reclassification operate prospectively from the date of reclassification. In the case of reclassification from the category in question to that of the amortised cost, the cumulative gain (loss) recognised in the revaluation reserve is recognised as an adjustment to the fair value of the financial asset at the date of reclassification. In the case of reclassification to the category of fair value through profit or loss, the accumulated profit (loss) previously recognised in the revaluation reserve is reclassified from shareholders' equity to profit (loss) for the year.
For further information on the criteria for the classification of financial instruments, reference should be made to the following paragraph "Criteria for the classification of financial assets".

Recognition criteria
Initial recognition of financial assets occurs at settlement date, for debt securities and equity securities, at the disbursement date for loans. On initial recognition, assets are recorded at fair value, including transaction costs and revenues directly attributable to the instrument.

Measurement criteria
Subsequent to initial recognition, assets classified at fair value through comprehensive income, other than equity securities, are measured at fair value, with the impact of the application of amortised cost, the effects of impairment and any exchange rate effect recognised in profit and loss while other gains or losses arising from a change in fair value are recognised in a specific equity reserve until the financial asset is derecognised. Upon disposal, in whole or in part, the cumulative gain or loss in the valuation reserve is reversed, in whole or in part, to profit and loss.
The equity instruments chosen for classification in this category are measured at fair value and the amounts recognised as a contra-entry to equity (statement of comprehensive income) must not be subsequently transferred to profit and loss, even in the event of disposal. The only component relating to the equity securities in question that is recognised in profit and loss is the related dividends.
Fair value is determined on the basis of the criteria already illustrated for Financial assets measured at fair value through profit or loss.
For equity securities included in this category, not listed on an active market, the cost criterion is used as a fair value estimate only to a residual extent and limited to a few circumstances, i.e. in the event of the non-applicability of all the measurement methods mentioned above, or in the presence of a wide range of possible fair value measurements, in which the cost represents the most significant estimate.
For further information on the criteria for determining fair value, reference should be made to Section “A.4 Disclosure of Fair Value”.
Financial assets measured at fair value with an impact on comprehensive income - both in the form of debt securities and loans - are subject to the verification of the significant increase in credit risk (impairment) envisaged by IFRS 9, as are Assets at amortised cost, with the consequent recognition in profit and loss of an adjustment to cover expected losses. More specifically, on instruments classified as stage 1 (i.e. on financial assets at the time of origination, if not impaired, and on instruments for which there has been no significant increase in credit risk compared to the initial recognition date), an expected loss of one year is recorded at the initial recognition date and at each subsequent reporting date. On the other hand, for instruments classified as stage 2 (performing instruments for which there has been a significant increase in credit risk since the date of initial recognition) and stage 3 (impaired exposures), an expected loss is recognised for the entire residual life of the financial instrument.
Conversely, equity securities are not subject to impairment.
Reference should be made to the paragraph below entitled “Impairment of financial assets” for further details.

Derecognition criteria
Financial assets are derecognised solely if the sale leads to the substantial transfer of all the risks and rewards connected to the assets. Conversely, if a significant part of the risks and rewards relative to the sold financial assets is maintained, they continue to be recorded in assets, even though their title has been transferred.
When it is not possible to ascertain the substantial transfer of risks and rewards, the financial assets are derecognised where no control over the assets has been maintained. If this is not the case, when, even partial, control is maintained, the assets continue to be recognised for the entity’s continuing involvement, measured by the exposure to changes in value of assets sold and to variations in the relevant cash flows.
Lastly, financial assets sold are derecognised if the entity retains the contractual rights to receive the cash flows of the asset, but signs a simultaneous obligation to pay such cash flows, and only such cash flows, without significant delay to third parties.

3. Financial assets measured at amortised cost

Classification criteria
This category includes financial assets (in particular loans and debt securities) that meet both of the following conditions:
- the financial asset is owned according to a business model whose objective is achieved both by the collection of contractually determined cash flows (the “Hold to Collect” business model); and
- the contractual terms of the financial asset provide, at certain dates, for cash flows consisting solely of payments of principal and interest on the amount of principal to be repaid (the so-called “SPPI test” passed).

More specifically, they are recognised under this caption:
- loans to banks in the various technical forms meeting the above requirements;
- loans to customers in the various technical forms meeting the above requirements;
- debt securities meeting the above requirements.

This category also includes operating receivables connected with the provision of financial assets and services as defined by the Consolidated Banking Act and the Consolidated Finance Act (for example, for the distribution of financial products and servicing activities).

According to the general rules provided for by IFRS 9 on the reclassification of financial assets, reclassifications to other categories of financial assets are not permitted unless the entity modifies its business model for the management of financial assets. In such cases, which are expected to be highly infrequent, financial assets may be reclassified from the category measured at amortised cost into one of the other two categories provided for by IFRS 9 (Financial assets measured at fair value through comprehensive income or Financial assets measured at fair value through profit or loss). The transfer value is represented by the fair value at the time of reclassification and the effects of the reclassification operate prospectively from the date of reclassification. Gains or losses resulting from the difference between the amortised cost of the financial asset and its fair value are recognised in profit and loss in the case of reclassification to financial assets measured at fair value through profit or loss and to equity, in the appropriate valuation reserve, and in the case of reclassification to financial assets measured at fair value through comprehensive income.

For further information on the criteria for the classification of financial instruments, reference should be made to the following paragraph "Criteria for the classification of financial assets".

Recognition criteria
Initial recognition of the financial asset occurs at the settlement date for debt securities and at the disbursement date for loans. On initial recognition, assets are recorded at fair value, including transaction costs and revenues directly attributable to the instrument.
In particular, as far as receivables are concerned, the disbursement date normally coincides with the date of signing of the contract. Should this not be the case, a commitment to disburse funds is made along the subscription of the contract, which will cease to exist upon disbursement of the loan. The loan is recognised based on its fair value, equal to the amount disbursed or subscription price, inclusive of the costs/revenues directly attributable to the single loan and determinable from inception, even when settled at a later date. Costs that, even with the aforementioned characteristics, are reimbursed by the borrower or are classifiable as normal internal administrative costs are excluded.

Measurement criteria
After the initial recognition, investments under consideration are valued at amortised cost, using the effective interest method. In these terms, the asset is recognised in the financial statements at an amount equal to its initial recognition value less any capital repayments, plus or minus the cumulative amortisation (calculated using the effective interest rate method referred to above) of the difference between this initial amount and the amount at maturity (typically attributable to costs/income charged directly to the individual asset) and adjusted by any provision for hedging losses. The effective interest rate is the rate that exactly discounts estimated future cash payments of the asset, for principal and interest, to the amount disbursed inclusive of the costs/revenues attributable to the same investment. This measurement method uses a financial approach and allows distribution of the economic effect of the costs/revenues directly attributable to a financial asset through its expected residual maturity.
The amortised cost method is not used for assets - measured at historical cost - whose short duration makes the effect of the application of the discounting logic negligible, for those without a defined maturity or for revoked receivables.
The measurement criteria, as better described in the paragraph "Impairment of financial assets", are closely linked to the inclusion of the instruments in question in one of the three stages (stages of credit risk) provided for by IFRS 9, the last of which (stage 3) includes impaired financial assets and the remaining two (stages 1 and 2) include performing financial assets.
With reference to the accounting representation of the above valuation effects, value adjustments relating to this type of asset are recognised in the Income Statement:

- at the time of initial recognition, for an amount equal to the expected loss at twelve months;
- at the time of the subsequent measurement of the asset, where the credit risk has not increased significantly with respect to the initial recognition, in relation to changes in the amount of value adjustments for losses expected in the following twelve months;
- at the time of the subsequent measurement of the asset, where the credit risk has significantly increased with respect to the initial recognition, in relation to the recognition of value adjustments for expected losses relating to the entire residual life of the asset as provided for in the contract;
- at the time of the subsequent measurement of the asset, where - after there was a significant increase in credit risk compared to the initial recognition - the "significance" of this increase ceased to exist, in relation to the adjustment of the accumulated value adjustments to take account of the transition from an expected loss over the entire residual life of the instrument ("lifetime") to one to twelve months.

If the financial assets in question are performing, they are subject to a measurement, aimed at defining the value adjustments to be recorded in the financial statements, at the level of individual credit ratios (or tranches of securities), according to the risk parameters represented by probability of default (PD), loss given default (LGD) and exposure at default (EAD), derived from AIRB models and appropriately adjusted to take account of the provisions of IFRS 9.

If, in addition to a significant increase in credit risk, there is also objective evidence of impairment, the amount of the loss is measured as the difference between the book value of the asset - classified as "impaired", like all other transactions with the same counterparty - and the present value of estimated future cash flows discounted at the original effective interest rate. The amount of the loss, to be recognised in the Income Statement, is defined on the basis of an analytical measurement process or determined by homogeneous categories and, therefore, analytically attributed to each position and takes into account, as detailed in the paragraph "Impairment of financial assets", forward looking information and possible alternative recovery scenarios.
Impaired assets include financial instruments that have been granted the status of non-performing, probable default or past due/overdue by more than ninety days according to the rules of the Bank of Italy, consistent with the IAS/IFRS and European Supervision regulations.
Expected cash flows consider expected recovery periods and the presumed realisable value of any guarantees.
The original effective rate of each asset remains unchanged over time even though the relationship has been restructured with a variation of the contractual interest rate and even though the relationship, in practice, no longer bears contractual interest.
If the reasons for impairment are no longer applicable following an event subsequent to the registration of impairment, recoveries are recorded in the income statement. The size of the recovery must not lead the carrying amount of the financial asset to exceed the amortised cost had no impairment losses been recognised in previous periods.
Recoveries on impairment including time value effects are recognised in net interest income.
In some cases, during the life of the financial assets in question and, in particular, of the receivables, the original contractual conditions are subject to subsequent amendment at the request of the parties to the contract. When, over the life of an instrument, contractual clauses are amended, it is necessary to check whether the original asset should continue to be recognised in the financial statements or, on the contrary, whether the original instrument should be derecognised and a new financial instrument recognised.
In general, changes to a financial asset lead to the derecognition of that asset and the recognition of a new asset when they are "substantial". The measurement of the "substantiality" of the change must be made taking into account both qualitative and quantitative elements. In some cases, in fact, it may be clear, without recourse to complex analyses, that the changes introduced substantially modify the characteristics and/or contractual flows of a given asset while, in other cases, further analyses (including quantitative analyses) will have to be carried out in order to appreciate the effects of the same and verify the need to proceed or not with the derecognition of the asset and the recognition of a new financial instrument.
The analyses (qualitative-quantitative) aimed at defining the "substantiality" of the contractual changes made to a financial activity will therefore have to take into account:

- the purposes for which the changes were made: for example, renegotiations for commercial reasons and concessions due to the financial difficulties of the counterparty:
  - the former, aimed at "retaining" the customer, involve a debtor who is not in financial difficulty. This case study includes all the renegotiation operations that are aimed at adjusting the cost of the debt to market conditions. These transactions involve a change in the original terms of the contract, usually requested by the debtor, which relates to aspects related to the cost of the debt, with a consequent economic benefit for the debtor. In general, it is considered that whenever a bank renegotiates in order to avoid losing its customer, such renegotiation should be considered as substantial because, if it is not renegotiated, the customer could be financed by another intermediary and the bank would suffer a decrease in expected future revenues;
  - the latter, carried out for "credit risk reasons" (forbearance measures), are attributable to the bank's attempt to maximise the recovery of cash flows from the original credit. The underlying risks and benefits, following the changes, are normally not substantially transferred and, consequently, the accounting representation that provides the most relevant information for the reader of the financial statements (except for what will be described below in relation to objective elements), is that carried out by means of "modification accounting" - which entails the recognition in profit and loss of the difference between the book value and the present value of the modified cash flows discounted at the original interest rate - and not by means of derecognition;
- the presence of specific objective elements ("triggers") that affect the characteristics and/or contractual flows of the financial instrument (such as, for example, a change in the currency or a change in the type of risk to which one is exposed, when correlated with equity and commodity parameters), which are deemed to entail derecognition in view of their impact (expected to be significant) on the original contractual flows.

Derecognition criteria

Financial assets are derecognised solely if the sale leads to the substantial transfer of all the risks and rewards connected to the assets. Conversely, if a significant part of the risks and rewards relative to the sold financial assets is maintained, they continue to be recorded in assets, even though their title has been transferred.
When it is not possible to ascertain the substantial transfer of risks and rewards, the financial assets are derecognised where no control over the assets has been maintained. If this is not the case, when, even partial, control is maintained, the assets continue to be recognised for the entity's continuing involvement, measured by the exposure to changes in value of assets sold and to variations in the relevant cash flows.
Lastly, financial assets sold are derecognised if the entity retains the contractual rights to receive the cash flows of the asset, but signs a simultaneous obligation to pay such cash flows, and only such cash flows, without significant delay to third parties.

4. Hedging transactions

The Intesa Sanpaolo Group avails itself of the possibility, provided for in the introduction of IFRS 9, to continue to apply in full the provisions of IAS 39 on hedge accounting (in the carved out version approved by the European Commission) for each type of hedge (both for specific hedges and for macro hedges).

Classification criteria: type of hedge
Hedging transactions are aimed at neutralising potential losses on a specific item or group of items, attributable to a certain risk, if such a risk should actually occur.
The following types of hedging transactions are used:
- fair value hedges: this has the objective of covering exposure to changes in the fair value (attributable to the different risk categories) of assets and liabilities in the balance sheet, or on a portion of these, of groups of assets/liabilities, of binding commitments and portfolios of financial assets and liabilities with fair value hedges, including "core deposits", as permitted by IAS 39 endorsed by the European Commission; General fair value hedges ("macro hedges") are designed to reduce fluctuations in fair value attributable to interest rate risk, by a monetary amount deriving from a portfolio of financial assets or liabilities. Net amounts deriving from the imbalance of assets and liabilities cannot be subject to a macro-hedge;
- cash flow hedges: this has the objective of covering exposure to variability in future cash flows attributable to particular risks associated with balance sheet captions. This type of hedge is essentially used to stabilise the interest flow on variable rate funding to the extent that the latter finances fixed rate investments. In certain circumstances, similar transactions are carried out with respect to some types of floating rate investments;
- hedging of a foreign currency investment: used to hedge the risks of an investment in a foreign company expressed in foreign currency.

Only hedging transactions which involve counterparties outside the Bank may qualify for hedge accounting.
Given the Group's decision to continue to apply IAS 39 in full to hedging relationships, it is not possible to designate equity instruments classified as financial assets at fair value through other comprehensive income (FVOCI) as hedged items for price or foreign exchange risk, since these instruments do not impact the income statement, even in the event of a sale (except for dividends which are recognised in profit and loss).

Recognition criteria
Hedging derivative instruments, like all derivatives, are initially recognised and subsequently measured at fair value.

Measurement criteria
Hedging derivatives are measured at fair value. Specifically:
- in the case of fair value hedges, the change in the fair value of the hedged item is offset by the change in fair value of the hedging instrument. Offsetting is recognised via the registration in the income statement of the gains and losses referred to both the hedged item (as concerns the variations produced by the underlying risk factor), and the hedging instrument. Any difference, which represents the partial ineffectiveness of the hedge, is therefore the net economic effect. In the case of general fair value hedging transactions ("macro hedges"), changes in fair value with reference to the hedged risk of the hedged assets and liabilities are recognised in the balance sheet respectively under caption 60. "Fair value change of financial assets in hedged portfolios" or 50. "Fair value change of financial liabilities in hedged portfolios";
- in the case of cash flow hedges, changes in fair value of the derivative are recorded in equity, for the effective portion of the hedge, and these are registered in the income statement only when, with reference to the hedged item, there is a variation in the flows to be offset or if the hedge is ineffective;
- hedges of net investments in foreign currency are treated in the same way as cash flow hedges.

Derivatives are designated as hedging instruments if there is formal designation and documentation of the hedging relationship between the hedged item and the hedging instrument and if this is effective at inception and prospectively over the entire period of the hedge.
The effectiveness of the hedge depends on the extent to which changes in the fair value of the hedged item or the related expected cash flows are offset by those of the hedging instrument. The effectiveness can therefore be appreciated by comparing the above changes, taking into account the intention pursued by the company when the hedge was set up. A hedge is effective when the variations in fair value (or cash flows) of the hedging financial instrument almost completely neutralise, that is within the 80-125% range, the changes in the fair value of the hedged item, for the type of risk being hedged.

Effectiveness is measured at every close of annual or interim financial statements using:
- which justify the application of hedge accounting, since these prove the expected effectiveness of the hedge
- retrospective tests, which evidence the degree of hedge effectiveness reached in the period to which they refer, or rather, measure how far the actual results have deviated from the perfect hedge.

If such assessments do not confirm hedge effectiveness, from that moment hedge accounting is discontinued, the derivative is reclassified in instruments held for trading and the hedged item is measured on the basis of its classification in the balance sheet. In the event of the interruption of a fair value macro-hedge relationship, the cumulative revaluations/write-downs recorded under caption 60. "Fair value change of financial assets in hedged portfolios" or 50. "Fair value change of financial liabilities in hedged portfolios" are recorded in profit and loss under interest income or expense over the residual maturity of the original hedge relationship, subject to verification that the conditions are met.

5. Equity investments

Classification criteria

The caption includes investments in subsidiary companies subject to joint control and associates.
Subsidiary companies are those entities in which the Bank is exposed to variable returns, or holds rights over such returns, deriving from its relationship with them and at the same time has the capacity to affect such returns by exercising its power over such entities.
Joint ventures are entities over which, on a contractual basis, control is shared between the Bank and one or more parties external to the Group, or when decisions concerning significant assets require the unanimous consent of all parties sharing control.
Companies are considered associates, that is, companies subject to significant influence, when the Bank holds at least 20% of voting rights (including "potential" voting rights) or if the Parent Company – with a lower equity stake – has the power of participating in the determination of financial and management policies of the company based on specific juridical relations, such as the participation in voting syndicates.
Certain companies in which Intesa Sanpaolo holds a stake exceeding 20% are not considered subject to significant influence since the Bank exclusively has economic rights on a portion of the returns generated by the investment, but does not have access to management policies and may exercise governance rights limited to the protection of its economic interests.

Recognition criteria

Equity investments are recognised at settlement date. On initial recognition equity investments are recorded at cost.

Measurement criteria

Equity investments are measured at cost, which may be adjusted if permanent losses are deemed to have occurred. If there is evidence of impairment, the recoverable amount of the investment is estimated, considering the present value of the future cash flows which may be generated by the investment, including the final disposal value.
If the recoverable amount is lower than the book value, the difference is recorded in the income statement.
If the reasons for impairment are no longer applicable following an event subsequent to the registration of impairment, recoveries are recorded in the income statement.

Derecognition criteria

Investments in associates and companies subject to joint control are derecognised when the contractual rights to the cash flows from the assets expire or when the investment is sold transferring substantially all the risks and rewards connected to the assets.

6. Property and equipment

Classification criteria

Property and equipment include land, buildings used in operations, investment property, valuable artistic assets, technical plants, furniture and fittings, as well as equipment of any kind that is expected to be used for more than one period.
Tangible assets held for use in the production or supply of goods and services are classified as "assets for functional use" in accordance with IAS 16. Real estate held for investment purposes (in order to earn rentals or for capital appreciation) is classified as "assets held for investment purposes" in accordance with IAS 40.
The caption also includes property, plant and equipment classified in accordance with IAS 2 - Inventories, which refer to assets deriving from the enforcement of guarantees or from the purchase at auction that the company intends to sell in the near future, without carrying out significant restructuring works, and which do not have the conditions to be classified in the previous categories.
Finally, assets used under financial leasing contracts are recorded under property, plant and equipment, even though their legal ownership remains with the leasing company.

Recognition criteria
Property, plant and equipment are initially measured at cost which comprises in addition to their purchase price any costs directly attributable to the purchase and required for them to be operational.
Extraordinary maintenance expenses which lead to a rise in future economic benefits are attributed to increase the value of assets, while other ordinary maintenance costs are recorded in profit and loss.

Measurement criteria
Property, plant and equipment are measured at cost, less any depreciation and impairment losses, with the exception of property for functional use and valuable artistic assets, which are valued using the revaluation method.
Real estate held for investment purposes is valued using the fair value method.
For property, plant and equipment subject to measurement using the revaluation method:
- if the book value of an asset is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the caption “revaluation reserve”; however, if it recovers a decrease in a revaluation of the same asset previously recognised in profit or loss, it must be recognised as income;
- if the book value of an asset is decreased as a result of the revaluation, the decrease shall be recognised in other comprehensive income as a revaluation surplus to the extent that there is any credit balance in the revaluation surplus in respect of that asset; otherwise such reduction shall be recorded in the Income Statement.

Property, plant and equipment are systematically depreciated, adopting the straight-line method over their useful life. The depreciable amount is represented by the cost of the goods (or by the net re-determined value if the valuation method adopted is that of the re-determination of value) net of the residual value at the end of the depreciation process, if significant. Buildings are depreciated for a portion deemed suitable to represent their deterioration over time following their use, considering extraordinary maintenance expenses, which are recognised in the carrying value of the assets. In order to determine the useful life of the various types of assets and the corresponding depreciation coefficients, the Bank’s real estate assets were segmented into four clusters: (i) Restricted and non-restricted listed buildings, (ii) freestanding real estate, (iii) Bank branches and (iv) Other real estate.

The following are not depreciated:
- land, irrespective of whether acquired individually or embedded in the value of buildings, since it has an indefinite useful life;
- valuable works of art, other historical, artistic and decorative assets because their useful life cannot be estimated and their value is normally destined to increase over time;
- investment properties which, as required by IAS 40, are measured at fair value through profit or loss and therefore do not have to be depreciated.

If there is some evidence that a tangible asset measured at cost may have been impaired, the carrying value of the asset and its recoverable amount are compared. Any impairment losses are recorded in the income statement.
If the reasons for impairment cease to exist, a value recovery is recorded which may not exceed the value that the asset would have had, net of depreciation, in the absence of previous impairment losses.
Tangible assets recognised in accordance with IAS 2 are valued at the lower of cost and net realisable value, it being understood that a comparison is made between the book value of the asset and its recoverable value where there is any indication that the asset may have suffered a loss in value. Any impairment losses are recorded in the income statement.

Derecognition criteria
Property, plant and equipment are derecognised from the balance sheet on disposal or when the asset is permanently withdrawn from use and no future economic benefits are expected from its disposal.

7. Intangible assets

Classification criteria
Intangible assets are recognised as such if they may be identified and stem from legal or contractual rights. Intangible assets include goodwill, which represents the positive difference between purchase price and fair value of assets and liabilities pertaining to the acquired company.

Recognition and measurement criteria
Intangible assets are recognised at cost, adjusted for any accessory charges only if it is probable that the future economic benefits attributable to the assets will be realised and if the cost of the asset may be reliably determined. If this is not the case, the cost of the intangible asset is recorded in the income statement in the year in which it was sustained.

For assets with finite useful life, the cost is amortised on a straight-line basis or in decreasing portions determined on the basis of the economic benefits expected from the asset. Assets with indefinite useful life are not amortised on a straight-line basis, but are tested periodically to determine whether their carrying value is adequate.
If there is any indication that an asset may have suffered impairment losses, the asset's recoverable amount is estimated. The impairment loss, which is recorded in the income statement, is equal to the difference between the book value of the assets and the recoverable amount.

In particular intangible assets include:
- technology-based intangible assets, such as application software, which are amortised on the basis of their expected technological obsolescence and in any case no longer than a maximum period of seven years;
- customer-related intangible assets represented by the valuation, in business combinations, of asset management transactions, non-financial assets related to the provision of services and the insurance portfolio. Such assets with a finite life, are originally measured by the discounting, using a rate representing the time value of money and the asset's specific risks, of the income margins on the ongoing relations at the time of the business combination over a period which expresses their residual, contractual or estimated life. They are amortised, for asset management transactions and non-financial assets related to the provision of services, on a straight-line basis over the period of greater significance of the expected economic benefits in case of relations which do not have a predetermined duration or in decreasing portions corresponding to the duration of the contract in case of relations with predetermined expiry;
- marketing related intangibles represented by the measurement of the brand name which is also recorded at the time of business combinations. This asset is considered as having indefinite life since it is deemed to contribute for an indefinite period of time to the formation of income flows.

Lastly, intangible assets include goodwill.

Goodwill may be recorded as part of a business combination when the positive difference between fair value of shareholders' equity acquired and the purchase price of the equity investment is representative of the future income-generation potential of the equity investment.
If this difference should be negative (badwill) or if goodwill may not be attributed considering future income-generation potential of the equity investments, the same difference is directly recorded in the income statement.
Once a year (or every time that there is evidence of impairment losses), an impairment test is carried out for goodwill. This requires the identification of the cash-generating unit to which goodwill is allocated. The cash generating units of the Intesa Sanpaolo Group correspond to the operating divisions presented in segment reporting. The business operations carried out directly by the Parent Company falls under the Cash-generating units corresponding to Banca dei Territori and Corporate and Investment Banking. Therefore, goodwill is allocated to such divisions.

Derecognition criteria

Intangible assets are derecognised from the balance sheet on disposal or if no future economic benefits are expected.

8. Other assets

Other assets essentially include items awaiting settlement and items that do not relate to other balance sheet items, including receivables arising from the supply of non-financial goods and services, tax items other than those recognised in their own item (for example, related to withholding tax), gold, silver and precious metals and accrued income other than those that should be capitalised on the related financial assets, including those arising from contracts with customers pursuant to IFRS 15, paragraphs 116 et seq. As required by paragraphs 91 et seq. of IFRS 15, costs incurred in the acquisition and performance of long-term customer contracts are capitalised and amortised to the extent that they are incremental and are expected to be recovered.

9. Non-current assets held for sale and discontinued operations and related liabilities
Non-current assets/liabilities for which a disposal process has commenced and for which disposal is deemed to be extremely probable are recorded in assets under Non-current assets held for sale and discontinued operations and in liabilities under Liabilities associated with non-current assets held for sale and discontinued operations. These assets/liabilities are valued at the lower of their book value and their fair value net of disposal costs, with the exception of certain types of assets (e.g. financial assets falling within the scope of application of IFRS 9) for which IFRS 5 specifically provides that the measurement criteria of the relevant accounting standard must be applied.

The income and charges (net of tax) attributable to non-current assets held for sale and discontinued operations or recorded as such in the year are recognised in the income statement in a separate caption.

10. Current and deferred tax
Income tax, calculated according to domestic tax regulations, is accounted for as a cost in compliance with the accruals concept, in line with the method followed to include, in the financial statements, the costs and income that generated it. Therefore, it represents the balance of current and deferred taxation relating to the net result for the period. Current tax assets and liabilities include the tax balances of the Bank due to the relevant Italian and foreign tax authorities. More specifically, these captions include the net balance of current tax liabilities for the year, calculated on the basis of a prudent estimate of the tax charges due for the year, assessed according to the tax regulations currently in force, and the current tax assets represented by advances paid and other tax credits for withholding taxes borne or tax credits of previous years that the Bank claimed against taxes payable in future years. Current tax assets also include tax credits for which the Bank has requested a refund from the relevant tax authorities, as well as amounts paid provisionally in the course of litigation with the tax authorities. The risk inherent in these proceedings - in the same way as the risks inherent in proceedings that did not require provisional payments - is measured using the logic of IAS 37, in relation to the probability of the use of economic resources to fulfil them.

Considering the Group’s adoption of the national fiscal consolidation provisions, tax positions which may be referred to the Bank and those originated by other Group companies are managed separately from an administrative standpoint.
Deferred taxation is calculated according to the balance sheet liability method, taking into account the tax effect of the temporary differences between the book value of the assets and liabilities and their value for taxation purposes, which will determine taxable income or deductible amounts in the future. To this end, “taxable temporary differences” are differences which will give rise to taxable income in future years while “deductible temporary differences” are those which will give rise to deductible amounts in future years.
Deferred tax liabilities are calculated by applying the tax rates currently in force to taxable temporary differences that are likely to generate a tax burden, and to the deductible temporary differences for which it is likely that there will be future taxable amounts at the time when the related tax deductibility occurs (probability test). Deferred tax assets and liabilities related to the same tax and due in the same period are compensated.
If deferred tax assets and liabilities refer to items affecting the Income Statement, the counterbalance is represented by income taxes.
Where deferred tax assets and liabilities relate to transactions that have been recorded in shareholders' equity without affecting earnings (such as adjustments on IAS/IFRS first-time adoption, valuations of financial instruments recognised at fair value through comprehensive income or of cash flow hedge derivative contracts), the balancing entry is made in shareholders' equity, under specific reserves where so provided (e.g. valuation reserves).
No provision is made for reserves subject to taxation only in the event of distribution, since the size of the available reserves which have already been taxed, leads to the belief that the Bank will not undertake any transactions which may cause taxation of the untaxed reserves.
Deferred tax liabilities referred to companies included in the fiscal consolidation are reported in their financial statements, in application of the matching principle and in consideration of the fact that the effects of fiscal consolidation are limited to the settlement of current tax positions.

11. Provisions for risks and charges

Provisions for risks and charges against obligations and guarantees issued
The sub-caption “Provisions for risks and charges” includes the provisions for credit risk recognised for commitments to disburse funds and guarantees issued, which fall within the scope of application of the rules on impairment in accordance with IFRS 9. In principle, the same methods of allocation between the three stages (credit risk stages) and calculation of the expected loss shown with reference to financial assets measured at amortised cost or at fair value through comprehensive income are adopted for these cases.
The aggregate also includes provisions for risks and charges set up to cover other types of obligations and guarantees issued which, by virtue of their specific nature, do not fall within the scope of application of the impairment test pursuant to IFRS 9.

Post employment benefits
Company post employment benefits are based on agreements and qualify as defined benefit plans. Liabilities related to such plans and the relative cost of current service are determined on the basis of actuarial assumptions based on the Projected Unit Credit Method. This method sets out that future obligations are forecast using past time-series analyses and the demographic curve and that such future cash flows are discounted based on a market interest rate. The provisions made in each year of service are considered separately and give rise to an additional unit of benefit entitlement for the purposes of the final obligation. The discount rate used is determined on the basis of the market yields recorded at the valuation dates of bonds of primary companies, taking into account the average residual duration of the liability. The present value of the liability at the reference date of the financial statements is also adjusted by the fair value of any plan assets.

Actuarial gains and losses (i.e. changes in the present value of the obligation arising from changes in actuarial assumptions and adjustments based on past experience) are recognised in the statement of comprehensive income.

Other provisions
Other provisions for risks and charges record provisions related to legal obligations or connected to labour relationships or to litigations, also of a fiscal nature, originating from a past event for which a disbursement will probably arise to settle the obligations, provided that the amount of the disbursement may be estimated reliably.
Consequently, a provision is recognised when, and only when:

- there is a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the reference date of the financial statements and take into account the risks and uncertainties that inevitably surround many events and circumstances. Where time value is significant, provisions are discounted using current market rates. Provisions and increases due to time value are recorded in the income statement.

If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation or when the obligation is settled, the provision should be reversed.

The caption also includes long-term benefits to employees, whose charges are determined with the same actuarial criteria described for post employment benefits. Actuarial profits and losses are all immediately recognised in the income statement.

12. Financial liabilities measured at amortised cost

Classification criteria
Payables due to banks, Payables due to customers and Securities issued include various forms of funding on the interbank market and with customers, repurchase agreements with commitment to repurchase and funding via certificates of deposit, bonds issued and other funding instruments in circulation, net of any amounts repurchased.
It also includes the payables recorded by the Bank in the capacity of lessee under financial lease transactions.

Recognition criteria
Initial recognition of these financial liabilities occurs at the date of subscription of the contract, which normally coincides with the time of collection of the sums deposited or the issue of debt securities.
Initial recognition is based on the fair value of the liabilities, normally equal to the amount collected or the issue price, increased by any additional charges/revenues directly attributable to the single funding or issuing transaction. Internal administrative costs are excluded.

Measurement criteria
After initial recognition, financial liabilities are measured at amortised cost with the effective interest method. An exception is made for short-term liabilities, where time value is immaterial, which are stated at collected amount.

Derecognition criteria
Financial liabilities are derecognised from the balance sheet when they have expired or extinguished. Derecognition also occurs for repurchase of previously-issued bonds. The difference between book value of the liability and amount paid for repurchase is recorded in profit and loss.
Placement of own securities, after their repurchase, is considered a new issue with recognition at the new placement price.

13. Financial liabilities held for trading

Recognition criteria
These financial instruments are recognised at the subscription or issue date at a value which reflects the fair value of the instrument, without taking into account directly attributable transaction costs or revenues.
This category of liabilities includes, in particular, trading derivatives with a negative fair value, as well as embedded derivatives with a negative fair value present in complex contracts - where the primary contract is a financial liability but not strictly related to them. It also includes liabilities determined by short selling generated by securities trading activities.

Measurement criteria
All financial liabilities held for trading are measured at fair value through profit and loss.

Derecognition criteria
Financial liabilities held for trading are derecognised when the contractual rights to the related cash flows expire or when the financial liability is sold with the substantial transfer of all the risks and rewards connected to it.

14. Financial liabilities designated at fair value

Classification criteria
Financial liabilities designated at fair value through profit and loss are recorded under this item, on the basis of the fair value option given to companies by IFRS 9 and in compliance with the cases contemplated in the rules of reference.

Recognition criteria
These liabilities are recognised at fair value as at the date of issue, including the value of any embedded derivatives, net of placement fees paid.

Measurement criteria
These liabilities are measured at fair value and the result is recognised in accordance with the following rules set out in IFRS 9:

- changes in fair value that are attributable to changes in creditworthiness must be recognised in the statement of comprehensive income (shareholders' equity);
- the remaining changes in fair value must be recognised in the Income Statement.

The amounts recognised in the statement of comprehensive income are not subsequently reclassified to profit and loss. This method of accounting does not have to be applied when the recognition of the effects of one’s creditworthiness under shareholders' equity leads to or accentuates an accounting mismatch in profit and loss. In this case, the gains or losses linked to the liability, including those determined as a result of the change in its creditworthiness, must be recorded in profit or loss.

Derecognition criteria
The financial liabilities measured at fair value through profit and loss are derecognised when the contractual rights to the related cash flows expire or when the financial liability is sold with the substantial transfer of all the risks and rewards connected to it.

15. Foreign currency transactions

Initial recognition
Foreign currency transactions are recorded, on initial recognition, in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

Subsequent measurement
At every close of annual or interim financial statements, captions in foreign currency are measured as follows:
- foreign currency monetary items are translated using the closing rate;
- non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction;
- non-monetary items that are measured at fair value in a foreign currency are translated using the closing rates.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements are recognised through profit and loss in the period in which they arise.
When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised through profit and loss, any exchange component of that gain or loss is recognised through profit and loss.

16. Other information

Treasury shares
Any treasury shares held are directly deducted from equity. Similarly, their original cost and the profits or losses deriving from

their subsequent sale are recorded in equity.

Accruals, prepayments and deferrals
Accruals, prepayments and deferrals for the year that include income and charges for the period, matured on assets and liabilities, are shown in the financial statements as an increase or decrease of the assets and liabilities to which they are related.

Leasehold improvements
The costs sustained for restructuring property belonging to third parties are capitalised in consideration of the fact that for the duration of the rental contract the using company has control of the assets and may receive their future economic benefits. These costs, recorded in Other assets as provided for by the instructions of the Bank of Italy, are amortised over a period which must not exceed the duration of the rental contract.

Employee termination indemnities
Employee termination indemnities qualify as a “post employment benefit” classified as:
- a “defined contribution plan” to the extent of the portions accruing from 1 January 2007 (the date the reform of the supplementary pension schemes came into force pursuant to Legislative Decree 252 of 5 December 2005) when the employee opted for the complementary pension scheme or decided to allocate such portions to the INPS (the Italian Social Security Institute) Treasury fund. Therefore, the amounts, recorded under personnel expenses, are determined on the basis of amounts due without the application of actuarial calculation;
- a “defined benefit plan”, therefore recognised in the financial statements on the basis of the actuarial value determined using the "Projected Unit Credit Method" to the extent of the portions accrued until 31 December 2006. These amounts are recognised at their actuarial value determined using the “Projected Unit Credit Method”, without applying the pro-rata of the service rendered. Indeed, the current service cost of employee termination indemnities is almost entirely accrued and its revaluation in the years to come is not expected to generate significant benefits for employees.

For the purposes of discounting, the rate used is the market yield on bonds of primary companies, taking into account the average remaining life of the liability, weighted based on the percentage amount paid and advanced, for each maturity, with respect to the total to be paid and advanced until the expiry of the entire obligation.
Plan service costs are recognised as personnel costs, while actuarial gains and losses are recognised in the statement of comprehensive income

Share-based payments
Share-based payments are recorded in the income statement, with a corresponding increase in shareholders’ equity, on the basis of the fair value of financial instruments attributed at assignment date, dividing the charge over the period set forth by the plan.
In the case of options, the fair value is calculated using a model which considers, in addition to information such as strike price and expiry date of the option, spot price of the shares and their expected volatility, expected dividends and the risk-free interest rate, as well as the specific characteristics of the plan. The pricing model values the option and the probability of realisation of the condition on the basis of which the options have been assigned.
The combination of the two values supplies the fair value of the assigned instrument.
Any decrease in the number of financial instruments granted is accounted for as a cancellation of such instruments.

Employee benefits
Employee benefits are defined as all types of remuneration paid by the company in exchange for the work performed by employees. Employee benefits are divided between:
- short-term benefits (other than employment relationship termination benefits and equity compensation) that are expected to be paid in full within twelve months from the end of the period in which the employees render the service and are recognised in full in profit and loss at the time of vesting (for example, “extraordinary” wages, salaries and benefits fall into this category);
- post-employment benefits due after the end of the employment relationship which oblige the company to make future payments to employees. These include severance indemnities and pension funds, which in turn are divided into defined-contribution plans and defined-benefit plans or company pension funds;
- termination benefits, i.e. those compensation that the company pays to employees as recompense at the termination of the employment relationship, following the company’s decision to terminate the employment relationship before the normal retirement date;
- long-term benefits, other than the previous ones, which are not expected to be fully extinguished within the twelve months following the end of the financial year in which the employees worked.

Recognition of revenues and costs
Revenues are gross flows of economic benefits deriving from the performance of the company’s ordinary business and are recognised when control of the goods or services is transferred to the customer, at an amount that represents the amount of the consideration to which they are considered to be entitled. In particular, revenues are recognised by applying a model that must meet the following criteria:
- identification of the contract, defined as an agreement in which the parties have undertaken to fulfil their respective obligations;
- identification of the individual performance obligations contained in the contract;
- determination of the transaction price, i.e. the expected consideration for the transfer of the goods or services to the customer;

- distribution of the transaction price of each performance obligation, based on the sale prices of the individual obligation;
- recognition of revenues when (or as) the performance obligation is fulfilled by transferring the promised good or service to the customer.

The transaction price represents the amount of consideration to which the entity believes it is entitled in exchange for transferring the promised goods and services to the customer. It may include fixed or variable amounts or both. Revenues from variable fees are recognised in profit and loss if they can be reliably estimated and only if it is highly probable that this fee will not be reversed from profit and loss in future periods in whole or in a significant part. In the event of a strong prevalence of uncertainty factors linked to the nature of the consideration, it will be recognised only when this uncertainty is resolved.

Revenues may be recognised:
- at a specified time, when the entity fulfils its performance obligation by transferring the promised good or service to the customer, or
- over time, as the entity fulfils its performance obligation so by transferring the promised good or service to the customer.

The asset is transferred when, or during the period in which, the customer acquires control of it.

Specifically:
- interest is recognised on accrual on the basis of the contractual interest rate or the effective interest rate in the case of application of amortised cost. Interest income (or interest expense) includes differentials and positive (or negative) margins accrued until the reference date of the financial statements, relating to financial derivatives:
  a) hedging interest-generating assets and liabilities;
  b) classified in the balance sheet in the trading book, though related to financial assets and/or liabilities designated at fair value through profit and loss (fair value option) in management terms;
  c) related in management terms to assets and/or liabilities classified in the trading book and providing for the settlement of differentials or margins with different maturities;
- overdue interest, which may be provided for by the relevant contracts is recorded in the income statement solely at the time of collection;
- dividends are posted in the income statement in the financial year when their distribution is approved;
- commission income from services is recorded, on the basis of the existence of contractual agreements, in the period in which the services have been rendered. Commission income included in the amortised cost for the purposes of determining the effective interest rate are recognised under interest;
- revenues from the sale of financial instruments, determined by the difference between transaction amount paid or received and the fair value of the instrument, are recognised in the Income Statement at the time of the transaction if the fair value is determinable with reference to effective market quotes, or assets and liabilities measured using valuation techniques based on market-observable parameters other than financial instruments quotes (level 1 and 2 of the fair value hierarchy). When such reference parameters are not observable on the market (level 3) or the instruments present a reduced liquidity, the financial instrument is recognised at a value equal to the price of the transaction; the difference with respect to the fair value is recorded in the Income Statement during the life of the transaction;
- profits and losses from securities trading are recognised in the Income Statement at the date of sale, on the basis of the difference between the consideration paid or collected and the carrying value of such instruments;
- revenues from the sale of non-financial assets are recognised when the sale is completed, or when the performance obligation vis-à-vis the customer is fulfilled.

Costs are recognised in the Income Statement on an accruals basis; costs relating to obtaining and fulfilling contracts with customers are recognised in the Income Statement in the periods in which the related revenues are recognised.

Use of estimates and assumptions in preparing financial disclosures

The preparation of financial reports requires the use of estimates and assumptions that may have a significant effect on the amounts stated in the balance sheet and income statement, and on the potential assets and liabilities disclosed in the financial statements. Estimates are based on available information and subjective measurements, often founded on past experience, which are used to formulate reasonable assumptions to be made in measuring operating events. Given their nature, the estimates and assumptions used may vary from year to year, and hence it cannot be excluded that current amounts carried in the financial statements may differ significantly in future financial years as a result of changes in the subjective measurements made.

The main cases for which subjective measurements are required to be made by corporate management include:

- the measurement of impairment losses on loans, investment, and, generally, other financial assets;
- the use of measurement models for determining the fair value of financial instruments not listed on active markets;
- the measurement of the appropriateness of amounts stated for goodwill and other intangible assets;
- quantification of the fair value of the properties and valuable artistic assets;
- the measurement of personnel funds and provisions for risks and charges;
- the estimates and assumptions on the collectability of deferred tax assets;
- the demographic (linked to the estimated mortality of insured people) and financial (deriving from the possible trend in financial markets) assumptions used to structure insurance products and define the basis for calculating integrative reserves.

For some of the cases listed above, the main factors which are the subject of estimates by the Bank and which therefore contribute to determining the carrying value of assets and liabilities can be identified. Without claiming to be exhaustive, it should be noted that:

- for the determination of the fair value of financial instruments not listed on active markets, where it is necessary to use parameters that cannot be inferred from the market, the main estimates concern, on the one hand, the development of future financial flows (or even income flows, in the case of shares), possibly subject to future events and, on the other, the level of certain input parameters not listed on active markets;
- for the allocation of receivables and debt securities classified under Financial assets at amortised cost and Financial assets at fair value through comprehensive income to the three credit risk stages envisaged by IFRS 9 and the calculation of the related expected losses, the main estimates concern:
  - the determination of parameters for a significant increase in credit risk, based essentially on models for measuring the probability of default (PD) at the origination of financial assets and at the balance sheet date;
  - the inclusion of forward looking factors, including macroeconomic factors, for the determination of PD and LGD;
  - the determination of the probability of the sale of impaired financial assets, through the realisation of positions on the market;
- certain elements are taken into consideration in determining the estimates of future cash flows from impaired loans: the expected recovery times, the estimated realisable value of any guarantees and the costs that are expected to be incurred to recover the credit exposure;
- for the determination of the value in use of intangible assets with an indefinite life (brand name and goodwill) with reference to Cash Generating Units (CGUs), the future cash flows in the analytical forecast period and the flows used to determine the terminal value generated by the CGU are estimated separately and discounted appropriately. The cost of capital is included among the elements subject to estimate;
- for the determination of the value in use of intangible assets with a finite life (asset management and insurance portfolios) with reference to the CGUs, the useful life is estimated on the one hand and the future cash flows from the asset on the other. In the case of intangible assets with a finite useful life, the cost of capital is also included in the estimates;
- the determination of the fair value of real estate and of valuable artistic assets is carried out through the preparation of special appraisals by qualified and independent companies. For the preparation of the appraisals relating to the properties, the rental fees, sale prices, discount rates and capitalisation rates were estimated, while for the preparation of the appraisals relating to the valuable artistic assets, the estimate of the value was derived from the pattern of trade in similar works (by technique, size, subject) by the same artist/creator, or of the schools and regional movements closest in style and technique;
- for the quantification of provisions for pensions and similar obligations, the present value of the obligations is estimated, taking into account the flows deriving from historical statistical analyses, suitably discounted, and the demographic curve;
- for the quantification of the provisions for risks and charges, an estimate is made - where possible - of the amount of disbursements necessary to meet the obligations, taking into account the actual probability of having to invest resources;
- for the determination of the items relating to deferred taxation, the probability is estimated of an actual future incurrence of taxes (taxable temporary differences) and the degree of reasonable certainty - if any - of future taxable amounts at the time when the tax deductibility will become apparent (deductible temporary differences).

The criteria for classifying financial assets

The classification of financial assets in the three categories provided for by the standard depends on two criteria, or drivers, of classification: the business model with which the financial instruments are managed (Business Model) and the contractual characteristics of the financial flows of the financial assets (SPPI Test).
The combined provisions of the two drivers mentioned above give rise to the classification of financial assets, as evidenced below:

- Financial assets measured at amortised cost: assets that pass the SPPI test and are part of the “Hold to collect” (HTC) business model;
- Financial assets measured at fair value through other comprehensive income (FVOCI): assets that pass the SPPI test and are part of the “Hold to collect and sell” (HTCS) business model;
- Financial assets measured at fair value through profit and loss (FVTPL): this is a residual category, which includes financial instruments that cannot be classified in the previous categories based on the results of the business model test or the test on the characteristics of the contractual flows (SPPI test not passed).

SPPI tests

In order for a financial asset to be classified at amortised cost or at FVOCI - in addition to the analysis relating to the business model - the contractual terms of the asset itself must provide, on certain dates, for cash flows represented solely by payments of principal and interest on the amount of capital to be repaid (“*solely payment of principal and interest*” - SPPI). This analysis must be carried out, in particular, for loans and debt securities.
The SPPI test must be carried out on each individual financial instrument at the time of recognition in the financial statements. After initial recognition, and as long as it is recognised in the financial statements, the asset is no longer subject to new measurements for the purposes of the SPPI test. If a financial instrument is derecognised and a new financial asset is recognised, the SPPI test must be carried out on the new asset.
For the purposes of applying the SPPI test, IFRS 9 provides the following definitions:

- Capital: the fair value of the financial asset at the time of initial recognition. This value may change over the life of the financial instrument, for example as a result of repayments of part of the principal;
- Interest: the consideration for the time value of money and for the credit risk associated with the capital outstanding in a particular period of time. It may also include remuneration for other basic risks and costs associated with lending and a profit margin.

In assessing whether the contractual flows of a financial asset can be defined as SPPI, IFRS 9 refers to the general concept of a “*basic lending arrangement*”, which is independent of the legal form of the asset. When contractual clauses introduce exposure to risks or volatility of contractual cash flows that are inconsistent with the definition of *basic lending arrangements*, such as exposure to changes in share or commodity prices, the contractual flows do not meet the definition of *SPPI.* The application of the classification driver based on contractual cash flows sometimes requires subjective judgment and, therefore, the definition of internal application policies.

In cases where the time value of money is modified (“*modified time value of money*”*)* - for example, when the interest rate of the financial asset is periodically restated, but the frequency of the restatement or the frequency of coupon payments do not reflect the nature of the interest rate (for example, the interest rate is restated monthly on the basis of a one-year rate) or when the interest rate is periodically restated on the basis of an average of particular short or medium/long-term rates - the enterprise must assess, using both quantitative and qualitative elements, whether the contractual flows of money respond to the definition of SPPI (or benchmark cash flows test). If the test shows that the contractual cash flows (not discounted) are “significantly different” from the cash flows (also not discounted) of a *benchmark instrument (*i.e. without the modified time value element*)*, the contractual cash flows cannot be considered as meeting the definition of SPPI.
Special analyses (the so-called “*look through tests*”) are required by the standard and are therefore also carried out for multiple *contractually-linked instruments* (“CLIs”) that create concentrations of credit risk for the settlement of debt and for *non-recourse assets*, for example in cases where the credit can only be claimed in relation to certain assets of the debtor or the financial flows deriving from certain assets.

The presence of contractual clauses that can change the frequency or amount of contractual cash flows must also be considered to assess whether these flows meet the requirements to be considered as SPPI (e.g. prepayment options, possibility of deferring contractual cash flows, instruments with embedded derivatives, subordinated instruments, etc.).

However, as required by IFRS 9, a feature of the contractual cash flows does not affect the classification of the financial asset if it can only have a *de minimis* effect on the contractual cash flows of the financial asset (in each period and cumulatively). Similarly, if a cash flow feature is *unrealistic (not genuine),* or if it affects the contractual cash flows of the instrument only upon the occurrence of an extremely rare, very unusual and very unlikely event, it does not affect the classification of the financial asset.

In order to carry out the SPPI test, the Intesa Sanpaolo Group uses the services provided by well-known info-providers for debt securities transactions. This choice, on the one hand, allows front office operators operating in securities to have an immediate outcome for the test, allowing a streamlining of practices during the purchase, and on the other hand allows them to take advantage of market settings shared by multiple operators and audit firms. Only if the securities are not managed by the info-providers, the test is carried out manually using a proprietary tool based on a methodology developed internally (decision trees).

Conversely, a proprietary tool based on an internally developed methodology (decision trees) has been developed for the SPPI test in the context of the credit granting processes. In particular, given the significant differences in characteristics, differentiated management is envisaged for products that can be traced back to a contractual standard (typically retail loan portfolio) and tailor-made loans (typically corporate loan portfolio).
For standard products, the SPPI test is carried out during the structuring of the contractual standard, through the "New Product Coordination" process and the outcome of the test is extended to all the individual reports relating to the same product in the catalogue. On the other hand, for tailor-made products, the SPPI test is carried out for each new credit line/report submitted to the decision-making body through the use of the proprietary tool.

The decision trees - included in the proprietary tool - have been prepared internally (for both debt securities and loans) and capture the possible non-SPPI compliant characteristics. They take into account the indications provided by IFRS 9, as well as the interpretations of the standard defined by the Intesa Sanpaolo Group. Trees are used both for the implementation of the rules of the proprietary tool and for the verification and validation of the methodology adopted by the info-providers.

Business model
As far as the business model is concerned, IFRS 9 identifies three cases in relation to the way in which cash flows and sales of financial assets are managed:
- *Hold to Collect (HTC):* this is a business model whose objective is achieved by collecting the contractual cash flows of the financial assets included in the portfolios associated with it. The inclusion of a portfolio of financial assets in this business model does not necessarily mean that it is impossible to sell the instruments, even if it is necessary to consider the frequency, value and timing of sales in previous years, the reasons for sales and expectations regarding future sales;
- *Hold to Collect and Sell (HTCS):* this is a mixed business model, whose objective is achieved through the collection of contractual cash flows from financial assets in the portfolio and (also) through a sales activity that is an integral part of the strategy. Both activities (collection of contractual flows and sale) are indispensable for the achievement of the objective of the business model. Therefore, sales are more frequent and significant than an HTC business model and are an integral part of the strategies pursued;
- *Others/Trading:* this is a residual category that includes both financial assets held for trading and financial assets managed with a business model that cannot be traced back to the previous categories (Hold to Collect and Hold to Collect and Sell). In general, this classification applies to a portfolio of financial assets whose management and performance are measured at fair value.

The business model reflects the way in which financial assets are managed to generate cash flows for the benefit of the entity and is defined by top management through the appropriate involvement of business structures. It is observed considering the way in which financial assets are managed and, as a consequence, the extent to which the portfolio's cash flows derive from the collection of contractual flows, from the sale of financial assets or from both of these assets. The measurement is not made on the basis of scenarios which, according to reasonable forecasts of the entity, are not likely to occur, such as the so-called worst case or stress case scenarios. For example, if the entity expects to sell a particular portfolio of financial assets only in a stress case scenario, that scenario does not affect the measurement of the entity's business model for those assets if that scenario, based on the entity's reasonable expectations, is not expected to occur.

The business model does not depend on the intentions that management has with reference to a single financial instrument, but refers to the way in which groups of financial assets are managed in order to achieve a specific business objective.

In summary, the business model:
- reflects the way in which financial assets are managed to generate cash flows;
- is defined by top management, through the appropriate involvement of business units;
- must be observable in view of the way in which financial assets are managed.

In operational terms, the assessment of the business model is carried out in accordance with the company organisation, the specialisation of the business functions, the risk cascading model and the assignment of delegated powers (limits). In carrying out the assessment of the business model, all relevant factors available at the date of the assessment are used. The evidence referred to above includes strategy, risks and their management, remuneration policies, reporting and sales figures. In the analysis of the business model, it is essential that the elements investigated show coherence between them and in particular are consistent with the strategy pursued. The evidence of assets not in line with the strategy must be analysed and adequately justified.

In this regard and in relation to the management purposes for which the financial assets are held, it is evidenced that a specific document of Rules regarding the business model - approved by the competent levels of governance - defines and sets out the elements constituting the business model in relation to the financial assets included in the portfolios managed in the performance of operations on the business structures for the Intesa Sanpaolo Group.

For the Hold to Collect portfolios, the Intesa Sanpaolo Group has defined the thresholds for the admissibility of sales that do not affect the classification (frequent but not significant, individually and in aggregate, or infrequent even if of significant amount) and, at the same time, the parameters have been established to identify sales consistent with this business model as they are attributable to an increase in credit risk.
More specifically, under an HTC business model sales are allowed:

- in the event of an increase in credit risk, which occurs:
  - for securities, when there is a downgrade of predetermined notches with respect to the origination rating. The approach adopted foresees that the number of notches is differentiated according to the origination rating, in line with the methodology in use for the identification of “significant deterioration”, i.e. for the staging transition;
  - for loans, if they are assignments of impaired loans or loans classified as stage 2;
- when they are frequent but not significant in terms of value or occasional even if significant in terms of value. In order to determine these aspects, frequency and significance thresholds have been defined:
  - frequency is defined as the percentage ratio between the number of positions sold (ISINs or ratios) during the observation period and the total number of positions in the portfolio during the observation period;
  - significance is defined as the percentage ratio of the nominal value of sales to the total nominal value of the instruments in the portfolio over the period considered.

Where both frequency and significance thresholds are exceeded at the same time, an additional assessment is required to confirm the consistency of the HTC business model (e.g. to assess whether sales are made close to maturity).
With reference to the determination of “Risks” and “Reporting” on HTCS and Trading business models, the provisions of the RAF and Market Risk Charter apply in principle when controlling market risks and governance measures are defined for monitoring the limits of portfolios classified with HTCS and Other/Trading business models.

Amortised cost measurement
The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition net of any principal repayments, plus or minus cumulative amortisation, calculated using the effective interest rate method, of any difference between initial amount and amount at maturity and net of any reduction for impairment.

The effective interest rate is the rate that exactly discounts future cash payments or receipts through the expected life of the financial instrument or through the subsequent date for recalculation of the price to the net carrying amount of the financial asset or financial liability. In the calculation of the present value, the effective interest rate is applied to the flow of future cash receipts or payments through the entire useful life of the financial asset or liability or for a shorter period when certain conditions recur (for example review of market interest rates).

After initial recognition, amortised cost enables allocation of revenues and costs directly by decreasing or increasing the value of the instrument over its entire expected life via the amortisation process. The determination of amortised cost varies depending on the fact that financial assets/liabilities have fixed or variable rates and – in this last case – if the volatility of the rate is known or not beforehand. For instruments with fixed rate or fixed rate by time bands, future cash flows are quantified on the basis of the known interest rate (sole or variable) over the life of the loan. For financial assets/liabilities with a variable rate, for which the volatility is not known beforehand (for example because it is linked to an index), the determination of cash flows is carried out based on the last rate available. At every revision of the interest rate the amortisation plan and the effective interest rate for the entire life of the investment, that is, until maturity, are recalculated. Any changes are recorded in the income statement as income or loss.

Amortised cost measurement is carried out for financial assets measured at amortised cost and for those measured at fair value with an impact on comprehensive income, as well as for financial liabilities measured at amortised cost.

Financial assets and liabilities traded at market conditions are initially recognised at fair value, which normally corresponds to the amount disbursed or paid including, for instruments measured at amortised cost, transaction costs and any directly attributable fees.

Transaction costs include internal or external marginal costs and income attributable to the issue, the acquisition or the disposal of a financial instrument which are not debited to the client. These commissions, which must be directly attributable to the single financial asset or liability, modify the original effective interest rate, and therefore the effective interest rate associated to the transaction differs from contractual interest rate. Transaction costs do not include costs/income referred to more than one transaction and the components related to events which may occur during the life of the financial instrument, but which are not certain at the time of the initial agreement, such as for example: commissions for retrocession, for non-use, for advance termination. Furthermore, amortised cost does not include costs which would be sustained independently from the transaction (e.g. administrative and communication costs, stationery expenses), those, which though directly attributable to the transaction are part of standard practice for the management of the financing (e.g. activities related to the loan granting process), as well as commissions of services received following structured finance activities which would in any case have been received independently from the subsequent financing of the transaction (e.g. commissions for facility and arrangement).
With particular reference to loans, the following are considered costs attributable to the financial instrument: commissions paid to the distribution channels, fees paid for consultancy/assistance for the organisation and/or participation in syndicated loans and, finally, up-front commissions related to loans granted at rates above market rates; while the revenues considered in the

calculation of the amortised cost are up-front commissions related to loans granted at rates lower than market rates, participation in syndicated transactions and brokerage commissions linked to commissions paid by brokerage companies.
For securities not measured at fair value through profit or loss, the following are considered transaction costs: commissions on contracts with brokers operating on the Italian stock exchange, commissions paid to dealers operating on the Italian and foreign stock and bond markets defined on the basis of the commission tables. Stamp duty is not considered in amortised cost since it is immaterial.
Regarding securities issued, amortised cost considers placement commissions on bond issues paid to third parties, amounts paid to stock exchanges and remuneration paid to Independent auditors for the activities performed for each single issue, while amortised cost does not consider commissions paid to rating agencies, legal and advisory/audit expenses for the annual update of prospectuses, the costs for the use of indexes and commissions which originate during the life of the bond issue.

Amortised cost is also applied for the measurement of loss incurred by the financial instruments listed above as well as for the measurement of instruments issued or purchased at a value other than their fair value. The latter are measured at fair value, instead of the amount collected or paid, by discounting expected future cash flows at a rate equal to the effective interest rate of similar instruments (in terms of credit rating, contractual expiry, currency, etc.), with the simultaneous registration in the income statement of a financial charge or income; after initial recognition, these are measured at amortised cost with the evidencing of higher or lower effective interest with respect to nominal interest. Lastly, also structured liabilities which are not measured at fair value through profit and loss as the embedded derivative has been separated from the financial instrument are measured at amortised cost.

As indicated by IFRS 9, in some cases, a financial asset is considered impaired at the time of initial recognition because the credit risk is very high and, in the case of purchase, is purchased with large discounts (compared to the initial disbursement value). If the financial assets in question, based on the application of the classification drivers (i.e. SPPI test and Business model), are classified as assets valued at amortised cost or fair value through comprehensive income, they are classified as "Purchased or Originated Credit Impaired Assets" (in short "POCI") and are subject to special treatment with regard to the impairment process. In addition, on financial assets classified as POCI, a credit-adjusted effective interest rate is calculated at the date of initial recognition, for which it is necessary to include the expected initial losses in the estimates of financial flows. For the application of the amortised cost, and the consequent calculation of the interest, the effective interest rate corrected for the loan is applied.

The amortised cost measurement criteria is not applied to financial assets/liabilities hedged for which fair value changes related to the risk hedged are recorded through profit and loss. The financial instrument is again measured at amortised cost in the case of hedge termination; from that moment the fair value changes recorded before are amortised, calculating a new effective interest rate which considers the value of the loan adjusted by the fair value of the hedged part, until the natural expiry of the hedge. Moreover, as already mentioned in the paragraphs relating to financial assets and liabilities valued at amortised cost, the measurement at amortised cost does not apply to financial assets/liabilities whose short duration makes the economic effect of discounting negligible, nor to receivables without a defined maturity or for revoked receivables.

Impairment of assets

Impairment of financial assets

At each balance sheet date, in accordance with IFRS 9, financial assets other than those measured at fair value through profit or loss are subject to an assessment to determine whether there is any evidence that the carrying value of the assets may not be fully recoverable. A similar analysis is also carried out for commitments to disburse funds and guarantees issued that fall within the scope of impairment pursuant to IFRS 9.
In the event that such evidence exists (so-called "impairment evidence"), the financial assets in question - consistently, where existing, with all the remaining assets pertaining to the same counterparty - are considered impaired and are included in stage 3. These exposures, represented by financial assets classified - in accordance with the provisions of Bank of Italy Circular no. 262/2005 - in the categories of non-performing loans, probable default and exposures past due by more than ninety days, must be subject to value adjustments equal to the expected losses relating to their entire residual life.

Impairment of performing financial assets

For financial assets for which there is no evidence of impairment (non-impaired financial instruments), it is necessary, instead, to verify whether there are indicators such that the credit risk of the individual transaction is significantly increased compared to the time of initial recognition. The consequences of this verification, from the point of view of classification (or, more properly, staging) and measurement, are as follows:

- where such indicators exist, the financial asset is included in stage 2. In this case, the measurement, in accordance with the international accounting standards and even in the absence of a manifest loss of value, provides for the recognition of value adjustments equal to the expected losses over the entire residual life of the financial instrument. These adjustments are subject to review at each subsequent reporting date both to periodically check their consistency with the constantly updated loss estimates, and to take into account - in the event of indicators of a "significantly increased" credit risk are no longer available - the changed forecast period for calculating the expected loss.
- Where these indicators do not exist, the financial asset is included in stage 1. In this case, the measurement, in accordance with the international accounting standards and even in the absence of a manifest impairment, provides for the recognition of expected losses, for the specific financial instrument, over the following twelve months. These adjustments are subject to review at each subsequent balance sheet date both to periodically check their consistency with the constantly updated loss estimates, and to take into account - in the event of indicators of a "significantly increased" credit risk - the changed forecast period for calculating the expected loss.

With regard to the measurement of financial assets and, in particular, the identification of the "significant increase" in credit risk (a necessary and sufficient condition for the classification of the asset being valued in stage 2), the elements that - pursuant to the principle and its operating application carried out by the Intesa Sanpaolo Group - constitute the main determinants to be taken into consideration are as follows:

- the change in the probability of lifetime default compared to the time of initial recognition of the financial instrument in the financial statements. It is, therefore, a measurement carried out by adopting a "relative" criterion, which is configured as the main "driver";
- the possible presence of an overdue one that - without prejudice to the thresholds of significance identified by the regulations - is such as to be at least 30 days old. In this case, in other words, the credit risk of the exposure is presumed to be "significantly increased" and, therefore, the "transition" in stage 2 follows (if the exposure was previously included in stage 1);
- the possible presence of forbearance measures, which - again on a presumption basis - entail the classification of exposures among those whose credit risk is "significantly increased" with respect to initial recognition.

By focusing on the main of the above triggers (the change in the probability of default lifetime), the significant increase in credit risk ("SICR") is determined by comparing the relative change in the lifetime Probability of Default recorded between the date of first recognition of the report and the date of observation (Delta PD Lifetime) with predetermined thresholds of significance. The assignment of a Lifetime PD to individual reports is carried out by attribution to the master scale of the ratings for each segment both at the date of first recognition and at the observation. Ratings are determined on the basis of internal models, where available, or management models. In the absence of a rating, the PD Benchmarks on the type of rated counterparty are assigned.

This "relative" change in PD is an indicator of the increase or decrease in credit risk during the reference period. In order to determine whether, in accordance with IFRS 9, any increase in credit risk can be considered "significant" (and therefore involve the transition between stages), it is necessary to define specific thresholds. Lifetime PD increases below these thresholds are not considered significant and, as a result, do not involve the transfer of individual lines of credit/debt tranches from stage 1 to stage 2; such a shift is, instead, necessary in the presence of relative increases in PD above the thresholds in question. The thresholds used were estimated on the basis of a process of simulations and optimisation of predictive performance, developed using historical granular portfolio data. Specific thresholds are defined for Corporate, Retail, Large Corporate and SME Retail models and extended for methodological affinity to other models. The thresholds are differentiated by residual maturity, annual granularity and rating class.

The determination of the thresholds has been calibrated in order to find a correct balance between the performance indicators relating to the capacity of the thresholds themselves:

- intercept stage 2 positions before their transition to default;
- identify the positions for which the return to stage 1 is synonymous with an effective improvement in creditworthiness.

Some special considerations apply to the so-called "staging" of securities. Unlike loans, in fact, for this type of exposure, buying and selling operations subsequent to the first purchase (carried out with reference to the same ISIN) can usually fall within the ordinary activity of managing positions (with the consequent need to identify a methodology to be adopted for the identification of sales and repayments in order to determine the residual quantities of individual transactions to which to associate a credit quality/rating to the origination to be compared with that of the reporting date). In this context, it was considered that the use of the "first-in-first-out" or "FIFO" method (for the reversal to profit and loss of the recorded ECL, in the event of sales and refunds) contributes to a more transparent management of the portfolio, also from the point of view of front office operators, allowing, at the same time, a continuous updating of the creditworthiness assessment on the basis of new purchases.

Once the allocation of exposures to the various stages of credit risk has been defined, the determination of expected losses (ECL) is carried out, at the level of individual transactions or tranches of securities, starting from the IRB/management model, based on the probability of default (PD), loss given default (LGD) and exposure at default (EAD) parameters, on which appropriate corrective action is taken to ensure compliance with the specific requirements of IFRS 9.

The following definitions apply to PD, LGD and EAD:
- PD (Probability of Default): probability of migrating from performing to impaired credit status within a one-year time horizon. In models consistent with supervisory requirements, the PD factor is typically quantified through the rating. In the Intesa Sanpaolo Group, PD values derive from internal rating models, where available, supplemented by external evaluations or average segment/portfolio data;
- LGD (Loss Given Default): percentage of loss in case of default. In models that are consistent with supervisory requirements, it is quantified through the historical experience of recoveries discounted to present value on practices that have been subject to impaired lending;
- EAD (Exposure At Default) or credit equivalent: the amount of the exposure at the time of default.

As evidenced above, in order to comply with IFRS 9, it was necessary to make specific adjustments to these factors, of which we would point out in particular:
- the adoption of a Point in Time (PIT) PD against the Through the Cycle (TTC) PD used for the purposes of Basel;
- the removal from LGD of some additional components, such as indirect costs (non-recurring costs) and additional conservative margins specifically introduced for regulatory models, as well as the component related to the adverse economic cycle (or the downturn);
- the use of PDs and, where necessary, multi-period LGDs to determine the expected loss for the entire remaining life of the financial instrument (stages 2 and 3);
- the use, as part of the process of discounting expected future cash flows, of the effective interest rate of the individual transaction, unlike the provisions of the regulatory models, in which the discount of individual cash flows takes place using the discount rates determined in accordance with prudential regulations.

In relation to multi-period EAD, in line with the provisions of IFRS 9, the Intesa Sanpaolo Group refers to plans at amortised cost for both loans and debt securities, regardless of the related measurement methods (amortised cost or fair value with an impact on comprehensive income). For commitments to disburse funds (margins), the EAD is instead assumed to be the weighted nominal value for a specific Credit Conversion Factor (CCF).

The measurement of financial assets also reflects the best estimate of the effects of future conditions, especially economic conditions, on the basis of which forward looking PD and LGD are conditioned. In the context of IFRS 9, also on the basis of the indications of the international Regulators, information on future macroeconomic scenarios in which the Bank may find itself operating and which clearly influence the situation of debtors with reference both to the “riskiness” of migration of exposures to lower quality classes (therefore concerning the “staging”) and to recoverable amounts (therefore concerning the determination of the expected loss on exposures) are of particular importance. 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 different alternatives considered, the approach that the Intesa Sanpaolo Group has decided to adopt is represented by 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 corrected with an Add-On aimed at including any differences with respect to worst-case and improvement scenarios. If the overall impact of the Add-On is positive on the risk parameters, the effect of the Add-On has been sterilised for both staging and ECL calculation purposes. The macroeconomic scenario is determined by the Bank’s Internal Research Department by means of forecasting models that are then shared with the market to determine consensus. Alternative improvement and worsening scenarios are determined by stressing variables in input to forecasting models.

This methodology - in a nutshell - provides, therefore, that:

- each exposure (credit line/security tranche) is classified into a single stage;
- both the stage assignment and the calculation of the ECL are defined by considering a single forecast macroeconomic reference scenario (the one considered the most likely and used for other purposes within the Intesa Sanpaolo Group, such as, as already mentioned, the preparation of the budget and the business plan). The risk parameters of the scenario are corrected by means of a special “add-on” that takes into account the presence of non-linear effects in the relationship between the risk parameters themselves and the macroeconomic variables. In fact, in reality, there is rarely a direct correlation between the macroeconomic forecasting trends implicit in the scenario used, on the one hand, and the magnitude of credit losses, on the other, and, consequently, the effects of the only scenario identified must be “corrected” by a specific factor (“add-on”), modelled separately. The add-on in question is defined by referring to alternative paths (worst case and improvement scenarios) to the baseline scenario, identified on the basis of reference variables, such as, for example, average annual GDP growth rates of certain countries (Italy, the United States, Germany, France, Spain and the United Kingdom), European and United States stock exchange indices and residential real estate prices in the United States and Italy.

Impairment of non-performing financial assets

Impaired loans classified as non-performing are subject to the following measurement methods:

- analytical-statistical measurement, which is adopted for exposures of less than €2 million and is based on the application of specific LGD grids, plus an add-on to take account of forward looking information, particularly that relating to the impact of future macroeconomic scenarios;
- analytical-specific measurement, which is adopted for customers with exposures of more than €2 million and is based on the percentage write-downs attributed by the manager, following specific analysis and measurement processes, plus an Add-On component in order to take account of forward looking information, in particular that relating to the impact of future macroeconomic scenarios (with the exception of non-performing loans with mortgage guarantees, for which the impact of future scenarios is included by means of the methods for determining the haircuts to the value of the properties under guarantee).

Irrespective of the division of these exposures between those subject to analytical-statistical measurement and those subject to analytical-specific evaluation (as identified above), the Add-Ons provided for include the sale scenarios for assignable non-performing loans when the business plan provides for the assignment of non-performing loans and these transactions are still to be carried out. The measurement of assignable non-performing loans considers the possibility of also realising these receivables through sale.

The measurement of likely defaults (Unlikely to Pay - UTP) is also carried out on the basis of different approaches:

- analytical-statistical measurement, for cash exposures below €2 million, based on the application of specific LGD statistical grids plus an Add-On in order to take account of the impacts of future macroeconomic scenarios;
- analytical-specific measurement for cash exposures of more than €2 million, based on the depreciation percentages attributed by the manager, plus an Add-On component to take account, also in this case, of the impact of future macroeconomic scenarios.

Irrespective of the division of these exposures between those subject to analytical-statistical measurement and those subject to analytical-specific measurement (as identified above), the Add-Ons provided for include the sale scenarios for assignable UTPs when the business plan provides for the assignment of UTPs and these transactions are still to be carried out. The measurement of UTPs considers the possibility of also realising these receivables through sale.

Impaired loans classified as past due and/or in excess of limits are, on the other hand, subject to analytical measurement on a statistical basis, regardless of the amount of cash exposure. Again, however, the adjustment defined on the basis of the LGD statistical grids is supplemented to take account of the Add-On component attributable to the effect of future macroeconomic scenarios.

The following is a brief description of how the analytical-specific and analytical-statistical measurement is carried out:

- the analytical-specific measurement for non-performing loans and probable defaults exceeding €2 million is an assessment made by managers of individual positions based on a qualitative and quantitative analysis of the economic and financial situation of the debtor, the riskiness of the credit ratio, any mitigating factors (guarantees) and taking into account the financial effect of the time estimated as necessary for recovery.

  In particular, for non-performing loans, a series of elements, differently present depending on the characteristics of the positions, and to be assessed with the utmost care and prudence, are of importance, among which are merely examples:
  - the nature of the loan, whether privileged or unsecured;
  - net assets of obligated/third-party collateral providers;
  - the complexity of the current or potential litigation and/or the underlying legal issues;
  - exposure of obligors to the banking system and other creditors;
  - last financial statements deposited;
  - the legal status of the persons liable for payment and the pending insolvency and/or individual proceedings.

  In order to determine the estimated recoverable value of receivables secured by real estate, in order to take into account both the historical series of recoveries and forward-looking considerations in accordance with IFRS 9, an approach has been defined that focuses on the measurement of real estate with a logic based on the average expected auction and the relative reduction in the price observed, determining average haircuts differentiated by type of property guarantee (residential, commercial, industrial and land). For non-performing mortgage loans in an analytical-specific measurement, therefore, an add-on from the macroeconomic scenario is not applied, in order to avoid redundancies, as the forward looking component is already taken into account through the haircut.

  With reference to probable defaults, the measurement is based on a qualitative and quantitative analysis of the debtor's economic, financial and asset situation and on a precise verification of the risk situation.

  The determination of the impairment loss presupposes the evaluation of the future cash flows that the debtor is believed to be able to produce and that will also be used to service the financial debt. This estimate should be made on the basis of two alternative approaches:
  - "Going Concern Approach" scenario: the operating cash flows of the debtor (or the effective guarantor) continue to be produced and are used to repay the financial debts contracted. The assumption of continuity does not exclude the possible realisation of guarantees, but only to the extent that this can be done without compromising the debtor's ability to generate future cash flows. The going concern method is also applied to cases in which the recoverability of the exposure is based on the possible disposal of assets by the debtor or on extraordinary transactions;

  - o the "Gone Concern Approach" scenario: applicable in cases where the debtor's cash flows are considered to be expected to disappear. This is a scenario whose application could possibly concern positions for which the classification as non-performing is foreseen. In this context, assuming that shareholder interventions and/or extraordinary debt restructuring operations in turnaround contexts are not reasonably practicable, recovery of the receivable is essentially based on the value of the guarantees that assist the Bank's credit and, alternatively, on the realisable value of the assets, taking into account the insolvency assets and any causes of pre-emption;

- the analytical-statistical measurement, carried out for non-performing loans and probable defaults of less than €2 million and for past due loans and/or overruns, presents specific features depending on the type of exposure involved.
  With reference to non-performing loans, the analytical-statistical measurement is based on the Non-Performing LGD grids, where the LGD Defaulted Asset model is characterised mainly by the differentiation of loss rates based, in addition to the regulatory segment, on the permanence in the state of risk ("vintage") and on the possible activation of judicial recovery procedures. The grids are also differentiated for the other axes of significant analysis when estimating the model (e.g. technical form, type of guarantee, geographical area, exposure range, etc.). The recovery time grids are broken down mainly by regulatory segment and by further axes of analysis that are significant during modelling (e.g. recovery procedures, exposure band, technical form).
  With regard to probable defaults, the measurement is performed by applying statistical LGD grids specifically estimated for positions classified as Probable Defaults, in line with the estimated LGD grids for non-performing loans. The model for estimating the LGD grid for Probable Defaults is in fact similar to that described above for non-performing loans and calculates the expected loss rate of the ratio being measured according to its characteristics. The LGD for Probable Defaults is obtained by recalibrating the non-performing LGD using the Danger Rate module. The Danger Rate is a multiplying correction factor, aimed at recalibrating the non-performing LGD with the information available on other default events, in order to produce an LGD that is representative of all the possible default events and their evolution.
  Moreover, for the two subclasses of the risk status "Probable Defaults" ("Probable Non-Forborne Defaults" and "Probable Forborne Defaults"), different grids are estimated to take into appropriate consideration the characteristics of the Forborne receivables, which, in addition to having lower average loss levels due to the effect of the "Forbearance Measures", are also affected by the regulatory constraints that prevent them from performing again prior to 12 months from the date of the successful renegotiation.
  With reference to past due receivables and/or overruns, the methods for determining the grids are similar to those described for Probable Defaults (Framework Danger Rate). In this case, the vintage factor is taken from the introduction of a differentiation based on the past due duration (past due at 90 days/180 days), which determines a significant change in the loss rates of the grids, which are also broken down, in a differentiated manner, by regulatory segment and by additional axes of analysis (e.g. technical form, type of guarantee, geographical area, exposure range, etc.) common to the other categories of impaired loans.

With regard to the inclusion of forward looking information, it should be noted that, also in relation to impaired exposures, in addition to a component linked to current economic conditions, a component linked to the most-likely and worst case scenarios envisaged in the time horizon of the following three years was considered, according to the criteria already described. As required by IFRS 9, it is also necessary to consider the effects of the forward looking scenario with respect to LGD estimates anchored to current conditions through the above mentioned component. As already mentioned, the forward looking scenario component aims at capturing the non-linearity of the relationship between macroeconomic variables and the measurement of ECL, through the analysis of the forecast uncertainty of the variables used for the preparation of the most-likely scenario. It is based on the same methodological framework used for performing loans, but ignores the improvement scenario from a prudential point of view, considering only the average worst-case and most-likely scenarios over the next three years.

Turning to the alternative recovery scenarios, it is evidenced that the Intesa Sanpaolo Group, in relation to the objectives of reducing the stock of non-performing loans in place, included in the business plans, and the commitments undertaken with the Supervisory Authorities, with specific reference to the so-called NPL Strategy, considers the sale of certain portfolios as the strategy that can, under certain conditions, maximise the recovery of cash flows, also in consideration of the recovery times.
In particular, the ECB, with the "NPL Guidance" published in March 2017, requested banks with an above-average incidence of impaired loans from European banks to define a strategy aimed at achieving a progressive reduction of loans. In 2017, the Intesa Sanpaolo Group submitted a plan to the ECB to reduce impaired loans, mainly focused on recovery activities through internal management, which foresaw the achievement of an NPL ratio of 10.5% at the end of 2019.
In the last part of 2017 - in the light of regulatory developments, with the publication in October of the draft Addendum to the "NPL Guidance" aimed at determining minimum levels of prudential provisions for impaired loans, and of the indications provided by the Supervisory Authority to banks with above-average impaired exposures regarding the need to proceed more effectively with the reduction of non-performing loans - the Intesa Sanpaolo Group, as part of the preparation of the 2018-2021 Business Plan, approved by the Board of Directors on 6 February 2018, has identified a significant de-risking as one of its priorities, with the aim of bringing the Group - in 2021 - to reduce the incidence of gross impaired loans to around 6% of the loan portfolio. To this end, a new "NPL Plan" has been prepared, sent to the ECB, which provides for the strengthening of activities aimed at recovering positions internally and the transfer of a significant portfolio of non-performing loans.

Consequently, the "ordinary" scenario, which envisages a recovery strategy based on the collection of the receivable typically through legal actions, sent to recovery companies, and the realisation of mortgage guarantees, was accompanied - as a recovery strategy and within the limits of the sale amounts set out in the said "NPL Plan" - by the sale of the receivable itself. In the light of this, and until the proposed sales transactions are carried out, for a defined perimeter of non-performing loans with the characteristics of assignability, in order to determine the overall expected loss of the exposures, the recoverable values based on the ordinary internal recovery process and the amounts recoverable from the sale, estimated on the basis of market measurements carried out by an external expert, are weighted according to the share of the portfolio destined for sale, as envisaged by the NPL strategy, with respect to the total of the assignable portfolio.
In this context, the perimeter of assignable non-performing loans is identified within the positions managed by the applicable structures of the Chief Lending Officer, taking into account the following exclusion criteria:

- positions in relation to which disputes or controversies are in progress (situations in which the debtor has taken legal action against the bank to contest the reasons for the loan or its classification as non-performing);
- positions guaranteed by Credit Consortia, as it is costly to identify in a precise manner the guarantees that assist the individual credit lines;
- positions disbursed to companies resident abroad, in consideration of the operational complexities deriving from the regulatory and operational differences with respect to the jurisdictions in which the debtors are located;
- securitised positions, since the securitisation structure needs to be dismantled, involving the various stakeholders;
- positions towards entities other than normal households and production companies (e.g. not-for-profit bodies);
- pooled loans, to avoid the involvement of third parties in the transfer process, and positions with third-party funds or special facilities such as to make the transfer process operationally burdensome.

In particular, the recoverable value of assignable non-performing loans is quantified as the average of (i) the "value in the event of assignment" (fair value) and (ii) the "value in the event of collection", assuming as weighting amounts, respectively, the percentage of assignable loans that management expects to sell and the percentage that it expects to keep in its portfolio. It should be noted that the "value in the event of collection" was determined according to the ordinary logic followed by the Intesa Sanpaolo Group for the impairment of non-performing loans, i.e. on the basis of an analytical measurement for exposures above a defined threshold (equal to €2 million) and on the basis of an analytical-statistical measurement for the others. The analytical-statistical measurement of "sub-threshold" exposures envisages grouping them into homogeneous clusters by credit risk. As explained above, it should be noted that the measurement of the value in the event of a sale was carried out by an external expert.

As already mentioned, it should also be noted that the financial assets purchased or originated already impaired (POCI) have particular characteristics with regard to impairment. In this regard, value adjustments equal to the lifetime ECL must be recorded for the instruments in question from the date of initial recognition and for their entire life. At each subsequent balance sheet date, the amount of the lifetime ECL must therefore be adjusted, recording in profit and loss the amount of any change in expected losses over the life of the loan as a gain or loss due to impairment. In the light of the above, the POCI financial assets are initially entered in stage 3, without prejudice to the possibility of being subsequently moved to performing loans, on which, however, an expected loss equal to the lifetime ECL will continue to be recorded.

Finally, with regard to impaired loans, it should be noted that the Intesa Sanpaolo Group has recourse to the removal/deletion of uncollectible accounting entries and has consequently charged the residual amount, which has not yet been adjusted, to losses in the following cases:

- non-recoverability of the debt, resulting from certain and precise elements (such as, by way of example, unavailability and nullity of the debtor, failure to recover from securities and real estate executions, negative seizures, bankruptcy proceedings closed with no complete relief for the Bank, if there are no further guarantees usefully available, etc.);
- assignment of credit;
- waiver of the receivable, as a consequence of unilateral remission of the debt or residue against settlement contracts;
- without waiver of the receivable. With regard to full or partial write-offs without waiver of the receivable, in order to avoid the maintenance in the balance sheet of receivables that, although they continue to be managed by the recovery structures, present very marginal possibilities of recovery, it is necessary to proceed to the full or partial write-off for non-recoverability of the receivable even without closure of the legal practice. The write-off may only affect the portion of the receivable covered by provisions; therefore each receivable can be written off up to the limit of the Net Book Value.

Impairment of equity investments
At each balance sheet date the investments in associates or companies subject to joint control are subjected to an impairment test to assess whether there is objective evidence to consider that the carrying value of such assets is not fully recoverable.

The process of detection of any impairment involves the verification of the presence of impairment indicators and the determination of any write-down. The impairment indicators are essentially divided into two categories: qualitative and quantitative indicators.
Among the qualitative indicators, we would like to point out:
- the generation of negative economic results or in any case a significant variance with respect to the targets budgeted or established in the multi-year plans disclosed to the market;
- the announcement/start up of bankruptcy proceedings or restructuring plans;
- the downward revision of the rating by more than two classes;
- failures to discharge payment obligations fully and in a timely manner for debt securities issued;
- the use of industrial policy instruments aimed at dealing with serious crises or at enabling companies to face restructuring/reorganisation processes.

Quantitative indicators include:
- the reduction of the fair value below the book value by more than 30% or for a period longer than 24 months;
- the market capitalisation lower than the company's net book value, in the case of securities listed on active markets, or by a book value of the investment in the Parent Company's financial statements higher than the book value in the consolidated financial statements of the investee's net assets and goodwill or by distribution by the latter of a dividend that is higher than its total income.

The presence of impairment indicators results in the recognition of a write-down to the extent that the recoverable amount is lower than the carrying value.
The recoverable amount consists of the higher of the fair value net of sales costs and the value in use.
For a description of the measurement techniques used to determine fair value, reference should be made to chapter A.4 - Disclosure of Fair Value.
Value in use is the present value of the expected cash flows from the asset; it reflects estimated expected future cash flows from the asset, the estimate of possible changes in the amount and/or timing of cash flows, time value of money, the price able to repay the risk of the asset and other factors, which may affect the appreciation by market participants of expected future cash flows from the asset.
Value in use is determined by discounting future cash flows.

For controlling investments in subsidiaries, the single investments are not individually significant for the purposes of the impairment test in the Parent Company's financial statements, instead they are included in the impairment test of the Cash Generating Units (CGU) conducted at consolidated level. The CGUs identified are represented in some cases (Banca dei Territori and Corporate & Investment Banking) by operations conducted directly by the Parent Company and some subsidiaries, in other cases (International Subsidiary Banks) by combinations of subsidiaries, and also (Private Banking and Asset Management) when they are linked to the associated legal entity. When an investment does not produce cash flows that are largely independent of the cash flows from other assets the impairment tests are conducted at CGU level, rather than at the individual investment level. Consequently, when the assets attributable to a subsidiary are included in a CGU that is broader than the investment itself, as described in more detail in the following chapter, the impairment test can only be conducted at this level and not at the level of individual subsidiary for which the accurate estimation of a value in use is not possible.

Impairment of Other non-financial assets
Property, equipment and intangible assets with definite useful life are subject to impairment testing if there is the indication that the book value of the asset may no longer be recovered. The recoverable amount is determined with reference to the fair value of the property and equipment or intangible assets less costs to sell or the value in use if determinable and if it is higher than fair value.
With regard to real estate, in order to verify the presence of impairment indicators, the Bank annually carries out an analysis of the different scenarios of the real estate markets. If these analyses reveal indicators of impairment, an expert's report is prepared on the properties for which this presence has been verified.
For other property, equipment and intangible assets (other than those recognised following business combinations) it is assumed that the carrying value normally corresponds to the value in use, since it is determined by a depreciation or amortisation process estimated on the basis of the effective contribution of the asset to the production process, and since the determination of fair value is extremely subjective. The two values diverge and lead to impairment, in case of damages, exit from the production process or other similar non-recurring circumstances.
Intangible assets recognised following a business combination and in application of IFRS 3 are subject to an impairment test at each balance sheet date to assess whether there is objective evidence of an impairment loss.
Intangible assets with a finite life, represented by the value of the asset management portfolio and the value of the insurance portfolio, in the presence of impairment indicators are subjected to a new valuation process to assess the recoverability of the book values. The recoverable amount is determined on the basis of the value in use, namely the present value estimated using a rate representing the time value of money and the asset's specific risks, of the income margins generated by the existing relations as at the valuation date over a period which expresses their expected residual life.
Intangible assets with an indefinite life, represented by the valuation of the brand name and goodwill, do not have independent cash flows and therefore annually undergo an assessment of the adequacy of the value recorded under the assets with reference to the Cash Generating Unit (CGU) to which the values are attributed at the time of the business combinations. As CGU identification requires an analysis of the management characteristics and reporting methods used by management, and as the logic for strategic decision-making by management of the Parent Company is that of the Group as a whole and not only that of the Parent Company as an individual entity, the CGUs are identified in the consolidated financial statements.

The CGUs identified are represented in some cases (Banca dei Territori and Corporate & Investment Banking) by operations conducted directly by the Parent Company and some subsidiaries, in other cases (International Subsidiary Banks) by combinations of subsidiaries, and also (Private Banking and Asset Management) when they are linked to the associated legal entity. As stated, as these are the same CGUs identified at consolidated level, the assessment of the retention of goodwill and other assets with an indefinite life recorded in the Intesa Sanpaolo Group's financial statements is also valid with reference to the values recorded in the Parent Company's financial statements. Therefore, the assessment conducted at consolidated level with reference to the individual CGUs is used, after comparing the book value of the assets in the Parent Company's financial statements, without conducting, if the result is positive, a new test in the Parent Company's financial statements.
If, at consolidated financial statement level, an impairment needs to be recognised for a particular CGU, this write-down must be assigned to the assets that make up the CGU starting with goodwill. If the need to record an adjustment relates to a CGU that does not coincide with the associated legal entity, the write-down is assigned to the banking subsidiaries, after the elimination of the goodwill pertaining to the CGU recorded in the Parent Company's financial statements under a specific caption, on the basis of the respective fair values.

Business combinations

Business combinations are governed by IFRS 3.
The transfer of control over a company (or over a group of assets managed together as a single business) is considered a business combination.
For this purpose, control is deemed to have been transferred when the investor is exposed to, or has rights over, variable returns arising from his relationship with the investee and at the same time has the ability to affect returns by exercising its power over that entity.
IFRS 3 requires that an acquirer be identified in any business combination. The acquirer is identified as the combining entity that obtains control of the other combining entities or businesses. If a controlling entity cannot be identified, following the definition of control described above, as for example in the case of exchange of equity investments, the identification of the acquirer must occur considering other factors such as: the entity which has a significantly higher fair value, the entity which pays a cash consideration, the entity which issues new shares.
The acquisition, and therefore the initial consolidation of the acquired entity, must be recognised in the books on the date in which the acquirer effectively obtains control over the acquired company or businesses. When the combination occurs via an exchange of voting ordinary equity instruments, the date of the exchange normally coincides with the date of the acquisition. However, it is always necessary to verify that there are no agreements which may lead to transfer of control prior to the date of the exchange.
The transferred consideration as part of a business combination is equal to the sum of the fair value, as at the transaction date, of the assets sold, the liabilities undertaken and the capital instruments issued by the acquirer in exchange for acquisition of control.
In transactions which entail payment in cash (or when payment is envisaged by means of financial instruments similar to cash), the price is the agreed consideration, which may be discounted if an instalment payment is envisaged for a period longer than the short term; when payment occurs via an instrument other than cash, therefore via the issue of financial instruments, the price is equal to the fair value of such instruments net of the costs directly attributable to their issue. For the determination of fair value of financial instruments, reference should be made to chapter A.4 - Disclosure of Fair Value, with the understanding that, in the case of shares listed on active markets, fair value is represented by stock exchange quotations at acquisition date or, should that not be available, the last quotation available.
Purchase price at acquisition date includes any adjustments to the cost contingent on future events, if provided for by the combination agreement and only if the adjustment is probable, can be measured reliably and realised within the twelve months subsequent to the date of acquisition of control. Instead, any restoration related to any loss in the value of the assets used as consideration is not included in purchase price since it is already considered either in the fair value of equity instruments or as a reduction in the premium or an increase in the discount on the initial issue of debt instruments.
Acquisition costs are the costs incurred by the acquirer in carrying out the business combination; including, for example, professional fees paid to independent auditors, experts, legal advisors, costs for legal opinions and audit of accounts, preparation of disclosure documents required by the law, as well as advisory fees sustained to identify potential acquisition targets if the contract provides for the payment of success fees as well as the registration and issue costs of debt securities or equities.
Acquisition costs must be recognised as charges when incurred and when the related services are provided, except for the costs relating to the issue of debt securities or equities which must be recognised in accordance with IAS 32.
Business combinations must be accounted for using the "acquisition method" whereby identifiable assets acquired (including any intangible assets which had not been previously recognised by the acquired company) or liabilities assumed (including contingent liabilities) are recognised at their fair value at acquisition date.

Moreover, for each business combination, any minority interest in the acquired company can be recognised at fair value (therefore increasing the consideration transferred) or in proportion to the minority investment in the net identifiable assets of the acquired companies.
If control is achieved in stages, the acquirer recalculates its previous interest in the acquired company at the acquisition date fair value. Any difference with respect to the previous carrying amount is taken to income statement.
Excess between the consideration transferred (being the fair value of transferred assets, liabilities incurred and equity instruments issued by the acquirer), increased, where present, by minority interests (determined as above) as well as the fair value of the stakes already held by the acquirer, and the fair value of acquired assets and liabilities should be recognised as goodwill; if, on the other hand, the latter are higher than the sum of the consideration, minority interests and the fair value of the shares already held, the difference must be charged to profit or loss.
The accounting for business combination can be determined provisionally by the end of the year in which the combination is realised and must be completed within twelve months of the acquisition date.
The following combinations are outside the scope of IFRS 3 – business combinations: transactions aimed at acquiring control over one or more entities which are not part of the company's business or transactions conducted for organisational purposes, therefore between two or more companies or businesses which are already part of the Intesa Sanpaolo Group, and which do not entail changes in control, independently of the extent of minority interests in each of the combining entities before and after the business combinations (business combinations involving entities under common control). These transactions are considered immaterial. Therefore, since there are no specific provisions in IAS/IFRS and in compliance with IAS 8 which requires – in the absence of a specific Standard – that the reporting entity must use its judgement in applying an accounting policy that results in disclosure that is relevant, reliable, prudent and that reflects the economic substance of the transaction, these are accounted for safeguarding the consistency of the values of the acquiree in the financial statements of the acquirer.
Mergers are examples of concentrations between companies and represent the most complete business combinations, since they imply the legal and economic unification of the merged entities.
Mergers which entail the establishment of a new legal entity and mergers by incorporation (which entail that an entity is absorbed by another existing entity) are treated according to the criteria illustrated above, that is:

- if the transaction leads to the transfer of control of a company, it is accounted for as a business combination as provided for by IFRS 3;
- if the transaction does not lead to the transfer of control, it is accounted for by privileging the continuity of the values of the merged company.

A. 3 - DISCLOSURE ON TRANSFERS BETWEEN PORTFOLIOS OF FINANCIAL ASSETS

No items have been included in the tables provided by the Bank of Italy in section A.3 "Transfers between portfolios of financial assets".

A. 4 – FAIR VALUE, PRUDENT VALUE AND INDEPENDENT PRICE VERIFICATION DISCLOSURE

General fair value principles

The Bank regulates and formalises the measurement of the fair value of financial instruments through the Group's "Fair Value Policy," a document prepared by the Financial and Market Risk Department which is applicable to the Parent Bank and all the subsidiaries subject to consolidation.

The first part of the document, titled "General Principles" after receiving the go ahead of the Group Financial Risks Committee and the Managing Director and CEO, is subject to review and approval at least once a year by the Board of Directors, with the support of the Risk Committee. The second part - "Detailed methodologies" - is subject to the Group's Financial Risk Committee review, revision and approval at least once a year. This Committee has been specifically tasked for this purposes by the Administrative Bodies and it also examines the interventions and updates of material importance, which are submitted for approval by the Central Financial Risk and Market Management.

Pursuant to IFRS 9, based on the rules for the classification and measurement of financial instruments, an instrument is measured at fair value according to the business model adopted or if it does not pass the SPPI (Solely Payment of Principal and Interest) test, depending on the contractual characteristics of its cash flows.

Pursuant to IFRS 13, which provides a framework for fair value measurement and disclosures, fair value is the price that would be received for the sale of an asset, or that would be paid to transfer a liability in an arm's length transaction (i.e., not a forced liquidation or sale below cost) as at the measurement date. *Fair value* is a market valuation criterion, which is not specifically related to an individual bank. Underlying the definition of fair value is the assumption that the bank is pursuing a normal course of business and that there are no asset liquidation plans or any plans to significantly reduce the level of its activities or to settle transactions under unfavourable conditions.
The bank must measure the fair value of an asset or liability by adopting assumptions that market participants would use to determine the price of the asset or liability, acting in their best financial interests. The fair value measurement assumes that the sale of the asset or the transfer of the liability takes place:

a. in the main active market of the asset or liability;
b. in the absence of a principal market, in the active market most advantageous for the asset or liability.

The undertaking does not need to carry out an exhaustive search of all possible markets to identify the main market or, in the absence of the main market, the most advantageous market, as it suffices to take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity normally operates to sell the asset or transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market. The Bank believes that the main market for a financial asset or liability coincides with the market in which the Bank normally operates.

An active market is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. A financial instrument is considered to be listed on an active market if the prices that reflect normal market transactions are promptly and regularly available through the Stock Exchange, Mediators, Intermediaries, direct exchange markets or independent markets, Quote Services or authorised entities and if these prices represent actual, regular market transactions.

In specific cases, governed by internal policies and despite the presence of prices available on regulated markets, special in-depth studies are carried out to verify the significance of the prices available on the official market. In the event of a significant reduction in the volume or level of the transactions compared to the level that is usual for the asset or liability (or for similar assets or liabilities) pursuant to certain indicators (number of transactions, low significance of prices expressed by the market, significant increase in implicit premiums for liquidity risk, widening or increase in the bid-ask spread, reduction or total absence of a market for new issues, scarcity of information in the public domain), the listed transactions or prices must be analysed. A decrease in the volume and level of activity alone may not indicate that the price of a transaction or the quoted price does not represent fair value or that the transaction in that market is not ordinary. If an entity determines that a transaction or a listed price does not represent the fair value (e.g. transactions that do not take place in the ordinary course of business) an adjustment to transaction prices or listed prices is necessary if the entity uses those prices as the basis for fair value measurement and that adjustment may be significant relative to the overall fair value measurement.

General prudent value principles

The Bank regulates and formalises the measurement of the prudent value of financial instruments through the Group's "Prudent Value Policy," a document prepared by the Financial and Market Risk Department which is applicable to the Parent Bank and all the subsidiaries included in the consolidation perimeter.

After receiving the go ahead of the Group Financial Risks Committee and the Managing Director and CEO, the "Guidelines for the Prudent Valuation of Financial instruments" (prudent valuation) are reviewed and approved at least once a year by the Board of Directors, with the support of the Risk Committee. The "Prudent Valuation Rules for Financial Instruments" are subject to the Group's Financial Risk Committee review, revision and approval at least once a year. This Committee has been specifically tasked for this purposes by the Administrative Bodies and it also examines the interventions and updates of material importance, which are submitted for approval by the Central Financial Risk and Market Management.

According to the provisions of EU Regulation 575/2013 (the Capital Requirement Regulation - CRR), prudent valuation means the calculation of specific Additional Valuation Adjustments (AVA) for financial instruments measured at fair value, for intercepting various sources of valuation uncertainty and therefore ensuring the achievement of an adequate degree of certainty in the valuation of positions. The total value of the AVAs is deducted from the Tier 1 capital.

General Independent Price Verification Principles

The Bank regulates and formalises the independent validation process through the Group's "Independent Price Verification Policy," a document prepared by the Financial and Market Risk Department which is applicable to the Parent Bank and all the subsidiaries included in the consolidation perimeter.

After receiving the go ahead of the Group Financial Risks Committee and the Managing Director and CEO, the "Guidelines for Independent Price Verification", they are reviewed and approved at least once a year by the Board of Directors, with the support of the Risk Committee. The "Level 1 and 2 Independent Price Verification Rules" are subject to the Group's Financial Risk Committee review, revision and approval at least once a year. This Committee has been specifically tasked for this purposes by the Administrative Bodies and it also examines the interventions and updates of material importance, which are submitted for approval by the Central Financial Risk and Market Management.

According to the provisions of EU Regulation 575/2013 (the Capital Requirement Regulation - CRR), art. 4, par. 1.70 and 105, par. 8, the bank regulates the Independent Price Verification (IPV) process or a procedure for regular verification of the accuracy and independence of market prices for financial instruments or data used into pricing models, carried out by an organizational unit independent of the operators, at a frequency that is commensurate with the trading activity and the nature of the market.

The fair value of the financial instruments

Official listed prices on an active market constitute the best estimate of fair value. these quotes therefore represent the prices to use on a priority basis to measure the financial assets and liabilities in the trading portfolio.

If there is no active market, fair value is calculated by using measurement techniques that establish, in the final analysis, the price the product would have had at the measurement date, in an arm's length exchange motivated by normal business considerations. An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. These techniques include:

- the reference to market values indirectly associated with the instrument to be measured and compared with products that have similar risk profiles;
- measurements that even partially employ input which does not originate from non-observable market parameters which the analyst derives from estimates and assumptions.

Choosing one of these methodologies is not optional and they must be applied in hierarchical order: if a price expressed on an active market is available, no other measurement approaches can be used.

Inputs used in valuation techniques

Inputs are defined as the assumptions that market participants would use in determining the price of the asset or liability, including assumptions about the risk such as, for example, the risk inherent in a particular valuation technique used to measure the fair value or the risk inherent in the inputs of the valuation technique). Inputs van be observable or not.
Observable inputs are those that are processed using market data, such as publicly available information on actual transactions or events that reflect assumptions that market participants would use in determining the price of the asset or liability.
Non-observable inputs are those for which market information is not available, which are processed using the best available information on assumptions that market participants would use to determine the price of the asset or liability.

Fair value hierarchy

IFRS 13 establishes a fair value hierarchy that classifies the inputs of the valuation techniques used to measure fair value into three levels. This hierarchy gives the highest priority to quoted (unadjusted) prices in active markets for identical assets or liabilities (Level 1 data) and the lowest priority to unobservable inputs (Level 3 data). In particular:

- The fair value level is classified as 1 when the valuation of the instrument is obtained directly from quoted (unadjusted) prices in active markets for identical assets or liabilities which the entity can access at the valuation date.
- The fair value level is classified at 2 if no active market price has been found and the valuation is carried out by technical means, on the basis of parameters observable on the market, or on the use of parameters not observable but supported and confirmed by market evidence, such as prices, spreads or other inputs (Comparable Approach).
- The fair value level is classified at 3 when the valuations are carried out using different inputs, not all derived directly from parameters that are observable on the market and therefore involve estimates and assumptions by the auditor.

Where different inputs are used to measure the fair value of an asset or liability, classification in the hierarchy is determined on the basis of the lowest level input used for the measurement. To assign the fair value hierarchy, priority is given to inputs from valuation techniques rather than to the valuation techniques themselves.
For the respective valuation models/inputs of financial instruments, the "Fair Value Hierarchy" Annex of the Fair Value Policy defines the minimum rules that must satisfy the market inputs to be classified at level 2, and the thresholds of significance that, if exceeded, lead to an attribution at level 3.

For Level 1 financial instruments, the "current" price offered ("money") for financial assets and the current price requested ("letter") for financial liabilities, recorded at the end of the reference period, are used on the main market that can be accessed.
For financial instruments with an insignificant supply/demand differential, or for financial assets and liabilities with characteristics for offsetting positions for market risk, an average market price (still referring to the last day of the reference period) is used instead of the offer price or the ask price.
Contributed bonds (i.e. quoted on the EuroMTS circuit or for which at least three bid and ask prices can be derived on an ongoing basis from the main price contribution international platforms) are considered to be Level 1 financial instruments, as are contributed equities (i.e. listed on the official reference market), contributed harmonised investment funds, spot exchange transactions, derivative contracts for which quotations are available on an active market (e.g. futures and exchanged traded options)[5] and the "hedge" funds for which the NAV (Net Asset Value) is available, with the frequency provided for in the subscription contract, and the check list does not highlight any criticality in points in terms of liquidity risk or counterparty risk.
By contrast, all other financial instruments that do not belong to the categories described above or that do not have the contribution depth defined by the Fair Value Policy are not considered level 1 instruments.

When no quotation on an active market exists or the market is not functioning regularly, that is when the market does not have a sufficient and continuous number of trades, and bid-ask spreads and volatility that are not sufficiently contained, the fair value of the financial instruments is mainly determined through the use of valuation techniques whose objective is the establishment of the price at which, in an orderly transaction, the asset is sold or the liability transferred between market participants, as at the measurement date, under current market conditions.
These techniques include:

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

In the case of level 2 inputs, the valuation is not based on the price of the same financial instrument to be measured, but on prices or credit spreads presumed from official listing of instruments which are similar in terms of risk factors, using a given calculation
methodology (pricing model). The use of this approach requires the identification of transactions on active markets in relation to instruments that, in terms of risk factors, are comparable with the instrument to be measured. Level 2 calculation methodologies reproduce prices of financial instruments quoted on active markets (model calibration) and do not contain discretional parameters – parameters the values of which cannot be inferred from quotations of financial instruments present on active markets or fixed at levels capable of reproducing quotations on active markets – that significantly influence the final valuation.
The following are measured using level 2 input models:

- bonds without official quotations expressed by an active market and whose fair value is determined through the use of an appropriate credit spread which is estimated starting from contributed and liquid financial instruments with similar characteristics;
- derivatives measured through specific pricing models, fed by input parameters (such as yield, foreign exchange and volatility curves) observed on the market;
- ABSs for which significant prices are not available and whose fair value is measured using valuation techniques that consider parameters which may be inferable from the market;

[5] Solely within the perimeter of foreign branches and foreign banks and where expressly required by local regulations, bonds valued using official closing and/or fixing quotes provided by local authorities (central bank, monetary authority or local stock exchange) may be classified at level 1, following verification of the active market conditions by the decentralised Risk Management Units expressly authorised by the Risk Management Department.

- equities measured based on direct transactions, that is significant transactions on the stock registered in a time frame considered to be sufficiently short with respect to measurement date and in constant market conditions, therefore using the "relative" valuation models based on multipliers;
- loans measured through the discounting of future cash flows.

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

The following are measured according to this method:
- debt securities and complex credit derivatives (CDOs) included among structured credit products and credit derivatives on index tranches;
- hedge funds not included in level 1;
- funds, shareholdings and other equities measured using models based on discounted cash flows;
- some loans, of a smaller amount, classified in the available-for-sale portfolio;
- certain transactions involving derivatives or structured bonds, measures at level 3 inputs;

Identification, certification and processing of market data and valuation sources
The process of calculating fair value and the need to distinguish between products that can be valued on the basis of actual market prices, rather than through the application of comparative or model approaches, highlights the need to establish unambiguous principles in determining market parameters. To this end, the Market Data Reference Guide – a document that is regulated and updated by the Financial and Market Risk Department – establishes the processes necessary to identify market parameters and the means according to which such data must be extracted and used. This market data can originate from elementary as well as derived data. In particular, for each asset class, the regulation identifies the requirements , cut-off and certification procedures. The document formalises the collection of suitable contribution sources or the valuation of financial instruments held for various reasons in the portfolios of the Parent Company and its subsidiaries. These sources are also used for evaluations conducted for third parties pursuant to previously concluded Service Level Agreements. Suitability is assured through compliance with the reference requirements, which are based on the principles of data comparability, availability and transparency, i.e. the possibility of finding the data on one or more infoproviding systems, measuring the bid-ask contribution and, finally, for OTC products, by verifying the comparability of the sources. For each market parameter category, the cut-off time is determined unambiguously, referring to the timing of data collection, the reference bid/ask side and the number of contributions required to verify the price.
All market parameters used by the Intesa Sanpaolo Group are subject to certification (Validation Process) by the Financial and Market Risks Department, in terms of timely control (detecting the integrity of the data recorded on the proprietary platform with respect to the source), likelihood tests (consistency of each individual data with similar or comparable data) and verification of the actual application methods.

Financial instrument valuation process

Financial instruments are valuated in several stages, as follows:
- identification of valuation sources: for each asset class, the Fair Value Policy and the Market Data Reference Guide establish the processes necessary to identify market parameters and the means according to which such data must be extracted and used;
- certification and treatment of market data for periodic measurements: this stage consists of the accurate verification of the market parameters used (verifying the integrity of data contained on the proprietary platform with respect to the source of contribution), reliability tests (consistency of each single figure with similar or comparable figures) and verification of concrete application means.
- certification of pricing models (“Model Validation”): this phase verifies the consistency and the adherence of the various measurement techniques used with current market practice, to highlight any critical aspects in the pricing models used and determine any adjustments necessary for measurement;
- periodic monitoring of the consistency of pricing models over time (“Model Risk Monitoring”): periodical monitoring of the adherence to the market of the pricing model in order to discover any gaps promptly and start the necessary verifications and interventions.

Model Validation

In general, all the valuation methods used by the Bank must undergo an internal certification process involving the various relevant structures. In the presence of high complexity and/or market dislocation, independent certification by accredited financial services companies is also possible. In particular, the internal certification process begins with the introduction of operations in a new financial instrument that requires the adaptation of existing valuation methods or the development of new methodologies, or when existing methodologies must be adapted to evaluate already existing contracts.
The validation of methodologies involves a series of operational stages, followed when necessary, including:

- contextualisation of the problem within current market practice and the available literature on the subject;
- analysis of financial aspects and relevant payoff types;
- formalization and independent derivation of mathematical aspects;
- analysis of numerical/implementation aspects and testing by replicating, when deemed necessary, the pricing libraries of Front Office systems using an independent prototype;
- analysis of the relevant market data, verifying the presence, liquidity and frequency with which the contributions are updated;
- analysis of calibration methods, i.e. the model's ability to optimise internal parameters (or metadata) to best replicate the information provided by quoted instruments;
- stress test of model parameters not observable on the market and analysis of the effects on the valuation of complex instruments;
- market testing by comparing, where possible, the prices obtained from the model against the quotations available from the counterparties.

If this analysis does not reveal any particular critical points, the Financial and Market Risk Department validates the methodology, which becomes an integral part of the Group's Fair Value Policy and can be used for official evaluations. If the analysis shows a significant "Model Risk", but which falls within the limits of the method's ability to correctly manage the reference contracts, the Risk Management Department identifies the additional method for determining the appropriate adjustments to be made to the fair value and validates the integrated method.

Model Risk Monitoring

The performance of the certified and actually used evaluation methods is constantly monitored to promptly detect any deviations from the market and initiate the necessary checks and interventions. This monitoring is carried out in a number of ways, including:

- repricing of elementary contributed instruments: verification of the model's ability to reproduce the market prices of any relevant listed instruments. An automatic repricing system for elementary financial instruments is operational on the Bank's Front Office systems, which systematically checks for any deviations between the model and the market;
- comparison with benchmark data: extensive use of data provided by qualified external providers (e.g. Markit), enables contribution to and obtaining consensus valuations from leading market counterparties for interest rate, equity, credit, exchange rate and commodity instruments. This is more information than is normally available from standard sources in terms of, for example, deadlines, underlying assets, strikes, etc. The available consensus data is monitored constantly and updated to cover the most significant exposures;
- comparison with market prices: checks based on prices provided by counterparties via Collateral Management, indicative quotations provided by brokers, implicit parameters derived from such indicative quotations, price checks of the most recent revaluation of the price of the financial instrument following unwinding, disposals, new similar or comparable transactions.

If significant deviations are found, an impact analysis is carried out on the respective portfolios and any adjustments to be made to the corresponding valuations are quantified, as described in the following paragraph.

Fair value adjustments

Fair value adjustments are a prudent monetary buffer designed to take into account valuation uncertainty or the difficulty of disinvesting particular financial positions, and may refer to a single financial instrument or to the net position for a given risk factor. Adjustments may be calculated as additions to the assessment or included directly therein. They are reviewed periodically, also in consideration of the evolution of the markets, i.e. the potential introduction of new liquid instruments, different calculation methods and, in general, methodological refinements, which can also lead to substantial changes in the chosen models and the implementation thereof.

In particular, fair value adjustments are envisaged for the following categories of valuation uncertainty.

- Input data uncertainty: any valuation uncertainty related to valuation input data (whether mid, bid or ask) is measured in view of the temporary or structural conditions on the markets or in relation to the size of the countervalues held (in the case of a merger), and where necessary, an adjustment to fair value is made, quantifying the consequent impact on the valuations.
- Illiquidity of the underlying positions or risk factors: similarly to the previous case, the market bid-ask spread is measured and, where necessary, a fair value adjustment is made, with determination of the impact on the valuations.

- Model Risk: is based on the identification and use of variants of the same model or alternative models, used to carry out comparison analyses for determination of the variability of valuations (in particular the potential direction of the price when the model changes) and the behaviour of the model in various market scenarios (stress testing). The fair value adjustment is based, where possible, on easily comprehensible and measurable financial variables (e.g. vega, delta, correlation shift).
- Credit and counterparty risk: counterparty and funding risks, collectively referred to as XVA, include the Bilateral Credit Value Adjustment (bCVA) and the Funding Value Adjustment (FVA). The bCVA considers the counterparty risk premium linked to the possibility counterparties not honouring their loan commitments (e.g. in the event of bankruptcy). It in turn consists of two components, called Credit Value Adjustment (CVA) and Debit Value Adjustment DVA, which consider, respectively, scenarios in which the Counterparty goes bankrupt before the Bank does (and the Bank has a positive exposure to the Counterparty), and the opposite, where the Bank goes bankrupt before the Counterparty (and the Bank has a negative exposure to the Counterparty). The bCVA depends on the default probabilities and Loss Given Defaults of the counterparties, and on the overall exposure existing between the two counterparties. The latter must be calculated with account taken of any counterparty risk mitigation arrangements, in particular netting and collateralisation arrangements (CSAs). Conversely, the Funding Value Adjustment (FVA) takes into account the financing risk premium, connected to the financing costs of the cash flows generated by a portfolio of OTC derivatives (coupons, dividends, collateral, etc.). Like the bCVA, the FVA depends on the probability of default of the counterparties and takes into account any netting and collateralisation agreements (CSAs).

The process of managing fair value adjustments is formalised in the Fair Value Policy with appropriate calculation methods according to the different configuration of the points indicated above, and is carried out in the most objective, consistent and systematic manner possible by the Risk Management Department. The introduction and release of fair value adjustments depends on the dynamics of the above factors. These processes are a combination of strictly specified quantitative and qualitative elements, evaluated according to how the risk factors that generated the adjustments are configured over time; therefore, estimates subsequent to the first registration are always guided by the mitigation or removal of these risks.
For new products, the decision to apply adjustments is taken during the new product approval process, pursuant to the recommendation of the Financial and Market Risk Department.

A.4.1 Fair value hierarchy Levels 2 and 3: measurement techniques and inputs used

The following paragraphs provide information on the valuation instruments used, by type of financial instrument (securities, derivatives, structured products, hedge funds).

I. Valuation of non-contributed securities

Non-contributed instruments (or instruments without official quotations expressed by an active market) are valuated using an appropriate credit spread which is estimated from contributed and liquid financial instruments with similar characteristics. The sources used to implement this measurement are:

- contributed and liquid securities issued by the same issuer;
- credit default swap on the same reference entity;
- contributed and liquid securities issued by an issuer with the same rating that belongs to the same sector.

In any case, account is taken of the different seniority of the security to be priced in relation to the issuer's debt structure.
For Italian issuers, a rating/duration matrix is constructed based on the spreads of government issues to which the differentials between the various rating/duration classes with respect to public issues (regions, provinces, municipalities, government agencies) are applied.
When applying the spread for the pricing of the non-contributed instrument, if the estimated 'fair' credit curve does not respect the same characteristics of the instrument, correction factors are considered.
Also, for bonds that are not quoted on active markets, an extra spread, estimated based on the bid/ask spread recorded on the market, is added to the "fair" credit spread component, to take account of the higher premium demanded by the market compared to similar contributed securities.
Finally, if the instrument includes an optional component, a further adjustment is made to the spread by adding a component designed to capture the hedging costs of the structure and any illiquidity of the underlying assets. This component is calculated based on the type of option, using the corresponding valuation models for derivatives indicated below.

Similarly, with respect to financial liabilities designated at fair value through profit and loss, the credit spread of the Intesa Sanpaolo Group is determined and measured based on the bonds issued by the Parent Company, with regular, periodic coupons, maturity beyond one year and quoted on an active market in compliance with IAS/IFRS. The implicit credit rating is determined on the basis of market prices and subsequently adjusted through interpolation models which generate credit spread curves by type of coupon, maturity and subordination level.

II. Valuation models for interest rate, foreign exchange, equity, inflation, commodity and credit derivatives

The fair value of an OTC derivative instrument is calculated considering the risk premium related to the various underlying risk factors. Specifically, there are two relevant cases, according to whether or not the instrument is subject to collateralisation agreements (CSAs) aimed at mitigating the liquidity and counterparty risk.

a. For CSA transactions with characteristics that reduce counterparty and liquidity risk to a negligible level, the fair value is calculated according to the non-arbitrage principle, by including the market risk premium related to the risk factors underlying the contract (e.g. interest rates, volatility, etc.), and considering the rate of remuneration for the collateral as the discount rate for the future cash flows. Given that the rate of remuneration for the collateral is generally an overnight rate, and the corresponding discount curve is constructed based on the market prices of Overnight Indexed Swap (OIS) instruments, this approach is called "OIS discounting".

b. For transactions without CSAs, or with CSAs with characteristics that do not reduce the counterparty and liquidity risk to a negligible level (e.g., One Way CSAs, or with non-negligible limits or minimum transfer amounts), the fair value of the instrument may be stated, under appropriate circumstances, as the sum of the reference (or base) value, equal to the price of the corresponding collateralised instrument (see point above), and several additional valuation components related to the counterparty and liquidity risk premium, referred to jointly as XVA.

For derivatives measurement, in consideration of their number and complexity, a systematic reference framework has been developed which represents the common elements (calculation algorithms, processing models, market data used, basic assumptions of the model) that are used to measure all categories of derivatives.
Interest rate, foreign exchange, equity, inflation, commodity and credit derivatives, if not traded on regulated markets, are Over The Counter (OTC) instruments, which are bilaterally exchanged with market counterparties and are measured through specific valuation models, fed by input parameters (such as, for example, yield, foreign exchange and volatility curves) observed on the market and subject to the monitoring processes illustrated above.

The table below illustrates the main models used to measure OTC derivatives on the basis of the category of underlying asset.

Underlying class	Valuation models	Market data and input parameters
Interest rate	Net Present Value, Black, SABR, Libor Market Model, 1- and 2-factor Hull-White, Mixture of 1- and 2-factor Hull-White, Bivariate lognormal, Rendistato, Hagan replication	Interest rate curves (deposits, FRA, Futures, OIS, swap, basis swap, Rendistato basket), cap/floor/swaption option volatility, correlation between interest rates,
Foreign exchange rate	Net present Value FX, Garman-Kohlhagen, Lognormal with Uncertain Volatility (LMUV), Stochastic Local Volatility (SLV), Local Volatility (LV)	Interest rate curves, spot and forward FX curves, FX volatility, "quanto" volatility and correlations
Equity	Accrual, Net present Value Equity, Black-Scholes, Heston, Local Volatility, Jump Diffusion	Interest rate curves, underlying asset spot rate, expected dividends, underlying asset volatility and correlation between underlying assets, "quanto" volatility and correlations
Inflation	Bifactorial Inflation	Nominal and inflation interest rate curves, interest and inflation rate volatility, seasonality ratios of consumer price index, correlation between inflation rates
Commodity	Net present Value Commodity, Generalised Black-Scholes, Independent Forward	Interest rate curves, spot rate, forwards and futures of underlying assets, underlying asset volatility and correlation between underlying assets, "quanto" volatility and correlations
Loans	Net present Value, Black Model, Contingent CDS	Probability of default, Recovery rate.

As envisaged by IFRS 13, in determining fair value, the Intesa Sanpaolo Group also takes into account the effect of non-performance risk. This risk includes changes in the counterparty credit rating and changes in the issuer's own credit risk.

III. *Valuation model for structured credit products*

Regarding ABSs, if significant prices are not available, valuation techniques are used that take into account parameters that can be gathered from an active market (level 2 inputs) or, where parameters cannot be observed, estimated parameters (level 3 inputs, where significant).

In this case, the cash flows are obtained from infoproviders or specialised platforms; the spreads are gathered from prices available on the market/consensus platforms, further strengthened by a qualitative analysis relative to the performance of the underlying assets presumed from periodic investor reports and aimed at highlighting structural aspects that are not (or not fully) encompassed by the analyses described above, relating to the actual future ability to pay the expected cash flows and analyses of relative value with respect to other similar structures. The results of these analyses are subject to backtesting with actual sales prices.

For securitised high-yield loans to European corporate borrowers (CLO HY loans), valuation techniques call for calculation of the net present value of the expected cash flows, determined through specialised platforms, discounted using market spreads. When modelling expected future flows, account is taken of all contractual aspects of the CLO HY loans that may influence the waterfall. For this asset class, the process of determining fair value also involves stress of the main unobservable variables and a credit analysis aimed at identifying any weaknesses of the individual assets securing the CLOs that results in a revision of the input parameters.

With regard to debt securities and complex credit derivatives (funded and unfunded CDOs) the fair value is determined based on a quantitative model which estimates joint losses on collateral with a simulation of the relevant cash flows which uses copula functions.
The most significant factors considered in the simulation – for each collateral – are the risk-neutral probability of default derived from market spreads, recovery rates, the correlation between the value of collateral present in the structure and the expected residual life of the contract.
For spreads, the valuation process incorporates, as promptly as possible, all the market inputs (including synthetic indices such as LCDX, Levx and CMBX) considered to be significant: consensus parameters calculated by multicontribution platforms and market spread estimates provided by major dealers are used.
The Market Data Reference Guide, which sets out credit spread contribution sources, was moreover integrated with specific policies for the other inputs such as correlations and recovery rates.
For specific types of collateral, such as trust preferred securities, the probability of default is estimated using the Expected Default Frequency from Moody's - KMV.
In order to incorporate high market dislocation and intense market illiquidity phenomena in the valuations, a series of corrections have been prepared for the valuations referred to the main input parameters:
- stress of recovery rates: expected recovery rates on the assets held as collateral in every deal have been decreased by 25% (50% for underlying REITS);
- asset value correlation stress: inter and intra correlations have been increased and decreased by 15% or 25% depending on the type of product;
- stress of spreads: the spreads, used to determine the marginal distributions of defaults, have been increased by 25%;
- stress of expected residual maturities: the latter have been increased by 1 year.

Each of these modules contributes to the definition of a sensitivity grid of the value to the single parameter; results are then aggregated assuming independence between the single elements.

After this valuation, credit analyses on underlying assets were fine-tuned to incorporate further valuation elements not included in the quantitative models. In particular, a Qualitative Credit Review is provided for and entails an accurate analysis of credit aspects referred to the specific structure of the ABS/CDO and to the collateral present. This is to identify any present or future weaknesses which emerge from the characteristics of the underlying assets, which could have been missed by rating agencies and as such not fully considered in the valuations described in the previous point. The results of this analysis are condensed in certain objective elements (such as Past Due, Weighted Average Delinquency, etc.) which are summarised in an indicator representing credit quality. Based on the value of this synthetic indicator, specific thresholds have been identified which correspond to a number of downgrades, so as to proceed to a consistent adjustment in the valuation. Lastly, for this class of products, an additional adjustment may be applied, subject to an authorisation procedure that, above a certain warning threshold, involves both the area of the Chief Risk Officer and the Financial Reporting Officer.

IV. The measurement of equity instruments

Equities for which fair value is determined using level 2 inputs include:
- equity instruments measured based on direct transactions, that is significant transactions on the stock registered in a time frame considered to be sufficiently short with respect to measurement date and in constant market conditions;
- equity instruments measured using relative methods, based on multipliers: implied multiples in transactions in comparable listed or unlisted companies, within a time frame deemed sufficiently short with respect to the time of measurement and under constant market conditions (M&A multiples) or implicit multiples in the stock market prices of a sample of comparable companies (stock market multiples).

Equities for which fair value is determined using level 3 inputs include:
- equity instruments for which analytical models based on flows are used, which determine the value through estimates of the cash or income flows that the company is expected to generate over time, discounted using an appropriate rate based on the level of risk of the instrument;
- equity instruments measured based on asset criteria such as NAV or Adjusted Net Asset Value (ANAV), which estimates the fair value of the various components of the assets of the investee.

V. Valuation of hedge funds

The determination of the fair value of a hedge fund is the result of an analytical process that involves two distinct approaches applied respectively to funds managed through a Managed Account Platform (MAP), which ensures full daily transparency of the instruments underlying the funds, and the funds not managed via MAP.

For the funds not managed via the MAP, the fair value is calculated by applying to the NAV provided by the Fund Administrator a deduction deriving from a measurement process aimed at taking into account the effect of any idiosyncratic risks, which may be reclassified mainly into the two following types:

- counterparty risk, i.e. the risk that the assets of the fund are exposed to when a single service provider is entrusted with prime brokerage or custodian activities, subject to the risk of default.
- illiquidity risk, i.e. the risk that the assets of the fund are illiquid due to the limited prices available or due to a lack of information on the assessment policies used by the fund.

These risks are measured based on the information present in the documentation received periodically from the fund managers or administrators.

For the funds managed via MAP, the Fair Value corresponds to the Net Asset Value (NAV) provided by the Fund Administrator. No adjustment is applied to these types of funds, since the infrastructure guaranteeing the daily transparency allows the underlying instruments to be controlled and monitored to the extent that the counterparty and illiquidity risk is mitigated.

The application of adjustments for counterparty and liquidity risk is subject to an authorisation procedure that, above a certain warning threshold, involves both the area of the Chief Risk Officer and the Financial Reporting Officer.

For both types of investment, the level of the fair value hierarchy is attributed on the basis of the prevalence, in percentage terms over the NAV, of the weight of the assets priced according to the various levels.

VI. Other level 2 and 3 valuation models

Loans are included among financial instruments whose fair value is determined on a recurring basis through level 2 inputs. In particular, for medium- and long-term assets and liabilities measurement is carried out by discounting future cash flows. This is based on the discount rate adjustment approach, in which the risk factors connected to the granting of loans are taken into consideration in the rate used to discount future cash flows.

The fair value of the financial instruments

In line with criteria indicated in Delegated Regulation (EU) 2016/101, the Bank is subject to the application of the core approach for the determination of AVAs both at individual and at consolidated level for all the positions designated at fair value. In particular the following AVAs are considered:

- Market price uncertainty: this reflects the uncertainty of the market prices, calculated at valuation exposure level.
- Close-out costs: reflect the uncertainty of the exit price calculated at valuation exposure level.
- Model risks: consider the valuation model risk which arises due to the potential existence of a range of different models or model calibrations, which are used by market participants, and the lack of a firm exit price for the specific product being valued.
- Unearned credit spreads: reflect the valuation uncertainty in the adjustment necessary according to the applicable accounting framework to include the current value of expected losses due to counterparty default on derivative positions.
- Investment and funding costs: represent the valuation uncertainty in the funding costs used when assessing the exit price according to the applicable accounting framework.
- Concentrated positions: : reflect the uncertainty relating to the exit price of the positions defined as concentrated.
- Future administrative costs: consider administrative costs and future hedging costs over the expected life of the valuation exposures for which a direct exit price is not applied for the close-out costs AVAs.
- Early termination: considers the potential losses arising from non-contractual early terminations of customer trades.
- Operational risks: consider the potential losses which may be incurred consequently to the operational risks connected to the valuation processes.

The prudent value corresponds to the exit price from the position with a level of certainty equal to 90%. Where possible, this value is determined on the basis of a distribution of exit prices observed on the market. In all the other cases, an expert-based approach is used, referring to the qualitative and quantitative information available.

The AVA value associated to the single position and to the single source of uncertainty in valuation thus corresponds to the difference between the prudent value and the fair value. The total AVA is obtained by aggregating the single AVAs, taking into account the corresponding weighting ratios.
The “Rules on Prudent Valuation of Financial Instruments” outline, for each AVA, the definition and interpretation, scope of application, input data and detailed calculation method for each class of financial instrument.

Independent verification of financial instrument prices

Independent Price Verification (IPV) is "a process by which market prices or marking to model inputs are regularly verified for accuracy and independence" (Art. 4(1.70) EU Regulation 575/2013), performed "in addition to daily marking to market or marking to model. Verification of market prices and model inputs shall be performed by a person or unit independent from persons or units that benefit from the trading book" (Art. 105(8) EU Regulation 575/2013).

The Bank has set up an IPV process with 3 levels of controls in line with the provisions of Bank of Italy Circular 285/2013, incorporated into the System of Integrated Internal Controls, which requires that risk management processes be integrated with the processes and methods for assessing the company's activities, including for accounting purposes.

In terms of the IPV, the level 1, 2 and 3 control functions have the following main responsibilities:
- the level 1 control function participates in the definition of the methodological reference framework and conducts the first level implementations and controls, reporting the results to the business, to the level 2 control functions;
- the second-level control function defines the methodology and control framework, ensures compliance with current regulations and consistency between IPV controls, accounting valuations and supplementary valuation adjustments (AVAs) (conducted based on the Fair Value Policy and the Prudent Valuation Policy, respectively); supervises the level 1 controls and conducts level 2 controls;
- the level 3 control function conducts internal audit controls aimed at identifying breaches of procedures and regulations, in addition to periodically assessing the completeness, adequacy, operation (in terms of efficiency and efficacy) and reliability of the organisational structure of the other components of the internal control system and the information system at the Bank level, at a set frequency based on the nature and level of the risks.

Level 1 and 2 IPV controls are qualitative and quantitative controls. They are distinguished according to the type of instruments subject to control. They are applied consistently to the input data underlying the valuations as well as to the valuations themselves, ensuring the consistency between the management valuations and the accounting valuations carried out on the various systems. They are characterized by the completeness and suitability of their application, absence of overlaps, sequentiality and complementarity in execution. The IPV control tools utilise special applications or computer procedures to the greatest possible extent, as these allow extensive data analysis to be conducted on a daily basis. In particular:
- level 1 controls are aimed at ensuring the validation of market data entered into the systems and they are based on an in-depth analysis of the data obtained from external providers. If the level 1 controls indicate that the data in the systems exceeds certain thresholds, or in any case the data is not considered correct by the level 1 control functions, a comparison process (challenge) is initiated with the involvement of the business and the level 2 control functions, based on the complexity of the specific issue.
- Level 2 controls are characterized by sequentiality and complementarity in execution, in relation to level 1 controls and they are designed to ensure alignment between management and accounting valuations, based on a thorough analysis of consensus or counterparty data and, where these are not available, through the application of pricing models associated with the respective instruments.

The results of the IPV process are analysed, evaluated and coordinated by the IPV Table, a technical body set up specifically for this purpose, with the aim of facilitating integration and comparison between the business functions and the control functions.

Pursuant to IFRS 13 rules, the table below shows the effect of a change in one or more of the unobservable parameters applied in the valuation techniques used to determine fair value, for financial assets and financial liabilities measured at level 3 fair value.

(thousands of euro)

Type of financial instrument	Valuation technique	Main non-observable inputs (Level 3)	% Change range		Favourable Fair Value Changes	Unfavourable Fair Value changes
			minimum value	maximum value		
OTC derivatives subject to Fair Value adjustment for CVA / DVA	CVA	Loss Given Default Rate (LGD)	0%	100%	38	-36

A.4.2 Valuations processes and sensitivities

For a description of the valuation processes used by the Intesa Sanpaolo Group for instruments valued at level 3 on a recurring and non-recurring basis, refer to paragraphs A.4.1 and A.4.5, respectively.
Pursuant to IFRS 13 rules, it is hereby noted that for financial assets and financial liabilities measured at level 3 fair value, the effects of a change in one or more of the unobservable parameters used in the valuation techniques used to determine fair value were found to be immaterial.

A.4.3 Fair value hierarchy

For financial assets and liabilities measured at fair value on a recurring basis, the Bank crosses levels based on the following guidelines.
For debt securities, the transition from level 3 to level 2 occurs when the relevant parameters used as inputs in the valuation technique inputs are observable on the market at the reference date. Conversely, the transition from level 3 to level 1 occurs when an active market, as defined by IFRS 13, has been successfully verified, at the reference date. The transition from level 2 to level 3 occurs when, at the reference date, some of the significant parameters in the determination of the fair value are not directly observable on the market.
For OTC derivatives, the initial choice of the fair value hierarchy level depends on the degree of significance and observability of the parameters used to evaluate the "risk free" component. The calculation of the counterparty/issuer default risk component, with unobservable parameters, may result in a reclassification to Level 3. In particular, this occurs when:
– the counterparty's credit is impaired and the current exposure is positive;
– with reference to the netting set, the ratio between the bilateral Credit Value Adjustment (bCVA) component and the comprehensive fair value is above a significant threshold and there is a significant sensitivity to downgrading.
For equity instruments classified as available-for-sale assets, the level switch takes place:
– when observable market inputs became available during the period (e.g. prices defined as part of comparable transactions on the same instrument between independent and informed counterparties). In this case, the Bank reclassifies from level 3 to level 2;
- when the directly or indirectly observable elements used as the basis for the valuation have ceased to exist, or are no longer up to date (e.g. there are no recent comparables or multiples are no longer applicable). In this case, the Bank applies valuation techniques that use unobservable inputs.

A.4.4 Other information

The Bank does not apply the exception provided by paragraph 48 of IFRS 13 (fair value on the basis of net exposure) in relation to financial assets and liabilities with positions that offset each other insofar as market risk or counterparty risk.

FAIR VALUE OF REAL ESTATE AND VALUABLE ARTISTIC HERITAGE

Fair value of real estate

As already explained in detail in the first part relating to accounting policies, the Group employs the revaluation model for measuring the value of the real estate assets it uses in company operations pursuant to IAS 16 while investment properties are measured according to IAS 40.

Methodology for the evaluation of real estate assets

The revaluation method applied to real estate used in operations requires that tangible assets the fair value of which can be reliably determined, be recognised at a revalued value, equal to their fair value at the date of the revaluation, net of depreciation and any accumulated impairment losses.
For real estate held for investment purposes, the Intesa Sanpaolo Group has chosen the fair value method, according to which all real estate investments are measured at fair value, after initial recognition.

Valuation approach

IFRS 13 defines fair value as "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".
The valuation approach has been defined on the basis of the instrumental value and the real estate usage plan, which consists of 3 main groups:

- trophy assets; historic properties with and without restrictions
- instrumental properties;
- non-instrumental properties.

The properties are valued individually (asset by asset) without considering any discount, or premium, that may be applied during commercial negotiations if all or part of the portfolio is sold in bulk or by lots.

The Intesa Sanpaolo Group has chosen to entrust the valuation activity to external companies that operate internationally and are professionally qualified and able to provide real estate valuations based on RICS Valuation standards[6]. These companies guarantee:

- that the value calculated will be consistent with the fair value configuration indicated in the international accounting standards;
- compliance with the professional, ethical and independence requirements applicable to assessors, in line with international and European standards.

The following methods are used to determine the value of the assets, according to the characteristics of the asset and the conditions on the reference market; the assessor determines the most suitable method for each individual property.

- Discounted Cash Flow;

The discounted cash flow method is based on the discounting of future net revenues deriving from the rental or sale of the property (for a variable period based on the rental/occupational situation of the property and its subsequent optimisation). At the end of this period, the value of the property is assumed to be the amount at which it would be sold at a price obtained by capitalising the income of the last year at a market rate for investments similar to the object of the estimate or through a split sale. This method is used for the valuation of all properties used for business purposes or leased to third parties, located in Italy.

- Comparative or Market Method;

The comparative or market method is based on a comparison between the asset in question and similar assets recently traded or currently offered on the same market or on competitive markets. This criterion is based on a comparison with properties that have recently been sold or offered on the open market which may share the same characteristics. In the absence of observations directly related to the property in question, the cases that are used are as similar as possible to the property in question, and any necessary corrections are made. This method, which also represents the basis for other valuation methods, can be adopted for all the goods subject to analysis and in particular for goods not in use and/or in any case free and available for use, in Italy and abroad

- Income approach;

The income method is based on the current value of future income of a property, which is obtained by capitalising the income using a market rate. For example, this method can be applied to instrumental buildings abroad, where the building is expected to be used for a prolonged period.

- Investment value or “Worth”.

The Investment value or “Worth” is defined by the IVS as follows: “the value of an asset to a particular owner or prospective owner for individual investment or operational objectives”.
This definition is consistent with the provisions of the latest edition of the “RICS Valuation - Global Standards 2017" published by the Royal Institution of Chartered Surveyors of the United Kingdom, where the Investment Value is defined as "The value of an asset to the owner or a prospective owner for individual investment or operational objectives".
The Investment Value is attributable to those properties built independently or properties with a strong instrumental connotation subject to significant investments for technological, construction and operational adaptation.
The Investment Value of these properties is determined on the basis of a 12+6 year plan for instrumental use without break options, the annual rent for which is determined by applying an appropriate gross rate of return to the amount of direct and indirect costs capitalised by the Owner, including the costs of purchasing the land. The Investment Value is attributable to those properties built independently or properties with a strong instrumental connotation subject to significant investments for technological, construction and operational adaptation.

Valuation frequency

Revaluations must take place on a regular basis so as to ensure that the carrying amount does not differ materially from the amount which would have been determined using the fair value at the balance sheet date.
The frequency of revaluations depends on the fluctuations in the fair value of the property being revalued. When the fair value of the revalued asset differs materially from its carrying amount, a further revaluation is required.
In particular, based on the performance of the markets, a different valuation frequency was identified which, depending on the characteristics of the assets and their location, is considered to be necessary in order to reflect the significant changes in the value of the assets themselves.
The following distinction is made for properties classified as properties for instrumental use:

- for the so-called "trophy assets", i.e. buildings of particular prestige used by management functions located in the main cities where the bank has its headquarters or which are of particular historical and artistic interest because they are subject to restrictions set by the Ministry for Cultural Heritage and Activities, the recalculation is carried out by verifying the value through a scenario analysis (analysis of market trends) every year and with a new appraisal every two years;
- for other buildings used for instrumental purposes, the restatement takes place alongside the scenario analysis (market trend analysis) every year and through a new appraisal every three years.

If the scenario analysis reveals significant changes (+ or - 10%), precise and updated appraisals are required to adjust the fair value of the asset to the valuations of the real estate market.
For real estate used for investment purposes, the value is determined on the basis of new appraisals each year.

[6] Standards contained in the document of the Royal Institution of Chartered Surveyors of the United Kingdom entitled 'RICS Valuation - Global Standard 2017' (also known as the “Red Book”)

Scenario analysis
As part of the annual update of the fair value of instrumental properties, in the years in which the property is not expected to revalue, a scenario analysis (analysis of market trends) is carried out using the best information sources available for the various countries in which the properties are located, with the aim of recording, on the basis of databases, the deviations in market values between the analysis and the previous period.
Therefore, for each property, the appraisers define the annual deviations of the rents and/or prices for the relevant asset class.
This activity is carried out toward the end of the year so that a range of deviations can be inserted in two different thresholds and be able to schedule an accurate estimate for the properties with deviations that exceeded the threshold.
The allowed variation threshold is +/-10%
If the deviations exceed this threshold, a new appraisal will be conducted before the end of the year.

Fair value of valuable artistic heritage
The Bank's valuable artistic heritage is also measured using the revaluation method. This method requires that tangible fixed assets, the fair value of which can be reliably determined, be recognised at a revalued value, equal to their fair value at the date of the revaluation.

Valuation approach
The valuation is outsourced to qualified, independent appraisers.
At least four different values can be formulated for a single artistic asset:
– the commercial or current market value;
– the liquidation value;
– the restoration value;
– the insurance value.
In evaluating Intesa Sanpaolo's collections, the main criterion adopted was the "Current market or commercial value"; additional value configurations can be used if the main value configuration produces irregular results.
For fair value measurement, the same criteria apply as were used for the initial selection of assets to be included in the "fine artistic heritage":
– state of preservation of the work;
– historical importance of the artist;
– critical/historical-artistic importance of the work;
– origin of the work;
– quality and attribution of the creation of the work;
– declaration of interest by Mibac [Italian Ministry of Culture].

Once the criteria have been defined, the fair value can be inferred, by comparison, from the online databases with over 100 million works such as Artnet and Artprice, which monitor the results of the main Italian and international auction houses such as Christie's, Sotheby's, Dorotheum, Pandolfini, Wannenes and il Ponte. The results of the auctions are objective parameters, which must be compared against the market as a whole, in an analysis that also includes monitoring of sales by galleries and market exhibitions.
The comparison involves analysing the auctions of similar works (by technique, size, subject), by the same artist or schools and similar areas in terms of style and rhythm, based on which the commercial value of the work can be deduced.
The valuation approach is based on the monitoring of the objective market values of the works included in the class under investigation. This approach is based on three principles:
– it favours a prudential principle, analysing the average values of several different information sources, based on robust, up-to-date and statically representative databases: in a market of "unique" works, for which transactions have sometimes not taken place for decades, this approach ensures the periodic identification of any outlier values and avoids speculative actions;
– it is a comparative method by its very nature, with monitoring of transactions worldwide through many distribution channels, to avoid considering exclusively some transaction forms and the amounts involved therein: in a global market with global demand, this approach enables verification of any geographical arbitrage or the emergence of specific phenomena of appreciation/depreciation that could come to bear on the value;
– it is recursive by nature, since it updates and monitors price trends over the shortest period of time that the specific features of the market allow, i.e. quarterly: in a market in which trades are not monitored daily, the short detection period ensures maximum care and timeliness of any changes.

Valuation frequency.
Artistic assets are revalued by an appraiser every three years. However, a scenario analysis is carried out annually to identify any appreciable changes in value, in which case the appraisal takes place sooner.

Scenario analysis

In order to identify and consider the market changes as these apply to the works being appraised, the relevant exchanges are monitored for signs of significant change that would require appraisals to be conducted earlier than scheduled.

Scenario analysis is fundamentally important in terms of monitoring the market in terms of works similar to those owned by Intesa Sanpaolo, since in recent years significant progress has been made in this area.

In terms of the parameters that are applicable for evaluation purposes, there has been an interesting level of growth and evolution of the market and this has a direct impact on the scenario analyses that will be conducted regularly to monitor the trend.

In the light of the above, a scenario analysis of the art market is conducted annually, based on an examination of the sector publications and the most qualified annual reports produced by leading consulting firms (Deloitte Luxembourg &ArtTactic, Art &Finance Report) or other accredited banking groups (The Art Market 2018. An Art Basel & UBS Report).

Monitoring has two purposes:

- monitoring of the market prices of the prime works/collections included in the Intesa Sanpaolo collections by value; these represent approximately 75% of the total value of the "fine art heritage" class and the monitoring involves following the results of the main international auctions (which take place according to a very specific schedule) and the reports issued by the main world databases (Art Price, Art Net), with analytics that constitute useful tools for monitoring prices;
- monitoring the general overall trends prevalent in of the art market, to pinpoint the trends and innovations that are relevant to Intesa Sanpaolo's "valuable artistic heritage"; this consists in monitoring the outcomes of the main international auctions (which follow a very specific schedule) and the reports issued by the main global databases (Art Price, ArtNet); since the works of many artists whose works are included in the Intesa Sanpaolo collection rarely go up for auction because of the limited number of pieces left on the market, it is important to monitor the performance of similar artists and works; this is why monitoring extends to artists and works in the same areas, so as to ensure that trends are taken into account.

If the annual monitoring indicates that there has been an increase or decrease in value of more than 15% (referring to the individual works/collections of artists featured in the Intesa Sanpaolo collections which are comparable using objective criteria such as size, technique, period of completion, etc.), the appraisals are assigned by following the usual internal procedures , so as to ensure that the carrying amount of these works is aligned.

The analysis is entrusted to appraisers whose reliability, independence and professionalism have been validated.|

Quantitative information

A.4.5 Fair value hierarchy

A.4.5.1 Assets and liabilities carried at fair value on a recurring basis: breakdown by fair value levels

(thousands of euro)

Assets / Liabilities measured at fair value	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Financial assets measured at fair value through profit or loss	**9**	**10,165**	**1,044**	**-**	**9,216**	**193**
Financial assets held for trading	-	10,056	228	-	9,216	193
of which: Equities	-	-	-	-	-	-
of which: UCI	-	-	-	-	-	-
b) Financial assets designated at fair value	-	-	-	-	-	-
c) Other financial assets mandatorily measured at fair value	9	109	816	-	-	-
of which: Equities	-	-	-	-	-	-
of which: UCI	-	-	*805*	-	-	-
2. Financial assets measured at fair value through other comprehensive income	**5,851**	**28,530**	**1,664**	**3,034**	**28,175**	**3,176**
of which: Equities	*4*	*28,179*	*1,620*	*5*	*28,175*	*1,946*
3. Hedging derivatives	**-**	**2,050**	**-**	**-**	**5,057**	**-**
4. Property and equipment	**-**	**-**	**55,493**	**-**	**-**	**56,583**
5. Intangible assets	**-**	**-**	**-**	**-**	**-**	**-**
Total	**5,860**	**40,745**	**58,201**	**3,034**	**42,448**	**59,952**
1. Financial liabilities held for trading	**-**	**10,496**	**-**	**-**	**9,514**	**-**
2. Financial liabilities designated at fair value	**-**	**-**	**-**	**-**	**-**	**-**
3. Hedging derivatives	**-**	**4,565**	**-**	**-**	**2,136**	**-**
Total	**-**	**15,061**	**-**	**-**	**11,650**	**-**

A.4.5.2 Annual changes in assets measured at fair value on a recurring basis (level 3)

(thousands of euro)

	Financial assets measured at fair value through profit or loss				Financial assets measured at fair value through other comprehensive income	Hedging derivatives	Property and .	Intangible assets
	TOTAL	*of which: Financial assets held for trading*	*of which: b) Financial assets designated at fair value*	*of which: c) Other financial assets mandatorily measured at fair value*				
1. Initial amount	**782**	**193**	**-**	**589**	**3,176**	**-**	**56,583**	**-**
2. Increases	**335**	**35**	**-**	**300**	**30**	**-**	**-**	**-**
2.1 Purchases	300	-	-	300		-	-	-
2.2 Gains recognised in:	-	-	-	-	-	-	-	-
2.2.1 Income Statement	-	-	-	-	-	-	-	-
- of which capital gains	-	-	-	-	-	-	-	-
2.2.2. Shareholders' equity	-	X	X	X	-	-	-	-
2.3 Transfers from other levels	-	-	-	-	-	-	-	-
2.4 Other increases	35	35	-	-	30	-	-	-
3. Decreases	**73**	**-**	**-**	**73**	**1,542**	**-**	**1,090**	**-**
3.1 Sales	25	-	-	25	815	-	-	-
3.2 Reimbursements	-	-	-	-	-	-	-	-
3.3 Losses recognised in:	48	-	-	48		-	-	-
3.3.1 Income Statement	*48*	-	-	*48*	-	-	-	-
- of which capital losses	*48*	-	-	*48*	-	-	-	-
3.3.2. Shareholders' equity	-	X	X	X	-	-	-	-
3.4 Transfers to other levels	-	-	-	-	328	-	-	-
3.5 Other decreases	-	-	-	-	399	-	1,090	-
4. Final amount	**1,044**	**228**	**-**	**816**	**1,664**	**-**	**55,493**	**-**

A.4.5.3 Annual changes in liabilities at fair value on a recurring basis (level 3)

In 2018, there were no changes in liabilities at fair value on a recurring basis at level 3.

A.4.5.4 Assets and liabilities not carried at fair value or carried at fair value on a non-recurring basis: breakdown by fair value levels

(thousands of euro)

Assets/Liabilities not measured at fair value or measured at fair value on a non-recurring basis	31.12.2018				31.12.2017			
	Book value	Level 1	Level 2	Level 3	Book value	Level 1	Level 2	Level 3
1. Financial assets measured at amortised cost	2,795,537	-	1,810,488	1,039,469	2,912,271	-	1,821,934	1,154,879
2. Investment property	11,389	-	-	11,389	11,848	-		11,848
3. Non-current assets held for sale and discontinued operatior	-	-	-	-	-	-	-	-
Total	**2,806,926**	**-**	**1,810,488**	**1,050,858**	**2,924,119**	**-**	**1,821,934**	**1,166,727**
1. Financial liabilities measured at amortised cost	2,674,962	-	2,551,879	122,133	2,769,492	-	2,594,484	178,260
2. Liabilities associated with assets held for sale	-	-	-	-	-	-	-	-
Total	**2,674,962**	**-**	**2,551,879**	**122,133**	**2,769,492**	**-**	**2,594,484**	**178,260**

Financial assets and liabilities

For assets and liabilities that are not measured at fair value (receivables and receivables consisting of securities, payables and securities issued), the Bank's practice is to determine fair value by calculating the present value of future cash flows at a rate that incorporates an estimate of the main risks and uncertainties associated with the financial instrument being measured (the "discount rate adjustment approach").

In particular, the interest rate used to discount future cash flows is determined taking into account the following risk factors:

- interest rate risk, which represents the return that the market offers for each unit of capital lent to risk-free counterparties;
- credit risk, which represents the premium for lending capital to counterparties with a risk of default;
- the cost of liquidity associated with the receivable.

For fixed rate instruments, the cash flows are equal to those provided for in the contract; for floating-rate instruments, future cash flows are determined on the basis of forward interest rates implicit in the zero-coupon interest rate curves observed at the different fixing dates, differentiated by type of indexation.

The value of the risk premium (credit spread) is determined at the level of the individual position, through the acquisition of the risk class (LGD) and the rating (PD). These amounts, together with the average residual duration, constitute the guiding criterion for the evaluation of the credit spread. The same rules apply to the construction of spread curves that refer to securities issued by Intesa Sanpaolo.

The following assumptions were used in determining the fair values shown in table A.4.5.4:

- for receivables represented by securities, the same rules are followed as for the fair value measurement of other categories of securities;
- for issued securities, the rules used are the same as those applied to the securities;
- the book value is applied as a reasonable approximation of the fair value for:
  - financial items (assets and liabilities) on demand or with an original duration of 12 months or less and a residual duration of 12 months or less which, in the table, are shown in the column corresponding to level 2 of the fair value hierarchy, except for on-demand investments which are shown in the column corresponding to level 3 of the fair value hierarchy;
  - impaired assets which, in the table, are included in the column corresponding to level 3 of the fair value hierarchy.

A.5 - Day One Profit/Loss

The Bank does not pursue activities that would result in a "day one profit/loss".

Part B – Information on the balance sheet

ASSETS

SECTION 1 - CASH AND CASH EQUIVALENTS - ITEM 10

1.1 Cash and cash equivalents: breakdown

(thousands of euros)

	31.12.2018	31.12.2017
a) Cash	29,981	29,620
b) On-demand deposits at central banks	-	-
TOTAL	**29,981**	**29,620**

SECTION 2 - FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS - ITEM 20

2.1 Financial assets held for trading: breakdown

(thousands of euros)

Captions/Amounts	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
A. Cash assets						
1. Debt securities	-	-	-	-	-	-
1.1 Structured securities	-	-	-	-	-	-
1.2 Other debt securities	-	-	-	-	-	-
2. Equities	-	-	-	-	-	-
3. Quotas of UCI	-	-	-	-	-	-
4. Loans	-	-	-	-	-	-
4.1 Repurchase agreements	-	-	-	-	-	-
4.2 Other	-	-	-	-	-	-
Total A	**-**	**-**	**-**	**-**	**-**	**-**
B. Derivatives						
1. Financial derivatives	-	10,056	228	-	9,216	193
1.1 trading	-	10,056	228	-	9,216	193
1.2 fair value option	-	-	-	-	-	-
1.3 other	-	-	-	-	-	-
2. Credit derivatives	-	-	-	-	-	-
2.1 trading	-	-	-	-	-	-
2.2 fair value option	-	-	-	-	-	-
2.3 other	-	-	-	-	-	-
Total B	**-**	**10,056**	**228**	**-**	**9,216**	**193**
TOTAL (A+B)	**-**	**10,056**	**228**	**-**	**9,216**	**193**

Note that trading derivatives held by the Bank exclusively refer to trading transactions with customers which are perfectly matched with other institutional counterparties (typically Banca Imi and the Parent Company).

2.2. Financial assets held for trading: borrower/issuer breakdown

(thousands of euros)

	31.12.2018	31.12.2017
A) CASH ASSETS		
1. Debt securities	**-**	**-**
a) Central banks	-	-
b) Public administration	-	-
c) Banks	-	-
d) Other financial companies	-	-
of which: insurance companies	-	-
e) Non-financial companies	-	-
2. Equities	-	-
a) Banks	-	-
b) Other financial companies	-	-
of which: insurance companies	-	-
c) Non-financial companies	-	-
d) Other issuers	-	-
3. Quotas of UCI	-	-
4. Loans	-	-
a) Central banks	-	-
b) Public administration	-	-
c) Banks	-	-
d) Other financial companies	-	-
of which: insurance companies	-	-
e) Non-financial companies	-	-
f) Households	-	-
Total A	**-**	**-**
B) DERIVATIVES		
a) Central counterparties	-	-
b) Other	10,284	9,409
Total B	**10,284**	**9,409**
TOTAL (A+B)	**10,284**	**9,409**

2.3 Financial assets designated at fair value: breakdown

Not applicable

2.4 Financial assets designated at fair value: borrower/issuer breakdown

Not applicable

2.5 Other financial assets mandatorily measured at fair value: breakdown

(thousands of euros)

Captions/Amounts	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Debt securities	**-**	**-**	**11**	-	**-**	**-**
1.1 Structured securities	-	-	-	-	-	-
1.2 Other debt securities	-	-	11	-	-	-
2. Equities	**-**	**-**	**-**	**-**	**-**	**-**
3. Quotas of UCI	**-**	**-**	**805**	**-**	**-**	**-**
4. Loans	**9**	**109**	**-**	**-**	**-**	**-**
4.1 Repurchase agreements	-	-	-	-	-	-
4.2 Other	9	109	-	-	-	-
Total	**9**	**109**	**816**	**-**	**-**	**-**

2.6 Other financial assets mandatorily measured at fair value: borrower/issuer breakdown

(thousands of euros)

	31.12.2018	31.12.2017
1. Equities	**-**	**-**
of which: banks	-	-
of which: other financial companies	-	-
of which: non-financial companies	-	-
2. Debt securities	**11**	**-**
a) Central banks	-	-
b) Public administration	-	-
c) Banks	-	-
d) Other financial companies	11	-
of which: insurance companies	-	-
e) Non-financial companies	-	-
3. Quotas of UCI	**805**	**-**
4. Loans	**118**	**-**
a) Central banks	-	-
b) Public administration	-	-
c) Banks	9	-
d) Other financial companies	-	-
of which: insurance companies	-	-
e) Non-financial companies	109	-
f) Households	-	-
Total	**934**	**-**

SECTION 3 - FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME - ITEM 30

3.1 Financial assets measured at fair value through other comprehensive income: breakdown

(thousands of euros)

Captions/Amounts	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Debt securities	**5,847**	**351**	**44**	**3,029**	**-**	**1,230**
1.1 Structured securities	-	-	-	-	-	-
1.2 Other debt securities	5,847	351	44	3,029	-	1,230
2. Equities	**4**	**28,179**	**1,620**	**5**	**28,175**	**1,946**
3. Loans	**-**	**-**	**-**	**-**	**-**	**-**
Total	**5,851**	**28,530**	**1,664**	**3,034**	**28,175**	**3,176**

Financial assets measured at fair value through OCI (equity instruments measured at fair value - level 2) include the new shares issued by Bank of Italy in application of Legislative Decree no.133 of 30 November 2013 converted into Law no. 5 of 29 January 2014 and as a result of the changes in the Articles of Association approved by the Shareholders' Meeting of Bank of Italy on 23 December 2013 which entered into force on 31 December 2013. The aforementioned legislative provision authorized the Bank of Italy to amend its Articles of Association and increase its share capital from 156,000 euro to 7,500,000,000 euro; following the share capital increase, the central bank's share capital is made up of registered shares of 25,000 euro each. The amendments to the articles of association have substantially changed the nature of the securities that represent equity interests in the Bank of Italy by profoundly innovating the associated rights, compared to those prior to the reform. As a result of these changes, as of the 2013 financial statements the shares already held (1,126 shares) were cancelled and were replaced by new securities which have been recognized for an equal number in compliance with the requirements of IAS 39 The value of initial recognition of the new shares (amounting to 28,150 thousand euro) corresponds to their nominal value which was assumed equal to the fair value at that date in compliance with the document “An update of the value of Bank of Italy’s shares” published by the Bank of Italy and the Ministry of Economy and Finance on 9 November 2013.

For the 2018 financial statements, as in the previous year, the investment in Bank of Italy was measured using the direct transaction valuation method, taking into account the transactions occurred from 2015 onwards; these transactions took place at nominal value and this approach therefore confirms the carrying value of the residual shares.
In support of the valuation according to the direct transaction method, a valuation was also carried out using the DDM method, based on the methodological choices already adopted in the 2014 financial statements - where the DDM was the main method for assessing the Bank of Italy shares - and in the 2015, 2016 and 2017 financial statements, where the DDM had been adopted as a control method in view of the direct transactions occurred during the year. For the purposes of the DDM application, the fact that, after 31 December 2016, the dividend is no longer due on shares exceeding 3%, is not a decisive element in evaluating the investment. According to IFRS 13 fair value is a market concept (“exit price”) and not specific to the entity and any specific limitations or characteristics of the financial instrument must be considered only if taken into account by other market operators as well; in the specific case, the limitation for the seller as to the dividend entitlement for shares exceeding 3% would not be transferred to the purchasing entity. A reasonable liquidity discount was also applied to the calculation, to take into account the fact that the shares are not traded on a regulated market and are subject to legal restrictions on their purchase and sale. Based on the DDM, the value of the investment in Bank of Italy is greater than its book value.

3.2 Financial assets measured at fair value through other comprehensive income: borrower/issuer breakdown

(thousands of euros)

Captions/Amounts	**31.12.2018**	**31.12.2017**
1. Debt securities	**6,242**	**4,259**
a) Central banks	-	-
b) Public administration	6,211	3,640
c) Banks	-	-
d) Other financial companies	30	619
of which: insurance companies	-	-
e) Non-financial companies	-	-
2. Equities	**29,803**	**30,126**
a) Banks	28,154	28,155
d) Other issuers:	1,649	1,971
- other financial companies	1,644	1,966
of which: insurance companies	-	-
- non-financial companies	5	5
- other	-	-
3. Loans	**-**	**-**
a) Central banks	-	-
b) Public administration	-	-
c) Banks	-	-
d) Other financial companies	-	-
of which: insurance companies	-	-
e) Non-financial companies	-	-
f) Households	-	-
Total	**36,045**	**34,385**

3.3 Financial assets measured at fair value through other comprehensive income: gross amount and total adjustments

(thousands of euros)

		Gross amount				**Total adjustments**			
		Stage 1	***of which: Instruments with low credit risk***	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**	**Total partial write-offs**
Debt securities		6,234	*34*	-	14	-6	-	-	**-**
Loans		-	-	-	-	-	-	-	**-**
Total	**31.12.2018**	**6,234**	***34***	**-**	**14**	**-6**	**-**	**-**	**X**
Total	**31.12.2017**	**4,259**	***X***	**X**	**X**				**X**
of which: purchased or originated credit-impaired financial assets		*X*	*X*	-	-	*X*	-	-	**-**

SECTION 4 - FINANCIAL ASSETS MEASURED AT AMORTISED COST – ITEM 40

4.1 Financial assets measured at amortised cost: breakdown of amounts due from banks

(thousands of euros)

Transaction type/Amount	31.12.2018						31.12.2017					
	Book value			Fair value			Book value			Fair value		
	Stage 1 and 2	Stage 3	*of which: purchased or originated credit-impaired*	Level 1	Level 2	Level 3	Stage 1 and 2	Stage 3	*of which: purchased or originated credit-impaired*	Level 1	Level 2	Level 3
A. Due from central banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
1. Time deposits	-	-	-	X	X	X	-	-	-	X	X	X
2. Compulsory reserve	-	-	-	X	X	X	-	-	-	X	X	X
3. Repurchase agreements	-	-	-	X	X	X	-	-	-	X	X	X
4. Other	-	-	-	X	X	X	-	-	-	X	X	X
B. Due from banks	**368,467**	**-**	**-**	**-**	**23,648**	**344,825**	**343,366**	**-**	**-**	**-**	**23,722**	**319,645**
1. Loans	368,467	-	-	-	23,648	344,825	343,366	-	-	-	23,722	319,645
1.1 Current accounts and on demand deposits	343,478	-	-	X	X	X	318,517	-	-	X	X	X
1.2. Time deposits	21,324	-	-	X	X	X	21,868	-	-	X	X	X
1.3. Other loans:	3,664	-	-	X	X	X	2,981	-	-	X	X	X
- Reverse repurchase agreements	-	-	-	*X*	*X*	*X*	-	-	-	X	X	X
- Finance leases	-	-	-	*X*	*X*	*X*	-	-	-	X	X	X
- other	*3,664*	-	-	*X*	*X*	*X*	*2,981*	-	-	X	X	X
2. Debt securities	-	-	-	-	-	-	-	-	-	-	-	-
2.1 Structured	-	-	-	-	-	-	-	-	-	-	-	-
2.2 Other	-	-	-	-	-	-	-	-	-	-	-	-
Total	**368,467**	**-**	**-**	**-**	**23,648**	**344,825**	**343,366**	**-**	**-**	**-**	**23,722**	**319,645**

Note that the compulsory reseve with the Bank of Italy is indirectly fulfilled through the Parent Company, where a specific deposit is held which at 31 December 2018 amounted to 21,213 thousand euro.

4.2 Financial assets measured at amortised cost: breakdown of loans to customers

(thousands of euros)

Transaction type/Amount	31.12.2018						31.12.2017					
	Book value			Fair value			Book value			Fair value		
	Stage 1 and 2	Stage 3	*of which: purchased or originated credit-impaired*	Level 1	Level 2	Level 3	Stage 1 and 2	Stage 3	*of which: purchased or originated credit-impaired*	Level 1	Level 2	Level 3
1. Loans	**2,240,414**	**186,656**	**-**	**-**	**1,786,840**	**694,644**	**2,250,347**	**318,558**	**-**	**-**	**1,798,212**	**835,234**
1.1. Current accounts	151,826	31,673	-	X	X	X	181,738	59,817	-	X	X	X
1.2. Reverse repurchase agreements	-	-	-	X	X	X	-	-	-	X	X	X
1.3. Mortgages	1,688,426	131,128	-	X	X	X	1,650,361	219,896	-	X	X	X
1.4. Credit card loans, personal loans, and transfer of one fifth of salaries	37,719	121	-	X	X	X	33,742	188	-	X	X	X
1.5. Finance leases	-	-	-	X	X	X	-	-	-	X	X	X
1.6. Factoring	-	-	-	X	X	X	-	-	-	X	X	X
1.7. Other loans	362,443	23,735	-	X	X	X	384,506	38,657	-	X	X	X
2. Debt securities	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
2.1. Structured securities	-	-	-	-	-	-	-	-	-	-	-	-
2.2. Other debt securities	-	-	-	-	-	-	-	-	-	-	-	-
Total	**2,240,414**	**186,656**	**-**	**-**	**1,786,840**	**694,644**	**2,250,347**	**318,558**	**-**	**-**	**1,798,212**	**835,234**

4.3 - Finance leases

Not applicable

4.4 Financial assets measured at amortised cost: breakdown by borrower/issuer of loans to customers

(thousands of euros)

Transaction type/Amount	31.12.2018			31.12.2017		
	Stage 1 and 2	Stage 3	*Of which: purchased or originated credit-impaired assets*	Stage 1 and 2	Stage 3	*Of which: purchased or originated credit-impaired assets*
1. Debt securities	**-**	**-**	**-**	**-**	**-**	**-**
a) Public administration	-	-	-	-	-	-
b) Other financial companies	-	-	-	-	-	-
of which: insurance companies	-	-	-	-	-	-
c) Non-financial companies	-	-	-	-	-	-
2. Loans	**2,240,414**	**186,656**	**-**	**2,250,347**	**318,558**	**-**
a) Public administration	12,472	-	-	29,418	5,520	-
b) Other financial companies	8,069	7,758	-	10,619	9,011	-
of which: insurance companies	*1,411*	-	-	*2,177*	-	-
c) Non-financial companies	1,028,295	140,056	-	1,273,915	269,009	-
d) Households	1,191,578	38,841	-	936,395	35,018	-
TOTAL	**2,240,414**	**186,656**	**-**	**2,250,347**	**318,558**	**-**

4.5 Financial assets measured at amortised cost: gross amount and total adjustments

(thousands of euros)

		Gross amount				Total adjustments			
		Stage 1	*Of which: Instruments with low credit risk*	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	Total partial write-offs
Debt securities		-	-	-	-	-	-	-	-
Loans		2,322,124	*367,571*	299,838	434,933	3,797	9,285	248,277	**61,164**
Total	**31.12.2018**	**2,322,124**	***367,571***	**299,838**	**434,933**	**3,797**	**9,285**	**248,277**	**X**
Total	**31.12.2017**	**2,600,420**	***X***	**-**	**670,077**	**-**	**6,708**	**351,518**	**X**
of which: purchased or originated credit-impaired financial assets		*X*	*X*	-	-	*X*	-	-	-

SECTION 5 – HEDGING DERIVATIVES – ITEM 50

5.1 Hedging derivatives: breakdown by type of hedge and level

(thousands of euros)

	Fair value 31.12.2018			Notional amount 31.12.2018	Fair value 31.12.2017			Notional amount 31.12.2017
	Level 1	Level 2	Level 3		Level 1	Level 2	Level 3	
A. Financial derivatives								
1. Fair value	-	2,050	-	227,747	-	5,057	-	475,545
2. Cash flows	-	-	-	-	-	-	-	-
3. Foreign investments	-	-	-	-	-	-	-	-
B. Credit derivatives								
1. Fair value	-	-	-	-	-	-	-	-
2. Cash flows	-	-	-	-	-	-	-	-
Total	**-**	**2,050**	**-**	**227,747**	**-**	**5,057**	**-**	**475,545**

Financial derivatives consist of specific fair value hedges on loans to customers ("Capped Loans") and of macro fair value hedges on core deposits (" demand deposit model") and on fixed rate loans to customers.

5.2 Hedging derivatives: breakdown by hedged portfolio and type of hedge

(thousands of euros)

Transactions/Type of hedge	Fair value							Cash flow		Foreign investment
	Specific									
	Debt securities and interest rates	Equities and stock indices	Foreign exchange rates and gold	Credit risk	Commodities	Other	Generic	Specific	Generic	
1. Financial assets measured at fair value through other comprehensive income	-	-	-	-	X	X	X	-	X	X
2. Financial assets measured at amortised cost	98	X	-	-	X	X	X	-	X	X
3. Portfolio	X	X	X	X	X	X	855	X	-	X
4. Other transactions	-	-	-	-	-	-	X	-	X	-
Total assets	**98**	**-**	**-**	**-**	**-**	**-**	**855**	**-**	**-**	**-**
1. Financial liabilities	-	X	-	-	-	-	X	-	X	X
2. Portfolio	X	X	X	X	X	X	1,097	X	-	X
Total liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**1,097**	**-**	**-**	**-**
1. Forecast transactions	X	X	X	X	X	X	X	-	X	X
2. Financial assets and liabilities portfolio	X	X	X	X	X	X	-	X	-	-

Hedging derivatives which at 31 December 2018 have a positive fair value refer to:

- in relation to total assets, specific interest rate hedging instruments on Capped loans for approximately 98 thousand euro and macro hedging instruments on fixed-rate loans for around 855 thousand euro;
- in relation to total liabilities, macro hedging instruments on sight deposits for approximately 1,097 thousand euro.

SECTION 6 – FAIR VALUE CHANGE OF FINANCIAL ASSETS IN HEDGED PORTFOLIOS – ITEM 60

6.1 Fair value change of hedged assets: breakdown by hedged portfolios

(thousands of euros)

Fair value change of hedged assets/Amounts	31.12.2018	31.12.2017
1. Positive fair value change	**1,632**	**-**
1.1. of specific portfolios:	-	-
a) financial assets measured at amortised cost	-	-
b) financial assets measured at fair value through other comprehensive income	-	-
1.2. overall	1,632	-
2. Negative fair value change	**-**	**-2,881**
2.1. in specific portfolios:	-	-2,881
a) financial assets measured at amortised cost	-	*-2,881*
b) financial assets measured at fair value through other comprehensive income	-	-
2.2. overall	-	-
TOTAL	**1,632**	**-2,881**

SECTION 7 – INVESTMENTS IN ASSOCIATES AND COMPANIES SUBJECT TO JOINT CONTROL – CAPTION 70

7.1 Investments in associates and companies subject to joint control: information on investments

	Titles	Legal headquarters/Operating headquarters	Stake %	Voting rights %
C. COMPANIES SUBJECT TO SIGNIFICANT INFLUENCE				
1	Intesa Sanpaolo Group Services S.c.p.A.	Turin	0.001	
2	Sviluppo Industriale S.p.A. in liquidation and subject to a creditors' arrangement	Florence	28.266	

(*) Voting rights at the ordinary Shareholders' Meeting. Voting rights are only recorded if different from the percentage of share capital.

The reasons why an investee is subject to significant influence are described in Part A - Accounting Policies, to which reference is made.

7.2 Significant investments: balance sheet value, fair value and dividends received

(thousands of euros)

	Titles	Book value	Fair value (*)	Dividends received
A. WHOLLY CONTROLLED SUBSIDIARIES				
B. JOINTLY CONTROLLED SUBSIDIARIES				
C. COMPANIES SUBJECT TO SIGNIFICANT INFLUENCE				
1	Intesa Sanpaolo Group Services S.c.p.A.	10		
2	arrangement	-		
TOTAL		**10**	**-**	**-**

(*) Fair value is not indicated, as there are no listed companies.

7.3 Individually material investments in associates and companies subject to joint control: financial information

(thousands of euros)

Titles	Cash and cash equivalents:	Financial assets	Non-financial assets	Financial liabilities	Non-financial liabilities	Total revenue (**)	Margin of interest	Value adjustments and recoveries on tangible and intangible assets	Profit (loss) on current operations before tax	Profit (loss) on current operations after tax	Profit (loss) on groups of assets held for sale after tax	Profit (loss) for the period (1)	Other income components after tax (2)	Overall profitability (3) = (1) + (2)
C. COMPANIES SUBJECT TO SIGNIFICANT INFLUENCE														
1 Intesa Sanpaolo Group Services S.c.p.A.	X	3,393	2,669,894	1,321,904	883,759	1,914,008	-10,334	X	4,973	-	-	-	-	-
2 Sviluppo Industriale S.p.A. in liquidation and subject to a creditors' arrangement (*)	X	116	90	1,392	100	165	X	X	130	130		130	-	130

(*) Dates refer to the 2016 financial statement

(**) Total revenue indicates the overall amount of the income components with a positive effect before tax

7.5 Investments in associates and companies subject to joint control: annual changes

(thousands of euros)

	31.12.2018	31.12.2017
A. Initial balance	**10**	**49**
B. Increases	**-**	**-**
B.1 purchases	-	-
of which business combinations	-	-
B.2 recoveries	-	-
B.3 revaluations	-	-
B.4 other changes	-	-
C. Decreases	**-**	**-39**
C.1 sales	-	-39
of which business combinations	-	-
C.2 impairment losses	-	-
C.3 write-downs	-	-
C.4 other changes	-	-
D. Final amount	**10**	**10**
E. Total revaluations	**-**	**-**
F. Total impairment losses	**-**	**-**

SECTION 8 – PROPERTY AND EQUIPMENT – CAPTION 80

8.1 Property and equipment used in operations: breakdown of assets measured at cost

(thousands of euros)

Assets/Amounts	31.12.2018	31.12.2017
1. Property and equipment owned	**3,077**	**3,340**
a) land	-	-
b) buildings	-	-
c) furniture	2,191	2,438
d) electronic equipment	883	899
e) other	3	3
2. Property and equipment acquired under finance lease	**-**	**-**
a) land	-	-
b) buildings	-	-
c) furniture	-	-
d) electronic equipment	-	-
e) other	-	-
Total	**3,077**	**3,340**
of which: resulting from the enforcement of guarantees	-	-

8.2 Investment property: breakdown of assets measured at cost

Not applicable

8.3 Property and equipment used in operations: breakdown of revalued assets

(thousands of euros)

Assets/Amounts	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Property and equipment owned	**-**	**-**	**44,104**	**-**	**-**	**44,735**
a) land	-	-	10,858	-	-	12,773
b) buildings	-	-	25,359	-	-	24,075
c) furniture	-	-	7,887	-	-	7,887
d) electronic equipment	-	-	-	-	-	-
e) other	-	-	-	-	-	-
2. Property and equipment acquired under finance lease	**-**	**-**	**-**	**-**	**-**	**-**
a) land	-	-	-	-	-	-
b) buildings	-	-	-	-	-	-
c) furniture	-	-	-	-	-	-
d) electronic equipment	-	-	-	-	-	-
e) other	-	-	-	-	-	-
Total	**-**	**-**	**44,104**	**-**	**-**	**44,735**
of which: resulting from the enforcement of guarantees	-	-	-	-	-	-

8.4 Investment property: breakdown of assets measured at fair value

(thousands of euros)

Assets/Amounts	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
1. Property and equipment owned	**-**	**-**	**11,389**	**-**	**-**	**11,848**
a) land	-	-	3,770	-	-	3,219
b) buildings	-	-	7,619	-	-	8,629
2. Property and equipment acquired under finance lease	**-**	**-**	**-**	**-**	**-**	**-**
a) land	-	-	-	-	-	-
b) buildings	-	-	-	-	-	-
TOTAL	**-**	**-**	**11,389**	**-**	**-**	**11,848**
of which: resulting from the enforcement of guarantees	-	-	-	-	-	-

8.5 Inventories of property and equipment governed by IAS 2: breakdown

Not applicable

8.6 Property and equipment used in operations: annual changes

(thousands of euros)

	Land	Buildings	Furniture	Electronic equipment	c) valuable art assets	Other	Total
A. Gross initial carrying amount	**12,773**	**24,075**	**10,671**	**11,624**	**7,887**	**61**	**67,091**
A.1 Total net adjustments	-	-	8,233	10,725		58	19,016
A.2 Net initial carrying amount	**12,773**	**24,075**	**2,438**	**899**	**7,887**	**3**	**48,075**
B. Increases	**-**	**2,119**	**58**	**423**	**-**	**1**	**2,601**
B.1 Purchases	-	-	58	422	-	-	480
of which business combinations	-	-	-	-	-	-	-
B.2 Capitalised improvement costs	-	204	-	-	-	-	204
B.3 Recoveries	-	-	-	-	-	-	-
B.4 Positive fair value differences recognised in	-	-	-	-	-	-	-
a) shareholders' equity	-	-	-	-	-	-	-
b) income statement	-	-	-	-	-	-	-
B.5 Positive foreign exchange differences	-	-	-	-	-	-	-
B.6 Transfer from investment property	-	-	X	X	X	X	-
B.7 Other changes	-	1,915	-	1	-	1	1,917
C. Decreases	**-1,915**	**-835**	**-305**	**-439**	**-**	**-1**	**-3,495**
C.1 Sales	-	-	-	-	-	-	-
of which business combinations	-	-	-	-	-	-	-
C.2 Depreciation	-	-835	-301	-439	-	-1	-1,576
C.3 Impairment losses recognised in	-	-	-	-	-	-	-
a) shareholders' equity	-	-	-	-	-	-	-
b) income statement	-	-	-	-	-	-	-
C.4 Negative fair value differences recognised in	-	-	-	-	-	-	-
a) shareholders' equity	-	-	-	-	-	-	-
b) income statement	-	-	-	-	-	-	-
C.5 Negative foreign exchange differences	-	-	-	-	-	-	-
C.6 Transfer to:	-	-	-	-	-	-	-
a) investment property	-	-	X	X	X	X	-
b) non-current assets held for sale and discontinued operations	-	-	-	-	-	-	-
C.7 Other changes	-1,915	-	-4	-	-	-	-1,919
D. Net final carrying amount	**10,858**	**25,359**	**2,191**	**883**	**7,887**	**3**	**47,181**
D.1 Total net adjustments	-	835	8,534	11,164		57	20,590
D.2 Gross final carrying amount	**10,858**	**24,524**	**10,725**	**12,047**	**7,887**	**60**	**66,101**
E. Measurement at cost	8,871	22,319	-	-	3,799	-	-

Sub-items A.1 and D.1 show the amounts of accumulated amortization and accumulated depreciation as well as the adjustments recognized to align the carrying amount of the asset to its recoverable value.

8.7 Investment property: annual changes

(thousands of euros)

	Total 31/12/2018	
	Land	Buildings
A. Initial balance	**3,219**	**8,629**
B. Increases	**817**	**30**
B.1 Purchases	-	-
of which business combinations	-	-
B.2 Capitalised improvement costs	-	-
B.3 positive fair value differences	-	-
B.4 Recoveries	-	-
B.5 Positive foreign exchange differences	-	-
B.6 Transfer from property used in operations	-	-
B.7 Other changes	817	30
C. Decreases	**-267**	**-1,039**
C.1 Sales	-	-
of which business combinations	-	-
C.2 Depreciation	-	-
C.3 Negative fair value differences	-172	-287
C.4 Impairment losses	-	-
C.5 Negative foreign exchange differences	-	-
C.6 Transferral to other activity portfolios	-	-
a) property used in operations	-	-
b) non-current assets held for sale and discontinued operations	-	-
C.7 Other changes	-95	-752
D. Final amount	**3,769**	**7,620**
E. Fair value measurement	-	-

No value is reported in sub-item E as according to Bank of Italy’s instructions this item must be filled out only for buildings accounted for at cost.

8.8 Inventories of property and equipment governed by IAS 2: annual changes

Not applicable

SECTION 9 – INTANGIBLE ASSETS - CAPTION 90

9.1 Intangible assets: breakdown by type of asset

(thousands of euros)

Assets/Amounts	31.12.2018		31.12.2017	
	Finite useful life	Indefinite useful life	Finite useful life	Indefinite useful life
A.1 Goodwill	**X**	**17,100**	**X**	**17,100**
A.2 Other intangible assets	**-**	**-**	**-**	**-**
A.2.1 Assets measured at cost	-	-	-	-
a) Internally generated intangible assets	-	-	-	-
b) Other assets	-	-	-	-
A.2.2 Assets measured at fair value	-	-	-	-
a) Internally generated intangible assets	-	-	-	-
b) Other assets	-	-	-	-
Total	**-**	**17,100**	**-**	**17,100**

Goodwill

The goodwill recorded at 31 December 2018, amounting to 17,100 thousand euro, was tested for impairment as a result of which no adjustments were required.

The methods for allocating goodwill to the cash-generating units ("CGUs") and for testing it for impairment are described in detail in paragraph 16 "Other information" in part A.2 of these explanatory notes.
In particular, within the Intesa Sanpaolo Group, the CGUs that over time have benefited from business combination synergies and which correspond to the group business units are listed below:
- Banca dei territori;
- Corporate and investment banking;
-Foreign Banks;
- Private Banking;
- Asset Management;
- Insurance.

In line with the provisions of IAS 36, the Intesa Sanpaolo Group has tested for impairment the goodwill allocated to the above CGUs.
Cassa di Risparmio di Pistoia e della Lucchesia is included in Banca dei Territori CGU; accordingly, the goodwill recorded in the separate financial statements was not considered as a single asset and its value was tested for impairment with reference to the greater CGU of which the Bank is part.
The Parent Company carried out the impairment test on the goodwill of its CGUs, including therefore the Banca dei Territori CGU, estimating their value in use by discounting the expected cash flows determined at the operating division level; the outcome of the consolidated impairment test on the Banca dei Territori division did not result in any impairment loss for the division's goodwill.
In the absence of independent cash flow forecast for the individual banks included in the Banca dei Territori Division, the implied Goodwill/ Total deposits (goodwill on total deposits) multiple of Banca dei Territori division was taken into account and applied to the corresponding values of Banca CR Firenze.
Given the Group's organizational model, this method was considered as a "proxy" of the Bank's value in use.

The method described above has determined a recoverable value of the goodwill which is higher than its book value.

9.2 Intangible assets: annual changes

(thousands of euros)

	Goodwill	Other intangible assets: internally generated		Other intangible assets: other		Total
		Finite useful life	Indefinite useful life	Finite useful life	Indefinite useful life	
A. Initial balance	**17,100**	**-**	**-**	**-**	**-**	**17,100**
A.1 Total net adjustments	-	-	-	-	-	-
A.2 Net initial carrying amount	**17,100**	**-**	**-**	**-**	**-**	**17,100**
B. Increases	**-**	**-**	**-**	**-**	**-**	**-**
B.1 Purchases	-	-	-	-	-	-
of which business combinations	-	-	-	-	-	-
intangible assets	X	-	-	-	-	-
B.3 Recoveries	X	-	-	-	-	-
recognised in	-	-	-	-	-	-
- shareholders' equity	X	-	-	-	-	-
- income statement	X	-	-	-	-	-
B.5 Positive foreign exchange differences	-	-	-	-	-	-
B.6 Other changes	-	-	-	-	-	-
C. Decreases	**-**	**-**	**-**	**-**	**-**	**-**
C.1 Sales	-	-	-	-	-	-
of which business combinations	-	-	-	-	-	-
C.2 Impairment losses	-	-	-	-	-	-
- Amortisation	X	-	-	-	-	-
- Write-downs recognised in	-	-	-	-	-	-
shareholders' equity	X	-	-	-	-	-
income statement	-	-	-	-	-	-
C.3 Negative fair value differences	-	-	-	-	-	-
- shareholders' equity	X	-	-	-	-	-
- income statement	X	-	-	-	-	-
C.4 Transferral to non-current assets held for sale	-	-	-	-	-	-
C.5 Negative foreign exchange differences	-	-	-	-	-	-
C.6 Other changes	-	-	-	-	-	-
D. Net final carrying amount	**17,100**	**-**	**-**	**-**	**-**	**17,100**
D.1 Total net adjustments	1,700	-	-	-	-	1,700
E. Gross final carrying amount	**18,800**	**-**	**-**	**-**	**-**	**18,800**
F. Measurement at cost	**-**	**-**	**-**	**-**	**-**	**-**

SECTION 10 - TAX ASSETS AND TAX LIABILITIES - ITEM 100 OF ASSETS AND ITEM 60 OF LIABILITIES

IAS 12 provides for the recognition of deferred tax liabilities and assets according to the following criteria:
- taxable temporary differences: a deferred tax liability must be recognized for all taxable temporary differences;
- deductible temporary differences: a deferred tax asset must be recognized for all deductible temporary differences if it is probable that taxable income will be achieved against which the deductible temporary difference can be used. Deferred tax assets that were not recognized in a specific year - as the conditions for their recognition were not met - must be recognized in the year in which these requirements are met.

Accordingly, the amount of deferred tax assets recognized in the financial statements must be tested annually (Probability test) to verify whether there is reasonable certainty that taxable income will be achieved in the future and that, therefore, the deferred tax assets can be recovered.
Considering that Cassa di Risparmio di Pistoia e della Lucchesia, like most other Group companies, participates in the tax consolidation, the recognition requirements are verified by the Consolidating entity which, after assessing the Group's prospective income capacity, communicates the outcome of the probability test on an annual basis. Therefore, the positive outcome of the probability test satisfies the requirements for recognition of deferred tax assets in the Bank's financial statements.

The deferred tax assets under law 214/2011, recognized in respect of the write-down of receivables and the amortization of goodwill and intangible assets, are reported in table 13.3.1. In this regard, it should be noted that Legislative Decree 225/2010, converted with amendments into Law 10/2011 as amended, states that, when specific financial requirements are met, the aforementioned deferred tax assets are convered into receivables from the Inland Revenue, so that, in addition to their reversal at the respective deadlines, these assets benefit from an additional and supplementary recovery method which automatically makes the probability test for these types of deferred tax assets fully satisfied.

Taking into account the Bank’s tax position and the positive outcome of the probability test, all deferred tax assets and liabilities were accounted for by applying the IRES and IRAP tax rates currently in force; in this regard it should be noted that these rates are respectively 27.5% and 5.57% as the Stability Law for 2016, although it has provided for a reduction of the IRES rate from 27.5% to 24.0% as of 1 January 2017, has simultaneously introduced an additional 3.5% IRES tax for credit and financial institutions.
It should also be noted that following the regulatory amendment which, starting in 2015, has introduced the IRAP deductibility of personnel expenses for employees with a permanent employment contract, deferred IRAP tax assets were recognized on personnel allowances which will be fiscally relevant at the time of their use.
Finally, it should be noted that no deferred tax assets are recognized on IRES tax losses as a result of participation in the Parent Company's National Tax Consolidation; however, deferred tax assets are recognized for tax losses in respect of the IRES surcharge.

In accordance with IAS/ IFRS requirements, current and deferred assets and/or liabilities are recognized in relation to shareholders' equity items mainly associated with the change in the criterion for measuring tangible assets, the securities and investment portfolio valuation effect and the recognition of *actuarial gains or losses* on liability provisions measured according to IAS 19.

The “Share Capital” item includes reserves subject to taxation upon distribution totaling 57,607 thousand euro, established on the basis of Laws 823/1973, 576/1975, 72/1983, 408/1990, 413/1991, 342/2000 and 266/2005, for which, however, no deferred tax liabilities were recognized (with a total theoretical amount of 19,051 thousands euro) since a reduction in the share capital that could lead to the payment of the aforementioned taxes is currently unlikely.

10.1 Deferred tax assets: breakdown

(thousands of euros)

	31.12.2018	31.12.2017
Balancing entry in the income statement		
A. Deductible temporary differences		
Adjustments to loans deductible in future years	51,580	38,128
Provisions for future expenses	2,174	2,286
Higher tax value of investments, securities and other assets	12	12
Extraordinary expenses on leaving incentives	4,771	4,844
Other	5,618	7,362
B. Taxable temporary differences		
Costs deducted not for accounting purposes pursuant to article 109 of the TUIR	-	-
Capital gains in instalments	-	-
Difference between book value and tax value pursuant to article 128 of the TUIR	-	-
Lower tax value of investments, securities and other assets	-	-
Other	-	-
TOTAL	**64,155**	**52,632**
As a balancing entry in net worth		
Cash flow hedge	-	-
Recognition of actuarial gains (losses)	1,069	1,359
Financial assets measured at fair value through other comprehensive income	78	24
TOTAL	**1,147**	**1,383**
Total deferred tax assets:	**65,302**	**54,015**

“Other” deferred tax assets mainly refer to the residual deductibility of goodwill.
The significant increase in the item "Adjustments to loans and receivables deductible in future years" is exclusively due to the 2019 Budget Law (Law No. 145 of 30 December 2018), which provided for the tax deductibility over ten years of the adjustments to loans to customers recognized upon first application of the IFRS 9.

10.2 Deferred tax liabilities: breakdown

(thousands of euros)

	31.12.2018	31.12.2017
Balancing entry in the income statement	**-**	**-**
A. Taxable temporary differences		
Costs deducted not for accounting purposes pursuant to article 109 of the TUIR	-	-
TFR	-	-
Capital gains in instalments	-	-
Lower tax value of securities and other assets	-	-
Other	2,173	424
A. Deductible temporary differences		
Adjustments to loans deductible in future years	-	-
Higher tax value of securities and other assets	-	-
Other		
TOTAL	**2,173**	**424**
As a balancing entry in net worth	**-**	**-**
Cash flow hedge	-	-
Reserves L. 169/83	-	-
Reserves L. 213/98	-	-
Financial assets measured at fair value through other comprehensive income	1	23
Property and equipment	6,231	6,977
TOTAL	**6,232**	**7,000**
Total deferred-tax liabilities	**8,405**	**7,424**

10.3 Changes in deferred tax assets (as contra entry in the income statement)

(thousands of euros)

	31.12.2018	31.12.2017
1. Initial amount	**65,963**	**49,714**
2. Increases	**4,951**	**9,239**
2.1 Deferred tax recognised in the period	4,951	9,239
a) compared to previous periods	-	-
b) due to changes in accounting criteria	-	-
c) value recoveries	-	-
d) other	4,951	9,239
2.2 New taxes or increases in tax rates	-	-
2.3 Other increases	-	-
3. Decreases	**-6,759**	**-6,321**
3.1 Deferred tax recognised in the period	-3,022	-4,906
a) reversals	-3,022	-4,906
b) write-downs for non-recoverability	-	-
b) changes in accounting criteria	-	-
d) other	-	-
3.2 Reductions in tax rates	-	-
3.3 Other decreases	-3,737	-1,415
a) transformation into tax credits pursuant to Law 214/2011	-3,737	-1,415
b) other	-	-
4. Final amount	**64,155**	**52,632**

10.3bis Changes in deferred tax assets pursuant to Law 214/2011

(thousands of euros)

	31.12.2018	31.12.2017
1. Initial amount	**44,876**	**46,291**
2. Increases	**-**	**2,902**
3. Decreases	**-3,737**	**-4,317**
3.1 Reversals	-	-2,902
3.2 Transformation into tax credits	-3,737	-1,415
a) deriving from losses in the period	*-835*	*-1,259*
b) deriving from tax losses	*-2,902*	*-156*
3.3 Other decreases	-	-
4. Final amount	**41,139**	**44,876**

10.4 Changes in deferred tax liabilities (as contra entry in the income statement)

(thousands of euros)

	31.12.2018	31.12.2017
1. Initial amount	**424**	**851**
2. Increases	**1,770**	**95**
2.1 Deferred tax recognised in the period	1,014	95
a) compared to previous periods	-	-
b) due to changes in accounting criteria	-	-
c) other	1,014	95
2.2 New taxes or increases in tax rates	-	-
2.3 Other increases	756	-
3. Decreases	**-21**	**-522**
3.1 Deferred tax cancelled in the period	-21	-522
a) reversals	-21	-522
b) due to changes in accounting criteria	-	-
c) other	-	-
3.2 Reductions in tax rates	-	-
3.3 Other decreases	-	-
4. Final amount	**2,173**	**424**

10.5 Changes in deferred tax assets (as contra entry in shareholders' equity)

(thousands of euros)

	31.12.2018	31.12.2017
1. Initial amount	**1,383**	**1,276**
2. Increases	**144**	**190**
2.1 Deferred tax recognised in the period	144	190
a) compared to previous periods	-	-
b) due to changes in accounting criteria	-	-
c) other	144	190
2.2 New taxes or increases in tax rates	-	-
2.3 Other increases	-	-
3. Decreases	**-380**	**-83**
3.1 Deferred tax recognised in the period	-380	-83
a) reversals	-380	-83
b) write-downs for non-recoverability	-	-
c) due to changes in accounting criteria	-	-
d) other	-	-
3.2 Reductions in tax rates	-	-
3.3 Other decreases	-	-
4. Final amount	**1,147**	**1,383**

10.6 Changes in deferred tax liabilities (as contra entry in shareholders' equity)

(thousands of euros)

	31.12.2018	31.12.2017
1. Initial amount	**7,000**	**17**
2. Increases	**381**	**6,983**
2.1 Deferred tax recognised in the period	381	6,983
a) compared to previous years	-	-
b) due to changes in accounting criteria	-	-
c) other	381	6,983
2.2 New taxes or increases in tax rates	-	-
2.3 Other increases	-	-
3. Decreases	**-1,149**	**-**
3.1 Deferred tax cancelled in the period	-1,149	-
a) reversals	-1,149	-
b) due to changes in accounting criteria	-	-
c) other	-	-
3.2 Reductions in tax rates	-	-
3.3 Other decreases	-	-
4. Final amount	**6,232**	**7,000**

10.7 Other information

No further information is provided other than that already provided in this Section.

SECTION 11 - NON-CURRENT ASSETS HELD FOR SALE, DISCONTINUED OPERATIONS AND ASSOCIATED LIABILITIES - ASSET ITEM 110 AND LIABILITY ITEM 70

11.1 Non-current assets held for sale and discontinued operations: breakdown by type of asset

Not applicable

SECTION 12 - OTHER ASSETS - ITEM 120

12.1 Other assets: breakdown

(thousands of euros)

Items	TOTAL
Due to tax authorities	5,734
Amounts to be credited and items under processing	8,129
Items in transit with branches and subsidiaries	302
Debit items in regulation currency	7
Cheques and other instruments held	5,148
Items relating to transactions in securities	5
Leasehold improvements	1,359
Other items	23,734
Accruals and prepayments	1,090
Personnel suspended	131
Active cycle	1,409
Stamp duty	649
Lawsuits and shortfalls	313
Positive balances from current accounts, banks and cheques	25
TOTAL 31/12/2018	**48,035**
TOTAL 31/12/2017	**46,762**

LIABILITIES

SECTION 1 – FINANCIAL LIABILITIES MEASURED AT AMORTISED COST - ITEM 10

1.1 Financial liabilities measured at amortised cost: breakdown of amounts due to banks

(thousands of euros)

Transaction type/Amount	31.12.2018				31.12.2017			
	Book value	Fair value			Book value	Fair value		
		Level 1	Level 2	Level 3		Level 1	Level 2	Level 3
1. Due to central banks	-	X	X	X	-	X	X	X
2. Due to banks	**548,137**	X	X	X	**557,238**	X	X	X
2.1 Current accounts and on demand deposits	14,995	X	X	X	1,790	X	X	X
2.2 Time deposits	532,691	X	X	X	555,022	X	X	X
2.3 Loans	108	X	X	X	139	X	X	X
2.3.1 Repurchase agreements	-	X	X	X	-	X	X	X
2.3.2 Other	108	X	X	X	139	X	X	X
2.4 Debts for commitments to repurchase own equity instruments	-	X	X	X	-	X	X	X
2.5 Other debts	343	X	X	X	287	X	X	X
Total	**548,137**		**447,837**	**100,108**	**557,238**		**456,910**	**103,561**

1.2 Financial liabilities measured at amortised cost: breakdown of amounts due to customers

(thousands of euros)

Transaction type/Amount	31.12.2018				31.12.2017			
	Book value	Fair value			Book value	Fair value		
		Level 1	Level 2	Level 3		Level 1	Level 2	Level 3
1. Current accounts and on demand deposits	2,070,908	X	X	X	2,105,124	X	X	X
2. Time deposits	21,662	X	X	X	75,500	X	X	X
3. Loans	1,071	X	X	X	560	X	X	X
3.1 Repurchase agreements	-	X	X	X	7	X	X	X
3.2 Other	1,071	X	X	X	560	X	X	X
4. Debts for commitments to repurchase own equity instruments	-	X	X	X	-	X	X	X
5. Other debts	32,426	X	X	X	29,770	X	X	X
Total	**2,126,067**		**2,104,042**	**22,025**	**2,210,954**		**2,136,929**	**74,044**

1.3 Financial liabilities measured at amortised cost: breakdown of securities issued

(thousands of euros)

Transaction type/Amount	31.12.2018				31.12.2017			
	Book value	Fair value			Book value	Fair value		
		Level 1	Level 2	Level 3		Level 1	Level 2	Level 3
A. Securities								
1. bonds	-	-	-	-	-	-	-	-
1.1 structured	-	-	-	-	-	-	-	-
1.2 other	-	-	-	-	-	-	-	-
2. other securities	758	-	104	654	1,300	-	645	655
2.1 structured	-	-	-	-	-	-	-	-
2.2 other	758	-	104	654	1,300	-	645	655
TOTAL	**758**	**-**	**104**	**654**	**1,300**	**-**	**645**	**655**

As at 31 December 2018, the item only includes certificates of deposit.

1.4 Details of subordinated payables/securities

No cases.

1.5 Details of structured payables

No cases.

1.6 Financial leasing payables

No cases.

SECTION 2 – FINANCIAL LIABILITIES HELD FOR TRADING - ITEM 20

2.1 Financial liabilities held for trading: breakdown

(thousands of euros)

Transaction type/Amount	31.12.2018					31.12.2017				
	Nominal or notional amount	Fair value			Fair value (*)	Nominal or notional amount	Fair value			Fair value (*)
		Level 1	Level 2	Level 3			Level 1	Level 2	Level 3	
A. CASH LIABILITIES										
1. Due to banks	-	-	-	-	-	-	-	-	-	-
2. Due to customers	-	-	-	-	-	-	-	-	-	-
3. Debt securities	-	-	-	-	X	-	-	-	-	X
3.1 Bonds	-	-	-	-	X	-	-	-	-	X
3.1.1 structured	-	-	-	-	X	-	-	-	-	X
3.1.2 other bonds	-	-	-	-	X	-	-	-	-	X
3.2 Other	-	-	-	-	X	-	-	-	-	X
3.2.1 structured	-	-	-	-	X	-	-	-	-	X
3.2.2 other	-	-	-	-	X	-	-	-	-	X
Total A	-	-	-	-	-	-	-	-	-	-
B. DERIVATIVES										
1. Financial derivatives	X	-	10,496	-	X	X	-	9,514	-	X
1.1 Trading	X	-	10,496	-	X	X	-	9,514	-	X
1.2 Fair value option	X	-	-	-	X	X	-	-	-	X
1.3 Other	X	-	-	-	X	X	-	-	-	X
2. Credit derivatives	X	-	-	-	X	X	-	-	-	X
2.1 Trading	X	-	-	-	X	X	-	-	-	X
2.2 Fair value option	X	-	-	-	X	X	-	-	-	X
2.3 Other	X	-	-	-	X	X	-	-	-	X
Total B	X	-	10,496	-	X	X	-	9,514	-	X
TOTAL (A+B)	X	-	10,496	-	X	X	-	9,514	-	X

(*) Fair value calculated excluding changes in creditworthiness of the issuer after issue date.

It should be noted that the trading derivatives held by "Cash" relate only to trading transactions with clients, fully matched by other counterparty institutions (typically Banca IMI and the parent company).

2.2 Details of financial liabilities held for trading: subordinated liabilities

No cases.

2.3 Details of financial liabilities held for trading: structured payables

No cases.

SECTION 3 – FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE – ITEM 30

No cases.

SECTION 4 - HEDGING DERIVATIVES – ITEM 40

4.1. Hedging derivatives: breakdown by type of hedge and level

(thousands of euros)

	Notional amount	Fair value	31.12.2018		Notional amount	Fair value	31.12.2017	
	31.12.2018	Level 1	Level 2	Level 3	31.12.2017	Level 1	Level 2	Level 3
A) Financial derivatives	**408,116**	**-**	**4,565**	**-**	**114,237**	**-**	**2,136**	**-**
1) Fair value	408,116	-	4,565	-	114,237	-	2,136	-
2) Cash flows	-	-	-	-	-	-	-	-
3) Foreign investments	-	-	-	-	-	-	-	-
B. Credit derivatives	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
1) Fair value	-	-	-	-	-	-	-	-
2) Cash flows	-	-	-	-	-	-	-	-
Total	**408,116**	**-**	**4,565**	**-**	**114,237**	**-**	**2,136**	**-**

Information on the types of hedging is provided in Section 5 "Hedging derivatives", in Item 50 of "Assets".

4.2. Hedging derivatives: breakdown by hedged portfolio and type of hedge

(thousands of euros)

Transactions/Type of hedge	**Fair value**							**Cash flow**		**Foreign investments**
	Specific									
	debt securities and interest rates	equities and stock indices	foreign exchange rates and gold	credit risk	commodities	other	Generic	Specific	Generic	
1. Financial assets measured at fair value through other comprehensive income	-	-	-	-	X	X	X	-	X	X
2. Financial assets measured at amortis	-	X	-	-	X	X	X	-	X	X
3. Portfolio	X	X	X	X	X	X	4,565	X	-	X
4. Other transactions	-	-	-	-	-	-	X	-	X	-
Total assets	**-**	**-**	**-**	**-**	**-**		**4,565**	**-**	**-**	**-**
1. Financial liabilities	-	X	-	X	-	-	X	-	X	X
2. Portfolio	X	X	X	X	X	X	-	X	-	X
Total liabilities	**-**	**-**	**-**	**-**	**-**		**-**	**-**	**-**	**-**
1. Forecast transactions	X	X	X	X	X	X	X	-	X	X
2. Financial assets and liabilities portfolio	X	X	X	X	X	X	-	X	-	-

The hedging derivatives that at 31 December 2018 presented a negative fair value relate to macro-hedging instruments for rate risks on fixed-rate loans.

SECTION 5 – FAIR VALUE CHANGE OF LIABILITIES IN HEDGED PORTFOLIOS – ITEM 50

5.1 Fair value change of hedged liabilities: breakdown by hedged portfolio

(thousands of euros)

Fair value change of hedged assets/Amounts	31.12.2018	31.12.2017
1. Positive fair value change of financial liabilities	829	1,432
2. Negative fair value change of financial liabilities	-	-
TOTAL	**829**	**1,432**

This item recognises the net change in the value of the liabilities covered by macro-hedging the interest rate risk. The Banca, making use of the powers set out in IAS 39 when defining carve-outs, has adopted the aforementioned macro-hedging to cover on-demand items (core deposits).

SECTION 6 – TAX LIABILITIES – ITEM 60

For information for this section, refer to Section 10 of "Assets".

SECTION 7 – LIABILITIES LINKED TO ASSETS HELD FOR SALE - ITEM 70

For information for this section, refer to Section 11 of "Assets".

SECTION 8 - OTHER LIABILITIES - ITEM 80

8.1 Other liabilities: breakdown

(thousands of euros)

Captions	31.12.2018
Amounts to be credited and items under processing	4,128
Amounts due to third parties	2,601
Items in transit with Italian branches	11
Illiquid items for portfolio transactions	36,157
Personnel expenses	946
Due to tax authorities	4,592
Credit items in regulation currency	2
Due to suppliers	11,028
Credit transfers in progress	10,860
Doubtful accounts being allocated	571
Loans to INPS for treasury fund and other social security contributions to be paid	1,748
Other items - insurance premiums	378
Other liabilities	17,151
Surplus cash	391
Accruals and deferred income	892
TOTAL 31/12/2018	**91,456**
TOTAL 31/12/2017	**63,387**

SECTION 9 - EMPLOYEE TERMINATION INDEMNITIES - ITEM 90

9.1 Employee termination indemnities: annual changes

(thousands of euros)

	31.12.2018	31.12.2017
A. Initial balance	**19,526**	**21,185**
B. Increases	**849**	**426**
B.1 Provisions in the year	184	214
B.2 Other	665	212
C. Decreases	**-3,601**	**-2,085**
C.1 Benefits paid	-2,400	-1,950
C.2 Other	-1,201	-135
D. Final amount	**16,774**	**19,526**

Sub-item B.1 is made up of provisions for 8 thousand euros and interest cost for the remaining 176 thousand euros.
Sub-item C.1 refers mostly to paid and future severance indemnity.
Sub-item C.2 contains the actuarial gains for 438 thousand euros: These changes are listed with the valuation reserves without entering the income statement.

9.2 Other information

At 31 December 2018, the amount for severance indemnity, determined pursuant to the Civil Code and existing legislation on work contracts, is equal to 15,012 thousand euros (16,994 thousand euros at the end of the year 2017).

SECTION 10 – ALLOWANCES FOR RISKS AND EXPENSES – ITEM 100

10.1 Allowances for risks and expenses: breakdown

(thousands of euros)

Captions/Amounts	31.12.2018	31.12.2017
1. Allowances for credit risk associated with commitments and financial guarantees given	**1,087**	**423**
2. Allowances on other commitments and other guarantees given	**-**	**-**
3. Post-employment benefits	**755**	**2,227**
4. Other allowances for risks and expenses	**19,883**	**21,541**
4.1 Legal disputes	1,909	2,193
4.2 Personnel expenses	17,087	16,915
4.3 Other	887	2,433
Total	**21,725**	**24,191**

Sub-item 3 "Company pension funds" includes only defined-benefit pension funds, described in section 12.3 below.

Sub-item 4 “Other allowances for risks and expenses” is split into:
- Legal disputes: the fund essentially exists for predicted disbursements for lawsuits bankruptcy claims;
- Charges for staff: the fund includes provisions allocated to leaving incentive programmes for staff, seniority bonuses for employees and reward and incentive systems and other expenses;
- Other: refers to appropriations allocated to other expenses, for various disputes and other needs.

10.2 Allowances for risks and expenses: annual changes

(thousands of euros)

	Allowances on other commitments and other	Post-employment benefits	Other allowances for risks and expenses	Total
A. Initial balance	**1,281**	**2,227**	**21,541**	**25,049**
B. Increases	**514**	**75**	**4,165**	**4,754**
B.1 Provisions in the year	514	74	3,811	4,399
B.2 Time value changes	-	1	4	5
B.3 Changes due to discount rate variations	-	-	-	-
B.4 Other changes	-	-	350	350
C. Decreases	**708**	**1,547**	**5,823**	**8,078**
C.1 Uses in the year	708	1,499	4,489	6,696
C.2 Changes due to discount rate variations	-	-	-	-
C.3 Other	-	48	1,334	1,382
D. Final amount	**1,087**	**755**	**19,883**	**21,725**

In sub-item B.1 "Other funds", provisions of expenses for staff, equal to 2,987 thousand euros, relate mostly to variable results bonuses (1,351 thousand euros), allocations for seniority bonuses (72 thousand euros) and recalculations due to the new leaving contracts introduced in October 2017 (1,561 thousand euros). The remaining amount is attributable mainly to a presumed increase in legal disputes (682 thousand euros).

Sub-item B.2 contains the expenses for discounting funds that matured in the period.

Sub-item C.1 "Pension funds" relates exclusively to the individual offer of capitalisation for the supplementary pension fund for staff at Istituto Bancario Sanpaolo di Torino, which was almost entirely used up, a transaction described in more detail in point 10.5.1 below.

Sub-item C.1 "Other funds" includes disbursements, uses and releases for redundancy, relating mainly to:
- leaving incentive plans and redundancy funds for around 1,656 thousand euros;
- incentive system for around 936 thousand euros;
- seniority bonus for around 129 thousand euros;
- disbursements and recoveries for excess funds for civil lawsuits, tax disputes and disputes with staff, for 989 thousand euros.

Sub-item C.3 "Other funds", for 1,264 thousand euros, relates to the zeroing of the fund for cancelled commissions, which following the introduction of IFRS 15 on 1 January 2018 was reclassified under "Other liabilities".

10.3 Allowances for credit risk associated with commitments and financial guarantees given

(thousands of euros)

	Allowances for credit risk associated with commitments and financial guarantees given			
	Stage 1	Stage 2	Stage 3	**Total**
1. Commitments to disburse funds	288	261	192	740
2. Financial guarantees given	117	51	179	347
Total	**405**	**312**	**371**	**1,087**

10.4 Allowances on other commitments and other guarantees given

No cases.

10.5 Defined-benefit company pension funds

10.5.1 Characteristics of the funds and related risks

Below is the information on the part of Item 120 "Allowances for risks and expenses: a) pensions and similar obligations" that relates to defined-benefit pensions, as requested in IAS 19 "Employee benefits".

It should be noted that the internal complementary pension fund in "Cash", set up on 30 November 1971 to integrate the services provided by the INPS for invalidity and old age, was transferred following an industrial agreement on 8 May 2012. Specifically, the positions for retired staff at 25 November 1996 and therefore subject to the "defined-benefit plan", were transferred to the supplementary pension fund for at Banco di Napoli (Fondo Banco). As for the positions for current staff, subject to the "defined-contribution plan", they were transferred on 26 November 2012 to the pension fund for staff at ISP Group companies (Fapa) and/or to the Sanpaolo IMI Group pension fund (Fondo Spimi). In the recent collective agreements signed on 5 August 2015, the social partners of the Intesa Sanpaolo Group finally brought together into one entity the various forms of supplementary defined-contribution pension, to create the Intesa Sanpaolo Group defined-contribution pension fund.

Therefore, at 31 December 2018 the funds in question contained:

- the supplementary pension fund for staff at Banco Napoli - Section A, an entity with legal personality and independent asset management, which includes management relating to already retired members of the previous FIP who in the course of 2010 did not take the chance to redeem the policy reserve, and therefore maintained their pension rights, transferring endowment to the Fondo Banco; this transferral also resulted in a joint guarantee in "Cash" for the Fondo Banco, along with the other banks in the Group, related to maintaining the technical balance of the same section over time;
- the supplementary pension fund for staff at the Istituto Bancario San Paolo di Torino, a fund with legal personality, full patrimonial autonomy pursuant to article 2117 of the Civil Code, and independent asset management. This fund was transferred by the parent company as part of its transferral to the bank of 18 operating points. "Cash" and the other Group companies are jointly responsible for commitments to employee members, retirees and third parties, proportional to the population of members of each.
  On 5 December 2017, Intesa Sanpaolo S.p.A., as parent company, signed an agreement with the trade unions, as company resources, to integrate the supplementary pension fund for staff at Istituto Bancario San Paolo di Torino into the one for staff at Banco di Napoli - Section A (which as of 1 January 2019 has changed its name to the Intesa Sanpaolo Group defined-benefit pension fund, based in Turin). This agreement also included the writing of individual offers of capitalisation for supplementary pensions for members, perfected in the second half of 2018: the applications received led to a decrease in bonds of around 1,676 million, covered partly by the pension fund (around 808 million), partly by using funds set up for the purpose at committed banks by virtue of the guarantee (around 868 million).

As international accounting principles state in reference to plans dividing risks between different entities under common control, the information in the tables below refers to the plans in their entirety, with the bank's share indicated at the bottom.

10.5.2 Changes during the period in liabilities (assets) net of defined benefits and refund rights

(thousands of euros)

Liabilities for defined-benefit obligation pension plans	31.12.2018			
	TFR	Supplementary pension fund for staff at Istituto Bancario San Paolo di Torino	Supplementary pension fund for staff at Banco di Napoli - Section A	External plans
Initial balance	**19,526**	**1,963,603**	**536,190**	**2,499,793**
Service cost related to work services	-	1,850	890	2,740
Service cost for past work services	-	-	-	-
Interest expense	184	5,190	5,550	10,740
Actuarial losses recognised as due to changes in financial assumptions	-	13,990	-	13,990
Actuarial losses recognised as due to changes in demographic assumptions	-	-	-	-
Actuarial losses based on past experience	-	-	-	-
Positive exchange differences	-	-	-	-
Increase in business combinations	-	-	-	-
Contribution of participants to the plan	-	-	-	-
Actuarial losses recognised as due to changes in financial assumptions	-286	-	-4,730	-4,730
Actuarial losses recognised as due to changes in demographic assumptions	-40	-6,970	-13,820	-20,790
Actuarial losses based on past experience	-112	-17,120	-5,470	-22,590
Negative exchange differences	-	-	-	-
Indemnity paid	-2,400	-15,300	-52,630	-67,930
Decrease in business combinations	-	-	-	-
Effect of reducing fund	-	-1,675,890	-	-1,675,890
Effect of destroying the fund	-	-	-	-
Other increases	665	-	5,600	5,600
Other decreases	-763	-	-	-
Final amount	**16,774**	**269,353**	**471,580**	**740,933**

Liability for the defined-benefit obligation pension plan	31/12/2018			
	TFR	Supplementary pension fund for staff at Istituto Bancario San Paolo di Torino	Supplementary pension fund for staff at Banco di Napoli - Section A	External plans
Unfinanced plans	16,774	-	-	-
Partially financed plans	-	-	-	-
Fully financed plans	-	269,353	471,580	740,933

Based on the results of actuarial calculations, the present value of the bank's defined-benefit obligations equals:

- 55 thousand euros related to the supplementary pension fund for staff at Istituto Bancario San Paolo di Torino;
- 1,034 thousand euros related to Section A of the Banco di Napoli fund.

(thousands of euros)

Plan assets	31.12.2018		
	Supplementary pension fund for staff at Istituto Ban	n fund for staff at Banc	Externalplans
Initial balance	**988,700**	**492,280**	**1,480,980**
Return on asset net of interest	-8,500	-26,280	-34,780
Interest income	2,810	5,080	7,890
Positive exchange differences	-	-	-
Increase in business combinations	-	-	-
Contributions paid by the employer	-	-	-
Contributions paid by participants in the plan	-	-	-
Negative exchange differences	-	-	-
Decrease in business combinations	-	-	-
Indemnity paid	-15,300	-52,630	-67,930
Effect of reducing the fund	-808,010	-	-808,010
Effect of destroying the fund	-	-	-
Other changes	-	6,100	6,100
Final amount	**159,700**	**424,550**	**584,250**
			-

10.5.3 Information on the fair value of the plan assets

(thousands of euros)

	31.12.2018					
	Supplementary pension fund for staff at Istituto Bancario San Paolo di Torino	%	Supplementary pension fund for staff at Banco di Napoli - Section A	%	External plans	%
Capital instruments	**-**		**101,840**	**24.0%**	**101,840**	**17.4%**
- of which fair value level 1	-		88,230		88,230	
Common investment funds	**13,250**	**8.3%**	**80,770**	**19.0%**	**94,020**	**16.1%**
- of which fair value level 1	-		49,730		49,730	
Debt securities	**2,230**	**1.4%**	**184,160**	**43.4%**	**186,390**	**31.9%**
- of which fair value level 1	2,230		184,160		186,390	
Real estate and shares in real estate companies	**96,420**	**60.4%**	**-**		**96,420**	**16.5%**
- of which fair value level 1	-		-		-	
Insurance asset management	**-**		**-**		**-**	
- of which fair value level 1	-		-		-	
Other assets	**47,800**	**29.9%**	**57,780**	**13.6%**	**105,580**	**18.1%**
TOTAL	**159,700**	**100.0%**	**424,550**	**100.0%**	**584,250**	**100.0%**

(thousands of euros)

Plan assets: supplementary information	31.12.2018					
	Supplementary pension fund for staff at Istituto Bancario San Paolo di Torino	%	Supplementary pension fund for staff at Banco di Napoli - Section A	%	External plans	%
Capital instruments			**101,840**	**24.0%**	**101,840**	**17.4%**
- of which financial companies			17,820		17,820	
- of which financial companies			84,020		84,020	
Common investment funds	**13,250**	**8.3%**	**80,770**	**19.0%**	**94,020**	**16.1%**
Debt securities	**2,230**	**1.4%**	**184,160**	**43.4%**	**186,390**	**31.9%**
Government bonds	2,230		72,390		74,620	
- of which investment grade rating	2,230		69,540		71,770	
- of which speculative grade rating			2,850		2,850	
Financial companies			44,650		44,650	
- of which investment grade rating			18,840		18,840	
- of which speculative grade rating			25,810		25,810	
Non-financial companies			67,120		67,120	
- of which investment grade rating			28,360		28,360	
- of which speculative grade rating			38,760		38,760	
Real estate and shares in real estate companies	**96,420**	**60.4%**			**96,420**	**16.5%**
Insurance asset management						
Other assets	**47,800**	**29.9%**	**57,780**	**13.6%**	**105,580**	**18.1%**
TOTAL ASSETS	**159,700**	**100.0%**	**424,550**	**100.0%**	**584,250**	**100.0%**

The final amounts for the bank's plan assets are:

- 33 thousand euros related to the supplementary pension fund for staff at Istituto Bancario San Paolo di Torino;
- 1,938 thousand euros related to Section A of the Banco di Napoli fund.

The liability share recorded for the bank, totalling 775 thousand euros, is entered under the item "Company pension funds" (see table 12.1) and breaks down as follows: 22 thousand euros relate to the supplementary pension fund for staff at Istituto Bancario San Paolo di Torino and represent the share part composed of technical deficit between plan liabilities and assets, and the remaining 733 thousand euros relate to the supplementary pension fund for Section A of the Banco di Napoli fund, for which no adjustment is provided for, given that the results of the actuarial valuation showed a technical advance of 904 thousand euros.

10.5.4 Description of the main actuarial assumptions

The annual increase in the fund is based on the existing legislation on pensions in the INPS regulation (automatic equalisation pursuant to article 34, paragraph 1 of Law 448/1998, as amended by article 69, paragraph 1 of Law 388/2000 and article 5, paragraph 6 of Law 127/2007).

Actuarial assumptions	31.12.2018				31.12.2017			
	Bank rate	Expected rate of return	Expected rate of salary increases (a)	Annual rate of inflation	Bank rate	Expected rate of return	Expected rate of salary increases	Annual rate of inflation
TFR	1.1%	X	2.7%	1.5%	1.0%	X	2.6%	1.5%
EXTERNAL PLANS	1.3%	2.9%	2.6%	1.5%	1.5%	4.0%	2.5%	1.5%

(a) Net of career development

As for the supplementary pension funds allocated for discounting, the rate used (1.3%) was the weighted average of the Euro Composite AA curve rates at 31 December 2018, using as weighting the ratio between the amount expected to be paid at each deadline and the total amount to be paid and to be expected until the cutting off of the relationship with the population in question.

10.5.5 Information on amounts, timing and uncertainty of finance flows

(thousands of euros)

Sensitivity analysis	31.12.2018 TFR		31.12.2018 EXTERNAL PLANS	
	+50 bps	-50 bps	+50 bps	-50 bps
Discount rate	16,018	17,582	702,521	783,288
Rate of salary increases	16,775	16,773	750,124	732,210
Rate of inflation	17,270	16,296	773,642	710,482

10.6 Allowances for risks and expenses – Other allowances

(thousands of euros)

	31.12.2018	31.12.2017
2. Other allowances		
2.1 Legal disputes	1,909	2,192
2.2 Personnel expenses	17,087	16,915
incentive-driven exit plans	*14,425*	*14,520*
employee seniority bonuses	*436*	*563*
other personnel expenses	*2,226*	*1,832*
2.3 Other risks and expenses	887	2,434
other	*887*	*2,434*
TOTAL	**19,883**	**21,541**

SECTION 11 – REDEEMABLE SHARES – ITEM 120

No cases.

SECTION 12 – BUSINESS ASSETS – ITEMS 110, 130, 140, 150, 160, 170 AND 180

12.1 "Share capital" and "Own shares": breakdown

For the information for this section, refer to Point 12.3 below.

12.2 Share capital - Number of shares: annual changes

Caption/Type	Ordinary	Other
A. Initial number of shares	**272,771,873**	**-**
- fully paid-in	272,771,873	-
- not fully paid-in	-	-
A.1 Own shares (-)	**-**	**-**
A.2 Shares outstanding: initial number	**272,771,873**	**-**
B. Increases	**-**	**-**
B.1 New issues	-	-
- for consideration:	-	-
business combinations		-
conversion of bonds	-	-
exercise of warrants	-	-
other	-	-
- for free:	-	-
in favour of employees	-	-
in favour of directors	-	-
other	-	-
B.2 Sale of treasury shares	-	-
B.3 Other		-
C. Decreases	**-**	**-**
C.1 Annulment	-	-
C.2 Purchase of treasury shares	-	-
C.3 Disposal of companies	-	-
C.4 Other changes		
D. Shares outstanding: final number	**272,771,873**	**-**
D.1 Own shares (+)	-	-
D.2 Existing shares at the end of the period	**272,771,873**	**-**
- fully paid-in	272,771,873	-
- not fully paid-in	-	-

12.3 Share capital: other information

(thousands of euros)

	number of shares	Book value
Share capital:		
Ordinary shares (nominal value per unit 0.63 euros)	272,771,873	171,846
Total	**272,771,873**	**171,846**

12.4 Profit reserves: other information

(thousands of euro

	Amount at 31/12/2018	Capital share	Profit share	Untaxed profit share (a)	Possibility of use (b)	Summary of uses in the last three years
Net worth						
– Share capital	171,846	72,496	41,743	57,607		
– Share premium (c)	73,578	67,983	5,595		A, B, C	
– Legal reserve	25,102		25,102		A(1), B	
– Statutory reserve	34,057		34,057		A, B, C	23,202
– Reserves for transactions under common control	- 39,004		-39,004			
– IFRS 2 reserve - Lecoip contribution	2,549	2,549				
– IFRS9 FTA reserve	- 34,953		-34,953			
– Other reserves	5,346		5,346		A, B, C	
Valuation reserves:						
– Tangible assets	14,372		14,372		(2)	
– FVOCI financial assets	-771		-771		(2)	
– Defined-benefit plans	-2,817		-2,817		(2)	
Total share capital and reserves	**249,305**	**143,028**	**48,670**	**57,607**	**-**	

(a) Portion of untaxed profit reserves, which in the case of distribution would become taxable income for the company, broken down as follows:

Law on revaluation (Law 266/2005)	23,818
Law on revaluation (Law 413/1991)	5,308
Law on revaluation (Law 408/1990)	18,280
Other laws on revaluation (823/1973, 576/1975 and 72/1983)	10,201
Total untaxed reserves recognised as share capital	**57,607**

(b) A = for increase in share capital; B = to cover losses; C = for distribution to shareholders.

(1) Available for increasing capital (A) for an amount exceeding one fifth of the share capital.

(2) The reserve is unavailable pursuant to article 6 of Legislative Decree 38/2005.

OTHER INFORMATION

1. Financial commitments and guarantees issued (different from those designated at fair value)

(thousands of euros)

	Commitments and financial guarantees given - nominal amount			31.12.2018
	Stage 1	Stage 2	Stage 3	
1. Commitments to disburse funds	**679,511**	**93,204**	**3,453**	**776,168**
a) Central banks	-	-	-	-
b) Public administration	81,103	35,630	-	116,733
c) Banks	598	-	-	598
d) Other financial companies	8,509	3,200	-	11,709
e) Non-financial companies	502,213	42,321	3,221	547,755
f) Households	87,088	12,053	232	99,373
2. Financial guarantees given	**160,942**	**3,397**	**860**	**165,199**
a) Central banks	-	-	-	-
b) Public administration	21	93	-	114
c) Banks	-	-	-	-
d) Other financial companies	291	41	-	332
e) Non-financial companies	159,491	3,062	725	163,278
f) Households	1,139	201	135	1,475

2. Other commitments and other guarantees issued

No cases.

3. Assets pledged as collateral of liabilities and commitments

(thousands of euros)

Portfolios	31.12.2018	31.12.2017
1. Financial assets measured at fair value through profit or loss	-	-
2. Financial assets measured at fair value through other comprehensive income	5,847	3,029
3. Financial assets measured at amortised cost	5,138	8,065
4. Property and equipment	-	-
of which: property and equipment that constitute inventories	-	-

4. Information on operating leasing

No cases.

5. Management and dealing on behalf of third parties

(thousands of euros)

Type of service	31.12.2018	31.12.2017
1. Trading on behalf of customers		
a) Purchases	-	-
1. settled	-	-
2. to be settled	-	-
b) Sales	-	-
1. regulated	-	-
2. unregulated	-	-
2. Individual portfolio management	**-**	**-**
3. Custody and administration of securities	**1,091,175**	**1,071,889**
a) third-party securities held in deposit: linked to custodian bank activity (excluding portfolio management)	-	-
1. securities issued by the reporting bank	-	-
2. other securities	-	-
third-party securities held in deposit (excluding portfolio management): other	542,552	534,709
1. securities issued by the reporting bank	*28*	*37*
2. other securities	*542,524*	*534,672*
c) third-party securities deposited with third parties	538,950	531,083
d) portfolio securities deposited with third parties	9,673	6,097
4. Other transactions	**-**	**-**

6. Financial assets subject to offsetting in the balance sheet or subject to netting framework arrangements or similar agreements

(thousands of euros)

Types	Gross amount of financial assets (a)	Amount of financial liabilities offset in the balance sheet (b)	Net amount of financial assets presented in the balance sheet (c = a-b)	Related amounts not subject to offsetting in the balance sheet		Net amount 31/12/2018	Net amount 31/12/2017
				Financial instruments (d)	Cash collateral (e)	(f=c-d-e)	
1. Derivatives	6,272	-	6,272	6,272	-	-	318
2. Repurchase agreements	-	-	-	-	-	-	-
3. Securities lending	-	-	-	-	-	-	-
4. Other	-	-	-	-	-	-	-
TOTAL 31/12/2018	**6,272**	**-**	**6,272**	**6,272**	**-**	**-**	**X**
TOTAL 31/12/2017	**7,929**	**-**	**7,929**	**7,611**	**-**	**X**	**318**

7. Financial liabilities subject to offsetting in the balance sheet or subject to netting framework arrangements or similar agreements

(thousands of euros)

Types	Gross amount of financial liabilities (a)	Amount of financial assets offset in the balance sheet (b)	Net amount of financial liabilities presented in the balance sheet (c = a-b)	Related amounts not subject to offsetting in the balance sheet		Net amount 31/12/2018	Net amount 31/12/2017
				Financial instruments (d)	Cash deposits pledged as collateral (e)	(f=c-d-e)	
1. Derivatives	10,839	-	10,839	6,272	-	4,567	1,145
2. Repurchase agreements	-	-	-	-	-	-	-
3. Securities lending	-	-	-	-	-	-	-
4. Other	-	-	-	-	-	-	-
TOTAL 31/12/2018	**10,839**	**-**	**10,839**	**6,272**	**-**	**4,567**	**X**
TOTAL 31/12/2017	**8,756**	**-**	**8,756**	**7,611**	**-**	**X**	**1,145**

Part C – Information on the income statement

SECTION 1 - INTEREST - ITEMS 10 AND 20

1.1 Interest income and similar revenues: breakdown

(thousands of euro)

Items/Types	Debt securities	Loans	Other transaction	2018	2017
1. Financial assets measured at fair value with impact on the income statement	**11**	**5**	**-**	**16**	**-**
1.1 Financial assets held for trading	-	-	-	-	-
1.2. Financial assets measured at fair value	-	-	-	-	-
1.3. Other financial assets mandatorily measured at fair value	11	5	-	16	-
2. Financial assets measured at fair value with impact on overall profitability	**17**	**-**	**X**	**17**	**7**
3. Financial assets measured at amortised cost	**-**	**58,994**	**X**	**58,994**	**53,144**
3.1 Loans to banks	-	443	X	443	709
3.2 Customer loans	-	58,551	X	58,551	52,435
4. Derivatives for hedging	**X**	**X**	**-4,369**	**-4,369**	**-**
5. Other assets	**X**	**X**	**40**	**40**	**44**
6. Financial liabilities	**X**	**X**	**X**	**894**	**-**
Total	**28**	**58,999**	**-4,329**	**55,592**	**53,195**
of which: interest income on impaired financial assets	*-*	*12,949*	*-*	*12,949*	

1.2 Interest income and similar revenues: other information

1.2.1 Interest income on financial assets in foreign currency

Interest income generated on financial assets in foreign currency totalled about Euro 714 thousand.

1.2.2 Interest income on finance lease transactions

Not present.

1.3 Interest expense and similar charges: breakdown

(thousands of euro)

Items/Types	Payables	Securities	Other transactions	2018	2017
1. Financial liabilities measured at amortised cost	-2,835	-1	X	-2,836	-2,942
1.1. Amounts owed to central banks	-	X	X	-	-
1.2 Funding from banks	-1,889	X	X	-1,889	-1,689
1.3 Customer deposits	-946	X	X	-946	-1,252
1.4 Outstanding securities	X	-1	X	-1	-1
2. Financial liabilities held for trading	-	-	-	-	-
3. Financial liabilities measured at fair value	-	-	-	-	-
4. Other liabilities and provisions	X	X	-	-	-973
5. Derivatives for hedging	X	X	1,130	1,130	-1,291
6. Financial assets	X	X	X	-1,194	-
Total	**-2,835**	**-1**	**1,130**	**-2,900**	**-5,206**

1.4 Interest expense and similar charges: other information

1.4.1 Interest expense on liabilities in foreign currency
Interest expense generated on liabilities in foreign currency amounted to Euro 433 thousand.

1.4.2 Interest expense on liabilities for finance lease transactions
Not present.

1.5 Differentials relating tohedging transactions

(thousands of euro)

Items	2018	2017
A. Positive differential relating to hedging transactions	1,130	2,572
B. Negative differential relating to hedging transactions	-4,369	-3,863
BALANCE (A - B)	**-3,239**	**-1,291**

As at 31 December 2018, sub-item A mainly included the positive spread regarding collection on demand hedging, while almost all of sub-item B included the negative spread referring to customer mortgage hedging.

SECTION 2 - COMMISSIONS - ITEMS 40 AND 50

2.1 Commission income: breakdown

(thousands of euro)

Type of services/Amounts	2018	2017
A) Guarantees given	**1,979**	**1,731**
B) Credit derivatives	**-**	**-**
C) management, brokerage and advisory services:	**33,805**	**36,747**
1. financial instrument trading	1	3
2. currency trading	672	548
3. individual portfolio management	-	-
4. securities custody and administration	158	190
5. custodian bank	-	-
6. placement of securities	15,800	18,068
7. receipt and issue of orders	777	805
8. consultancy services	84	-
8.1 on investments	84	-
8.2 on financial structure	-	-
9. distribution of third-party services	16,313	17,133
9.1. portfolio management	1,093	1,488
9.1.1 individual	1,093	1,478
9.1.2 collective	-	10
9.2 insurance products	10,885	11,812
9.3 other products	4,335	3,833
D) Collection and payment services	**3,465**	**3,215**
E) Servicing of securitisation transactions	**-**	**-**
F) Services for factoring transactions	**-**	**-**
G) Tax and tax rates collection	**-**	**-**
H) Management of multilateral trading facilities	**-**	**-**
I) Administration and management of current accounts	**14,679**	**13,901**
J) Other services	**8,968**	**8,664**
TOTAL	**62,896**	**64,258**

2.2 Commission income: products and services distribution channels

(thousands of euro)

Channels/Amounts	2018	2017
A) At own branches	**27,835**	**31,428**
1. portfolio management	1,093	1,488
2. securities placement	15,800	18,068
3. third-party services and products	10,942	11,869
B) Door-to-door	**-**	**-**
1. portfolio management	-	-
2. securities placement	-	-
3. third-party services and products	-	-
C) Other distribution channels	**-**	**-**
1. portfolio management	-	-
2. securities placement	-	-
3. third-party services and products	-	-

2.3 Commission expense: breakdown

(thousands of euro)

Services/Amounts	2018	2017
A) Guarantees received	**-214**	**-129**
B) Credit derivatives	**-**	**-**
C) Management and intermediation services:	**-101**	**-117**
1. trading of financial instruments	-1	-3
2. currency trading	-	-
3. portfolio management:	-	-
3.1 own	-	-
3.2 delegated to third parties	-	-
4. securities custody and administration	-93	-114
5. placement of financial instruments	-	-
6. door-to-door financial instruments, products and services	-7	-
D) Collection and payment services	**-272**	**-475**
E) Other services	**-2,687**	**-2,231**
TOTAL	**-3,274**	**-2,952**

SECTION 3 - DIVIDENDS AND SIMILAR REVENUES - ITEM 70

3.1 Dividends and similar income: breakdown

(thousands of euro)

Items/Income	2018		2017	
	Dividends	Similar income	Dividends	Similar income
A. Financial assets held for trading	-	-	-	-
B. Other financial assets mandatorily measured at fair value	-	-	-	-
C. Financial assets measured at fair value with impact on overall profitability	150	-	140	-
D. Equity investments	-	-	314	-
TOTAL	**150**	**-**	**454**	**-**

As at 31 December 2017, sub-item D "Equity Investments" consisted of collection of the Infogroup S.c.p.A. extraordinary dividend.

SECTION 4 - NET INCOME FROM TRADING ACTIVITIES - ITEM 80

4.1 Net result from trading activities: breakdown

(thousands of euro)

Transactions/Income components	Capital gains	Profit from trading	Capital losses	Losses from trading	Net result
1. Financial assets held for trading	**-**	**5**	**-**	**-**	**5**
1.1 Debt securities	-	5	-	-	5
1.2 Equities	-	-	-	-	-
1.3 Quotas of collective investment undertaking	-	-	-	-	-
1.4 Loans	-	-	-	-	-
1.5 Other	-	-	-	-	-
2. Financial liabilities held for trading	**-**	**-**	**-**	**-**	**-**
2.1 Debt securities	-	-	-	-	-
2.2 Accounts payable	-	-	-	-	-
2.3 Other	-	-	-	-	-
3. Financial assets and liabilities: exchange rate differences	**X**	**X**	**X**	**X**	741
4. Derivative instruments	**5,298**	**7,017**	**-5,433**	**-6,630**	**309**
4.1 Financial derivatives:	5,298	7,017	-5,433	-6,630	309
- on debt securities and interest rates	1,771	4,345	-1,968	-3,980	168
- on equities and stock exchange listings	-	-	-	-	-
- on currencies and gold	X	X	X	X	57
- other	3,527	2,672	-3,465	-2,650	84
4.2 Credit derivatives	-	-	-	-	-
of which: natural hedges connected with the fair value option					
TOTAL	**5,298**	**7,022**	**-5,433**	**-6,630**	**1,055**

SECTION 5 - NET RESULT OF HEDGING ACTIVITY - ITEM 90

5.1 Net result of hedging activity: breakdown

(thousands of euro)

Income components/Values	2018	2017
A. Income relating to:		
A.1 fair value hedging derivatives	989	4,623
A.2 hedged financial assets (fair value)	4,629	176
A.2 hedged financial liabilities (fair value)	-	3,146
A.4 cash flow hedge financial derivatives	-	-
A.5 currency assets and liabilities	-	-
Total income from hedge accounting (A)	**5,618**	**7,945**
B. Charges relating to:		
B.1 fair value hedging derivatives	-5,301	-1,711
B.2 hedged financial assets (fair value)	-562	-6,785
B.3 hedged financial liabilities (fair value)	-	-
B.4 cash flow hedge financial derivatives	-	-
B.5 currency assets and liabilities	-	-
Total charges from hedging activities (B)	**-5,863**	**-8,496**
C. Net income from hedging activities (A - B)	**-245**	**-551**

SECTION 6 - PROFIT (LOSS) FROM DISPOSAL/REPURCHASE - ITEM 100

6.1 Profit (Loss) from disposal/repurchase: breakdown

(thousands of euro)

Items/Income components	2018			2017		
	Profits	Losses	Net result	Profits	Losses	Net result
Financial assets						
1. Financial assets measured at amortised cost	-	-208	-208	-	-912	-912
1.1 Loans to banks	-	-	-	-	-	-
1.2 Customer loans	-	-208	-208	-	-912	-912
2. Financial assets measured at fair value with impact on overall profitability	-	-	-	-	-1,397	-1,397
2.1 Debt securities	-	-	-	-	-1,397	-1,397
2.2 Borrowing	-	-	-	-	-	-
Total assets	**-**	**-208**	**-208**	**-**	**-2,309**	**-2,309**
B. Financial liabilities measured at amortised cost						
1. Due to banks	-	-	-	-	-	-
2. Due to customers	-	-	-	-	-	-
3. Outstanding securities	-	-	-	-	-	-
Total liabilities	**-**	**-**	**-**	**-**	**-**	**-**

SECTION 7 - NET RESULT OF OTHER FINANCIAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE THROUGH THE INCOME STATEMENT - ITEM 110

7.1 Net change in value of other financial assets and liabilities measured at fair value through the income statement: breakdown of the financial assets and liabilities measured at fair value

(thousands of euro)

Transactions/Income components	Capital gains	Profit on sale	Capital losses	Loss on sale	Net result
1. Financial assets	**-**	**-**	**-2**	**-**	**-2**
1.1 Debt securities	-	-	-	-	-
1.2 Loans	-	-	-2	-	-2
2. Financial liabilities	**-**	**-**	**-**	**-**	**-**
2.1 Outstanding securities	-	-	-	-	-
2.2 Amounts owed to banks	-	-	-	-	-
2.3 Due to customers	-	-	-	-	-
3. Financial assets and liabilities in foreign currencies: exchange rate differences	**X**	**X**	**X**	**X**	-
TOTAL	**-**	**-**	**-2**	**-**	**-2**

7.1 Net change in value of other financial assets and liabilities measured at fair value through the income statement: breakdown of the other financial assets mandatorily measured at fair value

(thousands of euro)

Transactions/Income components	Capital gains	Profit on sale	Capital losses	Loss on sale	Net result
1. Financial assets	**4**	**-**	**-880**	**-**	**-876**
1.1 Debt securities	-	-	-832	-	-832
1.2 Equities	-	-	-	-	-
1.3 Quotas of collective investment undertaking	-	-	-48	-	-48
1.4 Borrowing	4	-	-	-	4
2. Financial assets in foreign currencies: exchange rate differences	**X**	**X**	**X**	**X**	-
TOTAL	**4**	**-**	**-880**	**-**	**-876**

SECTION 8 - NET VALUE ADJUSTMENTS DUE TO IMPAIRMENT - ITEM 130

8.1 Net value adjustments due to credit risk relating to financial assets measured at amortised cost: breakdown

(thousands of euro)

Transactions/Income components	Valueadjustments			Write-backs		2018	2017
	First and second stage	Third stage		First and second stage	Third stage		
		Write-off	Other				
A. Deposits with banks	**-23**	**-**	**-**	**12**	**-**	**-11**	**-**
- Loans	-23	-	-	12	-	-11	-
- Debt securities	-	-	-	-	-	-	-
of which: acquired or originated impaired loans	-	-	-	-	-	-	-
B. Customer loans	**-5,717**	**-3,658**	**-57,609**	**7,080**	**28,097**	**-31,807**	**-35,248**
- Loans	-5,717	-3,658	-57,609	7,080	28,097	-31,807	-35,248
- Debt securities	-	-	-	-	-	-	-
of which: acquired or originated impaired loans	-	-	-	-	-	-	-
C. Total	**-5,740**	**-3,658**	**-57,609**	**7,092**	**28,097**	**-31,818**	**-35,248**

8.2 Net value adjustments due to credit risk relating to financial assets measured at amortised cost through comprehensive income: breakdown

(thousands of euro)

Transactions/Income components	Valueadjustments			Write-backs		2018	2017
	First and second stage	Third stage		First and second stage	Third stage		
		Write-off	Other				
A. Debt securities	**-1**	**-**	**-**	**-**	**-**	**-1**	**-411**
B. Loans	**-**	**-**	**-**	**-**	**-**	**-**	**-**
- Customer loans	-	-	-	-	-	-	-
- Bank loans	-	-	-	-	-	-	-
of which: acquired or originated impaired financial assets	-	-	-	-	-	-	-
C. Total	**-1**	**-**	**-**	**-**	**-**	**-1**	**-411**

As at 31 December 2017, sub-item A “Debt Securities” basically consisted of the value adjustment on securitisation securities subscribed for the “Voluntary Scheme” intervention in the Savings Banks of Cesena, Rimini and San Miniato.

SECTION 9 - PROFIT/LOSS FROM CONTRACTUAL AMENDMENTS WITHOUT WRITE-OFFS - ITEM 140

9.1 Profit (Loss) from contractual amendments: breakdown

Not present as at 31 December 2018.

SECTION 10 - ADMINISTRATIVE COSTS - ITEM 160

10.1 Staff costs: breakdown

(thousands of euro)

Type of costs/Amounts	2018	2017
1) Staff	**-47,522**	**-62,332**
a) wages and salaries	-32,111	-33,076
b) social security charges	-8,406	-8,983
c) employee severance indemnity	-567	-628
d) pension costs	-	-
e) allocation to employee severance indemnity provision	-190	-214
f) allocation to provision for staff pensions and similar charges:	-75	-127
- defined-contribution	-	-
- defined benefit plans	-75	-127
g) payments to provisions for additional external social security:	-2,627	-2,616
- defined-contribution	-2,627	-2,616
- defined benefit plans	-	-
h) costs arising from payment agreements based on own equity instruments	-824	-1,117
i) other benefits in favour of employees	-2,722	-15,571
2) Other staff in active employment	**-**	**-**
3) Directors and auditors	**-306**	**-398**
4) Retired personnel	**-**	**-**
5) Recovery of expenses for employees seconded to other companies	**5,279**	**3,620**
6) Reimbursement of expenses for third-party employees seconded to the company	**-4,191**	**-3,643**
TOTAL	**-46,740**	**-62,753**

The item i "Other Employee Benefits" as at 31 December 2017 mainly consisted of provisions for early staff retirement incentives carried out following the agreements of 12 October 2017.

10.2 Average number of employees by category

	2018	2017
Staff	**591**	**640**
a) executives	2	3
b) managers	238	261
c) other employees	351	376
Other personnel	**-**	**-**
TOTAL	**591**	**640**

10.3 Defined benefit provisions for staff pensions: costs and revenues

As at 31 December 2018, the costs in question amounted to about Euro 9 thousand and were made up of also the interest cost accrued during the year on the "Supplementary National Insurance Fund provision for Istituto Bancario San Paolo di Torino personnel".

10.4 Other benefits in favour of employees

There are no further significant benefits in favour of employees to report other than those listed in table 10.1, sub-item 1), letter i).

10.5 Other administrative costs: breakdown

(thousands of euro)

Type of expense/values	2018	2017
IT services and electronic equipment maintenance expenses	-5	-32
Telephone, telecommunication and data transmission	-20	-34
Expenses for IT services	**-25**	**-66**
Fees payable for property lease and service expenses	-3,069	-3,148
Security service expenses	-250	-239
Office cleaning expenses	-488	-501
Property, furnishings and plant expenses	-633	-645
Energy expenses	-889	-1,028
Other property expenses	-77	-110
Property management costs	**-5,406**	**-5,671**
Expenses for printed material, stationery, consumables and publications	-217	-236
Expenses for transport and other associated services (including security guards)	-908	-892
Expenses for searches and information	-313	-336
Postal and telegraphic expenses	-724	-921
General operating costs	**-2,162**	**-2,385**
Cost of professional consultancy	-665	-408
Legal and judiciary costs	-1,711	-1,543
Bank and customer insurance premiums	-634	-708
Legal and professional costs	**-3,010**	**-2,659**
Advertising and promotional costs	**-71**	**-129**
Services rendered by third parties	**-17,473**	**-18,356**
Indirect personnel costs	-64	-108
Other costs	**-2,761**	**-2,177**
Indirect taxes and duties	**-7,191**	**-7,268**
Recovery of other expenses	**497**	**773**
TOTAL	**-37,666**	**-38,046**

SECTION 11 - NET ALLOCATIONS TO PROVISIONS FOR RISKS AND CHARGES – ITEM 170

11.1 Net allocations for credit risk relating to commitments to disburse provisions and financial guarantees given: breakdown

(millions of euro)

	Provisions	Reallocation	2018
Stage 1	-257	309	52
Stage 2	-198	208	10
Stage 3	-48	180	132
TOTAL	**-503**	**697**	**194**

11.2 Net allocations to other commitments and other guarantees given: breakdown

Not present as at 31 December 2018.

11.3 Net allocations to provisions for risks and charges: breakdown

(thousands of euro)

	Provisions	Reallocation	2018
Net provisions for legal disputes	-705	435	-270
Net provisions for other personnel charges	-	-	-
Net provisions for risks and charges	-119	28	-91
TOTAL	**-824**	**463**	**-361**

SECTION 12 - NET ADJUSTMENTS/WRITE-BACKS OF VALUE ON TANGIBLE ASSETS - ITEM 180

12.1 Net value adjustments on tangible assets: breakdown

(thousands of euro)

Asset/Income components	Depreciation	Write-downs for impairment	Write-backs	Net result
A. Tangible assets				
A.1 Owned	-1,576	-	-	-1,576
– *For business purposes*	-1,576	-	-	-1,576
– *For investment purposes*	-	-	-	-
- Inventory	X	-	-	-
A.2 Acquired under finance lease	-	-	-	-
– *For business purposes*	-	-	-	-
– *For investment purposes*	-	-	-	-
TOTAL	**-1,576**	**-**	**-**	**-1,576**

SECTION 13 - ADJUSTMENTS/WRITE-BACKS OF NET VALUE ON INTANGIBLE ASSETS - ITEM 190

13.1 Net value adjustments on intangible assets: breakdown

As at 31 December 2018, there are no value adjustments in intangible assets.

SECTION 14 – OTHER OPERATING COSTS AND INCOME – ITEM 200

14.1 Other operating costs: breakdown

(thousands of euro)

Type of expense/Values	2018	2017
Charges for litigations and provisions for customer restorations	-49	-5
Burglaries and robberies	-	-
Amortisation of leasehold improvements	-681	-884
Other non-recurring expenses	-794	-
Other	-725	-716
TOTAL	**-2,249**	**-1,605**

14.2 Other operating income: breakdown

(thousands of euro)

Income components/Values	2018	2017
Revenue on securitisation transactions	-	-
Recovery of insurance costs	-	-
Recovery of other expenses	6,448	6,637
Reimbursements of taxes and interest - previous years	-	-
Obsolete cheques	-	-
Recovery of rents payable	186	185
Recovery for services rendered to group companies	-	-
Recovery for services rendered to third parties	-	1
Recovery of taxes	-	-
Other income	2,025	11,074
Total	**8,659**	**17,897**

As at 31 December 2017, the contribution of about Euro 9,327 thousand by the Parent Company to sustain costs for the early staff retirement incentives connected with the agreements of 12 October 2017 was recognised.

SECTION 15 - PROFIT (LOSS) FROM EQUITY INVESTMENTS - ITEM 220

15.1 Profit (loss) from equity investments: breakdown

(thousands of euro)

Income component/Amounts	2018	2017
A. Income	-	1,654
1. Revaluations	-	-
2. Profits from disposal	-	*1,654*
3. Write-backs	-	-
4. Other income	-	-
B. Charges	-	-
1. Write-downs	-	-
2. Write-downs from impairment	-	-
3. Losses from disposal	-	-
4. Other	-	-
Net Income	**-**	**1,654**

As at 31 December 2017, sub-item A.2 “Profits from Disposals” essentially included the capital gain relating to the disposal of the equity investment in Infogroup S.c.p.A.

SECTION 16 – NET RESULT OF MEASUREMENT AT FAIR VALUE OF INTANGIBLE AND INTANGIBLE ASSETS – ITEM 230

16.1 Net result of the measurement at fair value (or at revalued value) or at break-up value of tangible and intangible assets: breakdown

(thousands of euro)

Asset/Income component	Revaluations (a)	Write-downs (b)	Exchange rate Positive (c)	Exchange rate Negative (d)	Net Result (a-b+c-d)
A. Tangible assets	-	-459	-	-	-459
A.1 Owned:	-	-459	-	-	-459
- For functional use	-	-	-	-	-
- Held for investment	-	-459	-	-	-459
- Inventory	-	-	-	-	
A.2 Acquired under finance lease:	-	-	-	-	-
- For functional use	-	-	-	-	-
- Held for investment	-	-	-	-	-
B. Intangible assets	-	-	-	-	-
B.1 Owned:	-	-	-	-	-
B.1.1 Generated internally	-	-	-	-	-
B.1.2 Other	-	-	-	-	-
A.2 Acquired under finance lease	-	-	-	-	-
Total	**-**	**-459**	**-**	**-**	**-459**

SECTION 17 – VALUE ADJUSTMENTS TO GOODWILL – ITEM 240

17.1 Value adjustments to goodwill: breakdown

As at 31 December 2018, this item was not measured by virtue of the positive result of the impairment test conducted in observance of the policies adopted by the Parent Company Intesa Sanpaolo, since the result of this test generated no impact on the income statement.

SECTION 18 - PROFIT (LOSS) FROM DISPOSAL OF INVESTMENTS - ITEM 250

18.1 Profit (loss) from disposal of investments: breakdown

(thousands of euro)

Income component/Amounts	2018	2017
A. Properties	1,702	13
- Profits from disposal	1,702	13
- Losses from disposal	-	-
B. Other assets	-	-
- Profits from disposal	-	-
- Losses from disposal	-	-
Net Income	**1,702**	**13**

SECTION 19 - INCOME TAX ON CURRENT OPERATIONS FOR THE YEAR - ITEM 270

19.1 Income tax on current operations for the year: breakdown

Income components/Values	2018	2017
1. Current income tax (-)	994	2,864
2. Changes in current taxes of previous years (+/-)	500	-
3. Reduction in current taxes of the year (+)	-	-
3bis. Reduction of current tax for the year due to tax credits pursuant to Italian Law no. 214/2011 (+)	3,737	1,415
4. Change in prepaid taxes (+/-)	-1,808	2,918
5. Change in deferred taxes (+/-)	-993	427
6. Taxes pertaining to the year (-) (1+/-2+3+3bis+/-4+/-5)	**2,430**	**7,624**

19.2 Reconciliation between theoretical and actual tax charges

	2018	2017
Profit (Loss) of current operations before tax	1,874	-13,384
Profit (loss) of disposal groups, gross of income taxes	-	-
Theoretical taxable profit	**1,874**	**-13,384**

(thousands of euro)

	Taxes	%
Income tax - Theoretical tax expense (*)	**-620**	**-33.1**
Increases of taxes	**-391**	**-20.9**
Non-deductible costs (losses on equity investments, ICI [local property tax], personnel costs, etc.)	-298	**-15.9**
Other	-93	**-5.0**
Decreases of taxes	**3,441**	**183.6**
Non-taxed gains on equity investments	-	**-**
Contribution of Veneto banks	287	**15.3**
Adjustment to deferred tax (recognition FROM IRAP on IFRS9 receivables)	2,734	**145.9**
Other	420	**22.4**
Total change in taxes	**3,050**	**162.8**
Actual tax burden before effect of substitute taxes	**2,430**	**129.7**
of which:		
- actual tax burden on current operations	**2,430**	**129.7**
- actual tax burden on groups of discontinued operations	**-**	**-**

(*) includes the ordinary 24% IRES rate, the 3.5% additional IRES rate and the 5.57 weighted average IRAP rate

SECTION 20 - PROFIT (LOSS) FROM DISCONTINUED OPERATIONS NET OF TAX - ITEM 290

20.1 - Profit (loss) from discontinued operations net of tax: breakdown

20.2 Breakdown of income tax on discontinued operations

Not present as at 31 December 2018.

SECTION 21 – OTHER INFORMATION

Information pursuant to Article 1, paragraph 125 of Italian Law no. 124/2017

Please note that Article 1, paragraph 125 of Italian Law no. 124/2017 - Annual law for the market and competition was affected by uncertainties in interpretation that were the purpose for the intervention of Assonime that, on 14 February 2018, formulated its own observations on the subject of implementing the aforesaid regulation; on 22 February 2019, Assonime issued Circular no. 5, which broaches and resolves some of the prior uncertainties on the interpretation level and that allows those "allocations", fees and remuneration justified by the business services and however in bilateral relationships that are typical of the earner's activity (such as credit brokering) to be excluded from the disclosure obligation. Therefore, it is specified that in 2018 contributions - present and itemised in the National State Aid Register that can be consulted by the public on the relevant website - for the total amount of about Euro 45 thousand were granted to the Company (Article 31 Reg (EU) 651/2014).

Part D – Comprehensive Income

STATEMENT OF COMPREHENSIVE INCOME

(millions of euro)

	Captions	Total 31/12/2018	Total 31/12/2017
10.	**NET INCOME (LOSS) FOR THE YEAR**	**4,304**	**-5,760**
	Other comprehensive income that may not be reclassified to the income statement:	**458**	**14,142**
20.	Equity securities at fair value through other comprehensive income:	-	-
	a) fair value changes	-326	
	b) transfers to other equity	-	-
30.	Financial liabilities at fair value through the income statement (change in creditworthiness)	-	-
	a) fair value changes	-	-
	b) transfers to other equity	-	-
40.	Equity security hedges at fair value through other comprehensive income:	-	-
	a) fair value changes (hedged instrument)	-	-
	b) fair value changes (hedging instrument)	-	-
50.	Property and equipment	-1	18,326
60.	Intangible assets	-	-
70.	Defined benefit plans	1,057	-295
80.	Non-current assets held for sale	-	-
90.	Share of valuation reserves connected with investments carried at equity	-	-
100.	Income taxes on other comprehensive income that may not be reclassified to the income statem	-272	-3,889
	Other comprehensive income that may be reclassified to the income statement:	**-115**	**-315**
110.	Hedges of foreign investments:	-	-
	a) fair value changes	-	-
	b) reclassification to the income statement	-	-
	c) other changes	-	-
120.	Foreign exchange differences:	-	-
	a) changes in value	-	-
	b) reclassification to the income statement	-	-
	c) other changes	-	-
130.	Cash flow hedges:	-	-
	a) fair value changes	-	-
	b) reclassification to the income statement	-	-
	c) other changes	-	-
	of which: result of net positions		
140.	Hedging instruments (undesignated items):	-	-
	a) fair value changes	-	-
	b) reclassification to the income statement	-	-
	c) other changes	-	-
150.	Financial assets (other than equity instruments) measured at fair value through other comprehensive income:	-173	-419
	a) fair value changes	-173	-419
	b) reclassification to the income statement	-	-
	- impairment losses	-	-
	- gains/losses from disposals	-	-
	c) other changes	-	-
160.	Non-current assets held for sale:	-	-
	a) fair value changes	-	-
	b) reclassification to the income statement	-	-
	c) other changes	-	-
170.	Share of valuation reserves connected with investments carried at equity:	-	-
	a) fair value changes	-	-
	b) reclassification to the income statement	-	-
	- impairment losses	-	-
	- gains/losses from disposals	-	-
	c) other changes	-	-
180.	Income taxes on other comprehensive income that may be reclassified to the income statement	58	104
190.	**Total other comprehensive income**	**343**	**13,827**
200.	**TOTAL COMPREHENSIVE INCOME (Captions 10+190)**	**4,647**	**8,067**

This part of the Notes to the Financial Statements provides the detailed information required by IAS 1.

Part E – Information on risks and relative hedging policies

INTRODUCTION

The Intesa Sanpaolo Group attaches great importance to risk management and control to ensure reliable and sustainable value creation in a context of controlled risk.
The risk management strategy aims to achieve a complete and consistent overview of risks, given both the macroeconomic scenario and the Group's risk profile, by fostering a culture of risk-awareness and enhancing the transparent and accurate representation of the risk level of the Group's portfolios.
The policies relating to the acceptance and governance of the risks that the Group is or could be exposed to are defined by Board of Directors of Intesa Sanpaolo, as the Parent Company, with the support of the Risks Committee. The Management Control Committee, which is the body that exercises control functions, supervises the adequacy, efficiency, functionality and reliability of the risk management process and of the risk appetite framework (RAF).
The Managing Director and CEO has the power to submit proposals for the adoption of resolutions concerning the risk system and implements all the resolutions of the Board of Directors, with particular reference to the implementation of the strategic guidelines, the RAF and the risk governance policies.
The Corporate Bodies also benefit from the risk supervisory activities of certain Management Committees. The operations of these Committees, including the Steering Committee, comply with the primary responsibilities of the Corporate Bodies over the internal control system and the prerogatives of corporate control functions, in particular the Chief Risk Officer, who exercises the risk control function.
Without prejudice to the powers of the Corporate Bodies, the Chief Risk Officer is responsible for: (i) governing the macro-process of defining, approving, monitoring and implementing the risk appetite framework with the support of the other corporate functions involved; (ii) setting the Group's risk management guidelines and policies, in accordance with the company's strategies and objectives; (iii) coordinating and verifying implementation by the responsible units of the Group, including within the various corporate areas; (iv) overseeing the Group's overall risk profile by establishing methods and monitoring exposure to the various types of risk and periodically reporting the situation to the Corporate Bodies.

To that end, the Chief Risk Officer Governance Area is responsible for the operational implementation of the strategic and management guidelines along the Bank's entire decision-making chain, down to the level of each operational unit. Specifically, the Area is broken down into the following Organisational Units:

- Credit Risk Management Department
- Financial and Market Risks Department
- Enterprise Risk Management Department
- Internal Validation and Controls Department
- Foreign Banks Risk Governance
- Coordination of Risk Management Initiatives.

Risk-taking strategies are summarised in the Group's risk appetite framework (RAF), approved by the Board of Directors. The RAF is established to ensure that risk-taking activities remain in line with shareholders' expectations, taking into account the Group's risk position and the economic situation. The framework establishes the general risk appetite principles, together with the controls for the overall risk profile and the main specific risks.
The general principles that govern the Group's risk-taking strategy may be summarised as follows:

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

The general principles apply both at Group level and business unit or company level. In the event of external growth, these general principles shall be applied by considering the specific characteristics of the market and the competitive scenario where the growth takes place.

The Risk Appetite Framework thus represents the overall framework in which the risks assumed by the Group are managed, while defining general risk appetite principles are defined and the structure for managing:
- the overall risk profile; and
- the Group's main specific risks.
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Management of the overall risk profile is based on the general principles laid down in the form of a framework of limits aimed at ensuring that the Group complies with minimum solvency, liquidity and profitability levels and keeps non-financial risks within appropriate limits, even in case of severe stress.
More specifically, management of overall risk is aimed at maintaining adequate levels of:
- capitalisation, also in conditions of severe macroeconomic stress, in relation to both Pillar 1 and Pillar 2, by monitoring the common equity ratio, the Total Capital Ratio, the Leverage Ratio and the Risk Bearing Capacity;
- liquidity, sufficient to respond to periods of tension, including prolonged periods of tension, on the various funding sourcing markets, with regard to both the short-term and structural situations, by monitoring the internal limits of the Liquidity Coverage Ratio, Net Stable Funding Ratio, Loan/Deposit Ratio and Asset Encumbrance;
- earnings stability, by monitoring the adjusted net income and the adjusted operating costs on revenues, which represent the main potential causes for their instability;
- management of operational, compliance and reputational risk, in order to minimise the potential impact of negative events that jeopardise the Group's economic stability and image.

In compliance with the EBA guidelines (EBA/GL/2015/02) concerning the "Minimum list of quantitative and qualitative recovery plan indicators", the Group has also included new asset quality, market-based and macroeconomic indicators as early warning indicators in the RAF, to ensure consistency with its Recovery Plan.
Specific risks are managed by setting *ad hoc* limits and mitigation actions to limit the impact of particularly severe future scenarios on the group. These limits and actions aim to address the particularly significant risk concentrations, such as concentration on individual counterparties, on sovereign risk and on the public sector.

With regard to specific risk management, the Credit Risk Appetite Framework (CRA), established in 2015, identifies areas of growth for loans and areas to be monitored, using an approach based on ratings and other useful predictive statistical indicators to guide lending growth by optimising the management of risk and expected loss. In 2018, the CRA was extended to the Non Banking Financial Institution, Corporate and SME Corporate Unrated portfolios, and to Credit Ceiling beneficiary Groups. The following were also implemented: i) a specific CRA limit for Leveraged Transactions, as defined in the Guidelines issued by the ECB, ii) an Early Warning threshold to control unsecured operations on Green Area counterparties. This threshold is intended to mitigate the effect of calendar provisioning in a downturn scenario.
CRA limits are approved within the RAF and are constantly monitored by the Parent Bank's Credit Risk Management Department.

Some of the key phases of the annual update of the Group's RAF are as follows:
- Risk assessment and preparation of the RAF: in this phase, the risk actually assumed (Risk Profile) is assessed against the maximum risk assumable risk (Risk Capacity) and the appetite for risk (Risk Appetite), with the Group's main risk types identified and investigating, including prospective risk types, using both quantitative and qualitative techniques; regulatory frameworks, situations of reference markets, the Group's position and the nature of potential threats are particularly analysed with the support of specific stress tests;
- Reconciliation of the RAF, the Business Plan and the Budget: coherence is sought between the RAF and the Business Plan/Budget in all preparation procedure phases through a cross-sharing and comparison process lasting several months. This process also involves the Chief Risk Officer Governance Area and the Chief Financial Officer Governance Area, as well as the Business Divisions/Units;
- Approval of the RAF: the Board of Directors sets and approves the risk objectives, the tolerance threshold (if identified) and the risk governance policies, in line with risk regulations.

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

The assessment of the overall Group risk profile is conducted annually with the ICAAP, and this serves as the capital adequacy self-assessment process according to the Group's internal rules, the results of which are then discussed and analysed by the Supervisor.
In accordance with the ECB requirements, the ICAAP process incorporates two complementary outlooks, both of which are analysed based on both the final statements and forward projections, and on the basis of baseline and worst-case scenarios:
- Regulatory outlook, in which the baseline scenario and the stress scenario are presented over the short term (one year) and the medium and long term (four years, in line with the time frame of the business plan)
- Financial and operational outlook, in which the operational measures and metrics covering all risks, including second-pillar risks, is presented, with a time frame of one year for the worst-case scenario and four years for the baseline scenario.

In order to best capture the specificities of the Group's business model (a financial conglomerate), the scope of the analysis also includes the insurance sector.
The quantitative reconciliation between regulatory requirements and operational estimates of capital adequacy is set out in a specific document in the ICAAP, which reports the differences in scope and definition of risks perceived in both areas, as well as the differences, where appreciable, in perceptions towards the two outlooks in terms of the main parameters (e.g. confidence interval and holding period) and assumptions (such as those relating to the diversification of effects).
The Group is also required to provide a Recovery Plan according to directions of the Supervisory Authorities. The Recovery Plan (introduced by the Bank Recovery and Resolution Directive, transposed into Italian law by Legislative Decree No. 180/2015 of 16 November 2015) establishes the methods and intervention measures to be used when an institution's financial position comes under severe stress, in order to restore financial strength and long-term viability.

Risk culture

The Group continues its strategic orientation towards a moderate risk profile, maintaining high levels of capital and liquidity, supported by ongoing attention to the internal control system and strengthened by operating limits and rules that facilitate its compliance with regulations. A culture based on widespread responsibility, balanced judgement aptitude and long-lasting sustainability of development initiatives is promoted through extensive staff training aimed both at acquiring in-depth knowledge of the overall risk management framework (approaches, methods, internal models, rules and limits, controls) and at internalising the Group's values (Code of Ethics, behaviour, rules of conduct and relations).
Particular attention is paid to ensuring full awareness of the principles and guidelines by systematically updating the reference documents (Tableau de Bord, ICAAP, Risk Appetite Framework) and the information set for the exercise of activities, whose contents are clarified through structured training approaches (Risk Academy). Ongoing relations are maintained with the Chief Risk Officers of the Group companies in order to share information on development plans and the progress of strategic projects, with the examination of the specific operational and regulatory aspects of the local markets. The survey conducted for the two-year period 2017/2018, aimed at profiling the Group's risk culture, analysed perceptions and opinions regarding a range of dimensions of the risk culture by means questionnaires and interviews. This included awareness of the risks to be dealt with, clarity on sustainable risk, compliance with the rules and limitations set, level and diffusion of responsibility, timeliness of response to difficulties, ability to learn from mistakes, quality of the reporting and communication processes, orientation towards cooperation and openness to dialogue, and willingness to nurture talent and experience.
The results were compared with the data obtained from the same survey carried out on a sample of international peers. The findings of the survey revealed a widespread awareness of behaviour and value profiles, together with positive perceptions from across the Group, which was particularly marked for some risk dimensions, such as risk awareness, trust, regulatory compliance and openness to dialogue. During 2018, initiatives were developed aimed at strengthening cooperation and information, with the aim of promoting working attitudes that are more strongly geared towards innovation and proactive problem-solving. Specifically, these initiatives were as follows: 1) meetings were held for discussion and dialogue on emerging issues, aimed at developing an appropriate "tone at the top"; 2) times for listening and procedures for frequent communication were promoted and made accessible to all personnel to ensure widespread awareness across all levels of the organisation; 3) workshops were held for broad groups of management to strengthen cross-collaboration and change-management profiles, in line with the trends in environment and competition dynamics; 4) easy-to-use (digital content) management development tools were rolled out, free of physical and logistic constraints, to develop individual attitudes and professional approaches. Finally, in furtherance of the personnel training programs imparted in previous years, an "on-site mentoring" programme was rolled out to shape operational behaviour, to evaluate the quality of risk management attitudes in the organisation and to monitor more significant and complex change processes, with particular attention to situations involving the Group's development (new acquisitions) and to internal business line restructuring. This aimed to ensure full operational continuity and to preserve high quality control standards that are uniform throughout the Group.

Scope of risks

The risks identified, covered and incorporated within economic capital are as follows:
- credit and counterparty risk. This category also includes concentration risk, country risk and residual risks, both from securitisations and uncertainty concerning loan recovery rates;

- market risk (trading book), including position, settlement and concentration risk on the trading book;
- financial risk of the banking book, mostly represented by interest rate and foreign exchange rate risk;
- operational risk, also including legal risk, compliance risk, ICT risk, model risk and financial reporting risk;
- strategic risk;
- risk concerning equity investments not subject to line-by-line consolidation;
- risk concerning real estate assets owned for whichever purpose.

Given the nature, frequency and potential impact of the risk, risk hedging looks to provide a constant balance between mitigation/hedging activities, control procedures/processes and capital protection measures, including stress tests.
Special attention is dedicated to managing short-term and structural liquidity position by following specific policies and procedures to ensure full compliance with the limits set at the Group level and operating sub-areas in accordance with international regulations and the risk appetite approved at the Group level.
The Group also attaches great importance to the management of reputational risk, which it pursues not only through organisational units specifically tasked with promoting and protecting the corporate image, but also through processes dedicated to identifying and assessing reputational risk and implementing specific reporting flows.
Measurements of each single type of risk for the Group are integrated in a summary value – the Economic Capital – which consists of the maximum "unexpected" loss the Group might incur over a year. This is a key measure for determining the Group's financial structure and its risk tolerance, as well as for guiding operations and ensuring the balance between assumed risk and shareholder return. This is estimated on the basis of the current situation and also as a forward-looking forecast, based on the budget assumptions and projected economic scenario.
Measurement of capital is included in corporate reporting; at Group level, this is submitted quarterly to the Steering Committee, the Risk Committee and the Board of Directors, as part of the Group's Risks Tableau de Bord.

The Parent Bank performs a guidance and coordination role for the Group companies, aimed at ensuring effective and efficient risk management at Group level, by exercising responsibility in setting the guidelines and methodological rules for the risk management process, and pursuing, in particular, integrated information at Group level to the Corporate Bodies of the Parent Bank, with regard to the completeness, adequacy, functioning and reliability of the internal control system. For the corporate control functions in particular, the Group has two different types of models: (i) the centralised management model based on the centralisation of the activities in the Parent Bank and (ii) the decentralised management model that involves the presence of locally established corporate control functions that conduct their activities under the direction and coordination of the same entities exercising corporate control functions as the Parent Banks, to which they report in functional terms.
Irrespective of the control model adopted within their company, the corporate bodies of the Group companies are aware of the choices made by the Parent Bank and are responsible for implementing the control strategies and policies pursued within their own organisations by facilitating their integration into the Group control processes.
For the purposes described above, the Intesa Sanpaolo Group uses a broad set of tools and techniques for risk measurement and management, as detailed in this Part E of the Notes to the Financial Statements.

Some of the information provided in this part of the document is based on internal management data and may not necessarily coincide with that contained in Parts B and C. The only exceptions to this rule are the tables and reports that specifically require the "book value" to be indicated.

Basel 3 regulations and the Internal Project

As regards compliance with the reforms of the previous arrangements of the Basel Committee ("Basel 3"), the Intesa Sanpaolo Group has undertaken adequate project initiatives, expanding the scope of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.

With respect to credit risks, the Bank, which falls within the scope of application of the "Basil 3 Project", received authorisation from the Supervisory Authority to use the AIRB method for the Corporate segment, with effect from the report as at 31 December 2010 (the FIRB method had been in use since December 2008).

In June 2010, the use of the IRB method was recognised for the Retail Mortgage segment.
Authorisation was also obtained to transition to the IRB method for the Real Estate segment, with effect from the report as at December 2012.
Notably, compared to the situation as at 31 December 2017, authorisation was received from the ECB on 31 August 2018 to use the new internal rating model for the Retail segment consisting of Residential Mortgages (model change) and Other Retail (first adoption)

With regard to counterparty risk, the Banking Group improved the measurement and monitoring of the risk by refining the instruments required under Basel 3.
For reporting purposes, the banks belonging to the Banche dei Territori Division were authorised, with effect from the report as at 31 December 2016, to use the internal models approach for the reporting of the requirement with respect to counterparty risk for OTC derivatives; for these banks, advanced risk measurement methods have been implemented for operational purposes since 2015.

With regard to Operational Risk, the Group obtained authorisation to use the Advanced Measurement Approach (AMA – internal model) to determine the associated capital requirement, with effect from the report as at 31 December 2010.

The annual statement, prepared at Group level, of the prudential control process for the purposes of capital adequacy, based on the widespread use of internal risk measurement methods, the determination of internal capital and available total capital, was approved and sent to the ECB in April 2018.

In 2018, the Intesa Sanpaolo Group participated in the EU-Wide Stress Test 2018, with the outcomes, which were highly positive for the Group, notified by the EBA on 2 November 2018. The stress test revealed that, as at 2020, which is the last year of the simulation, Intesa Sanpaolo's Common Equity Tier 1 ratio (CET1 ratio) would be:
- 13.04% under the transitional arrangements in force for 2020, and 12.28% on a fully loaded basis, in the baseline scenario;
- 10.40% under the transitional arrangements in force for 2020, and 9.66% on a fully loaded basis, in the worst-case scenario;

these figures compare to a starting figure, recorded at 31 December 2017 - which takes into account the impact of the first application of the IFRS 9 accounting standard - of 13.24% under the transitional arrangements and 11.85% on a fully loaded basis. The stress test reveals that, at 2020, the CET1 ratio would be 10.99% under the transitional arrangements and 10.26% on a fully loaded basis, taking into account the rights issue carried out on 11 July 2018 under the Long Term Incentive Plan 2018-2021 LECOIP 2.0, and the conversion of savings shares into ordinary shares, carried out on 7 August 2018, all other conditions being equal.

As part of its adoption of Basel 3, the Group publishes information concerning capital adequacy, exposure to risks and the general characteristics of the systems aimed at identifying, monitoring and managing them in a document entitled "Basel 3 - Pillar 3" or simply "Pillar 3".

The document is published on the website of the Parent Bank each quarter, as Intesa Sanpaolo is among those groups that have validated internal models in place for credit risk, market risk and operational risk: group.intesasanpaolo.com.

The internal control system

To ensure sound and prudent management, Cassa di Risparmio di Pistoia e della Lucchesia combines business profitability with attentive risk-taking and operating conduct that is based on fairness.
Therefore, the Bank, in line with legal and supervisory regulations in force, and consistent with the directions of the Parent Bank, has adopted an internal control system capable of identifying, and of measuring and continuously monitoring, the risks typical of its business activities, including outsourced activities.
The Bank's internal control system is built around a set of rules, functions, structures, resources, processes and procedures aimed at ensuring, in compliance with sound and prudent management, the achievement of the following objectives:
- verification that the Company's strategies and policies are being implemented;
- the containment of risk within the limits indicated in the reference framework for determining the Bank's risk appetite (Risk Appetite Framework – RAF);
- the safeguarding of asset value and protection from losses;
- the effectiveness and efficiency of Company processes;
- the reliability and security of Company information and IT procedures;
- the prevention of the risk that the Bank may be involved, including involuntarily involved, in illegal activities (with special regard to money-laundering, usury and financing of terrorism);
- the compliance of transactions with the law and supervisory regulations, as well as with internal policies, procedures and regulations.

The internal control system plays a crucial role and involves the entire corporate organisation (bodies, units, hierarchical levels, all personnel). In compliance with the provisions of Bank of Italy Circular 285/2013 (First Part, Title IV, Chapter 3) the "Integrated Internal Control System Regulation" was finalised. This aims to define the guidelines of the internal control system of Cassa di Risparmio di Pistoia e della Lucchesia through the adaptation of the reference principles and the definition of the responsibilities of the Bodies and of the functions with control duties, which contribute, in various ways, to the proper operation of the internal control system, as well as the identification of coordination arrangements and information flows supporting system integration.
The internal control system is outlined by a documentation structure (the "Governance Documents", adopted from time to time, on the Group's activities, as well as strictly operational regulations that govern business processes, individual activities and the associated controls) that provides organised and systematic access to the guidelines, procedures, organisational structures, and risks and controls in force within the Company, incorporating all the Company policies, the instructions of the Supervisory Authorities, and provisions of law, including the principles laid down in Legislative Decree 231/2001.

More specifically, the Company's rules set out organisational solutions that:
- ensure sufficient separation between the operational and control functions and prevent situations of conflict of interest in the assignment of responsibilities;

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

The Company's organisational solutions also include controls at each operational level that enable the uniform and formalised identification of responsibilities, particularly in relation to the tasks of controlling and correcting the irregularities found.

In terms of Corporate Governance, Cassa di Risparmio di Pistoia e della Lucchesia adopted the traditional system, where the Board of Directors is responsible for supervision of strategy and management, whereas the Board of Statutory Auditors is responsible for control functions.
In accordance with Legislative Decree 231/2001 on the administrative responsibility of companies, a Supervisory Body is established within the Bank, vested with independent powers of initiative and control, and is responsible for supervising the activities, effectiveness and compliance of the Bank's Organisational, Management and Control Model.

The internal control system adopted, which is based on three levels in line with the legal and regulatory provisions in force, replicates the instruments and procedures currently in use at the Intesa Sanpaolo Group.
Such a model provides for the following types of control:

– Level I: line controls which are aimed at ensuring proper performance of operations (for example, hierarchical, systematic and sample-based controls) and which, to the extent possible, are incorporated in the IT procedures. These are conducted by the same operating and business structures, also through units dedicated exclusively to control duties, which report to the persons responsible for those structures, or carried out by the back office;
– Level II: risk and compliance controls for the purpose of ensuring, inter alia:
  - o the correct implementation of the risk management process;
  - o compliance with the operating limits assigned to the various functions;
  - o compliance of company operations with the rules, including self-governance rules.

  The functions assigned to such controls are separate from the ones in charge of production and contribute to the definition of the risk governance policies and the risk management process. For Cassa di Risparmio di Pistoia e della Lucchesia, Level II includes the following Parent Bank structures, to which the following Bank activities have been outsourced:
  - o Chief Compliance Officer Governance Area, which is assigned the duties and responsibilities of the "compliance function", as defined in the reference regulations The Chief Compliance Officer's area also includes the Anti-Money Laundering Department, which is tasked with the duties and responsibilities of the "anti-money laundering function", as defined by the reference regulations;
  - o Chief Risk Officer Governance Area, which is assigned the role of the "risk management function", as defined by the applicable regulations The Chief Risk Officer Governance Area also includes the Internal Validation and Controls Department, which is tasked, among other things, with the duties and responsibilities of the "validation function", as defined by the applicable regulations.

Level III: internal audit controls to identify breaches of procedures and regulations, as well as to periodically assess the completeness, adequacy, functionality (in terms of efficiency and effectiveness) and reliability of the internal control system and the IT system (ICT audit), at scheduled deadlines in relation to the nature and intensity of the risks. The internal audit function for Cassa di Risparmio di Pistoia e della Lucchesia has been outsourced to the Parent Bank's Chief Audit Officer.
The internal control system is periodically reviewed and adapted in relation to business development and the reference context.

Compliance

The governance of compliance risk is of strategic importance to the Intesa Sanpaolo Group as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust.
The Group's Compliance Model, set out in the Guidelines approved by the Parent Bank's Corporate Bodies and ratified by the Board of Directors of Cassa di Risparmio di Pistoia e della Lucchesia, which indicate the responsibilities of the various company structures and macro processes to mitigate compliance risk:

– identifying and assessing compliance risk;
– proposing the functional and organisational measures for mitigation of this risk;
– conducting pre-assessments of the compliance of innovative projects, operations and new products and services;
– providing advice and assistance to the governing bodies and the business units in all areas with significant compliance risk;
– monitoring ongoing compliance, including through the use of information provided by the other control functions;
– disseminating a corporate culture founded on the principles of honesty, fairness and respect for the spirit and the letter of the rules.

Based on the Group's Compliance Model, the compliance risk governance activities of the Bank, whose operations are highly integrated with the Parent Bank, the compliance supervision is centralised at Intesa Sanpaolo. In this context, the Bank has appointed a manager designated by the Chief Compliance Officer as its local Compliance Officer, serving as its representatives, and has identified a Bank Contact Person tasked with supporting the local Compliance Officer by helping to identify and resolve problems in the area of compliance.

The local Compliance Officer submits periodic reports to the Corporate Bodies of the Bank on the adequacy of compliance control, with regard to all regulatory aspects applicable to the Group which show compliance risks. On an annual basis, these reports include an identification and assessment of the primary compliance risks to which the Group is exposed and a schedule of the associated management measures, and on a half-yearly basis they include a description of the activities performed, critical issues noted, and remedies identified. A specific notice is also given when events of particular significance occur.

Anti-Money Laundering

The duties and responsibilities of the Anti-Money Laundering Function, as envisaged by regulations, are assigned to the Parent Bank's AntiMoney Laundering Department, which reports directly to the Chief Compliance Officer, and is therefore independent and autonomous from the operating structures, also reports directly to the Corporate Bodies and has access to all of the Bank's activities and all information relevant to the performance of its duties.
Specifically, the Anti-Money Laundering Department ensures monitoring of compliance risk in the area of money laundering, terrorist financing and embargoes, corruption (financial crime) and weapons, in addition to administrative liability of entities, by:

- laying down the general principles to be adopted within the Group for the management of compliance risk;
- conducting ongoing monitoring, with the support of the competent functions, of developments in the national and international context of reference, verifying the adequacy of company processes and procedures with respect to applicable regulations and proposing appropriate organisational and procedural changes;
- providing advice to the functions of the Bank and establishing adequate training plans;
- preparing appropriate periodic reporting for Corporate Bodies and Senior Management;
- discharging required specific obligations, including, in particular, enhanced customer reviews, controls of proper management of the data storage Archive and the assessment and monthly submission to the Financial Reporting Unit of data relating to aggregated anti-money laundering reports, and the assessment reports of suspicious transactions received from operating structures for the submission to the Financial Reporting Unit of reports deemed accurate.

Risk Management and Internal Validation

The Chief Risk Officer Governance Area is responsible for operational implementation of the strategic and management guidelines for risk The tasks and functions are discussed in detail in the subsequent chapters of this Part.
Specifically, the Internal Validation and Controls Department:

- oversees the validation of the internal models, already in operation or in development, for all Pillar 1 and Pillar 2 risk profiles under the Basil Accord, and validates the internal methodologies used for pricing and for the purposes of IFRS9, in line with the independence requirements of reference regulations calculates default rates at Group level, at differing levels of detail, to allow risk to be represented for the various customer segments and based on the different applicable definitions of default. Finally, in line with recent regulatory developments, this function is also responsible for developing and maintaining the framework for the identification, assessment and management of the Model Risk for risk models (Pillars 1 and 2) and for management models
- carries out II level controls on credit based on a risk-based approach or based on statistical methods, aimed at verifying that single positions are properly classified and provisions ("single name" controls). In general, the discharging of control activities includes a credit processes assessment for the added purpose of verifying that suitable I level controls are in place with proper execution and traceability procedures
- carries out II level controls on risks other than credit risks, verifying that I level controls are properly established in terms of the completeness, efficiency and traceability of the relevant processes, identified through a regular risk assessment, which aligns a risk-based approach to an equity -based approach to identify priority areas for action.

Internal Auditing

The internal auditing activities are assigned to the Parent Bank's Chief Audit Officer.

The Parent Bank's Chief Audit Officer performs overall level 3 assessment of the internal control system, reporting possible improvements to the Corporate Bodies, with specific regard to the RAF, the risk management process and risk measurement and control instruments.
In particular, the Chief Audit Officer assesses the completeness, adequacy, functionality and reliability of the components of the internal control system, the risk management process and the corporate processes, also with regard to their ability to identify and prevent errors and irregularities. In this context, amongst others, the Chief Audit Officer audits the corporate functions of risk control and regulatory compliance, also by participating in plans so as to generate added value and improve the effectiveness of the control and corporate governance processes.
The Chief Audit Officer is also responsible for assessing the effectiveness of the corporate RAF definition process, the internal consistency of the overall framework and compliance of company operations with the RAF.
The Chief Audit Officer, as the head of the internal auditing function, enjoys due autonomy and independence from the

operating structures; The Chief Audit Officer has access to the activities, data and documents of all company functions .
The Chief Audit Officer uses personnel with the appropriate professional skills and expertise and ensures that its activities are performed in accordance with international best practices and standards for internal auditing established by the Institute of Internal Auditors (IIA).
As required by the international standards, the Chief Audit Officer is subject to an external quality assurance review every five years. The last review was carried out in 2016 and assigned the department the highest assessment envisaged ("Generally Compliant"). At the end of 2018, a new audit was started at the request of the Parent Bank's Management Control Committee, which will be completed in the first quarter of 2019.
In performing its duties, the Chief Audit Officer uses structured risk assessment methods to identify existing situations of greatest interest and the main new risk factors. Based on the assessments emerging from risk assessment and the resulting priorities, as well as on any specific requests for further enquiry expressed by top management and the Corporate Bodies, the Chief Audit Officer prepares and submits an Annual Intervention Plan for prior examination by the Board of Directors, on the basis of which it conducts its activities during the year, in addition to a Long-Term Plan.
The Chief Audit Officer ensures the proper conduct of the internal process for managing whistleblowing reports.
The Chief Audit Officer coordinates the "Integrated Internal Control System" meeting of the Group's Internal Control Coordination and Reputational and Operational Risk Committee.

Direct auditing was performed on the Bank and on the processes managed by the Parent Bank and ISP Group Services, on the Bank's behalf.

Any weaknesses detected during control activities have been systematically notified to the Bank's and the Group's functions involved for prompt improvement actions, which are monitored by follow-up activities to verify their effectiveness.
Major events were also the reported to the Board of Statutory Auditors in a prompt and timely manner. A similar approach is also used for administrative responsibility in accordance with Legislative Decree 231/01 for the specific Supervisory Authority.
Summary Internal control system assessments from the checks have been periodically submitted to the Board of Statutory Auditors, the Board of Directors and the CEO of the Bank. The main weaknesses detected and their development over time have been included in the Audit Tableau de Bord (TdB), with details of the mitigation actions underway, together with the related responsibilities and deadlines envisaged, so they can be systematically monitored. Reports on audits completed with a negative opinion or with the identification of major shortcomings were sent and clarified to the Statutory Bodies.

Lastly, the Chief Audit Officer ensured constant assessment of its own effectiveness and efficiency in line with the internal "quality assurance and improvement" plan drafted in accordance with the recommendations of international standards for professional audit practice. In this regard, an audit development plan entitled Future Audit Solutions and Transformation (FAST) was launched in 2018, in line with the 2018-2021 Business Plan strategies.

SECTION 1 – CREDIT RISK

QUALITATIVE INFORMATION

1. General

The Group's strategies, credit risk framework, powers and rules for credit granting and management are aimed at:
- coordinating actions targeted at achieving sustainable growth of lending operations consistent with the Group's risk appetite and value creation;
- diversifying the portfolio, limiting the concentration of exposures on single counterparties/groups, single economic sectors or geographical areas;
- efficiently selecting economic groups and individual creditors through a thorough analysis of their creditworthiness aimed at limiting the risk of insolvency;
- privileging lending business aimed at supporting the real economy and production system;
- constantly monitoring relationships, through the use of both IT procedures and systematic surveillance of positions, with the aim of detecting any symptoms of imbalance and promoting corrective measures geared towards preventing possible deterioration of the relationship in a timely manner.

Constant monitoring of the quality of the loan portfolio is also pursued through specific operating checks for all the phases of loan management.
The 2018-2021 Business Plan includes – among other things – an ambition for excellence in asset quality and a pillar of "significant de-risking at no cost to shareholders", where effective non-performing loan management is considered a top priority. The details of these strategies and the results for the year are described in the "2018-2021 Business Plan" Section of the Report on Operations.

2. Credit risk management policies

2.1 Organisation

Within the Intesa Sanpaolo Group, a fundamental role in managing and controlling credit risk is played by the Corporate Bodies, which, to the extent of their respective competences, ensure adequate coverage of credit risk by setting strategic guidelines and risk management policies, verifying that they remain constantly efficient and effective and assigning tasks and responsibilities to the company functions and units involved in the processes.
The coverage and governance of credit ensured by the Corporate Bodies is reflected in the current organisational structure, which identifies areas of central responsibility attributable to:
- Chief Lending Officer Governance Area
- Chief Risk Officer Governance Area
- Chief Financial Officer Governance Area

They ensure that risk control activities are managed and implemented, with an appropriate level of segregation, in addition to the establishment of the supporting processes and applications.

The Chief Lending Officer Governance Area, with the aid of its own structures (BdT Credit Department, CIB Credit Department, ISB Credit Department, Credit Governance Department, Credit Transformation Department and Capital Light Bank Department),
- assesses the creditworthiness of the loan applications received and, where applicable, approves them or issues a compliance opinion;
- ensures the proactive management of credit, under his/her responsibility, and the management and monitoring of non-performing loans;
- innovatively manages corporate crisis situations of customers, using industrial and financial restructuring instruments;
- analyses the credit portfolio and the credit cost development within the Group
- establishes the rules on credit granting and on non-performing loans;
- ensures that positions classified as non-performing, under his/her responsibility, are properly measured for financial reporting purposes;
- allocates the ratings to the positions that require specialist assessments and assesses the improvement override proposals made by the competent departments;
- defines operating credit processes, in collaboration with the Transformation Centre, also on proposal from the Group's various functions/structures
- optimises non-core assets for the Bank, in line with Group's objectives, aimed at their progressive reduction and divestment, also in collaboration with the other involved functions;
- performs a liaison and monitoring role for external servicer Intrum Italy; ensures the overall coordination of the subsidiaries Intesa Sanpaolo RE.O.CO. and Intesa Sanpaolo Provis.

The Chief Risk Officer Governance Area is responsible for adapting the Risk Appetite Framework to the management of credit risk, in accordance with company strategies and objectives, as well as for measuring and controlling the Group's risk exposures. Specifically, the Chief Risk Officer Governance Area:
- defines the metrics used to measure credit risk, including for overall performing credit assessment and statistical-based credit assessment;

- provides risk-adjusted pricing models and guidelines for expected loss, economic capital (ECAP), RWA and acceptance thresholds;
- monitors the absorption of capital associated with credit risks, supporting the Chief Financial Officer Governance Area in actively managing capital.
- formulates proposals for assigning Credit Granting and Managing Powers;.
- carries out II level controls and monitoring for credit risk coverage.

The activities are performed directly by the Chief Risk Officer Governance Area for both the Parent Bank and the main subsidiaries, according to a service contract.

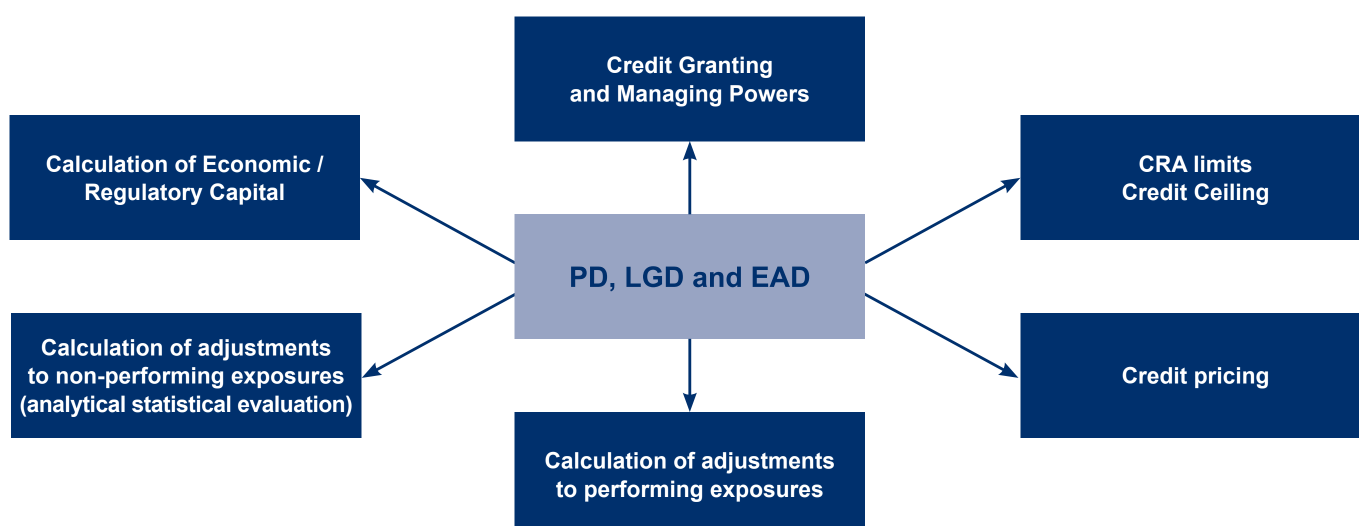
The Chief Financial Officer Governance Area:
- assists the Corporate Bodies in establishing the Group’s guidelines and policies – in accordance with corporate strategies and objectives – in terms of administration and taxation, planning and management control, treasury and financial management, research, credit portfolio management, relations with investors and rating agencies, and social and environmental responsibility, also coordinating the implementation of these activities by the responsible units of the Group;
- incorporating the changes in credit positions formulated by the competent structures, for financial reporting purposes.

The Chief IT, Digital and Innovation Officer establishes the model and oversees the Group’s Data Governance and Data Quality system, ensuring its diffusion and implementation and coordinating the activities of the parties involved.

Lastly, as is the case for all the risk areas and above all for credit risk, the Internal Auditing Department performs internal audits aimed at identifying breaches of the procedures and regulations and periodically assessing the completeness, adequacy, functioning (in terms of efficiency and effectiveness) and reliability of the internal control system and the ICT system (ICT audit), at pre-set intervals according to the nature and extent of the risks.

2.2 Management, measurement and control systems

Intesa Sanpaolo, as the Parent Bank, has set out codes of conduct in relation to credit risk acceptance, in order to prevent excessive concentrations, limit potential losses in worst-case scenarios and maintain credit quality, in line with the objectives of capital and financial balance.
Risk-weighted assets are an essential element for the management, measurement and control of credit risk, by incorporating the effects of the scale of exposure (exposure at default - EAD), the customer-related risk probability (probability of default - PD), the presumption of loss in the event of insolvency - taking into account the guarantees that mitigate loan-related acceptance of risk (loss given default - LGD) - and the duration of exposure (maturity).
These elements are also used to calculate expected loss - as detailed in paragraph 2.3 - which represents the average of the loss statistical distribution.
The components used to determine risk-weighted assets are also the core elements for determining credit granting and managing powers, credit risk appetite (CRA) limits and credit ceiling, for credit pricing, for calculating adjustments to performing and non-performing exposure value, and for calculating financial and regulatory capital.



Thus, by setting the risk-weighted assets, the determined credit granting and managing powers also constrain decision-making powers in the credit granting phase, with the delegated decision-making professionals and procedures specified for each counterparty. In particular, where loans granted by Group subsidiaries exceed certain thresholds, they are required to request a “Advisory Opinion” from the competent bodies of the Parent Bank.

The credit risk appetite aims to optimise the return-on-risk profile of assets. The "Rules on Credit Risk Appetite" regulate the application of CRA and the methods for calculating CRA colour class, to which exposure limits are assigned for the purposes of pursuing sustaining growth in lending based on the Group's credit risk appetite.
Another sustainability mechanism is the "Credit ceiling", intended as the overall limit of lines of credit which may be granted by companies of the Intesa Sanpaolo Group to the larger Economic Groups.

Transaction pricing calculation is aimed at determining the suitability of financial terms and conditions in terms of the generation of value compared to the expressed risk and in terms of all components included in calculating value, including the costs incurred by the structures.
[7]Value adjustments are measured on performing and non-performing exposures on the basis of functional parameters aimed at determining the regulatory financial requirements so that the effects of prospective forecasting data, evidence of nominal loss rates and the removal of indirect costs incurred as part of management procedures can be included in the measurement.
The capital at risk is defined as the maximum "unexpected" loss that the Group may incur with particular confidence levels. This is calculated with reference to the current status of the portfolio and on a dynamic basis, by determining the projected level, based on both the forecast macroeconomic scenario and on stress scenarios. Capital at risk is the fundamental element in the assessment of the Group's capital adequacy and is calculated as part of the ICAAP both with reference to regulatory parameters and from an operational standpoint.

The credit-granting phase is also governed by metrics complementing RWAs, which define coordination mechanisms and support tools to continuously exercise direction, governance and support in implementing provisions of corporate governance. More specifically, the company regulations include the Credit Granting and Management Rules, governing the ways in which credit risk to customers is assumed, and the "Credit Strategy Rules", guiding the development and formation of the credit portfolio so as to achieve an optimal medium-to-long term risk/yield profile.
The credit risk management processes also require credit positions to be subject to a specific periodic review carried out by the competent central or peripheral structures, and require customers to be assessed continuously, rather than during the first granting of a loan only, through a monthly monitoring process that interacts with the credit management and control processes and procedures so as to ensure the prompt assessment of any signs of non-performance that may arise and that reflect of the risk level of exposures. In this respect, an interception and classification system ("Early Warning System") is in place, having been adjusted in conjunction with the updates made to the internal ratings model, and applies to the Corporate, Retail SME and Retail portfolios. Where synthetic risk indicators confirm that anomalies persist over time, the positions in question are intercepted and reported by the Proactive Management process.

Country risk is an additional component of an individual creditor's insolvency risk, measured by credit risk control systems. This component is linked to losses potentially resulting from international lending operations caused by events in a country that are partly or entirely within the control of the government concerned, but not that of the individual residents of the country in question. Country risk therefore takes the form of both transfer risk for non-sovereign counterparties, due to the freezing of international payments, and sovereign risk, which is measured through an assessment of the sovereign states' creditworthiness. This definition includes all forms of cross-border lending to entities residing in a given country, whether they are the government, a bank, a private enterprise or an individual.
The country risk component is assessed in the context of the granting of credit to non-resident entities in order to obtain a preliminary evaluation of the absorption of country risk limits set on an ex-ante basis. Such limits, expressed in terms of economic capital, identify the maximum acceptable risk for the Group, defined on an annual basis as within the Group's Risk Appetite Framework.

Counterparty risk is a particular kind of credit risk associated with OTC derivative contracts that refers to the possibility that a counterparty may default before the contract matures. This risk, which is often referred to as replacement risk, is related to the case in which the market value of a position has become positive and thus, were the counterparty to default, the solvent party would be forced to replace the position on the market, thereby suffering a loss.
Counterparty risk also applies to securities financing transactions (repurchase agreements, securities lending, etc.).

In 2010 a specific project was launched to ensure that the Banking Group has an internal model for measuring counterparty risk, both for operational and regulatory purposes. The organisational functions involved, as described in the Bank's internal regulations, are:

- the Chief Risk Officer Governance Area, which is responsible for the counterparty risk measurement system by defining calculation methods, producing and analysing measures of exposure;

[1] The analytical-statistical measurement of non-performing exposures only applies to positions below EUR 2 million[7]

- the Level I and Level II control functions that use the measurements produced to monitor the assumed positions;
- the marketing and credit functions that draw on the foregoing measures as part of the granting process to determine the limits of the lines of credit.

Potential exposure (estimated with the actual average PFE - Potential Future Exposure) has been adopted by the entire Banking Group for the purposes of operational measurement of credit lines. The counterparty Risk Department produces daily risk estimates for the measurement of the usages of credit lines for OTC and SFT for the Parent Bank and Banca IMI. It also does this for the OTC derivatives for the banks of the Banca dei Territori division. It should be noted that the PFE method, in simplified form, is adopted for the banks of the International Subsidiary Banks Division, through the use of internally estimated add-ons.
In addition, the following company processes were implemented to complete the risk analysis process for the exposure measures implemented over time following the developments discussed above:
- definition and periodic calculation of stress tests on market scenarios and joint market/credit scenarios on counterparty risk measures;
- definition and periodic analysis of Wrong-Way Risk, i.e. the risk of a positive correlation between the future exposure to a counterparty and that counterparty's probability of default;
- definition and monitoring of management limits;
- contribution of collateral inflow/outflow risk measures, calculated on the basis of the internal counterparty risk model, for OTC and SFT derivatives transactions with collateral agreements (CSA, GMRA and similar);
- periodic reporting to the management of measures calculated using the internal exposure model, capital requirement, level of use of management limits, results of stress tests and analyses of wrong-way risk.
- definition and periodic calculation of back-testing analyses to monitor the model's predictive performance over time, with respect to the development of the risk factors underlying the portfolio transactions.

Concentration risk derives from the exposure to counterparties, groups of related counterparties and counterparties in the same business segment or that engage in the same business or operate in the same geographical region. In the annual update of the Risk Appetite Framework, these counterparties are subject to stress tests aimed at identifying and assessing threats for the Group and the most appropriate mitigating actions:
- aimed at defining exposure limits for specific geographical areas and sets of counterparties (top 20);
- aimed at ex ante limitation of exposures with significant concentration effects, in particular with reference to "large risks" and to credit lines subject to country risk;
- aimed at ex post correction of the profile, through the secondary loan market, through specific judgement metrics based on the maximisation of overall portfolio value.

Through specific control, guidance and coordination activities, the Internal Validation and Controls Department within the Chief Risk Officer Governance Area oversees the credit granting and management processes for the performing loans portfolio at the Group level, and through controls on individual positions, assesses that loans are properly classified. It also assesses the compliance of the internal risk measurement and management systems over time as regards determination of the capital requirements to the regulatory provisions, company needs and changes in the relative market.

The exchange of basic information flows between different Group entities is assured by the Group's Central Credit Register (exposure monitoring and control system) and by the "Posizione Complessiva di Rischio" (global risk position), which highlight and analyse credit risks for each counterparty/economic group both towards the Group as a whole and towards individual Group companies.
The design of power and generation architecture for reporting to Anacredit was completed during 2018, with the aim of supporting the "collection of granular credit and credit risk data" as defined by Regulation (EU) 2016/867 of 18 May 2016. The new reporting system has thus been operational since September 2018, in compliance with the regulatory provisions laid down by the ECB and implemented by the national central banks.

2.3 Expected loss measurement methods

The expected loss is the product of exposure at default, probability of default and Loss Given Default.
The Intesa Sanpaolo Group measures probability of default using different rating models according to counterpart's business segment (Corporate, Retail SME, Retail, Sovereigns, Italian Public sector entities and Banks). These models make it possible to summarise the counterparty's credit quality in a value, the rating, which reflects the probability of default over a period of one year, adjusted on the basis of the average level of the economic cycle. These ratings are then made comparable with those awarded by rating agencies, by means of a consistent scale of reference.
A number of rating models are used for the Corporate segment:
- models differentiated according to the market (domestic or international) and size bracket of the company are applied to most businesses;
- specific models are in use for specialised lending, one for real-estate initiatives, one for project-finance transactions and one for LBO/acquisition-finance and asset-finance transactions.

The Corporate model is also used to calculate RWAs for the Banking Book Equity portfolio.

With regard to the Retail portfolio, the models are structured as follows:
- for the Retail SME segment, a Group rating model by counterparty is used, following a scheme similar to that of the Corporate segment, meaning that it is extremely decentralised and its quantitative-objective elements are supplemented by qualitative-subjective elements;
- for the Retail segment, a new Group rating model by counterparty has been used since September 2018; this model replaced the previous model for residential mortgages to individuals, as well as the Other Retail acceptance management model that covered all the other products aimed at individual customers.

For the Institutions portfolio:
- models for banks (banks in mature economies and banks in emerging countries) consist of a quantitative part and a qualitative part, differentiated according to mature and emerging countries, a country rating component representing systemic risk and a component relating to specific country risk for banks most closely correlated with country risk; finally, a module (the "relationship manager's judgement") that allows the rating to be modified in certain conditions.
- models for municipalities and provinces on the one hand, and shadow rating models for regions on the other. An approach to extend the rating of the regulatory Entity (e.g. Region) has been adopted for local healthcare authorities and other sector entities, with possible changes on the basis of the assessment financial statement data (notching).

Expert-based models are used for counterparties belonging to the Non-Banking Financial Institutions portfolio.

The structure of the rating model for the Sovereign portfolio involves a quantitative module, which takes account of the structural rating assigned by the major international agencies, the risk implicit in market quotations of sovereign debt and a macroeconomic assessment estimated using a regression econometric model regression model, and a qualitative opinion component, which supplements the qualitative opinion with elements drawn from the broader scope of publicly available information concerning the political and economic structure of individual sovereign countries. The Sovereign rating model is used for operational purposes only.

The LGD model is based on the concept of "Economic LGD", namely the present value of the cash flows obtained in the various phases of the recovery process net of any administrative costs directly attributable to the exposure as well as the indirect management costs incurred by the Group, and consists, in brief, of the following elements:
- estimate of a Bad LGD Model: starting from the LGD observed on the portfolio, namely "Workout LGD", determined on the basis of the recoveries and costs, a regression econometric model of the LGD is estimated on variables considered to be significant for the determination of the loss associated to the Default event;
- application of a correction factor, known as the "Danger Rate": the Danger Rate is a multiplying correction factor, used to recalibrate Bad LGD with the information available on the other default events, in order to calculate an LGD representative of all the possible default events and their evolution;
- application of an additional correction factor, known as "Final Settlement Component": this component is used as an add-on to the estimate recalibrated for the Danger Rate in order to consider the loss rates associated with positions not evolved to the Bad Loan status (Unlikely to pay or Past Due positions).

LGD is determined according to differentiated models, specialised by operating segment (Corporate, Retail SME, Retail, Factoring, Leasing, Public Entities and Banks). As is the case for PD, LGD models have been adopted for International Subsidiary Banks, partly derived from the Parent Bank and adapted to the local situation.
For banks, the Loss Given Default (LGD) calculation model partly diverges from the models developed for the other segments as the estimation model used is based on the market price of debt instruments observed 30 days after the official date of default and relating to a sample of defaulted banks from all over the world, acquired from an external provider. The model is completed by an econometric estimate aimed at determining the most significant drivers, in accordance with the practice in use for the other models;.

Sovereign LGD is estimated by analysing historical recovery rates on sovereign defaults, differentiated into five categories according to the risk factors relevant to each country. For internal operational purposes, the country risk component for exposures to non-sovereign counterparties is estimated using a transfer risk rating model, the estimates from which can lead to transfer ratings different from the sovereign risk rating for the countries in question.
The LGD Transfer model allocates countries different geographical-based LGD values, estimated based on an analysis of the trend in the exchange rate of the local currency against the U.S. dollar, and in consideration of any support received from the International Monetary Foundation's anti-crisis fund.
The LGD Sovereign and LGD Transfer models are used for operational purposes only.

Exposure at default (EAD) is calculated according to different models, each of which specialised for each operating segment (Corporate, Retail SME, Retail, Factoring, Leasing, Public Entities and Banks). Specifically, the methodology used is based on data from the 12 months preceding the default event and differs based on whether or not there is a credit margin as at the observation date: if there is a margin, then the CCF analysis is used, otherwise the K factor analysis is used. In both cases, corrective factors are applied in compliance with regulatory requirements so as to provide estimates with a margin of conservatism.

Expected loss (EL) is estimated in line with supervision regulations and is based on the same risk parameters as adopted for the aforementioned AIRB models. When determining adjustments to credit exposures, these parameters are adapted to ensure they meet the requirements set forth in accounting standards which require a point-in-time approach to be adopted. Under this approach, all information available at the time of the measurement, including forecasting data, such as macroeconomic forecasts and scenarios, are incorporated into the calculation process. This applies where the approach adopted in the

development of the internal models used to determine regulatory equity requirements provides for ratings to be calibrated “through the cycle”, thus reflecting current conditions only in part.
More specifically, adjustments to performing credit risk involve the exposure risk level determined as at the current measurement date to be compared against the exposure risk level originally recognised at the time of disbursement/purchase: the fundamental criterion for calculating expected loss through the remaining lifetime of a financial instrument, or through the next 12 months only, is represented by the scale of risk increase, if any, that occurs during the period.
The methodology for LGD grid estimates substantially follows the same approach as that adopted for calculating equity requirements, with the following changes:

- nominal loss rate estimates are used instead of the discounted loss rate estimates used to calculate regulatory equity requirements;
- macroeconomic conditioning is included to take into account forward-looking scenarios;
- the indirect costs and additional encumbrances included for prudential valuation purposes are excluded, in application of the treatment criteria envisaged for calculating equity requirements.

Collective measurement is compulsory for all loans for which there is no objective evidence of impairment. Such loans must be measured collectively in homogeneous portfolios, i.e. with similar characteristics in terms of credit risk. The concept of "loss" to which to refer when measuring impairment is that of incurred loss, as opposed to expected or future losses. In the case of collective measurement, this means that reference should be made to the losses already included in the portfolio, although these cannot be identified with reference to specific loans, also defined as "incurred but not reported losses".
In any event, as soon as new information allows the loss to be assessed at the individual level, the financial asset must be excluded from collective measurement and subject to individual measurement.
Although international accounting standards do not explicitly refer to the methods developed in the context of supervisory regulations, the definition of the elements to which to refer when classifying loans into groups to be subject to collective measurement has many points of contact with the Basel 3 regulations and the possible synergies are therefore evident. Through exploitation of such synergies, a measurement model has been structured involving the use of risk parameters (Probability of Default and Loss Given Default) essentially similar to those of Basel 3.
Therefore, in accordance with regulatory provisions, the method calls for expected loss (EL) to be determined according to the risk parameters estimated for the AIRB models under banking supervision regulations.
Expected loss calculated for the purposes of the collective loan measurement procedure differs from that calculated for reporting purposes inasmuch as the LGD used in incurred loss does not (in accordance with international accounting standards) include indirect recovery costs and calibration on the negative phase of the cycle ("LGD downturn").
For loans to customers only, the expected loss (EL) is transformed into incurred loss (IL) by applying factors that capture the loss confirmation period (LCP) and economic cycle of the portfolio:

- the LCP is a factor that represents the time interval between the event that gives rise to the default and the occurrence of the sign of default, which allows the loss to be transformed from expected to incurred;
- the cyclical coefficient is an annually updated coefficient estimated on the basis of the economic cycle, made necessary by the fact that ratings, which are calibrated according to the long-term expected average level throughout the economic cycle, only partially reflect current conditions. This coefficient, which is determined by regulatory segment according to the methods described in the Group Accounting Policies, is equal to the ratio between the default rates, estimated for the following 12 months (according to the available forecast and the methods set out in the ICAAP), and the current probabilities of default.

The cyclical coefficients were reviewed for the collective valuation of performing loans for the 2017 Financial Statements and were examined and approved by the Chief Risk Officer. Specifically, the improvement in the default rates resulted in a reduction in the cyclical coefficients for the Corporate, SME Corporate and SME Retail segments. The Loss Confirmation Period factors, on the other hand, remained unchanged.
The illustrated measurement method has also been extended to guarantees and commitments. In the case of the latter, the unused margins on irrevocable lines of credit are not included in the basis of calculation

The EAD and LGD internal rating models are subject to an independent validation process carried out by the Validation function and a level three control by the Internal Auditing function. As a result of these activities, a report is produced for the Supervisory Authority on the compliance of the models with the supervisory regulations, which also verifies deviations of the ex-ante estimates and the effective ex post values. This report, approved by the Board of Directors of Intesa Sanpaolo, confirms the existence of the compliance requirements.

2.4 Credit risk mitigation techniques

Risk mitigation techniques include instruments that help to reduce the loss that the Bank would incur in the event of a counterparty default, i.e. the LGD described in the paragraph above; In particular, they include guarantees and certain types of contracts that result in a reduction in credit risk.
The evaluation of the mitigating factors is performed through a procedure that assigns a loss given default to each individual exposure, assuming the highest values in the case of ordinary non-guaranteed financing and decreasing in accordance with the strength given to any mitigating factors present. The Loss Given Default values are subsequently aggregated at customer level in order to provide a summary evaluation of the strength of the mitigating factors on the overall credit relation.

During the credit granting and managing process, the presence of mitigating factors is encouraged for counterparties with non-investment grade ratings or some types of transactions, namely medium-/long-term transactions.
The mitigating factors that have the greatest impact include pledges of financial assets and residential mortgages. Other forms of risk mitigation are pledges of non-financial assets and non-residential mortgages.
The strength of the personal guarantees issued by rated parties, typically banks/insurance companies, Credit Guarantee Consortia and corporations, is instead assessed on the basis of the type of guarantee and guarantor's credit quality.
Detailed processes govern the material acquisition of individual guarantees, identifying the responsible structures as well as the methods for correct finalisation of guarantees, for filing documentation and for complete and timely reporting of the related information in the applications.
The set of internal regulations and organisational and procedural controls is aimed at ensuring that:

- all the fulfilments are planned to ensure the validity and effectiveness of the credit protection;
- for generally and normally used guarantees, standard contracts are defined, accompanied by instructions for use;
- the methods for approving guarantee documents deviating from the standard by structures other than those in charge of commercial relations with the customer are identified.

The management of personal guarantees and real estate collateral uses a single platform at Group level, which is integrated with the register of real estate assets and the portal that manages the valuations.

The granting of credit with the acquisition of collateral is subject to internal rules and processes – for the evaluation of the asset, the acceptance of the guarantee and the control of its value. The enforcement of the guarantee is handled by specialist departments, which are responsible for credit recovery.
In any case, the presence of collateral does not grant exemption from an overall assessment of the credit risk, mainly concentrated on the creditor's ability to meet the obligations assumed, irrespective of the associated guarantee.
The assessment of the pledged collateral is based on the actual value, namely the market value for financial instruments listed in a regulated market, or, otherwise, the estimated realisable value. The resulting value is multiplied by the haircut percentage rates, differentiated according to the financial instruments accepted as collateral.
For real-estate collateral, the prudential market value is considered; for properties under construction, the construction cost is considered, net of prudential haircuts according to the intended use of the property.
Assets are appraised by internal and external experts. The external experts are included in a special list of professionals accredited on the basis of an individual verification of their capabilities, professionalism and experience. The valuation of residential properties used as collateral for mortgage loans to private individuals is mainly assigned to specialised companies. The work of the experts is monitored on an ongoing basis, by means of statistical verifications and spot checks carried out centrally.
The experts are required to produce estimates on the basis of standardised expert reports, differentiated according to the valuation method to be applied and the characteristics of the asset, in accordance with the "Property Valuation rules for credit purposes" prepared by the Bank. The internal Code is consistent with the "Guidelines for the valuation of properties securing credit exposures" promoted by the Italian Banking Association and with the "European Valuation Standards".
Property valuations are managed through a specific integrated platform covering the entire expert analysis phase, ensuring that assignments are properly awarded, on an independent basis and according to objective criteria, the workflow is thoroughly monitored, valuation standards are correctly applied and all information and documents regarding real estate are kept.
The market value of collateral property is recalculated periodically through various statistical valuation methods, which apply prices/ratios provided by an external supplier offering proven skills and a solid reputation for surveying and measuring the market prices of Italian real-estate assets.
Asset value is constantly monitored. The experts carry out inspections and verify the work progress for properties under construction. The valuation is updated in the event of limitation or splitting of the mortgage, of damage to the property, significant impairment losses reported by market indicators used to monitor fair value and, in any case, in accordance with the time limits established for major exposures or where real-estate collateral is held against non-performing loans.
In order to limit the risks of absence or termination of the protection, specific safeguards are in place, including: restoration of a pledge when the assets decrease below their initial value or, for mortgages, an obligation to carry insurance cover against fire damage and the presence of adequate monitoring of the property's value. An "umbrella" insurance policy is also in effect, covering damage to the entire portfolio of mortgaged properties put up as loan collateral, subject to certain restrictions. Guarantees are subject to accurate, regular control using a specific application, the CRM verifier, in which a series of tests have been implemented to confirm the effective compliance with the requirements set by prudential supervision regulations.
The support application verifies whether the guarantees received are eligible with reference to each of the three methods permitted by the regulations for calculating capital requirements. Based on the specifics of each category, the eligibility results are defined at the level of individual guarantee for unfunded guarantees (usually personal guarantees) or, for collateral, for each asset or financial instrument.

In addition, in recent years, the Bank has been heavily involved in the implementation of two integrated asset and guarantee management systems (PGA - Active Guarantees Portal and ABS - System Assets Archive) in order to improve the efficiency of collateral management. This has been accompanied by the development of a specific system for managing bad loans, to track the main legal actions and particularly those relating to the enforcement of real estate collateral (EPC – Ex Parte Creditoris).

A project was started for International Subsidiary Banks with the aim of guaranteeing a consistent approach at Group level to the use of the credit risk mitigation techniques. More specifically, a gap analysis of seven International Subsidiary Banks was completed for the main types of guarantees and for five of these banks an action plan was drawn up and is being implemented. The Covenant project, in particular, is managed through a dedicated application.

2.5. Non-performing financial assets

Management strategies and policies

Non-performing financial assets include those loans which, due to events that occur after their granting, show objective evidence of possible impairment.

On 9 January 2015, on the proposal of the European Banking Authority (EBA), the European Commission approved the "final" version of the “Final Draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No. 575/2013”.

Following this decision, the Bank of Italy issued an update to its corpus of regulations that, in line with the previous representation of the risk statuses of non-performing loans, fully reflects the new Community regulations with effect from 1 January 2015.

The definition of non-performing loans provided by the Bank of Italy in Circular 272 of 2008 (as subsequently updated) is convergent with the definition of “impaired” financial assets contained in accounting standard IFRS 9, and therefore all non-performing loans are registered as Stage 3 financial assets.

Based on the regulatory framework, supplemented by internal implementing rules, non-performing financial assets are classified into three categories, based on their level of severity: “bad loans”, “unlikely to pay” and “non-performing past due exposures”.

The type “exposures subject to concessions - forbearance” has also been established. These are exposures subject to renegotiation and/or refinancing due to financial difficulties (evident or in the process of becoming evident) of the debtor, which effectively constitute a subgroup of both non-performing exposures (Non-performing exposures with forbearance measures) and performing exposures (Other forborne exposures).

Non-performing exposures with forbearance measures do not represent a separate category of non-performing assets, rather, they are an attribute of the above categories of non-performing assets.

The process of managing such exposures, in close accordance with regulatory provisions concerning classification times and methods, is assisted by an IT tool that ensures pre-established, autonomous and independent management procedures.

The Intesa Sanpaolo Group adopts a “creditor" approach to identifying non-performing exposures. In this respect, the loan counterpart, overall, is assessed and classified, rather than each credit line granted to that counterpart.

Non-performing assets are subject to an individual measurement process or calculation of the expected loss for uniform categories (identified based on the risk status, duration of non-performance and significance of the exposure represented), with value adjustment allocated to each position.

Two methods are used to measure non-performing loans:

- analytical-statistical measurement, : for exposures equal to or below certain thresholds, on the basis of specific LGD (statistical) grids;
- analytical measurement, for exposures above certain thresholds, on the basis of the impairment estimates made the relationship manager, following analyses and assessments based on pre-established criteria.

An additional component (add-on) is added to the measurement component that has been determined using analytical-statistical measurement models or individual expert measurement, aimed at taking into account both the future macroeconomic scenarios and the incremental risk level of the counterparty if the same risk status is continued (“vintage”).

Measurements are performed when the exposures are classified as non-performing loans or when significant events occur and, in any case, are periodically revised.

With reference to past due loans and/or unlikely to pay loans, the structures responsible for their management are identified, on the basis of pre-determined thresholds of increasing significance, within geographical (regional) organisational units that perform specialist activities, and within the Head Office Departments responsible for the overall management and coordination of the matter as a whole.

With regard to bad loans, in 2018 the Group adopted a new organisational model. The organisational model that had been in place in previous years, up to 18 November 2018, called for:

- the assignment to the Loan Recovery Department of coordination of all loan recovery activities and direct management (for Intesa Sanpaolo and all banks in the Banca dei Territori Division) of all positions that it manages and customers classified to the bad loan category from May 2015 (with the exception of a portion of loans with individual exposures below a given threshold, collectively representing an insignificant percentage in terms of exposure with respect to total bad loans, which are assigned for management to new external servicers under a specific agreement and with predefined limits);
- the suspension (with limited exceptions), beginning May 2015, of assignment to external servicer Italfondiario S.p.A. of new bad loan flows, without prejudice to its management of the bad positions assigned to it until 30 April 2015;

- for bad positions of limited amounts, routine factoring without recourse to third-party companies on a monthly basis when they are classified as bad loans, with some specific exceptions.

The Loan Recovery Department relies on its own specialist units throughout the country to manage recovery activity for loans entrusted directly to it. As part of these activities, in order to identify the optimal strategies to be implemented for each position, judicial and non-judicial solutions are examined in terms of costs and benefits, also considering the financial impact of the estimated recovery times.

In accordance with the organisational model, since December 2018 credit recovery activities have been assigned to a leading international operator, as external servicing specialist, with whom a partnership has been formed with the aim of further improving credit recovery operations and ensuring future value creation by developing a specialist servicing platform in Italy, which is one of the leading European markets for NPL servicing.
Positions that the ISP Group has designated as sensitive are managed by an internal recovery unit. In the CLO area, the Capital Light Bank Department is responsible for the operational management of the service and for monitoring performance levels.
The servicer must comply with the measurement rules adopted by the ISP Group for the positions that it is assigned to manage.

The valuation of loans is also reviewed whenever significant events come to light that change recovery outlooks, such as the sale at auction of property pledged as collateral. For such events to be promptly recognised, the information assets relating to debtors and collateral are periodically monitored, and a constant check is kept on developments regarding out-of-courts agreements and the various phases of judicial proceedings in progress.
The operations of external servicers are monitored by the purpose-established internal structures.

The classification of positions within non-performing financial assets is undertaken on proposal of both central and local territorial structure owners of the commercial relation or of specialised central and local territorial structures in charge of loan monitoring and recovery. Classification involves the use of automatic mechanisms when given objective default thresholds are exceeded. This occurs, for instance, in cases of past-due loans which are continuously above the set thresholds for determined periods, and of performing positions with forborne exposures that have not yet completed their probation period, if those exposures become relevant for the purposes of regulatory provisions concerning reallocation to the non-performing category.
Automatic mechanisms also detect any mismatches, thereby ensuring that material non-performing loans to counterparties shared between the Group’s various intermediaries are subject to the required uniform convergence of management decisions. Materiality is represented by exceeding a pre-established warning threshold for loans classified as at the greatest risk, with respect to the overall exposure.
Automatic mechanisms within the system also ensure that positions are allocated to the risk status most representative of their creditworthiness (bad loans excluded) as material default continues.

The return to performing status of non-performing exposures is governed by the Supervisory Authority and specific internal regulations, and takes place on the proposal of the Structures responsible for their management, upon verification that the critical conditions or state of default no longer exist.
Exposures classified amongst “past-due loans” automatically become performing when payment is received The same mechanism is applied to exposures of moderate amounts previously classified as unlikely to pay when automatic mechanisms detect that the conditions that triggered reclassification no longer apply.

The Internal Validation and Controls Department of the Chief Risk Officer Governance Area performs the Level 2 control on the individual counterparties with non-performing loans, to verify their correct classification and/or adequate provisioning. Checks were also conducted on bad loans to which adjustments have been allocated on a lump-sum basis, also in line with the requirements of the LGD validation framework applied to bad loans (LGD defaulted asset).

With regard to the valuation of the different types of non-performing exposures, as already mentioned, the Group uses two general criteria:

- a specific individual valuation for bad loans and unlikely-to-pay loans of amounts above EUR 2 million euro. This valuation is performed by the managers of the individual positions based on a qualitative and quantitative analysis of the creditor's financial position, the risk level of the credit relationship, possible mitigating factors (collateral) and taking into account the financial impact of the estimated recovery time.
  For bad loans in particular, a series of elements are relevant, which differ according to the characteristics of the positions, and must be thoroughly and prudently assessed, including the following, listed merely as examples:
    - nature of the credit, whether preferential or unsecured;
    - net asset value of the creditors/third party collateral providers;
    - complexity of existing or potential litigation and/or the underlying legal issues;
    - exposure of the creditors to the banking system and other creditors;
    - last available financial statements;
    - legal status of the creditors and any pending insolvency and/or individual proceedings.

  For the valuation of real estate guarantees, surveys and/or expert opinions are taken into account, as well as impairment losses resulting from the progress of legal proceedings. The methods used to determine the estimated recoverable amounts in enforcement proceedings for real estate assets pledged as collateral take into account the different possible recovery times, the timing of the various auctions, the actual conditions for recovery of the asset, and the estimate of the amount of provisions needed to cover the decrease in the recoverable amount of the property associated with legal proceedings that take a long time.

For Unlikely-to-Pay Loans, the valuation is based on a qualitative and quantitative analysis of the creditor's financial position and on precise assessment of the risk situation.
The calculation of the impairment loss involves the valuation of the future cash flows that the creditor is considered to be able to generate and that will also be used to service the financial debt. This estimate must be made based on two alternative approaches:
   - the going concern approach: the operating cash flows of the creditor (or the beneficial owner) continue to be generated and are used to repay the financial debts contracted. The going concern assumption does not rule out the realisation of collateral, but only to the extent that this can take place without affecting the creditor's ability to generate future cash flows. The going concern approach is also used in cases where the recoverability of the exposure is based on the possible sale of assets by the creditor or on extraordinary transactions;
   - the gone concern approach: applicable in cases when it is believed that the creditor's cash flows will cease. This is a scenario that can apply to positions that have been classified as Bad Loans.

In this context, assuming that shareholders' interventions and/or extraordinary operations to restructure debt in turnaround situations are not reasonably feasible, recovery of the credit is essentially based on the value of the collateral that secures the Bank's credit claim and, alternatively, on the realisable value of the assets, taking into account the liabilities and possible pre-emptive claims.
- a statistical individual analysis for Bad Loans and Unlikely-to-Pay Loans of an amount of less than EUR 2 million and for past-due loans.
  With regard to bad loans, the individual-statistical assessment is based on the Bad Loan LGD grids, where the LGD Defaulted Asset model is mainly characterised by the differentiation of the loss rates that, in addition to the regulatory segment, is based on the continuation in the risk status ("vintage") and the possible activation of legal recovery proceedings. The grids are also differentiated for the other significant analysis axes used in the model estimation (e.g. technical type, type of guarantee, geographical area, exposure band, etc.).
  The recovery time grids are mainly broken down by regulatory segment and by additional significant analysis axes used in the modelling (e.g. recovery procedures, exposure band, technical type).
  For Unlikely-to-Pay Loans, the valuation is carried out by applying statistical LGD grids estimated specifically for positions classified as Unlikely-to-Pay Loans, in line with the estimated LGD grids for Bad Loans.
  The estimation model for the LGD grid for Unlikely-to-Pay Loans is similar to the one described above for bad loans and calculates the expected loss rate of the relationship being valued according to its characteristics. The LGD for Unlikely-to-Pay Loans is obtained by recalibrating the Bad Loan LGD using the Danger Rate module. The Danger Rate is a multiplying correction factor, used to recalibrate Bad Loan LGD with the information available on the other default events, in order to calculate an LGD representative of all the possible default events and their evolution;.
  In addition, for the two subclasses of the "Unlikely-to-Pay Loans" risk status ("Non-Forborne Unlikely-to-Pay Loans" and "Forborne Unlikely-to-Pay Loans"), differentiated grids are estimated to take into account the characteristics of the Forborne loans, which, in addition to having lower average loss levels due to the effect of the Forbearance Measures, are also affected by the regulatory constraints that prevent their return to performing loan status before 12 months from the date of the renegotiation.
  Guarantees given and commitments to disburse funds are first measured by converting exposure into on-balance sheet loans using the regulatory credit conversion factors (CCFs) and then by applying the LGD grids for on-balance sheet loans.

For past-due loans, the methods used to determine the grids are the same as those described for the Unlikely-to-Pay Loans (Framework Danger Rate). In this case, the vintage factor is captured by the introduction of a differentiation based on the duration of the past-due period (Past Due at 90 days/180 days) which produces a significant variation in the loss rates of the grids, which are also differentiated according to regulatory segment and additional analysis axes (e.g. technical type, type of guarantee, geographical area, exposure band, etc.) common to the other non-performing loan categories. For these loans, too, the add-on component is calculated based on the macroeconomic climate.

Write-offs

Lastly, with regard to non-performing loans, you are reminded that the Intesa Sanpaolo Group uses the write-off/deletion of unrecoverable accounting positions and, in the following cases, the consequent allocation of the remainder to the loss that has not yet been adjusted:

a) uncollectability of the debt, as a result of definite and precise elements (such as, for example, untraceability and indigence of the debtor, lack of recovery from realisation of securities and real estate, negative foreclosures, bankruptcy proceedings closed with no full compensation for the Bank, if there are no further guarantees that can be enforced etc.);
b) waiver of the credit claim, due to the unilateral cancellation of the debt or residual amount as a result of settlement agreements;
c) disposal of loans.

In some cases, partial write-offs of gross loans are also necessary to bring them into line with the Bank's actual credit claims. These circumstances occur, for example, in the case of unchallenged measures, in bankruptcy proceedings, under which a claim lower than the amount entered in the accounts is recognised.
In addition, the Group periodically (at least every six months) provides for bad loan portfolios to be fully or partially written-off where the following macro-features converge:
- coverage rate > 95%
- past-due bracket (the duration for loans have been past-due) > 5 years for non-collateralised loans or > 8 years for collateralised loans

The debt amounts written off are usually already fully provisioned.
Any recoveries from collections after write-off are recognised in profit and loss as write-backs.

Purchased or originated credit-impaired financial assets
In accordance with the IFRS 9 standard, loans considered to be non-performing, due to their high associated credit risk, from the moment they are first recognised in the financial statements are defined as purchased or originated credit-impaired (POCI) assets. If these loans fall within the scope of impairment referred to in IFRS 9, they are measured by recognising – from the date of initial recognition – provisions to cover lifetime expected credit loss. Non-performing loans are initially recognised during Stage 3, although may be moved to Stage 2 during their lifetime if a credit risk analysis deems them to no longer be impaired.

2.6 Renegotiated financial assets and forbearance

Forbearance: the prerequisites for renegotiation and financial difficulty
"Forbearance measures" are granted for a creditor that is facing, or is about to face, difficulties in meeting their payment obligations (troubled debt).
The term "forbearance measures" indicates contractual modifications granted to the creditor undergoing financial difficulties (modification), as well as the disbursement of a new loan in order to satisfy the pre-existing obligation (refinancing). "Forbearance measures" include contractual modifications, which may be freely requested by a debtor with regard to a contract already signed, but only if the creditor believes the debtor to be in financial difficulty ("embedded forbearance clauses"). Renegotiations conducted for commercial reasons/practices, regardless of the financial difficulties of the creditor, should therefore be separated from the concept of forbearance.

In many cases, financial difficulties are accompanied by economic imbalances on the part of the creditor, represented by the insufficiency of typical operations when it comes to paying, from revenues, all productive factors required by the company under normal market conditions.

Unlike the "creditor-based" approach used by the Intesa Sanpaolo Group for classifying non-performing exposures, EBA regulations require forborne assets, or forborne exposures, to be identified using a "transaction-based" approach. The term "exposure", in this context, means a renegotiated contracted, rather than the total exposure to a single creditor.

More generally, in compliance with the directives of the Supervisory Authorities, the policy of the Intesa Sanpaolo Group provides elements for identifying financial difficulty (of a performing creditor) which, in the presence of renegotiation/refinancing, requires one (or more) line/lines of credit of those granted to be classified as follows:
- a significant worsening of the creditor rating during the period prior (e.g. three months) to renegotiation;
- defaults of thirty days or more in the three months prior to renegotiation;
- the relevant creditor exposures have been registered on a "watch list", warning of a certain level of risk.

The definition of forborne exposure appears to transverse the macro-categories for classifying loans (performing and non-performing). Forborne assets can therefore be included among both stage 3 exposures - i.e. non-performing forborne loans or non-performing forbearances - and stage 2 exposures. According to the Intesa Sanpaolo Group's interpretation, designating an exposure as forborne means that there has been a "significant increase" in the risk level compared to when the loan originated (and that it was stage 2 or 3 classified when "forborne" status was assigned).

Trade renegotiations

Unlike forbearance measures, which concern loans to counterparties in financial difficulty, renegotiations for commercial reasons involve creditors that are not in conditions of financial difficulty and include all operations aimed at adjusting debt based on market conditions.

Commercial renegotiation deals involve altering the original conditions of a contract, usually at the request of the creditor and generally in relation to aspects concerning the cost (or duration) of the debt, through which the creditor derives an economic benefit. In general, renegotiations entered into by the bank to avoid losing a client should be considered substantial as, if the renegotiation did not take place, the customer would obtain financing from another broker and the bank would suffer a decrease *in expected future revenues.*

Subject to certain conditions, these transactions are treated in accounts as early repayments of the original debt and the granting of a new loan.

QUANTITATIVE INFORMATION

A. CREDIT QUALITY

A.1. Performing and non-performing exposures: amounts, adjustments, dynamics, economic and geographical distribution

A.1.1. Distribution of financial assets by portfolio and according to credit quality (carrying amounts)

(millions of euro)

Portfolios/Quality	Bad loans	Unlikely to pay	Non-performing past due exposures	Performing past due exposures	Other Performing exposures	Total
1. Financial assets measured at amortised cost	79,849	105,266	1,541	18,250	2,590,631	2,795,537
2. Financial assets measured at fair value through other comprehensive income	14	-	-	-	6,228	6,242
3. Financial assets designated at fair value	-	-	-	-	-	-
4. Financial assets mandatorily measured at fair value	-	-	-	-	129	129
5. Financial assets held for sale	-	-	-	-	-	-
Total 31/12/2018	**79,863**	**105,266**	**1,541**	**18,250**	**2,596,988**	**2,801,908**
Total 31/12/2017	**182,211**	**131,407**	**4,971**	**31,506**	**2,565,869**	**2,915,964**

A.1.2. Distribution of financial assets by portfolio and according to credit quality (gross and net values)

(millions of euro)

Portfolios/Quality	NON-PERFORMING ASSETS				PERFORMING ASSETS			TOTAL (net exposure)
	Gross exposure	Total adjustments	Net exposure	Total partial write-offs	Gross exposure	Total adjustments	Net exposure	
1. Financial assets measured at amortised cost	434,933	248,277	186,656	61,164	2,621,962	-13,082	2,608,881	2,795,537
2. Financial assets measured at fair value through other comprehensive income	14	-	14	-	6,234	-6	6,228	6,242
3. Financial assets designated at fair value	-	-	-	-	X	X	-	-
4. Financial assets mandatorily measured at fair value	-	-	-	-	X	X	129	129
5. Financial assets held for sale	-	-	-	-	-	-	-	-
Total 31/12/2018	**434,947**	**248,277**	**186,670**	**61,164**	**2,628,196**	**-13,088**	**2,615,238**	**2,801,908**
Total 31/12/2017	**670,108**	**351,519**	**318,589**	**-**	**2,604,458**	**7,107**	**2,597,375**	**2,915,964**

(millions of euro)

Portfolios/Quality	MANIFESTLY LOW QUALITY CREDIT ASSETS		OTHER ASSETS
	Cumulative write-downs	Net Exposure	Net exposure
1. Financial assets held for trading	-295	228	10,056
2. Hedging derivatives	-	-	2,050
Total 31/12/2018	**-295**	**228**	**12,106**
Total 31/12/2017	**128**	**195**	**14,271**

A.1.3. Breakdown of financial assets by past-due brackets (carrying amount)

(millions of euro)

Portfolios/risk stages	Stage 1			Stage 2			Stage 3		
	Between 1 and 30 days	Between 30 and 90 days	Over 90 days	Between 1 and 30 days	Between 30 and 90 days	Over 90 days	Between 1 and 30 days	Between 30 and 90 days	Over 90 days
1. Financial assets measured at amortised cost	4,699	1,509	504	4,182	1,994	5,362	4,870	1,327	180,459
2. Financial assets measured at fair value through other comprehensive income	-	-	-	-	-	-	-	-	14
Total 31/12/2018	**4,699**	**1,509**	**504**	**4,182**	**1,994**	**5,362**	**4,870**	**1,327**	**180,473**

A.1.4 Financial assets, commitments to disburse funds and financial guarantees given: changes in total adjustments and total provisions

(millions of euro)

Reasons/risk stages	TOTAL VALUE ADJUSTMENTS											
	Stage 1 and 2 assets				Stage 3 assets				Purchased or originated credit-impaired financial assets	Total provisions on commitments to disburse funds and financial guarantees given		TOTAL
	Financial assets measured at amortised cost	Financial assets measured at fair value through other comprehensive income	of which: individual impairment losses	of which: collective impairment losses	Financial assets measured at amortised cost	Financial assets measured at fair value through other comprehensive income	of which: individual impairment losses	of which: collective impairment losses		Stage 1 and 2	Stage 3	
Initial amount	**14,515**	**5**	**14,520**	**-**	**391,152**	**-**	**391,152**	**-**	**-**	**779**	**503**	**406,954**
Increases in purchased or originated financial assets	430	-	430	-	-	-	-	-	-	-	-	430
Derecognition other than write-offs	-1,616	-	-1,616	-	-136,699	-	-136,699	-	-	-	-	-138,315
Net adjustments/recoveries for credit risk (+/-)	-76	-	-76	-	28,603	-	28,603	-	-	-62	-133	28,332
- of which business combinations	-	-	-	-	-	-	-	-	-	-	-	-
Changes in the estimation methodology	-	1	1	-	-	-	-	-	-	-	-	1
Write-offs	-	-	-	-	-31,432	-	-31,432	-	-	-	-	-31,432
Other changes	-171	-	-171	-	-3,347	-	-3,347	-	-	-	-	-3,518
Final amount	**13,082**	**6**	**13,088**	**-**	**248,277**	**-**	**248,277**	**-**	**-**	**717**	**370**	**262,452**
Recoveries on collection of financial assets previously written off	-	-	-	-	831	-	831	-	-	-	-	831
Write-offs recognised directly to the income statement	-	-	-	-	-3,658	-	-3,658	-	-	-	-	-3,658

A.1.5 Financial assets, commitments to disburse funds and financial guarantees given: transfers between stages of credit risk (gross and nominal amounts)

(millions of euro)

Portfolios/risk stages	Gross values /nominal value					
	Transfers between Stage 1 and Stage 2		Transfers between Stage 2 and Stage 3		Transfers between Stage 1 and Stage 3	
	To Stage 2 from Stage 1	To Stage 1 from Stage 2	To Stage 3 from Stage 2	To Stage 2 from Stage 3	To Stage 3 from Stage 1	To Stage 1 from Stage 3
1. Financial assets measured at amortised cost	276,055	258,192	20,186	8,226	1,786	3,645
2. Financial assets measured at fair value through other comprehensive income	-	-	-	-	-	-
3. Commitments to disburse funds and financial guarantees given	71,567	41,699	50	51	-	-
Total 31/12/2018	**347,622**	**299,891**	**20,236**	**8,277**	**1,786**	**3,645**

A.1.6. On- and off-balance sheet credit exposures to banks: gross and net values

(millions of euro)

Type of exposure/amounts	GROSS EXPOSURE		TOTAL ADJUSTMENTS AND TOTAL PROVISIONS FOR CREDIT RISK	NET EXPOSURE	TOTAL PARTIAL WRITE-OFFS
	Non-performing	Performing			
A. ON-BALANCE SHEET EXPOSURES					
a) Bad loans	-	X	-	-	-
Of which: forborne exposures	-	*X*	-	-	-
b) Unlikely to pay	-	X	-	-	-
Of which: forborne exposures	-	*X*	-	-	-
c) Non-performing past due exposures	-	X	-	-	-
Of which: forborne exposures	-	*X*	-	-	-
d) Performing past due exposures	X	-	-	-	-
Of which: forborne exposures	X	-	-	-	-
e) Other performing exposures	X	368,660	-183	368,476	-
Of which: forborne exposures	X	-	-	-	-
TOTAL A	**-**	**368,660**	**-183**	**368,476**	**-**
B. OFF-BALANCE SHEET EXPOSURES					
a) Non-performing	-	X	-	-	-
b) Performing	X	613	-	613	-
TOTAL B	**-**	**613**	**-**	**613**	**-**
TOTAL (A + B)	**-**	**369,273**	**-183**	**369,089**	**-**

A.1.7. On- and off-balance sheet credit exposures to customers: gross and net values

(millions of euro)

Type of exposure/amounts	GROSS EXPOSURE		TOTAL ADJUSTMENTS AND TOTAL PROVISIONS FOR CREDIT RISK	NET EXPOSURE	TOTAL PARTIAL WRITE-OFFS
	Non-performing	Performing			
A. ON-BALANCE SHEET EXPOSURES					
a) Bad loans	286,938	X	-207,075	79,863	-60,223
Of which: forborne exposures	*50,478*	*X*	*-35,332*	*15,146*	*-2,332*
b) Unlikely to pay	146,032	X	-40,766	105,266	-941
Of which: forborne exposures	*78,287*	*X*	*-21,263*	*57,024*	*-568*
c) Non-performing past due exposures	1,977	X	-435	1,541	-
Of which: forborne exposures	136	*X*	*-30*	*106*	-
d) Performing past due exposures	X	18,930	-680	18,250	-
Of which: forborne exposures	X	2,462	-131	2,331	-
e) Other performing exposures	X	2,240,741	-12,220	2,228,512	-
Of which: forborne exposures	X	53,372	-2,841	50,531	-
TOTAL A	**434,947**	**2,259,671**	**-261,176**	**2,433,432**	**-61,164**
B. OFF-BALANCE SHEET EXPOSURES					
a) Non-performing	4,312	X	-370	3,942	-
b) Performing	X	942,506	-717	941,789	-
TOTAL B	**4,312**	**942,506**	**-1,087**	**945,731**	**-**
TOTAL (A + B)	**439,259**	**3,202,177**	**-262,263**	**3,379,163**	**-61,164**

A.1.8. On-balance sheet credit exposures to banks: changes in gross non-performing exposures

There are no non-performing on-balance sheet exposures banks.

A.1.8bis. On-balance sheet credit exposures to banks: changes in gross forborne exposures broken down by credit quality

There are no forborne on-balance sheet exposures banks.

A.1.9. On-balance sheet credit exposures to customers: changes in gross non-performing exposures

(millions of euro)

Reasons/Categories	Bad loans	Unlikely to pay	Non-performing past due
A. Initial gross exposure	**489,829**	**174,240**	**6,039**
- of which: exposures sold not derecognised	-	-	-
B. Increases	**42,393**	**29,343**	**11,859**
B.1 inflows from performing exposures	210	10,550	11,212
B.2 inflows from purchased or originated credit-impaired financial assets	-	-	-
B.3 transfers from other non-performing exposures categories	34,433	13,025	-
B.4 changes in contracts without derecognition	-	-	-
B.3 other increases	7,750	5,768	647
C. Decreases	**-245,284**	**-57,551**	**-15,921**
C.1 outflows to performing exposures	-1,755	-8,506	-1,609
C.2 write-offs	-32,835	-2,245	-10
C.3 collections	-16,016	-11,407	-1,230
C.4 profits on disposal	-50,956	-20	-
C.5 losses on disposal	-93	-1	-
C.6 transfers to other non-performing exposure categories	-41	-34,384	-13,033
C.7 changes in contracts without derecognition	-	-	-
C.8 other decreases	-143,588	-988	-39
D. Final gross exposure	**286,938**	**146,032**	**1,977**
- of which: exposures sold not derecognised	-	-	-

A.1.9bis. On-balance sheet credit exposures to customers: changes in gross forborne exposures broken down by credit quality

(millions of euro)

Reasons/Categories	Forborne exposures: non-performing	Forborne exposures: performing
A. Initial gross exposure	**140,501**	**73,042**
- of which: exposures sold not derecognised	-	-
B. Increases	**27,862**	**27,688**
B.1 inflows from non-forborne performing exposures	123	19,406
B.2 inflows from forborne performing exposures	5,768	X
B.3 inflows from non-performing forborne exposures	X	6,914
B.4 other increases	21,971	1,368
C. Decreases	**-39,463**	**-44,895**
C.1 outflows towards non-forborne performing exposures	X	-21,298
C.2 outflows towards forborne performing exposures	-6,914	X
C.3 outflows towards non-performing forborne exposures	X	-5,768
C.4 write-offs	-1,061	-
C.5 collections	-5,478	-15,329
C.6 profits on disposal	-2,593	-
C.7 losses on disposal	-	-
C.8 other decreases	-23,417	-2,500
D. Final gross exposure	**128,900**	**55,835**
- of which: exposures sold not derecognised	-	-

A.1.10. On-balance sheet non-performing credit exposures to banks: changes in total adjustments

There are no non-performing on-balance sheet exposures banks.

A.1.11. On-balance sheet non-performing credit exposures to customers: changes in total adjustments

(millions of euro)

Reasons/Categories	BAD LOANS		UNLIKELY TO PAY		NON-PERFORMING PAST DUE EXPOSURES	
		Of which: forborne exposures		Of which: forborne exposures		Of which: forborne exposures
A. initial total adjustments	**307,618**	**28,196**	**42,833**	**23,122**	**1,068**	**106**
- of which: exposures sold not derecognised	-	-	-	-	-	-
B. Increases	**93,835**	**14,821**	**27,905**	**10,556**	**2,598**	**941**
B.1 adjustments to purchased or originated credit-impaired financial assets	-	X	-	X	-	X
B.2 other adjustments	43,245	4,628	15,542	5,313	2,479	112
B.3 losses on disposal	93	-	-	-	-	-
B.4 transfers from other non-performing exposures categories	19,271	6,891	3,148	1,006	-	-
B.5 changes in contracts without derecognition	-	X	-	X	-	X
B.6 other increases	31,226	3,302	9,215	4,237	119	829
C. Decreases	**-194,378**	**-7,685**	**-29,972**	**-12,415**	**-3,231**	**-1,017**
C.1 recoveries on impairment losses	-9,097	-1,624	-4,477	-3,396	-39	-
C.2 recoveries on repayments	-13,980	-960	-501	-70	-	-
C.3 profits on disposal	-	-	-	-	-	-
C.4 write-offs	-32,835	-233	-2,245	-827	-	-
C.5 transfers to other non-performing exposure categories	-19	-	-19,256	-6,892	-3,145	-1,006
C.6 changes in contracts without derecognition	-	X	-	X	-	X
C.7 other decreases	-138,447	-4,868	-3,493	-1,230	-47	-11
D. Final total adjustments	**207,075**	**35,332**	**40,766**	**21,263**	**435**	**30**
- of which: exposures sold not derecognised	-	-	-	-	-	-

A.2. Classification of financial assets, commitments to disburse funds and financial guarantees given on the basis of external and internal ratings

A.2.1. Breakdown of financial assets, commitments to disburse funds and financial guarantees given: by external rating classes (gross value)

Standard & Poor's, Moody's, Fitch and DBRS ratings were used for the external ratings table. In compliance with the regulations, if there are two ratings for the same customer, the most prudential of the two is used to determine its capital requirements; when three ratings are available, the middle rating is adopted, and when all ratings are available, the second-best is taken. The Class 6 measurement column includes non-performing loans.

(millions of euro)

	External rating classes						Unrated	Total
	Class 1	Class 2	Class 3	Class 4	Class 5	Class 6		
A. Financial assets measured at amortised cost	**-**	**-**	**382,100**	**5**	**-**	**-**	**2,674,790**	**3,056,895**
- Stage 1	-	-	382,100	5	-	-	1,940,019	2,322,124
- Stage 2	-	-	-	-	-	-	299,838	299,838
- Stage 3	-	-	-	-	-	-	434,933	434,933
B. Financial assets measured at fair value through other comprehensive	**-**	**-**	**6,201**	**-**	**-**	**14**	**34**	**6,248**
- Stage 1	-	-	6,201	-	-	-	34	6,234
- Stage 2	-	-	-	-	-	-	-	**-**
- Stage 3	-	-	-	-	-	14	-	**14**
Total (A+B)	**-**	**-**	**388,301**	**5**	**-**	**14**	**2,674,824**	**3,063,143**
- of which purchased or originated credit-impaired financial assets	-	-	-	-	-	-	-	-
C. Commitments to disburse funds and financial guarantees given								
- Stage 1	-	-	1,270	-	-	-	839,184	840,454
- Stage 2	-	-	-	-	-	-	96,602	**96,602**
- Stage 3	-	-	-	-	-	-	4,312	**4,312**
Total (C)	**-**	**-**	**1,270**	**-**	**-**	**-**	**940,098**	**941,368**
Total (A+B+C)	**-**	**-**	**389,571**	**5**	**-**	**14**	**3,614,922**	**4,004,511**

Mapping of long-term ratings given by external ratings agencies

Long-term ratings to: central governments and central banks supervised issuers; public-sector entities; local authorities; multilateral development banks; enterprises and other parties.

	ECAI	
	Moody's	Fitch Standard & Poor's DBRS
Credit quality step		
Class 1	from Aaa to Aa3	from AAA to AA-
Class 2	from A1 to A3	from A+ to A-
Class 3	from Baa1 to Baa3	from BBB+ to BBB-
Class 4	from Ba1 to Ba3	from BB+ to BB-
Class 5	from B1 to B3	from B+ to B-
Class 6	Caa1 and lower	CCC+ and lower

Mapping of short-term ratings for supervised issuers and enterprises

	ECAI			
	Moody's	Fitch	Standard & Poor's	DBRS
Credit quality step				
Class 1	P -1	F1 +, F1	A -1 + , A -1	R -1
Class 2	P -2	F2	A -2	R -2
Class 3	P -3	F3	A -3	R -3
Class 4 to 6	NP	lower than F3	lower than A -3	R-4 R-5 R-6

Mapping of ratings for collective investment undertakings

	ECAI		
	Moody's	Fitch DBRS	Standard & Poor's
Credit quality step			
Class 1	from Aaa to Aa3	from AAA to AA-	from AAA m/f to AA - m/f
Class 2	from A1 to A3	from A+ to A-	from A + m/f to A - m/f
Classes 3 and 4	from Baa1 to Ba3	from BBB+ to BB-	from BBB + m/f to BB - m/f
Classes 5 and 6	B1 and lower	B+ and lower	B + m/f and lower

A.2.2. Breakdown of financial assets, commitments to disburse funds and financial guarantees given: by internal rating classes (gross value)

(millions of euro)

	Internal rating classes							Total
	CLASS 1	CLASS 2	CLASS 3	CLASS 4	CLASS 5	CLASS 6	Unrated	
A. Financial assets measured at amortised cost	**405,570**	**280,498**	**1,098,120**	**651,454**	**159,832**	**14,915**	**446,506**	**3,056,895**
- Stage 1	402,408	277,044	1,071,356	489,831	79,409	100	1,977	2,322,125
- Stage 2	3,162	3,454	26,764	161,349	79,947	6,222	18,939	299,837
- Stage 3	-	-	-	274	476	8,593	425,590	434,933
B. Financial assets measured at fair value through other comprehensive income	**-**	**-**	**6,200**	**-**	**-**	**14**	**34**	**6,248**
- Stage 1	-	-	6,200	-	-	-	34	6,234
- Stage 2	-	-	-	-	-	-	-	-
- Stage 3	-	-	-	-	-	14	-	14
Total (A+B)	**405,570**	**280,498**	**1,104,320**	**651,454**	**159,832**	**14,929**	**446,540**	**3,063,143**
- of which purchased or originated credit-impaired financial assets	-	-	-	-	-	-	-	-
C. Commitments to disburse funds and financial guarantees given								
- Stage 1	52,207	116,741	487,169	170,757	12,065	133	1,383	840,455
- Stage 2	-	-	4,554	76,077	5,101	566	10,303	96,601
- Stage 3	-	-	-	-	170	-	4,142	4,312
Total (C)	**52,207**	**116,741**	**491,723**	**246,834**	**17,336**	**699**	**15,828**	**941,368**
Total (A+B+C)	**457,777**	**397,239**	**1,596,043**	**898,288**	**177,168**	**15,628**	**462,368**	**4,004,511**

The internal ratings table draws on all ratings used in credit risk control and management systems, including external agencies' ratings for counterparts in customer segments for which no internal model is available. Unrated exposures essentially refer to segments to which no ratings models have been attributed.

A.3. Breakdown of guaranteed credit exposures by type of guarantee

A.3.1. On- and off-balance sheet guaranteed credit exposures to banks

There are no guaranteed credit exposures to banks.

A.3.2. On- and off-balance sheet guaranteed credit exposures to customers

(millions of euro)

	Gross exposure	Net exposure	Collateral (1)				Personal guarantees (2)									Total
							Credit derivatives					Commitments				
			Real estate assets - mortgages	Real estate assets - finance leases	Securities	Other	CLN	Other derivatives				Public Administration	Banks	Other financial companies	Other counterparties	(1)+(2)
								Central counterparties	Banks	Other financial companies	Other counterparties					
1. Guaranteed on-balance sheet credit exposures	**1,973,745**	**1,813,799**	**1,480,645**	**-**	**15,418**	**12,341**	**-**	**-**	**-**	**-**	**-**	**236**	**21,095**	**14,879**	**243,440**	**1,788,053**
1.1 totally guaranteed	1,884,534	1,755,785	1,466,482	-	13,385	11,422	-	-	-	-	-	222	21,095	11,057	231,303	1,754,966
- of which non-performing	*267,140*	*147,757*	*117,042*	-	*45*	*1,195*	-	-	-	-	-	*52*	-	*5,587*	*23,795*	*147,716*
1.2 partly guaranteed	89,211	58,014	14,163	-	2,033	919	-	-	-	-	-	14	-	3,822	12,137	33,087
- of which non-performing	*46,207*	*15,620*	*9,482*	-	*155*	-	-	-	-	-	-	*14*	-	*1,746*	*2,777*	*14,174*
2. Guaranteed off-balance sheet credit exposures	**230,838**	**230,447**	**22,306**	**-**	**5,645**	**6,421**	**-**	**-**	**-**	**-**	**-**	**16,367**	**8,905**	**1,632**	**126,069**	**187,347**
2.1 totally guaranteed	158,078	157,784	18,539	-	1,784	6,056	-	-	-	-	-	9,285	993	901	120,142	157,701
- of which non-performing	*2,600*	*2,475*	*566*	-	-	*65*	-	-	-	-	-	-	-	*27*	*1,817*	*2,475*
2.2 partly guaranteed	72,760	72,663	3,767	-	3,861	365	-	-	-	-	-	7,082	7,912	731	5,927	29,646
- of which non-performing	*652*	*611*	*431*	-	-	-	-	-	-	-	-	-	-	-	*179*	*610*

A.4. Financial and non-financial assets obtained by enforcing guarantees received

There are no such cases.

B. BREAKDOWN AND CONCENTRATION OF CREDIT EXPOSURES

B.1. Breakdown by sector of on- and off-balance sheet credit exposures to customers

(millions of euro)

Exposures/Counterparties	GOVERNMENTS		FINANCIAL COMPANIES		FINANCIAL COMPANIES (OF WHICH: INSURANCE COMPANIES)		NON-FINANCIAL COMPANIES		HOUSEHOLDS	
	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments
A. ON-BALANCE SHEET EXPOSURES										
A.1 Bad loans	14	-	43	-179	-	-	62,283	-175,186	17,523	-31,710
- of which forborne exposures	-	-	19	-39	-	-	12,801	-33,633	2,326	-1,660
A.2 Unlikely to pay	-	-	7,715	-1,493	-	-	77,237	-34,461	20,314	-4,812
'- of which forborne exposures	-	-	7,715	-1,493	-	-	37,063	-17,407	12,246	-2,363
A.3 Non-performing past due exposures	-	-	1	-	-	-	536	-199	1,004	-236
- of which forborne exposures	-	-	-	-	-	-	70	-17	36	-13
A.4 Performing exposures	18,669	-16	8,111	-28	-	-	1,028,404	-8,915	1,191,578	-3,945
- of which forborne exposures	-	-	-	-	-	-	34,261	-2,301	18,601	-670
Total A	**18,683**	**-16**	**15,870**	**-1,700**	**-**	**-**	**1,168,460**	**-218,761**	**1,230,419**	**-40,703**
B. OFF-BALANCE SHEET EXPOSURES										
B.1 Non-performing exposures	-	-	-	-	-	-	3,678	-268	264	-102
B.4. Performing exposures	116,834	-13	12,133	-19		-	712,457	-498	100,365	-187
Total B	**116,834**	**-**	**12,133**	**-**	**-**	**-**	**716,135**	**-268**	**100,629**	**-187**
TOTAL (A+B) 31/12/2018	**135,517**	**-16**	**28,003**	**-1,700**	**-**	**-**	**1,884,595**	**-219,029**	**1,331,048**	**-40,890**
TOTAL (A+B) 31/12/2017	**33,283**	**4,541**	**18,440**	**4,217**		**-**	**1,672,621**	**322,562**	**893,850**	**32,849**

data on family businesses have been deducted from NON-FINANCIAL COMPANIES and added to FAMILIES

B.2. Breakdown by geographical area of on- and off-balance sheet credit exposures to customers

(millions of euro)

Exposure/Geographical areas	ITALY		OTHER EUROPEAN COUNTRIES		AMERICA		ASIA		REST OF THE WORLD	
	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments
A. ON-BALANCE SHEET EXPOSURES										
A.1 Bad loans	79,833	-206,965	12	-88	15	-5	-	-1	3	17
A.2 Unlikely to pay	105,265	-40,765	-	-	1	-1	-	-	-	-
A.3 Non-performing past due exposures	1,541	-435	-	-	-	-	-	-	-	-
A.4 Performing exposures	2,205,260	-12,881	38,864	-18	1,625	-5	736	-	277	-
Total A	**2,391,899**	**-261,046**	**38,876**	**-106**	**1,641**	**-11**	**736**	**-1**	**280**	**17**
B. OFF-BALANCE SHEET EXPOSURES										
B.1 Non-performing exposures	3,942	-370	-	-	-	-	-	-	-	-
B.4. Performing exposures	938,679	-716	2,125	-	94	-	891	-1	-	-
Total B	**942,621**	**-1,086**	**2,125**	**-**	**94**	**-**	**891**	**-1**	**-**	**-**
Total (A+B) 31/12/2018	**3,334,520**	**-262,132**	**41,001**	**-106**	**1,735**	**-11**	**1,627**	**-2**	**280**	**17**
Total (A+B) 31/12/2017	**2,702,238**	**358,912**	**23,594**	**110**	**1,709**	**7**	**580**	**2**	**299**	**17**

B.2 Bis. Breakdown of relations with customers resident in ITALY by geographical area

(millions of euro)

Exposure/Geographical areas	NORTH-WEST		NORTH-EAST		CENTRAL		SOUTH AND ISLANDS	
	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments
EXPOSURES								
A.1 Bad loans	904	-4,750	45	-216	78,400	-200,522	484	-1,477
A.2 Unlikely to pay	7,886	-1,559	2,194	-1,306	94,349	-37,801	836	-99
A.3 Non-performing past due exposures	-	-	3	-2	1,538	-433	-	-
A.4 Performing exposures	72,332	-588	9,753	-30	2,118,292	-12,259	4,883	-5
Total A	**81,122**	**-6,897**	**11,995**	**-1,554**	**2,292,579**	**-251,015**	**6,203**	**-1,581**
B. OFF-BALANCE SHEET EXPOSURES								
B.1 Non-performing exposures	1	-1	-	-	3,882	-369	59	-1
B.4. Performing exposures	41,878	-39	2,975	-2	890,673	-674	3,153	-2
Total B	**41,879**	**-40**	**2,975**	**-2**	**894,555**	**-1,043**	**3,212**	**-3**
Total (A+B) 31/12/2018	**123,001**	**-6,937**	**14,970**	**-1,556**	**3,187,134**	**-252,058**	**9,415**	**-1,584**
Total (A+B) 31/12/2017	**89,509**	**6,155**	**12,577**	**1,466**	**2,591,080**	**349,639**	**8,843**	**1,652**

B.3. Breakdown by geographical area of on- and off-balance sheet credit exposures to banks

(millions of euro)

Exposure/Geographical areas	ITALY		OTHER EUROPEAN COUNTRIES		AMERICA		ASIA		REST OF THE WORLD	
	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments
A. ON-BALANCE SHEET EXPOSURES										
A.1 Bad loans	-	-	-	-	-	-	-	-	-	-
A.2 Unlikely to pay	-	-	-	-	-	-	-	-	-	-
A.3 Non-performing past due exposures	-	-	-	-	-	-	-	-	-	-
A.4 Performing exposures	368,476	-183	-	-	-	-	-	-	-	-
Total A	**368,476**	**-183**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
B. OFF-BALANCE SHEET EXPOSURES										
B.1 Non-performing exposures	-	-	-	-	-	-	-	-	-	-
B.4. Performing exposures	613	-	-	-	-	-	-	-	-	-
Total B	**613**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 31/12/2018	**369,089**	**-183**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total (A+B) 31/12/2017	**344,298**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

B.3Bis. Breakdown of relations with banks resident in ITALY by geographical area

(millions of euro)

Exposure/Geographical areas	NORTH-WEST		NORTH-EAST		CENTRAL		SOUTH AND ISLANDS	
	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments	Net exposure	Total adjustments
A. ON-BALANCE SHEET EXPOSURES								
A.1 Bad loans	-	-	-	-	-	-	-	-
A.2 Unlikely to pay	-	-	-	-	-	-	-	-
A.3 Non-performing past due exposures	-	-	-	-	-	-	-	-
A.4 Performing exposures	368,476	-183	-	-	-	-	-	-
Total A	**368,476**	**-183**	**-**	**-**	**-**	**-**	**-**	**-**
B. OFF-BALANCE SHEET EXPOSURES								
B.1 Non-performing exposures	-	-	-	-	-	-	-	-
B.4. Performing exposures	14	-	-	-	599	-	-	-
Total B	**14**	**-**	**-**	**-**	**599**	**-**	**-**	**-**
TOTAL (A+B) 31/12/2018	**368,490**	**-183**	**-**	**-**	**599**	**-**	**-**	**-**
Total (A+B) 31/12/2017	**343,710**	**-**	**-**	**-**	**588**	**-**	**-**	**-**

B.4. Large risks

As at 31 December 2018, 11 positions are classified as Large Risks.
The unweighted value of these positions is EUR 997.601 million, while the weighted value is EUR 333.711 million.

On the basis of applicable regulations, the number of large risks was calculated from exposures that exceeded 10% of eligible capital, where exposures means the sum of on-balance risk assets and off-balance transactions with a customer or a group of related customers, without weighting factors being applied.

In this way, exposures to the Intesa Sanpaolo Group (EUR 415.602 million), the Italian Treasury (EUR 135.304 million) and the Bank of Italy (EUR 28.150 million) are considered major risks, with exposure of greater than 10% of own funds (even with 0% weighting).

C. SECURITISATIONS

Qualitative information

The Bank does not have any own securitisations.

As at 31 December 2017, the Bank held the following securities in its portfolio, attributable to third-party securitisation transactions:

- securities relating to the securitisation of the NPLs of Cassa di Risparmio di Cesena, Cassa di Risparmio di Rimini and Cassa di Risparmio di San Miniato, subscribed by the National Interbank Deposit Guarantee Fund - Voluntary Scheme, as part of the intervention on those three Banks agreed with Crédit Agricole Cariparma; at the close of the period, the Bank held the following securities:
  - junior notes- nominal value of approximately EUR 399,000 - fully written down;
  - mezzanine notes – nominal value and book value: approximately EUR 30,000.

Quantitative information

C.1 Exposures deriving from the main "originated" securitisations by type of securitised asset and by type of exposure

There are no such cases.

C.2 Exposures deriving from the main "third-party" securitisations by type of securitised asset and by type of exposure

On-balance sheet

(millions of euro)

Type of securitised asset/ Exposure	ON-BALANCE SHEET EXPOSURES					
	Senior		Mezzanine		Junior	
	Book value	Adjust./ recoveries	Book value	Adjust./ recoveries	Book value	Adjust./ recoveries
Loans to businesses (including SMEs)	-	-	30	-	-	-
TOTAL	**-**	**-**	**30**	**-**	**-**	**-**

MODELS FOR THE MEASUREMENT OF CREDIT RISK

At the year-end, the expected loss amounted to 0.47% of disbursed loans, a 0.05 percentage point increase on the 2017 year-end (0.42%). This increase, which was due to a rise in the LGD in connection with the time series update, was partly mitigated by a reformation of portfolios towards less risky counterparts.

For the companies included in the roll out plan, the LGD and EAD internal rating models are subject to a second level of control by the Validation function and a third level three of control by the Internal Auditing function. The control functions produce an annual report for the Supervisory Authority on the compliance of the models with the supervisory regulations, which also verifies deviations between the ex-ante estimates made and the ex post values. This report, approved by the Board of Directors of Intesa Sanpaolo, confirms the compliance to the regulatory requirements.

SECTION 2 - MARKET RISKS

The financial operations of Cassa di Risparmio di Pistoia e della Lucchesia have a very moderate risk profile as the Bank aims to immunise interest rate and liquidity risks and minimise the exposure of net interest income and shareholders' equity to market volatility.

The financial risk of Cassa di Risparmio di Pistoia e della Lucchesia derives from the common operations carried out by customers feeding into the banking book, with this risk then immunised on the proposal of the Parent Group's governing bodies with a view to fully complying with the risk limits set by the Group Financial Risks Committee. Under the service agreements currently in place, the Financial and Market Risks Department is responsible for developing criteria and methodologies to measure and monitor financial risk exposure, while the Treasury Department is responsible for managing financial risks originating from within the Bank itself. The Group's overall financial risk profile and the eventual necessary changes are examined periodically by the Group Financial Risks Committee.

2.1. INTEREST RATE RISK AND PRICE RISK – REGULATORY TRADING BOOK

Cassa di Risparmio di Pistoia e della Lucchesia does not engage in trading activities: the trading book therefore concerns customer-related brokerage activities, with associated risk transferred to Banca IMI and/or Intesa Sanpaolo; there are therefore no financial risks on this book. Any interest rate risk positions in the trading book of Cassa di Risparmio di Pistoia e della Lucchesia Bank are therefore residual only.

2.2. INTEREST RATE RISK AND PRICE RISK – BANKING BOOK

QUALITATIVE INFORMATION

A. General aspects, interest rate risk and price risk management processes and measurement methods

The Treasury Department is directly responsible for financial risk management, as provided for in the organisational model of the Banks of the Banca dei Territori Division. The same operational approach is followed for the financial market access and market risk immunisation related activities of Cassa di Risparmio di Pistoia and Lucchesia which the Bank undertakes as part of its lending business (retail and corporate banking). To access short and medium-long term derivatives markets, Cassa di Risparmio di Pistoia e della Lucchesia currently leans on both the Parent Group and, directly, on Banca IMI, which performs this service using the synergies from its own market-making activities. As regards interest rate risk, intercompany market transactions are negotiated - mainly in the form of interbank deposits and short and medium-term derivative instruments (OIS, IRS, ...) - so as to bring the overall risk profile of the Bank in line with the target risk profile.

The following metrics are used to measure the interest rate risk generated by the banking book:
1. shift sensitivity of economic value (ΔEVE);
2. net interest income:
   i. shift sensitivity of net interest income (ΔNII);
   ii. dynamic simulation of net interest income (NII).
3. *Value at Risk* (VaR).

The shift sensitivity of the economic value (or shift sensitivity of the fair value) measures the change in the economic value of the *banking book* and is calculated at individual cash flow level for each financial instrument, based on different instantaneous rate shocks and reflects the changes in the present value of the cash flows of the positions already in the balance sheet for the entire remaining duration until maturity (*run-off balance sheet*).
In measurements, capital items are represented based on their contractual profile, except for categories of instruments whose risk profiles are different from those contractually envisaged. In this respect, therefore, the choice was made to use a behavioural representation to calculate the risk measures More specifically:
- for mortgages, statistical techniques are used to determine the probability of prepayment, in order to reduce the Group's exposure to interest rate risk (overhedging) and to liquidity risk (overfunding);
- for core deposits, a financial representation model is adopted aimed at reflecting the behavioural features of stability of deposits and partial and delayed reaction to market interest rate fluctuations, in order to stabilise net interest income both in absolute terms and in terms of variability over time;
- for the expected loss on loans, which represents the average cost of long-term lending, a shift in the discounting curve is envisaged, according to the aggregate credit risk levels by economic segment, in order to reduce this component in the cash flows.
- The cash flows used for both the contractual and behavioural profile are calculated at the contractual rate or at the FTP;.

The methods used for core deposits and prepayment are subject to regular backtesting. Backtesting is specifically laid out in the "Model Change" document and approved by the Group Financial Risks Committee.

To determine the present value, a multi-curve system is adopted which has different discounting and forwarding curves according to the type of instrument and the tenor of its indexing. For the determination of shift sensitivity, the standard shock applied to all the curves is defined as a parallel and uniform shifting of +100 basis points of the curves.
In addition to the standard +100 scenario, the measurement of the economic value (EVE) is also calculated based on the six scenarios prescribed by the BCBS document and based on historical stress simulations aimed at identifying worst and best case scenarios.

The shift sensitivity of the net interest income quantifies the impact on short-term interest income of a parallel, instantaneous and permanent, shock to the interest rate curve.
Margin sensitivity is measured using a method that enables the estimation of the expected change in net interest income as a result of a shock to the curves produced by items subject to interest rate revision within a gapping period set at 12 months from the analysis date.
This measure highlights the effect of variations in market interest rates on the net interest income generated by the portfolio being measured, on a constant balance sheet basis, excluding potential effects resulting from the new operations and from assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a forecast indicator of the future levels of the interest margin
To determine changes in net interest income (ΔNII), standard scenarios of parallel rate shocks of +-50 basis points are applied, in reference to a time horizon of twelve months.
Dynamic margin simulation analyses are also conducted that combine shifts in yield curves with changes in base and liquidity differentials, as well as changes in customer behaviour in different market scenarios.

Changes in net interest income and economic value are subject to monthly monitoring, at a consolidated level and for each Group company, with regard to the limits and sub-limits approved by the Group Financial Risks Committee.
For this purpose, measurements are shown as function-specific, classified into ceilings and sub-ceilings, time buckets (short, medium or long term), company and currency.
The scenarios used to test the limits are as follows:

- for exposure monitoring in terms of ΔEVE: instantaneous and parallel shock of +100 bp;
- for exposure monitoring in terms of ΔNII: instantaneous and parallel shock of +/- 50 bp;.

Value at Risk is calculated as the maximum potential loss in the portfolio's market value that could be recorded over a 10-day holding period with a 99% confidence level (parametric VaR).

QUANTITATIVE INFORMATION

1. Banking book: breakdown by residual duration (repricing date) of cash and derivatives financial assets and liabilities

The sensitivity of net interest income – assuming a +50, -50 and +100 basis point change in interest rates – amounted to 6.9 million euro, -7.4 million euro and 13.7 million euro, respectively, in 2018. The last of these figures was up on the EUR 12.2 million recorded at the end of 2017.

2. Banking book: internal models and other sensitivity analysis methodologies

In 2018, interest rate risk generated by the Cassa di Risparmio di Pistoia e della Lucchesia's banking book, measured through shift sensitivity of value, averaged 13.3 million euro with a year-end figure of 13 million euro, compared to a 2017 year-end figure value of 14.5 million euro.

Interest rate risk, measured in terms of VaR, averaged 1.1 million euro (compared to 1.4 million euro at 2017 year-end), with a minimum value of 1 million euro and a maximum value of 1.4 million euro, compared with a year-end figure of 1 million in 2018.

2.3. FOREIGN EXCHANGE RISK

QUALITATIVE INFORMATION

A. General aspects, foreign exchange risk management processes and measurement methods

“Foreign exchange risk” is defined as the possibility that foreign exchange rate fluctuations produce significant changes, both positive and negative, in the Group’s balance sheet aggregates. The key sources of exchange rate risk lie in:

- foreign currency lendings and borrowings with corporate and/or retail customers;
- purchases of securities, equity investments and other financial instruments in foreign currencies;
- trading of foreign currencies and banknotes;
- collection and/or payment of interest, commissions, dividends and administrative costs in foreign currencies.

More specifically, “structural” foreign exchange risk refers to the exposures deriving from commercial operations.
The main types of financial instruments traded include: spot and forward exchange transactions, forex swaps, domestic currency swaps, and foreign exchange options.

B. Foreign exchange risk hedging activities

Foreign exchange risk deriving from operating positions in foreign currency in the banking book is transferred from Cassa di Risparmio di Pistoia e della Lucchesia to the Treasury Department to enable the hedging of such risk. Essentially, this risk is mitigated by the practice of raising funds in the same currency as assets.
Furthermore, Cassa di Risparmio di Pistoia e della Lucchesia performs spot transactions at market conditions in order to readily hedge foreign exchange risk deriving from foreign currency operations with customers.

QUANTITATIVE INFORMATION

1. Breakdown by currency of assets and liabilities and of derivatives

(thousands of euro)

Captions	Currencies					
	US Dollar	Pound	Swiss Franc	Yen	Canadian Dollar	Other currencie
A. FINANCIAL ASSETS	**18,192**	**1,290**	**36**	**358**	**66**	**26,919**
A.1 Debt securities	-	-	-	-	-	6,253
A.2 Equities	24	-	-	-	-	-
A.3 Loans to banks	13,775	1,290	36	2	66	316
A.4 Loans to customers	4,393	-	-	356	-	20,350
A.5 Other financial assets	-	-	-	-	-	-
B. OTHER ASSETS	**418**	**208**	**433**	**50**	**95**	**313**
C. FINANCIAL LIABILITIES	**21,997**	**1,364**	**459**	**403**	**161**	**22,672**
C.1 Due to banks	108	8	425	402	161	21,491
C.2 Due to customers	21,889	1,356	34	1	-	423
C.3 Debt securities	-	-	-	-	-	758
C.4 Other financial liabilities	-	-	-	-	-	-
D. OTHER LIABILITIES	**2**	**-**	**-**	**-**	**-**	**1**
E. FINANCIAL DERIVATIVES						
- Options	-	-	-	-	-	758
long positions	365	-	-	-	-	-
short positions	365	-	-	-	-	-
- Other derivatives						
long positions	58,504	2,853	-	-	-	154
short positions	55,156	2,928	11	8	-	84
TOTAL ASSETS	**77,479**	**4,351**	**469**	**408**	**161**	**27,386**
TOTAL LIABILITIES	**77,520**	**4,292**	**470**	**411**	**161**	**22,758**
DIFFERENCE (+/-)	**-41**	**59**	**-1**	**-3**	**-**	**4,628**

2. Internal models and other sensitivity analysis methodologies

Foreign exchange risk deriving from operating positions in the banking book, measured by VaR (99% confidence level, 10-day holding period), was extremely moderate during the year.

SECTION 3 – DERIVATIVES AND HEDGING POLICIES

3.1 TRADING DERIVATIVES

A. FINANCIAL DERIVATIVES

Starting from 2016, the Bank has been authorised to use EPE (Expected Positive Exposure) internal models to determine the capital requirement for counterparty risk.

A.1. Financial trading derivatives: period-end notional amounts

(thousands of euro)

Underlying asset/Type of derivative	31.12.2018				31.12.2017			
	Over the counter			Organised markets	Over the counter			Organised markets
	Central counterparties	Without central counterparties			Central counterparties	Without central counterparties		
		With netting agreements	Without netting agreements			With netting agreements	Without netting agreements	
1. Debt securities and interest rates	-	**425,666**	**425,666**	-	-	**407,345**	**407,606**	-
a) Options	-	2,368	2,368	-	-	3,146	3,146	-
b) Swaps	-	423,298	423,298	-	-	404,199	404,199	-
c) Forwards	-	-	-	-	-	-	261	-
d) Futures	-	-	-	-	-	-	-	-
e) Other	-	-	-	-	-	-	-	-
2. Equities and stock indices	-	-	-	-	-	-	-	-
a) Options	-	-	-	-	-	-	-	-
b) Swaps	-	-	-	-	-	-	-	-
c) Forwards	-	-	-	-	-	-	-	-
d) Futures	-	-	-	-	-	-	-	-
e) Other	-	-	-	-	-	-	-	-
3. Foreign exchange rates and gold	-	**44,387**	**69,458**	-	-	**335,623**	**350,738**	-
a) Options	-	786	786	-	-	15,009	15,009	-
b) Swaps	-	-	-	-	-	-	-	-
c) Forwards	-	34,475	59,546	-	-	305,763	320,878	-
d) Futures	-	-	-	-	-	-	-	-
e) Other	-	9,126	9,126	-	-	14,851	14,851	-
4. Commodities	-	**9,131**	**9,131**	-	-	**4,581**	**4,581**	-
5. Other	-	-	-	-	-	-	-	-
TOTAL	-	**479,184**	**504,255**	-	-	**747,549**	**762,925**	-

A.2. Financial trading derivatives: gross positive and negative fair value – breakdown by product

(thousands of euro)

Type of derivative	31.12.2018				31.12.2017			
	Over the counter			Organised markets	Over the counter			Organised markets
	Central counterparties	Without central counterparties			Central counterparties	Without central counterparties		
		With netting agreements	Without netting agreements			With netting agreements	Without netting agreements	
1. Positive fair value								
a) Options	-	6	5	-	-	83	100	-
b) Interest rate swaps	-	37	5,677	-	-	136	5,045	-
c) Cross currency swaps	-	-	-	-	-	-	-	-
d) Equity swaps	-	-	-	-	-	-	-	-
e) Forwards	-	62	183	-	-	1,520	1,199	-
f) Futures	-	-	-	-	-	-	-	-
g) Other	-	4,117	75	-	-	1,133	81	-
Total	-	**4,222**	**5,940**	-	-	**2,872**	**6,425**	-
1. Negative fair value								
a) Options	-	5	6	-	-	101	83	-
b) Interest rate swaps	-	6,046	64	-	-	5,235	164	-
c) Cross currency swaps	-	-	-	-	-	-	-	-
d) Equity swaps	-	-	-	-	-	-	-	-
e) Forwards	-	147	98	-	-	1,202	1,516	-
f) Futures	-	-	-	-	-	-	-	-
g) Other	-	76	4,054	-	-	82	1,132	-
Total	-	**6,274**	**4,222**	-	-	**6,620**	**2,895**	-

A.3. OTC financial trading derivatives: notional values, gross positive and negative fair values by counterparty

(thousands of euro)

Underlying assets	Central counterparties	Banks	Other financial companies	Other counterparties
Contracts not included under netting agreements				
1. Debt securities and interest rates				
- notional amount	X	-	61,053	364,612
- positive fair value	X	-	112	5,565
- negative fair value	X	-	-	67
2. Equities and stock indices				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
3. Foreign exchange rates and gold				
- notional amount	X	12,535	-	56,923
- positive fair value	X	14	-	249
- negative fair value	X	22	-	103
4. Commodities				
- notional amount	X	-	-	9,131
- positive fair value	X	-	-	-
- negative fair value	X	-	-	4,029
5. Other				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
Contracts included under netting agreements				
1. Debt securities and interest rates				
- notional amount	-	425,666	-	-
- positive fair value	-	41	-	-
- negative fair value	-	6,046	-	-
2. Equities and stock indices				
- notional amount	-	-	-	-
- positive fair value	-	-	-	-
- negative fair value	-	-	-	-
3. Foreign exchange rates and gold				
- notional amount	-	44,388	-	-
- positive fair value	-	90	-	-
- negative fair value	-	228	-	-
5. Commodities				
- notional amount	-	9,131	-	-
- positive fair value	-	4,091	-	-
- negative fair value	-	-	-	-
4. Other				
- notional amount	-	-	-	-
- positive fair value	-	-	-	-
- negative fair value	-	-	-	-

A.4 Residual maturity of OTC financial trading derivatives: notional amounts

(thousands of euro)

Underlying/Residual maturity	Up to 1 year	Beyond 1 year and up to 5 years	Over 5 years	Total
A.1 Financial derivatives on debt securities and interest rates	**336,849**	**376,241**	**138,242**	**851,332**
A.2 Financial derivatives su Equities and stock indices	**-**	**-**	**-**	**-**
A.3 Financial derivatives on foreign exchange rates and gold	**110,914**	**2,933**	**-**	**113,847**
A.4 Financial derivatives on commodities	**3,683**	**14,578**	**-**	**18,261**
A.5 Other financial derivatives	**-**	**-**	**-**	**-**
Total 31.12.2018	**451,446**	**393,752**	**138,242**	**983,440**
Total 31.12.2017	**784,966**	**615,724**	**109,784**	**1,510,474**

B. CREDIT DERIVATIVES

The Bank does not hold credit derivatives.

3.2. ACCOUNTING HEDGES

QUALITATIVE INFORMATION

With IFRS 9 having been applicable for the first time, the Intesa Sanpaolo Group exercised the option, provided for in the Standard, to continue applying the provisions of IAS 39 in full for all hedge types (micro and macro). Therefore, the hedging provisions of IFRS 9 were not applicable.

A. Fair value hedge accounting

Intesa Sanpaolo Group's hedge accounting is aimed at rendering the banking book immune to changes in the fair value of borrowings and lendings caused by interest rate curve variations (interest rate risk).

The Group uses fair value hedges for specifically identified assets and liabilities (micro-hedging),.
mainly consisting of bonds issued, securities and lending to customers.
Fair value hedging is also applied for the macrohedging of:

- the stable portion of on-demand borrowings (core deposits), on the basis of the carved-out version of IAS 39, in accordance with the second option envisaged by IFRS 9, namely to apply the hedging provisions of IAS 39 in full;
- the quoted spread of floating-rate lending, where fair value macro-hedging covers the risk connected with the variation in the rate of the variable coupon on loans issued, when the coupon rate is fixed;
- a portion of fixed-rate lendings. For this last type, an open-portfolio macrohedging model has been adopted according to a bottom-layer approach that, in accordance with the interest rate risk measurement method involving modelling of the prepayment phenomenon, is more closely correlated with risk management activity and asset dynamics.

The main types of derivative contracts used are plain or structured interest rate swaps (IRS), overnight index swaps (OIS), cross-currency swaps (CCS) and options on interest rates stipulated with third parties or with other Group companies. The latter, in turn, cover risk in the market so that the hedging transactions meet the counterparty hedging criteria to qualify as IAS-compliant for consolidated financial statements.
Derivatives are not listed on regulated markets, but are traded over the counter (OTC). OTC contracts include those brokered through clearing houses.

B. Cash flow hedging

Cash flow hedging is used by the Intesa Sanpaolo Group to protect itself from exposure to changes in future cash flows due to interest rate curve variations related to a particular asset/liability, such as payments of future variable interest rates on a payable/receivable debt or a highly probable future transaction.

The Group uses cash value hedges for specifically identified assets and liabilities (micro-hedging),.
mainly consisting of bonds issued.
Cash value hedging is also applied for the macrohedging of:

- floating-rate borrowings, to the extent that they finance fixed-rate lendings;
- floating-rate lendings to cover fixed-rate borrowings.

The Bank does not have a cash flow microhedging strategy in particular and did not adopt a specific cash flow hedging strategy during the course of 2018.

The derivatives used are interest rate swaps (IRS) with counterparties, or with other Group companies. The latter, in turn, cover risk in the market so that the hedging transactions meet the counterparty hedging criteria to qualify as IAS-compliant for consolidated financial statements.
Derivatives are not listed on regulated markets, but are traded over the counter (OTC). OTC contracts include those brokered through clearing houses.

C. Hedging of foreign investments

The Bank does not have foreign investment risks.

D. Hedging instruments

The mean reasons causing the Group's model to be ineffective in measuring hedge effectiveness are as follows:
- mismatch between the notional values of the derivative and of the hedged underlying at the time of allocation or generated thereafter, such as for loan instalment repayments of loans or bond repurchases;;
- using different curves for the hedging derivative and for the hedged items when carrying out effectiveness testing on fair value hedges. Normally collateralised derivatives are discounted using the Eonia curve, while hedged items are discounted using the hedge index curve;
- the hedge's float leg value being included in the effectiveness test for fair value hedging.

Hedge ineffectiveness is detected in a timely manner for the purposes of:
- determining the effect on the income statement;
- assessing the possibility of continuing to apply the hedge accounting rules.

The Group does not employ dynamic hedging, as defined in IFRS 7, paragraph 23C.

E. Hedged items

The main types of hedged items are:
- debt securities recorded under assets
- debt securities issued and non-securities borrowings;
- fixed-rate lendings;
- floating-rate lendings;
- optional component of floating-rate mortgages;
- spread portion of floating-rate lendings;
- modelled on-demand borrowings.

E.1 Debt securities recorded under assets

These securities are covered under fair value micro-hedging relationships, with IRS, OIS and CCS used as hedging instruments.
The interest rate risk is hedged for the duration of the obligation.
The Dollar Offset Method is used to monitor hedge effectiveness.. This method is based on the ratio between the cumulative changes (from the start of hedging) in the fair value of the hedging instrument, which can be attributed to the hedged risk, as well as the past changes in the fair value of the hedged item (the "fair value delta"), net of the interest rate.

E.2 Debt securities issued and non-securities borrowings;

The Group currently has active fair value micro-hedging relationships in place over fixed-rated or structured borrowings and cash flow macro-hedging and micro-hedging relationships in place over floating-rate borrowings, with IRS, OIS and CCS used as hedging instruments.
The interest rate risk is hedged for the duration of the obligation.
The Dollar Offset Method is used to test the effectiveness of micro-hedges. This method is based on the ratio between the cumulative changes (from the start of hedging) in the fair value or cash flows of the hedging instrument, which can be attributed to the hedged risk, as well as the past changes in the fair value or cash flows of the hedged item (the "fair value delta"), net of the interest rate.
The effectiveness of macro-hedges is monitored by capacity testing. Under this test, the consistency of hedged items, in terms of floating-rate current and forecast borrowings (highly probable future transactions) are compared against the consistency of hedging instruments, which must always be in place throughout the life of the hedging relationship for each time band. The hedged item, in this case, are the expected cash flows expected from the borrowing, which will arise throughout the lifetime of the issue.

E.3 Fixed-rate lendings

The Group has assigned fair value micro-hedging relationships to fixed-rate lendings, and fair value macro-hedging relationships to the retail mortgages of the Parent Group and Network Banks, with IRS mainly used as the hedging instrument.
Interest rate risk is hedged for the lifetime of the underlying.
The Dollar Offset Method is used to test the effectiveness of micro-hedges.
For macro-hedging, the portfolio of hedged lendings is open-ended, i.e. the portfolio has a dynamic makeup of fixed-rate instruments managed at an aggregate level through time-specific hedging derivatives.

The effectiveness of macro-hedging on fixed-rate lendings is regularly tested using specific prospective and retrospective tests aimed at demonstrating that the potentially hedged portfolio contains a set of assets whose sensitivity profile and fair value changes for the interest rate risk purposes reflect those of the derivatives used for hedging.

E.4 Floating-rate lendings;

The Group currently has active cash flow macro-hedging relationships in place over floating-rate lendings, with IRS mainly used as the hedging instrument.
Hedging effectiveness is tested through a capacity test. Under this test, the consistency of hedged items, in terms of floating-rate current and forecast lendings are compared against the consistency of hedging instruments, which must always be in place throughout the life of the hedging relationship for each time band. The hedged item, in this case, are the expected cash flows expected from the lending, which will arise throughout the lifetime of the assets.

E.5 Optional component of floating-rate mortgages;

The optional components inherent in floating-rate mortgages (interest rate options) are covered under fair value micro-hedging relationships, with options (cap, floor, collar) used as hedging instruments.
The underlying may be partially or entirely hedged in terms of both time and amount.
The Dollar Offset Method is used to monitor hedge effectiveness..

E.6 Quoted spread of floating-rate loans;

This item is covered under fair value macro-hedging relationships, with OIS used as the hedging instrument.
This type of hedge aims to render the established interest rate risk immune from the quoted spreads of floating-rate lendings.

E.7 Modelled on-demand borrowing.

Modelled on-demand borrowing is covered under fair value macro-hedging relationships, as envisaged by the “carve out” under IAS 39, with IRS and OIS used as hedging instruments. This hedge type aims to render the interest rate margin immune from possible rate drops that would reduce the spread generated by the bank's core borrowing. The model is continuously monitored and tested by the Financial and Market Risks Department in order to promptly recognise changes in its main characteristics (volume, stability, reactivity) and, where appropriate, make the necessary adjustment.
The Dollar Offset Method is used to monitor hedge effectiveness..

QUANTITATIVE INFORMATION

A. FINANCIAL HEDGING DERIVATIVES

A.1 Financial hedging derivatives: period-end notional amounts

(thousands of euro)

Underlying asset/Type of derivative	31.12.2018				31.12.2017			
	Over the counter			Organised markets	Over the counter			Organised markets
	Central counterparties	Without central counterparties			Central counterparties	Without central counterparties		
		With netting agreements	Without netting agreements			With netting agreements	Without netting agreements	
1. Debt securities and interest rates	-	**635,863**	-	-	-	**597,931**	-	-
a) Options	-	7,944	-	-	-	14,342	-	-
b) Swaps	-	627,919	-	-	-	583,589	-	-
c) Forwards	-	-	-	-	-	-	-	-
d) Futures	-	-	-	-	-	-	-	-
e) Other	-	-	-	-	-	-	-	-
2. Equities and stock indices	-	-	-	-	-	-	-	-
a) Options	-	-	-	-	-	-	-	-
b) Swaps	-	-	-	-	-	-	-	-
c) Forwards	-	-	-	-	-	-	-	-
d) Futures	-	-	-	-	-	-	-	-
e) Other	-	-	-	-	-	-	-	-
3. Foreign exchange rates and gold	-	-	-	-	-	-	-	-
a) Options	-	-	-	-	-	-	-	-
b) Swaps	-	-	-	-	-	-	-	-
c) Forwards	-	-	-	-	-	-	-	-
d) Futures	-	-	-	-	-	-	-	-
e) Other	-	-	-	-	-	-	-	-
4. Commodities	-	-	-	-	-	-	-	-
5. Other	-	-	-	-	-	-	-	-
TOTAL	-	**635,863**	-	-	-	**597,931**	-	-

A.2 Financial hedging derivatives: gross positive and negative fair value – breakdown by product

(thousands of euro)

Type of derivative	Positive and negative fair value								Change in value used to assess hedge ineffectiveness	
	31.12.2018				31.12.2017					
	Over the counter			Organised markets	Over the counter			Organised markets	Total	Total
	Central counterparties	Without central counterparties			Central counterparties	Without central counterparties			31.12.2018	31.12.2017
		With netting agreements	Without netting agreements			With netting agreements	Without netting agreements			
1. Positive fair value										
a) Options	-	98	-	-	-	265	-	-	9	-1
b) Interest rate swaps	-	1,952	-	-	-	4,793	-	-	9	73
c) Cross currency swaps	-	-	-	-	-	-	-	-	-	-
d) Equity swaps	-	-	-	-	-	-	-	-	-	-
e) Forwards	-	-	-	-	-	-	-	-	-	-
f) Futures	-	-	-	-	-	-	-	-	-	-
g) Other	-	-	-	-	-	-	-	-	-	-
Total	-	**2,050**	-	-	-	**5,058**	-	-	**18**	**72**
1. Negative fair value										
a) Options	-	-	-	-	-	-	-	-		
b) Interest rate swaps	-	4,565	-	-	-	2,136	-	-	48	3
c) Cross currency swaps	-	-	-	-	-	-	-	-	-	-
d) Equity swaps	-	-	-	-	-	-	-	-	-	-
e) Forwards	-	-	-	-	-	-	-	-	-	-
f) Futures	-	-	-	-	-	-	-	-	-	-
g) Other	-	-	-	-	-	-	-	-	-	-
Total	-	**4,565**	-	-	-	**2,136**	-	-	**48**	**3**

A.3 OTC financial hedging derivatives: notional values, gross positive and negative fair values by counterparty

(thousands of euro)

Underlying assets	Central counterparties	Banks	Other financial companies	Other counterparties
Contracts not included under netting agreements				
1. Debt securities and interest rates				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
2. Equities and stock indices				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
3. Foreign exchange rates and gold				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
4. Commodities				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
5. Other				
- notional amount	X	-	-	-
- positive fair value	X	-	-	-
- negative fair value	X	-	-	-
Contracts included under netting agreements				
1. Debt securities and interest rates				
- notional amount	-	635,863	-	-
- positive fair value	-	2,050	-	-
- negative fair value	-	4,565	-	-
2. Equities and stock indices				
- notional amount	-	-	-	-
- positive fair value	-	-	-	-
- negative fair value	-	-	-	-
3. Foreign exchange rates and gold				
- notional amount	-	-	-	-
- positive fair value	-	-	-	-
- negative fair value	-	-	-	-
5. Commodities				
- notional amount	-	-	-	-
- positive fair value	-	-	-	-
- negative fair value	-	-	-	-
4. Other				
- notional amount	-	-	-	-
- positive fair value	-	-	-	-
- negative fair value	-	-	-	-

A.4 Residual maturity of OTC hedging derivatives: notional amounts

(thousands of euro)

Underlying/Residual maturity	Up to 1 year	Beyond 1 year and up to 5 years	Over 5 years	Total
A.1 Financial derivatives on debt securities and interest rates	118,720	205,278	311,865	635,863
A.2 Financial derivatives su Equities and stock indices	-	-	-	-
A.3 Financial derivatives on foreign exchange rates and gold	-	-	-	-
A.4 Financial derivatives on commodities	-	-	-	-
A.5 Other financial derivatives	-	-	-	-
Total 31.12.2018	118,720	205,278	311,865	635,863
Total 31.12.2017	109,698	223,940	264,293	597,931

B. CREDIT HEDGING DERIVATIVES

The Bank does not hold credit hedging derivatives.

C. NON-DERIVATIVE HEDGING INSTRUMENTS

The Bank does not hold non-derivative hedging instruments.

D. HEDGED ITEMS

D.1 Fair value hedges

(thousands of euro)

	Micro-hedges: book value	Micro-hedges – net positions: book value of assets and liabilities (prior to netting)	Micro-hedges			Macro-hedges: book value
			Cumulative fair value changes (hedged instrument)	Termination of hedging: residual cumulative fair value changes	Changes in value used to assess hedge ineffectiveness	
A. Assets						
1. Financial assets measured at fair value through other comprehensive income - hedging of:	-	-	-	-	-	
1.1 Debt securities and interest rates	-	-	-	-	-	X
1.2 Equities and stock indices	-	-	-	-	-	X
1.3 Foreign exchange rates and gold	-	-	-	-	-	X
1.4 Loans	-	-	-	-	-	X
1.5 Other	-	-	-	-	-	X
2. Financial assets measured at amortised cost - hedging of:	8,890	-	-108	144	10	543,360
1.1 Debt securities and interest rates	-	-	-	-	-	X
1.2 Equities and stock indices	-	-	-	-	-	X
1.3 Foreign exchange rates and gold	-	-	-	-	-	X
1.4 Loans	8,890	-	-108	144	10	X
1.5 Other	-	-	-	-	-	X
Total 31.12.2018	8,890	-	-108	144	10	543,360
Total 31.12.2017	14,938	-	-258	477	-1	435,408
B Liabilities						
1. Financial liabilities measured at amortised cost - hedging of:	-	-	-	-	-	87,019
1.1 Debt securities and interest rates	-	-	-	-	-	X
1.2 Foreign exchange rates and gold	-	-	-	-	-	X
1.3 Other	-	-	-	-	-	X
Total 31.12.2018	-	-	-	-	-	87,019
Total 31.12.2017	-	-	-	-	-	138,582

3.3. OTHER INFORMATION ON DERIVATIVE INSTRUMENTS (TRADING AND HEDGING)

A. CREDIT AND FINANCIAL DERIVATIVES

A.1. OTC credit and financial derivatives: net fair values by counterparty

(thousands of euro)

	Central counterparties	Banks	Other financial companies	Other counterparties
1. Debt securities and interest rates				
- notional amount	-	1,061,529	61,053	364,612
- positive net fair value	-	-	112	5,565
- negative net fair value	-	-	-	67
2. Equities and stock indices				
- notional amount	-	-	-	-
- positive net fair value	-	-	-	-
- negative net fair value	-	-	-	-
3. Foreign exchange rates and gold				
- notional amount	-	69,467	-	56,923
- positive net fair value	-	14	-	249
- negative net fair value	-	106	-	104
4. Commodities				
- notional amount	-	-	-	9,131
- positive net fair value	-	-	-	-
- negative net fair value	-	-	-	4,029
5. Other				
- notional amount	-	-	-	-
- positive net fair value	-	-	-	-
- negative net fair value	-	4,483	-	-
B. Credit derivatives				
1. Protection purchases				
- notional amount	-	-	-	-
- positive net fair value	-	-	-	-
- negative net fair value	-	-	-	-
2. Protection sales				
- notional amount	-	-	-	-
- positive net fair value	-	-	-	-
- negative net fair value	-	-	-	-

SECTION 4 - LIQUIDITY RISK

QUALITATIVE INFORMATION

A. General aspects, liquidity risk management processes and measurement methods

Liquidity risk is defined as the risk that the Bank may not be able to meet its payment obligations due to the inability to obtain funds on the market (funding liquidity risk) or liquidate its assets (market liquidity risk).
The arrangement of a suitable control and management system for that specific risk has a fundamental role in maintaining stability, not only at the level of each individual bank, but also of the market as a whole, given that imbalances within a single financial institution may have systemic repercussions. Such a system must be integrated into the overall risk management system and provide for incisive controls consistent with developments in the context of reference.
Intesa Sanpaolo's internal control and management system for liquidity risk is implemented within the Group Risk Appetite Framework and in compliance with the tolerance thresholds for liquidity risk approved in the system, which establish that the Group must maintain an adequate liquidity position in order to cope with periods of strain, including prolonged periods, on the various funding supply markets, also by establishing adequate liquidity reserves consisting of marketable securities and refinancing at Central Banks.
To this end, a balance needs to be maintained between incoming and outgoing funds, both in the short and medium-long term. This goal is implemented by the Group Liquidity Risk Management Guidelines approved by the Corporate Bodies of Intesa Sanpaolo, in implementation of the most recent applicable regulatory provisions.

The provisions on liquidity - introduced in the European Union in June 2013 with the publication of Regulation (EU) 575/2013 and Directive 2013/36/EU - were updated in early 2015 with the publication in the Official Journal of the European Union of Commission Delegated Regulation (EU) 2015/61 with regard to liquidity coverage requirements (Liquidity Coverage Ratio - LCR), supplementing and partially amending previous regulations. Under Delegated Regulation 2015/61, from 1 October 2015, banks are required to comply with the short-term indicator in accordance with the phase-in process provided for in Article 38 (100% from 1 January 2018).
Since March 2015, the Group Liquidity Risk Management Guidelines, which already referred to Bank of Italy Circulars 263 and 285, and Directive 2013/36/EU (CRD IV) and Regulation (EU) 575/2013 (CRR), have reflected the above-mentioned additional regulations, which revised the composition of the liquid assets eligible for liquidity reserves and the definition of the 30-day liquidity flows valid for the calculation of the LCR. With respect to structural liquidity, the most recent regulatory provisions of the Basel Committee concerning the Net Stable Funding Ratio (NSFR) have been adopted.
The Group Liquidity Risk Management Guidelines approved by Intesa Sanpaolo's Corporate Bodies illustrate the tasks of the various corporate functions, the rules and the set of control and management processes aimed at ensuring prudent monitoring of liquidity risk, thereby preventing the emergence of crisis situations.

Based on the model approved by the Intesa Sanpaolo Group, Cassa di Risparmio di Pistoia e della Lucchesia provides for liquidity risk management through the Parent Bank, which accesses markets directly or through its foreign subsidiaries in order to support the borrowing and lending demands arising from customer business activities, while overseeing that a balance is kept between equity deposits with varying residual lives.
From this standpoint, the Parent Group performs its functions of monitoring and managing liquidity not only in reference to its own organisation, but also by assessing the Group's overall transactions and the liquidity risk to which it is exposed.

In particular, the management and control guidelines include procedures for identifying risk factors, measuring exposure to risk, verifying compliance with exposure limits, performing stress tests, identifying appropriate risk mitigation initiatives, preparing emergency response plans and information reporting to corporate bodies. In this context, liquidity risk measurement metrics are laid down according to the criteria of short-term liquidity, structural liquidity and stress analysis.

Short-term liquidity is aimed at providing an adequate, balanced level of cash inflows and outflows the timing of which is certain or estimated to fall within a period of 12 months, while ensuring that the Parent Group's Central Treasury has a sufficient liquidity buffer, available for use as the main mitigation tool for liquidity risk.
The structural Liquidity Policy brings together all measures and limits aimed at monitoring and managing risks deriving from mismatches in the medium-long term maturity of assets and liabilities, which is necessary for strategic planning of liquidity management.
The Guidelines also envisage the time extension of the stress scenario for the LCR indicator, provided by the new regulatory framework, measuring, for up to 3 months, the effect of specific acute liquidity tensions (at Group level) combined with a widespread and general market crisis. The internal management guidelines also envisage an alert threshold (Stressed soft ratio) for the consolidated LCR indicator of up to 3 months, with the purpose of establishing an overall level of reserves covering greater cash outflows during a period of time that is adequate to implement the required operating measures to restore the Group to balanced conditions.
The principals and methodologies adopted at Parent Group level are also applied at an individual level. To that end, and in keeping with the Group's liquidity risk appetite, the system of individual limits requires the adoption of the LCR and NSFR indicators, the calculation algorithms for which have been adjusted as appropriate to take into account specific operational issues associated with the centralisation of treasury activities with the Parent Group.

In addition to the short-term and structural liquidity indicators and the stress analysis, the Guidelines also establish methods for management of a potential liquidity crisis, defined as a situation of difficulty or inability of the Bank to meet its cash obligations falling due, without implementing procedures and/or employing instruments that, due to their intensity or manner of use, do not qualify as ordinary administration. By setting itself the objectives of safeguarding the Group's asset value and also guaranteeing the continuity of operations under conditions of extreme liquidity emergency, the Contingency Liquidity Plan ensures, at the level of the Parent Bank, the identification of the early warning signals and their ongoing monitoring, the definition of procedures to be implemented in situations of liquidity stress, also indicating the immediate lines of action, and the intervention measures for the resolution of emergencies. The early warning indexes, aimed at spotting the signs of a potential liquidity strain, both systematic and specific, are monitored with daily frequency by the Financial and Market Risks Department.

Specifically, the corporate functions of the Parent Group responsible for ensuring the correct application of the Guidelines are the Treasury Department, the Planning and Active Value Management Department, which are responsible for liquidity risk, and the Financial and Market Risks Department, which is directly responsible for Level 2 controls and, as an active participant in the Financial Risks Committee, performs a primary role in managing and disseminating liquidity risk information, thus helping to enhance the Group's overall awareness of the existing position.
The Chief Audit Officer assesses the functioning of the overall structure of the control system overseeing the process for measuring, managing and controlling the Group's exposure to liquidity risk and verifies the adequacy and compliance of the process with the requirements established by the regulations. The results of the controls carried out are submitted to the Corporate Bodies of the Parent Group ISP, at least once a year.

QUANTITATIVE INFORMATION

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

Currency of denomination: Euro

(thousands of euro)

Captions/ Residual maturity	On demand	From more than 1 day to 7 days	From more than 7 days to 15 days	From more than 15 days to 1 month	From more than 1 month to 3 months	From more than 3 months to 6 months	From more than 6 months to 1 year	From more than 1 year to 5 years	Over 5 years	Indefinite useful life
A. Cash assets	**617,355**	**24,261**	**32,305**	**64,772**	**150,713**	**145,395**	**165,164**	**729,061**	**906,217**	**21,338**
A.1 Government bonds	-	-	-	-	-	9	9	6,000	-	14
A.2 Other debt securities	11	116	-	-	-	-	119	121	1,258	-
A.3 Quotas of UCI	805	-	-	-	-	-	-	-	-	-
A.4 Loans	616,539	24,145	32,305	64,772	150,713	145,386	165,036	722,940	904,959	21,324
- Banks	345,253	459	208	166	472	767	-	17	-	21,324
- Customers	271,286	23,686	32,097	64,606	150,241	144,619	165,036	722,923	904,959	-
B. Cash liabilities	**2,119,533**	**7,595**	**95**	**51,611**	**204,694**	**154,724**	**132,355**	**5,515**	**798**	**-**
B.1 Deposits and current accounts	2,085,911	7,595	95	51,599	204,694	154,666	132,310	5,295	-	-
- Banks	14,995	7,501	-	50,097	200,215	150,092	126,707	-	-	-
- Customers	2,070,916	94	95	1,502	4,479	4,574	5,603	5,295	-	-
B.2 Debt securities	758	-	-	-	-	-	-	-	-	-
B.3 Other liabilities	32,864	-	-	12	-	58	45	220	798	-
C. Off-balance sheet transactions										
C.1 Financial derivatives with exchange of capital										
- Long positions	-	-7,418	-40,668	-10,933	-47,778	-6,300	-4,395	-2,933	-	-
- Short positions	-	7,418	40,668	10,933	47,778	6,300	4,395	2,933	-	-
C.2 Financial derivatives without exchange of capital										
- Long positions	-9,809	-160	-	-216	-445	-584	-843	-	-	-
- Short positions	10,416	-	-	299	585	853	1,623	-	-	-
C.3 Deposits and loans to be settled										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-
C.4 Commitments to lend funds										
- Long positions	-	-	-	-	-	-	-	-1	-	-
- Short positions	1	-	-	-	-	-	-	-	-	-
C.5 Financial guarantees given	-118	-	-	-	-	-	-	-477	-	-
C.6 Financial guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of capital										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-
C.8 Credit derivatives without exchange of capital										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-

Currency of denomination: Other currencies

(thousands of euro)

Captions/ Residual maturity	On demand	From more than 1 day to 7 days	From more than 7 days to 15 days	From more than 15 days to 1 month	From more than 1 month to	From more than 3 months	From more than 6 months	From more than 1 year to	Over 5 years	Indefinite useful life
Cash assets	**15,939**	**4,723**	**5,153**	**11,651**	**3,457**	**143**	**-**	**-**	**-**	**-**
A.1 Government bonds	-	-	-	-	-	-	-	-	-	-
A.2 Other debt securities	-	-	-	-	-	-	-	-	-	-
A.3 Quotas of UCI	-	-	-	-	-	-	-	-	-	-
A.4 Loans	15,939	4,723	5,153	11,651	3,457	143	-	-	-	-
- Banks	15,493	-	-	-	-	-	-	-	-	-
- Customers	446	4,723	5,153	11,651	3,457	143	-	-	-	-
Cash liabilities	**38,522**	**7,501**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
B.1 Deposits and current accounts	37,760	7,501	-	-	-	-	-	-	-	-
- Banks	14,987	7,501	-	-	-	-	-	-	-	-
- Customers	22,773	-	-	-	-	-	-	-	-	-
B.2 Debt securities	-	-	-	-	-	-	-	-	-	-
B.3 Other liabilities	762	-	-	-	-	-	-	-	-	-
Off-balance sheet transactions										
C.1 Financial derivatives with exchange of capital										
- Long positions	-	5,372	20,283	5,470	23,920	3,153	2,209	1,466	-	-
- Short positions	-	2,049	20,284	5,470	23,920	3,153	2,209	1,466	-	-
C.2 Financial derivatives without exchange of capital										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-
C.3 Deposits and loans to be settled										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-
C.4 Commitments to lend funds										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-
C.5 Financial guarantees given	-	-	-	-	-	-	-	-	-	-
C.6 Financial guarantees received	-	-	-	-	-	-	-	-	-	-
C.7 Credit derivatives with exchange of capital										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-
C.8 Credit derivatives without exchange of capital										
- Long positions	-	-	-	-	-	-	-	-	-	-
- Short positions	-	-	-	-	-	-	-	-	-	-

SECTION 5 - OPERATIONAL RISK

QUALITATIVE INFORMATION

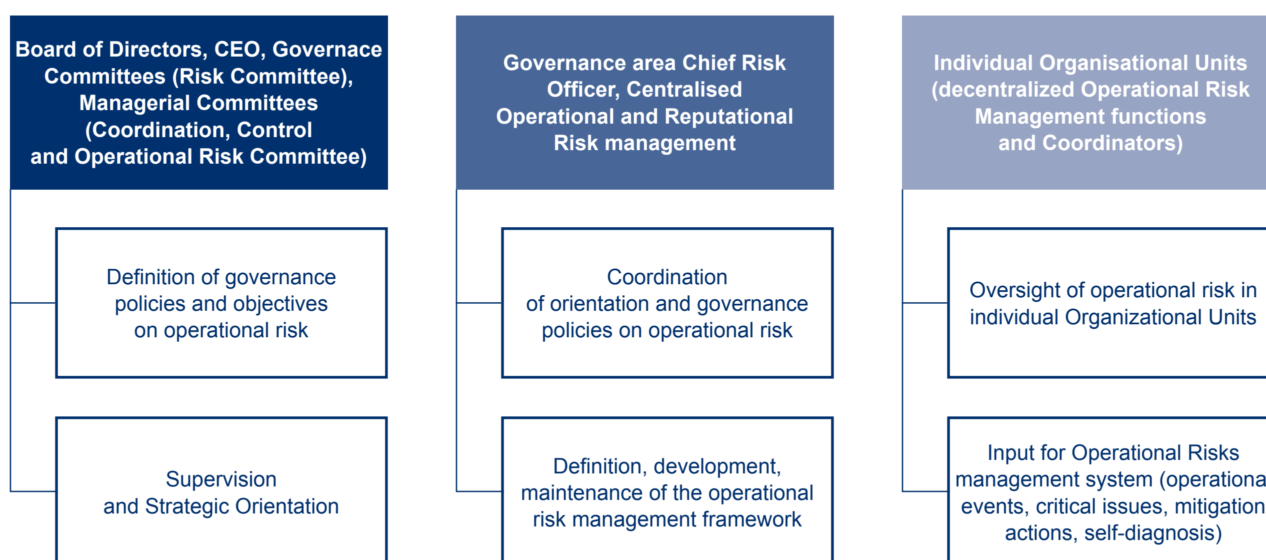
A. General aspects, operational risk management processes and measurement methods

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk and compliance risk, model risk, ICT risk and financial reporting risk; strategic and reputational risk are not included.

The Intesa Sanpaolo Group's deploys a prudent operational risk acceptance and management strategy aimed at ensuring the long-term strength and continuity of the Group. The Group also places a particular emphasis on achieving an optimal balance between its growth and comprehensive income objectives and associated risks.

Governance model

The Intesa Sanpaolo Group's Operational Risk Management activities are overseen by Corporate Bodies, Committees and structures allocated differentiated roles and responsibilities, which interact in order to create an effective operational risk management system that is closely integrated into the decision-making processes and the management of business operations.



Group Operational Risk Management Process

The Intesa Sanpaolo Group's Operational Risk Management Process is consists of the following phases:

Identification

The identification phase includes:
- structured gathering and timely update of data on operational events, decentralized to the Organizational Units;
- detection of critical issues in operations;
- performance of the annual self-diagnosis process;
- identification of potential operational risks deriving from the launch of new products and services, the start-up of new activities and the entry into new markets, as well as the risks associated with outsourcing;
- analysis of operational events and indicators from external consortia (O.R.X. - Operational Riskdata eXchange Association);
- identification of operational risk indicators (including IT and cyber risks, non-compliance risks, etc.) by each Organizational Unit.

Measurement and evaluation

Measurement involves transforming elementary data surveys (internal and external data on operational loss, Scenario Analysis and Business Environment Evaluation) into synthetic risk measures, using a purpose-built model. These measurements provide sufficient detail to understand the Group's overall risk profile and for the capital-at-risk to be quantified for the units of the Group.

Monitoring and control
Operational risk monitoring involves analysing and arranging the results obtained from identification and/or measurement in order to verify and control exposure to operational risk (including ICT and cyber risk) over time and to prevent harmful events from occurring.

Mitigation

Mitigation activities, which are defined based on the results of identification, measurement and monitoring, consist of the following:

- identifying, defining and implementing risk mitigation and transfer actions, in line with the risk appetite set;
- analysing and taking on residual operational risks;
- rationalising and optimising, in terms of the costs/benefits of insurance coverage and other possible forms of transferring the risk taken on by the Group.

To this end, in addition to benefitting from a traditional insurance plan (to protect against offences such as employee disloyalty, theft and damage, cash and valuables in transit losses, computer fraud, forgery, cyber-crimes, earthquake and fire, and third-party liability), in order to take advantage of the capital benefits provided, the Group has taken out an insurance coverage policy named Operational Risk Insurance Programme, pursuant to applicable regulations, which offers ad hoc coverage, which significantly increases the limit of liability, thus transferring the risk of significant operational losses to the insurance market.
In addition, with respect to risks relating to real property and infrastructure, with the aim of containing the impacts of phenomena such as catastrophic environmental events, situations of international crisis, and social protest events, the Group may activate its business continuity solutions.

Communication

Communication involves preparing sufficient operational information flows concerning operational risk management for the parties involved so as to enable process monitoring and a sufficient understanding of the exposure to such risks.

Self-diagnosis

Self-diagnosis is the annual process whereby the Organisational Units identify their own level of exposure to operational risk by assessing the coverage of factors specific to their own business environment (Business Environment Evaluation) and estimate potential future losses in the case of future events that could potentially harm their operations (Scenario Analysis). The evaluation takes into account the critical issues identified and the operational events actually occurred. This assessment does not replace specific risk assessments carried out by the specialised and control functions to the extent of their respective competences (e.g. evaluations carried by the Chief Audit Officer, the Responsible Manager and the Chief Compliance Officer), but instead allows the evaluations emerging during this process to be brought to the attention of the functions involved, and allows the findings to be discussed with the head of the relevant Organisational Unit.
Detecting issues critical to operations allows appropriate mitigation actions to be identified and defined, the implementation of which will be monitored over time for the purpose of reducing operational risk exposure.

ICT risk

ICT risk means the risk of incurring financial, reputational and market share losses connected with the use of information and communication technology. Where corporate risks are laid out for prudential purposes, this risk type is considered, under specific aspects, to fall under operational, reputational and strategic risks, and includes the risk of privacy, integrity and data availability breaches.
In line with the methodological framework laid defined for corporate risk management and, particularly, operational risk management, the Intesa Sanpaolo Group's ICT Risk management model has been developed with a view to integrating and coordinating the specific areas of expertise of the structures involved.
Every year, the Technical Functions (e.g: the ICT Division, IT functions of the main Italian and foreign subsidiaries) and the Cybersecurity Function identify the level of ICT risk exposure (which includes ICT security risk) of all managed ICT assets, using a (top-down) assessment of the coverage of the relevant Risk Factors. In addition to this analysis, which is carried out on all areas of application and corporate processes, where situations occur that could change the overall risk, where innovative projects are undertaken or where changes are made to key ICT system components, the Technical Functions and the Cybersecurity Function identify the level of ICT risk exposure of specific ICT system components.
Alongside this assessment, the Self-diagnosis process provides for a (bottom-up) assessment of the conduct of each of the Group’s Organisational Units, which analyse there own ICT risk exposure by expressing an opinion on the coverage of key risk factors in this respect (e.g. regarding the adequacy of the software to the Units operations, etc.).

Internal risk management system

The internal system for calculating the Intesa Sanpaolo Group's absorption of capital is designed to combine all main quantitative (operational losses: internal and external events) and qualitative (Self-diagnosis: Scenario Analysis and Business Environment Evaluation) sources of information.
Capital-at-risk is therefore identified as the minimum amount at Group level required to bear the maximum potential loss (worst case); Capital-at-risk is estimated using a Loss Distribution Approach model (actuarial statistical model to calculate the Value-at-risk of operational losses), applied on quantitative data and the results of the scenario analysis assuming a one-year estimation period, with a confidence level of 99.90%. The methodology also applies a corrective factor, which derives from the qualitative analyses of the risk level of the business environment (Business Environment Evaluation), to take into account the effectiveness of internal controls in the various Organisational Units.
The internal model's insurance mitigation component was approved by the Bank of Italy in June 2013 with immediate effect of its benefits on operations and on the capital requirements.

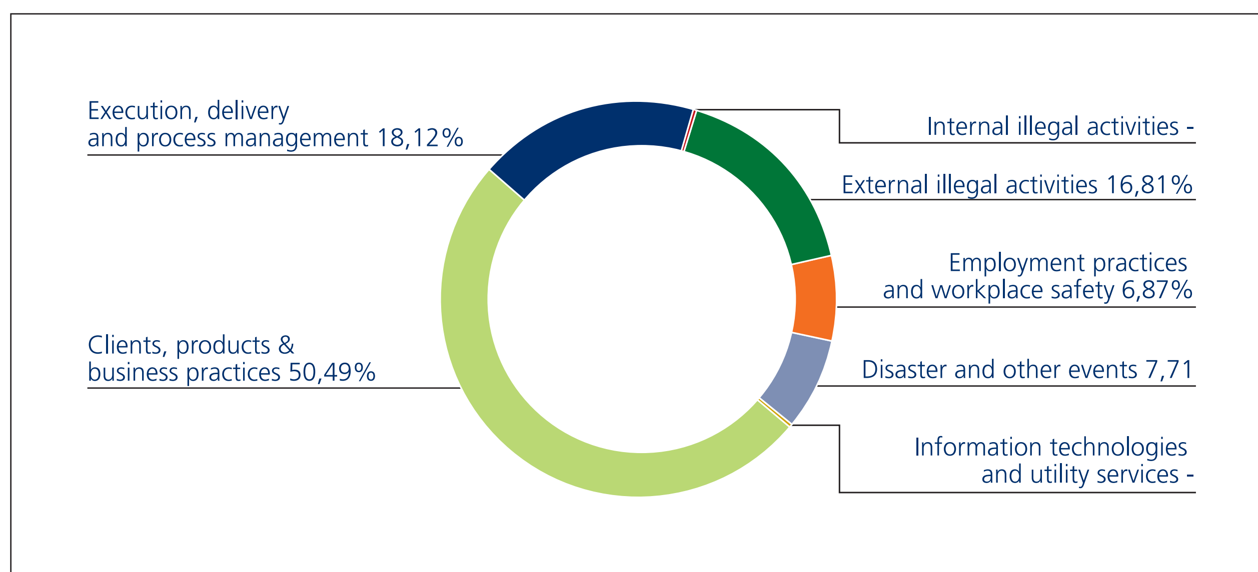
QUANTITATIVE INFORMATION

To determine its capital requirements, the Bank employs the Advanced AMA Method (internal model), authorised by the Supervisory Body, together with the Parent Group and other subsidiaries The capital absorption resulting from this process amounts to 14.119 million euro.

The following shows the breakdown of operating losses (which are above the obligatory detection threshold set by the Group) posted for the year, by event type.

Impact of operational losses by type of event

	2018	
	loss impact	% impact on total
Total	**632,142**	**100%**
Internal illegal activities	-	0.00%
External illegal activities	106,267	16.81%
Employment practices and workplace safety	43,400	6.87%
Clients, products & business practices	319,191	50.49%
of which bankruptcy revocatory disputes under Art. 67 of the Bankruptcy Law	*-*	*0.00%*
Disasters and other events	48,715	7.71%
Information technologies and utility services	-	0.00%
Execution, delivery and process management	114,569	18.12%



Legal risks

Legal risks have been thoroughly analysed in several areas, such as the Board of Statutory Auditors and the Bank's internal structures. Where a threat of financial losses has been found, provisions have been made in order to adjust the Allowances for Risks and Charges.

Tax risks

As regards the Bank, no new tax disputes are pending and therefore the litigation risk provision as at 31 December 2018 is zero; furthermore, no amounts were paid to the Tax Authority for temporary registration pending judgements.

The following case is mentioned for the sake of completeness:

- **IRES, IRAP** - with reference to the Formal Notice of Assessment notified to the bank by the Tuscany Regional Office following the audit for the year 2012, as at 31 December 2018 a report is outstanding for IRES and IRAP tax purposes relating to goodwill of 20.3 million euro - franked in 2012 with the payment of 16% substitute tax - the non-frankable part of which is accepted, without this amount being quantified. In November 2017, the Bank, after having been specifically invited to do so by the Italian Revenue Agency, provided additional documentation and specifications on the transaction in question; pending a possible inquiry, the Bank did not make any provision, however, as it considered the series of events and the grounds stated by the Italian Revenue Agency to be unfounded.

Part F - Information on capital

SECTION 1 - COMPANY SHAREHOLDERS' EQUITY

FOREWORD

Capital adequacy at the consolidated level and the individual investee companies levels is monitored by capital management, which defines the size and optimal combination of the various capital instruments, in compliance with regulatory constraints and the Group's risk profile.

The management and allocation of capital resources is a key area for the Intesa Sanpaolo Group, whether they are employed as a strategic lever or as a tool to ensure the consistency of business unit operating plans. Once the Group's set strategic objectives of profitability, capital solidity and liquidity have been defined, capital and financial resources are allocated to the business units through a process that assesses their growth potential, capacity to create value and financial autonomy.
There are two types of risk capital:

- regulatory capital for Pillar 1 risks;
- total internal capital for Pillar 2 risks, for ICAAP process purposes.

The regulatory capital and total internal capital differ insofar as the definition and coverage of risk categories. The first is derived from the schemes defined in the supervisory regulations, the second from management measurements.
Capital management therefore essentially involves managing current and prospective capital adequacy through attentive monitoring of the regulatory constraints of Pillar 1 (from 1 January 2014 according to Basel III rules) and the operational constraints of Pillar 2. The projections are also produced to reflect stress situations to ensure that available resources are adequate to cover all risks, including in adverse economic conditions.
The Group has also been compiling a Recovery Plan since 2013; this is in line with the regulatory provisions (Bank Recovery and Resolution Directive - BRRD - 2014/59/EU implemented in Italy on 16 November 2015 with Legislative Decree 180, 181), international practices and in line with the Group Risk Appetite Framework and the crisis management model adopted by the Bank.

Each year, a compatibility check is carried out on the projections at the consolidated and individual investee level, as part of the budget objectives allocation processes. Depending on the expected dynamics of the balance sheet and income statement aggregates, if necessary, appropriate capital management measures are identified as early as this stage to ensure that the individual business units have the necessary financial resources.
Compliance with capitalisation levels is monitored on a quarterly basis, followed by appropriate actions where necessary.
Capital adequacy requirements are fulfilled using various levers, such as the dividend distribution policy, definition of strategic finance operations (capital increases, convertible loans and subordinated bonds issues, disposal of non-strategic assets, etc.) and investment management, particularly based on the riskiness of the counterparties.
Additional analyses are conducted when preventive capital adequacy checks are conducted, on the occasion of extraordinary operations (mergers, acquisitions, disposals, etc.), whether these occur within the group or result in a change to the Group's perimeter.

A. Qualitative information

Own funds, risk-weighted assets (RWA) and solvency ratios as at 31 December 2018 were determined according to the new harmonised rules for banks and investment firms contained in Directive 2013/36/EU (CRD IV) and Regulation (EU) 575/2013 (CRR) of 26 June 2013, transposing the standards defined by the Basel Committee on Banking Supervision (Basel III framework) into the European Union, and Bank of Italy Circulars 285, 286 and 154.
The above regulatory provisions provided for the gradual introduction of the regulatory framework, over a transitional period, during which certain elements which, when fully operational, are fully computable and deductible in Common Equity and impact CET only up to a certain percentage. These transitional rules ceased to apply in 2018, except the filter on valuation reserves for actuarial gains and losses (IAS 19), for which the provisional treatment is still applicable until the end of the current financial year. In addition, specific interim provisions remain in force for subordinated instruments that do not comply with the requirements of the new regulatory provisions, aimed at the gradual exclusion of instruments that are no longer eligible for inclusion from own funds (over an 8 yea period).

Nevertheless, from 1 January 2018, European banks were required to apply IFRS 9 - Financial Instruments, in place of the IAS 39 which had been approved by Regulation (EU) 2067/2016 of 22 November 2016. Therefore, with accounting date from January 1, 2018, the "First Time Application" (FTA) standard was applied for the first time, which involved the restatement of financial instruments in compliance with the new classification criteria and the recalculation of values, where necessary, to take into account the new impairment and classification rules; the relative effects were recognised, only upon first-time application, as an offsetting entry to shareholders' equity.
Upon introduction of IFRS 9, on 12 December 2017 the European Parliament and the European Council issued Regulation (EU) 2395/2017 "Transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds [...]", which updates Regulation (EU) 575/2013, inserting the new article 473 bis, called "Introduction of IRFS 9", which allows banks to mitigate the impacts of introducing the new accounting standard on its own funds. In this regard, the Intesa Sanpaolo Group has chosen to adopt the so-called "static approach," which allows the re-inclusion of a progressively decreasing portion into Common Equity until 2022 (from 95% in 2018 to 25% in 2022) of the impact of IFRS 9, calculated net of the tax effect, as this results from the comparison of IAS value adjustments as at 31 December 2017 and IFRS 9 as at 1 January 2018, excluding the restatement of financial instruments, and after having zeroed any "*shortfall*" as at 31 December 2017.

B. Quantitative information

The book value of shareholders' equity is shown below and, in Section 2 below, the values relating to own funds and capital ratios are the quantitative aspects.

Section B.1. - Company shareholders' equity: breakdown

(thousands of euro)

Items/Amounts	31.12.2018	31.12.2017
1. Share capital	**171,846**	**171,846**
2. Share premiums	**73,578**	**73,578**
3. Reserves	**-6,903**	**33,548**
- of profits:	-9,452	33,528
a) legal	25,102	25,102
b) statutory	34,057	39,818
c) treasury shares	-	-
d) other	-68,611	-31,392
- other:	2,549	20
4. Equities	**-**	**-**
5. (Treasury shares)	-	-
6. Valuation reserves:	**10,784**	**10,420**
- Equities measured at fair value through other comprehensive income	-699	-393
- Equities measured at fair value through other comprehensive income	-	-
- Financial assets (except equities) measured at fair value through other comprehensive incom	-72	24
- Tangible assets	14,373	14,373
- Hedging of foreign investments	-	-
- Cash flow hedges	-	-
- Hedging instruments (undesignated items)	-	-
- foreign exchange differences	-	-
- Non current assets and disposal groups held for sale	-	-
- Financial liabilities measured at fair value through profit or loss (credit rating changes)		
- Actuarial gains (losses) on defined-benefit pension plans	-2,818	-3,584
- Share of valuation reserves relating to investments measured at equity	-	-
- Special revaluation laws	-	-
7. Profit (Loss) for the year	**4,304**	**-5,760**
Total	**253,609**	**283,632**

B.2. Valuation reserves of financial assets measured at fair value through other comprehensive income: breakdown

(thousands of euro)

Assets/Amounts	Total at 31.12.2018		Total at 31.12.2017	
	Positive reserve	Negative reserve	Positive reserve	Negative reserve
1. Debt securities	-	-72	46	-2
2. Equities	13	-712	8	-401
3. Loans	-	-	-	-
Total	**13**	**-784**	**54**	**-403**

B.3. Valuation reserves of financial assets measured at fair value through other comprehensive income: annual changes

(thousands of euro)

	Debt securities	Equities	Loans
1. Initial amount	**24**	**-393**	**-**
2. Positive changes	**-**	**72**	**-**
2.1 Fair value increases	-	-	-
2.2 Value adjustments for credit risk	-	X	-
2.3 Reversal into profit or loss of negative reserves on disposal	-	X	-
2.4 Transfers to other equity components (equities)	-	-	-
2.5 Other changes	-	72	-
3. Negative changes	**-96**	**-378**	**-**
3.1 Fair value decreases	-96	-378	-
3.2 Value adjustments for credit risk	-	-	-
3.3 Reversal into profit or loss of positive reserves	-	X	-
-on disposal	-	-	-
3.4 Transfers to other equity components (equities)	-	-	-
3.5 Other changes	-	-	-
4. Final amount	**-72**	**-699**	**-**

B.4. Valuation reserves relating to defined benefit plans: annual changes

(thousands of euro)

	Actuarial gains/losses on employee severance indemnity	Actuarial gains/losses on defined-benefit pension funds
A. Initial amount	**-2,863**	**-721**
B. Increases	**318**	**448**
B.1 Fair value increases	318	34
B.2 Other changes	-	414
3. Negative changes	**-**	**-**
C.1 Fair value decreases		
C.2 other changes	-	
C.3 Business combinations	-	-
4. Final amount	**-2,545**	**-273**

During the year, these reserves increased by 766 thousand euros (of which 448 thousand euros relating to pension funds and 318 thousand euros relating to employee severance indemnities). At December 31, 2018, there was a total negative reserve for defined benefit plans of 273 thousand euros.
The increase for the year includes the realignment of the valuation reserve of 414 thousand euros for the portion corresponding to the obligation extinguished following acceptance of the voluntary capitalisation offer made by the Bank to the members of the "Cassa di Previdenza Integrativa per il Personale dell'Istituto Bancario San Paolo di Torino" fund.

SECTION 2 - OWN FUNDS AND CAPITAL RATIOS

2.1. Own funds

A. Qualitative information

The new harmonised rules for banks contained in Directive 2013/36/EU (CRD IV) and Regulation (EU) 575/2013 (CRR) of 26 June 2013 entered into effect on 1 January 2014, transposing the standards defined by the Basel Committee on Banking Supervision (Basel III framework) into the European Union. The main innovations of the reform are aimed at strengthening the capacity of credit institutions to absorb shocks arising from financial and economic tensions, regardless of their origin, improve risk management and governance and increase the transparency and disclosure procedures of the banks themselves. This Committee has essentially maintained the approach that underpinned the previous capital agreement known as "Basel II", complementing and strengthening it to increase the quantity and quality of intermediaries' capital endowment, as well as introducing counter-cyclical supervisory tools, liquidity management and leverage standards.
These regulations were implemented in Italy with the following circulars:
- Bank of Italy Circular No. 285 on Supervisory Provisions for Banks;
- Bank of Italy Circular No. 286 on the Instructions for the compilation of prudential reports for banks and real estate brokerage companies;
- Update of Bank of Italy Circular 154 on Supervisory Reports from Lending and Financial Institutions. Reporting schemes and instructions for the forwarding of information flows.

The new rules requires that Own Funds (the new name of Regulatory Capital) consist of three-level structure:
- Tier 1 Capital, which is in turn composed of:
  1) Common Equity Tier 1 (CET1);
  2) Additional Tier 1 capital (AT1);
- Tier 2 – T2.

Tier 1 capital consists mainly of capital instruments (ordinary shares net of treasury shares), share premium reserves, profit reserves, valuation reserves, as well as the items to be deducted; a number of prudential filters are also envisaged, including:

- filters on the reserves for cash flow hedges;
- filters on gains or losses on liabilities at fair value (whether derivative or not) connected with changes in creditworthiness;
- value adjustments on assets at fair value related to the "prudent valuation".

As already mentioned above, the regulations provide for a series of elements to be deducted from the Tier 1 capital:
- goodwill and other intangible assets;
- deferred tax assets (DTA) related to future profitability but which do not arise from temporary differences;
- excess of expected losses over total value adjustments (shortfall reserve) for IRB-weighted positions;
- deduction of losses for the current year;
- exposures for which the deduction option was chosen instead of the 1,250% risk weighting of risk-weighted assets (RWA);
- insignificant investments in CET 1 instruments issued by companies in the financial sector (with the part exceeding the deductible provided for by the regulations deducted);
- deferred tax assets (DTA) related to future profitability but which do not arise from temporary differences (after the amount exceeding the deductible provided by the regulations is deducted);
- significant investments in CET 1 instruments issued by companies in the financial sector (with the part exceeding the deductible provided for by the regulations deducted);

Additional Tier 1 capital generally includes equity instruments other than ordinary shares that meet the regulatory requirements for inclusion of Own Funds at this level (such as savings shares).

Tier 2 capital consists mainly of qualifying subordinated liabilities and any excess of value adjustments over the excess reserve for IRB-weighted positions.

1. Common Equity Tier 1 (CET1);

“CET 1 capital before the application of prudential filters" includes share capital, share premium reserve, various types of reserves, valuation reserves relating to available-for-sale securities and defined-benefit plans and severance indemnities, revaluation reserves for real estate and artistic assets and negative reserves set up to cover the*first-time application* of IRFS 9 totalling 249,305 thousand euros.
Item D "Items to be deducted from CET1" includes goodwill (17,100 thousand euros), the value of exposures to the securitization referring to the Mezzanine security deriving from the FITD’s intervention in the Voluntary Scheme for the transaction involving 3 Savings Banks totalling 30 thousand euros and 221 thousand euros for the commitments linked to the European BRRD directive on the resolution of banking crises.
Item E "Transitional regime - Impact on CET 1", positively valued at 33,219 thousand euros, refers entirely to the mitigation of the effects of introducing IFRS 9, an aspect already described under point A "Qualitative information".
The sum of all the elements listed above constitutes the "Total Primary class 1 capital (Common Equity Tier 1- CET1), which totals 265,088 thousand euros.

2. Tier 2 – T2 capital

The zeroing of "Tier 2 capital" compared to last year is due to the cancellation of the component linked to the excesses of the value adjustments on loans recognised, compared to the expected losses. These surpluses, which constituted almost the entirety of this category in the previous financial year, no longer contribute to the formation of T2 except insofar as any surplus compared to 95% of the first application of IRFS 9 which is recovered in CET 1.

Total equity was 265,088 thousand euros at 31 December 2018.

B. Quantitative information

(thousands of euro)

	31.12.2018	31.12.2017
A. Common Equity Tier 1 (CET1) prior to application of prudential filters	**249,305**	**283,632**
of which CET1 instruments subject to transitional arrangements	-	-
B. CET1 prudential filters (+ / -)	**-85**	**-18**
C. CET1 gross of the elements to be deducted and the effects of the transitional regime (A +/- B)	**249,220**	**283,614**
D. Items to be deducted from CET 1	**17,351**	**18,357**
E. Transitional regime - impact on CET1 (+/-)	**33,219**	**-1,653**
F. Total Common Equity Tier 1 (CET1) (C-D +/-E)	**265,088**	**263,604**
G. AT1 gross of the elements to be deducted and the effects of the transitional regime (A +/- B)	**-**	**1,227**
of which AT1 instruments subject to transitional arrangements	-	-
H. Items to be deducted from AT1	**-**	**-**
E. Transitional regime - impact on AT1 (+/-)	**-**	**-1,227**
L. Total Additional Tier 1 capital (AT1) (G - H +/- I)	**-**	**-**
M. Tier 2 Capital (Tier 2 -T2) gross of the elements to be deducted and the effects of the transitional regime	**6,022**	**3,530**
of which T2 instruments subject to transitional arrangements	-	-
N. Items to be deducted from T2	**-**	**-**
O. Transitional regime - impact on T2 (+/-)	**-6,022**	**1,719**
P. Total Tier 2 – T2 capital) (M - N +/- O)	**-**	**5,249**
Q. Total own funds (F + L + P)	**265,088**	**268,853**

Own funds decreased by approximately 3,765 thousand euros compared to the figure at 31 December 2017 in view of the absence of the transitional rules introduced in 2014 and of the first application of IRFS 9, the values shown for the individual items constituting own funds as at 31 December 2018 are difficult to compare with the figures as at 31 December 2017.

2.2. Capital adequacy

A. Qualitative information

On the basis of prudential supervisory instructions for banks (Bank of Italy Circular no. 285 of 17 December 2013 and subsequent amendments), which transpose the regulations on capital measurement and capital ratios (Basel III), the capital of an individual credit institution belonging to a banking group must represent at least 9.875% of the total weighted assets (total capital ratio) deriving from the typical risks of banking and financial activities (credit, counterparty, market and operational risks), weighted according to the regulatory segmentation of the debtor counterparties and taking into account the techniques used by the debtor counterparties.
With regard to credit risks, the Group received authorisation for methods based on internal ratings as from 31 December 2008 for the corporate portfolio, the perimeter of which comprises the Parent Bank, the network banks of the Banca dei Territori Division and the main Italian product companies. Subsequently, the scope of application was progressively extended to the SME Retail and Mortgage portfolios and to other Italian and foreign Group companies.
The development of rating models for the other segments and the extension of the scope of their application are proceeding according to a plan submitted to the Supervisory Authority.
Banks are also required to meet market risk capital requirements, which are calculated across the entire trading book separately for different types of risk: position risk on debt and equity securities and concentration risk. In addition, exchange rate risk, settlement risk and commodity risk need to be determined for the balance sheet as a whole. These risks are calculated using standard methodologies.
Counterparty risk is calculated independently of the allocation portfolio. Since the report of 31 December 2016, the bank has received authorisation from the Bank of Italy to use the internal counterparty risk model for regulatory purposes. From this reporting date, therefore, the bank uses the internal model to calculate the EAD component of the default risk requirement and to calculate the new CVA capital charge requirement.

Capital adequacy requirements are fulfilled with various instruments, such as the pay out policy, definition of strategic finance operations (capital increases, subordinated bonds issues) and investment policy management based on the riskiness of the counterparties. a further phase of analysis and preventive control of the Group's capital adequacy occurs whenever there are extraordinary transactions such as mergers, acquisitions and disposals, by estimating the impact of such events on the coefficients and planning any corrective actions aimed at complying with the constraints imposed by the Supervisory Authority.

B. Quantitative information

(thousands of euro)

Categories/Values	Unweighted amounts	Unweighted amounts	Weighted amounts/ requirements	Weighted amounts/ requirements
	31.12.2018	31.12.2017	31.12.2018	31.12.2017
A. RISK ASSETS				
A.1 Credit and counterparty risk	**3,535,530**	**3,645,056**	**1,232,923**	**1,213,681**
1. Standardised methodology	748,947	846,222	223,063	351,686
2. Methodology based on internal ratings	2,786,583	2,798,834	1,009,860	861,995
2.1 Basic	1,656	20	6,124	74
2.2 Advanced	2,784,927	2,798,814	1,003,736	861,921
3. Securitisations	-	-	-	-
B. REGULATORY CAPITAL REQUIREMENTS				
B.1 Credit and counterparty risk			**98,634**	**97,094**
B.2 Credit valuation adjustment risk			**-**	**12**
B.3 Settlement risk			**-**	**-**
B.4 Market risk:			**-**	**1**
1. Standardised methodology			-	1
2. Internal models			-	-
3. Concentration risk			-	-
B.5 Operational Risk			**14,119**	**14,583**
1. Basic method			-	-
2. Standardised method			-	-
3. Advanced method			14,119	14,583
B.6 Other calculation elements			**-**	**-**
B.7 Total prudential requirements			**112,753**	**111,690**
C. RISK ASSETS AND SUPERVISORY COEFFICIENTS				
C.1 Risk-weighted assets			**1,409,414**	**1,396,137**
C.2 Common equity tier 1 / Risk-weighted assets (CET1 capital ratio)			**18.81%**	**18.88%**
C.3 Tier 1 Capital / Risk weighted assets (Tier 1 capital ratio)			**18.81%**	**18.88%**
C.4 Total Own funds / Risk-weighted assets (Total capital ratio)			**18.81%**	**19.26%**

In accordance with regulatory requirements, for the standardised methodology, the "unweighted amounts" correspond to the exposure value, which takes account of prudential filters, risk mitigation techniques and credit conversion factors. For the internally rated methodology, the "unweighted amounts" correspond to the "exposure at the time of default" (EAD). For guarantees given and commitments to disburse funds, the credit conversion factors play a role in determining the EAD.

Part G – Business combinations

SECTON 1 – TRANSACTIONS CARRIED OUT IN THE YEAR

During the year no business combinations were undertaken pursuant to IFRS 3 involving the acquisition of control over businesses or legal entities.

SECTION 2 – TRANSACTIONS CARRIED OUT AFTER THE END OF THE YEAR

No business combinations governed by IFRS 3 have been undertaken since the end of 2018.

Part H – Information on compensation and transactions with related parties

INFORMATION ON COMPENSATION AND TRANSACTIONS {\cgrid0 WITH} RELATED PARTIES

Procedural features

The Board of Directors of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. has implemented, in compliance with the procedures provided for by the law, the Group Regulations for the management of transactions with Related Parties of Intesa Sanpaolo S.p.A., Related Parties of the Group and Relevant Persons pursuant to Article 136 of the Consolidated Banking Act (TUB) and has adopted the related Supplementary Addendum (hereinafter, jointly, the Regulations). The Regulation takes into account both the regulations issued by Consob, pursuant to Article 2391-bis of the Italian Civil Code, and the supervisory provisions introduced by the Bank of Italy on 12 December 2011 concerning risk activities and conflicts of interest of banks and banking groups vis-à-vis “Connected Parties” and issued in implementation of Article 53, paragraph 4 et seq. of the Banking Consolidation Act and in compliance with the resolution of the ICRC of 29 July 2008, no. 277 and, in addition, the rules established by Article 136 of the Banking Consolidation Act.

The Regulations govern the following aspects for the entire Intesa Sanpaolo Group:

- the criteria for identifying Related Parties and Connected Parties;
- the process of preliminary investigation, resolution and information to corporate bodies for transactions carried out with Related Parties and Connected Parties;
- market information for transactions with related parties;
- prudential limits and periodic reporting requirements to the Bank of Italy for risk activities with Related Parties;
- rules concerning organisational controls and controls;
- the general rules of disclosure and abstention for the management of the personal interests of representatives, employees and collaborators of the company, including those other than Connected Parties.

Pursuant to the Regulations, they are considered Related Parties of Intesa Sanpaolo: persons exercising control or significant influence, subsidiaries and associates, joint ventures, Group pension funds, Intesa Sanpaolo Directors and Key Managers, with their close relatives and significant investee companies.

The Group's Connected Entities are made up of the Connected Entities of each bank in the Group (including Cassa di Risparmio di Pistoia e della Lucchesia S.p.A.) and of each significant supervised intermediary with own funds exceeding 2% of total own funds at consolidated level. With respect to each relevant bank or supervised intermediary of the Group, they are Connected Persons: i) shareholders who exercise control or significant influence or who are in any case required to apply for authorisation pursuant to Article 19 of the Consolidated Banking Act (TUB) or who are able to appoint a member of the body with a management or strategic supervision function and the related corporate groups, ii) entities controlled, jointly controlled and associated, as well as entities controlled by them, including jointly with others; iii) corporate representatives and their relatives up to the second degree and significant investee entities.

By way of self-regulation, the Group has extended the rules on transactions with Related Parties and on risk activities and conflicts of interest with Related Parties: i) shareholders of Intesa Sanpaolo and related groups of companies that have a shareholding in the voting capital of the Parent Company that exceeds the minimum threshold provided for by the regulations on the disclosure of significant shareholdings in listed companies calculated solely on the shares they own or manage (currently 3%); ii) companies in which the close relatives of members with executive positions in banks and Significant Supervised Intermediaries of the Group hold executive offices; iii) companies with which the Group has significant equity and financial links. This solution makes it possible to develop a higher standard of monitoring transactions with the main entities at potential risk of conflict of interest - subjecting them to the investigative, decision-making and subsequent disclosure requirements to the Bodies and the market reserved for transactions with Related Parties and Connected Parties - and to contain within the prudential limits established by the Bank of Italy also the risk activities carried out by the Group with such parties.
The total perimeter of the parties considered relevant by the Regulation includes the Bank’s related parties identified in accordance with IAS 24.

The Regulations set forth the assessment procedures that must be followed by the Bank when carrying out transactions with Related Parties of Intesa Sanpaolo, Group Connected Parties and Relevant Parties pursuant to Article 136 of the Banking Consolidation Act to meet the requirements of substantial correctness of the transactions, requiring, among other things, a detailed examination of the reasons, interests, effects from an equity, economic and financial point of view and the conditions of the transaction.

In line with the regulations implemented by Consob and the Bank of Italy, a regime of full and partial exemptions from the application of the regulations is also envisaged.

As regards the resolution profiles of Intesa Sanpaolo's Related Party transactions and Group Connected Parties, the procedure is differentiated by:

- transactions for insignificant amounts: of a value less than or equal to €250,000 for natural persons and €1 million for parties other than natural persons (excluded from the application of the rules);
- less significant transactions: of a value above the low thresholds (€250,000 for natural persons and €1 million for parties other than natural persons) but below or equal to the thresholds of greater importance indicated below;
- more significant transactions: for a value above the threshold of 5% of the indicators defined by Consob and the Bank of Italy (approximately €2.5 billion for the Intesa Sanpaolo Group);
- transactions falling within the remit of the Shareholders' General Meeting, in accordance with the law or the Articles of Association.

In the process aimed at approving transactions with Related Parties of Intesa Sanpaolo and Group Connected Parties, a qualified role is played by the Related Party Transactions Committee, set up within the Bank's Board of Directors and consisting of three Directors meeting the necessary independence requirements. The Committee may avail itself, where deemed appropriate, of independent experts in relation to the significance, particular economic or structural characteristics of the transaction or the nature of the related party or connected party.
For more significant transactions, the Committee must be promptly involved in the analysis and negotiation phases, receiving a complete and timely flow of information, with the right of the Committee to request additional information and make observations.
All transactions carried out by the Bank with a Related Party or Connected Party which are not exempt on the basis of the Regulation are subject to the approval of the Parent Bank and reserved to the deliberative jurisdiction of the Board of Directors, subject to the opinion of the Related Party Transactions Committee. In addition, transactions with Related Parties or Connected Parties, even if ordinary and at market conditions, are subject to the opinion of the Bank's Related Party Transactions Committee and to the resolution of the Board of Directors if they are subject to the resolution of the Board of Directors on the basis of the Bank's corporate rules.
The Regulation provides for specific controls in the event that the Board of Directors should approve a transaction of lesser or greater importance, despite the negative opinion of the Committee of Independent Directors.

The Regulation also defines the general criteria for reporting, at least on a quarterly basis, to the Board of Directors and the Board of Statutory Auditors on transactions with Related Parties and Connected Parties carried out by the Bank during the reference period, in order to provide a complete picture of all the most significant transactions carried out, as well as the volumes and main characteristics of all those delegated. The disclosure must concern all transactions, even if exempt from the resolution procedure, with a value above the low thresholds; transactions of minor importance for intra-group financing and bank funding are excluded (unless they concern a subsidiary with significant interests of another related party or connected party and present non-market or standard conditions). For less significant transactions between group companies, ordinary transactions and transactions at market conditions, on the other hand, aggregate information is required on an annual basis.

The Regulation also governs transactions with Relevant Persons pursuant to Article 136 of the Consolidated Banking Act (TUB), which must be applied by all Italian banks of the Intesa Sanpaolo Group, including Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. This provision requires the adoption of an aggravated resolution procedure (unanimous resolution of the administrative body, excluding the vote of the member concerned, and the favourable vote of the members of the control body) to allow bank representatives to assume, directly or indirectly, obligations with the bank in which they hold the office of director of the bank).

This is without prejudice to the obligations provided for by the Italian Civil Code (Article 2391) and Article 53 of the Consolidated Banking Act (TUB) with regard to the interests of directors.
In particular, Article 2391 of the Italian Civil Code establishes that each Director must disclose any interest held, on their own behalf or on behalf of third parties, that they may detect in the exercise of their management function, with reference to a specific transaction. In accordance with the abovementioned provision, the Board of Directors has jurisdiction over decisions regarding transactions – including those with Related Parties – in which the Managing Director possesses an interest on his/her own account or through a third party and must therefore abstain from the decision, entrusting the Board as per Article 2391 of the Italian Civil Code.

In addition, Article 53 of the Consolidated Banking Act (TUB) provides that bank directors must abstain from resolutions in which they have a conflict of interest on their own behalf or on behalf of third parties.

1. Information regarding compensation of Supervisory and Management Board Members and Executives with strategic responsibilities

The following table shows the emoluments and remuneration paid to the Directors, Statutory Auditors, General Manager and Executives with strategic responsibilities of Cassa di Risparmio di Pistoia and Lucchesia S.p.a. required by paragraphs 16 and 18 of IAS 24.

(thousands of EUR)

	31/12/2018
Short-term benefits [1]	437
Post-employment benefits [2]	11
Other long-term benefits	-
Allowances for termination of employment	-
Share-based payments	-
Total remuneration paid	**448**

[1] It also includes the fixed and variable remuneration of the Directors as it is similar to the cost of labour and the social charges borne by the company for its employees.

[2] Includes the company's contribution to pension funds and the provision for employee severance payments in accordance with the

2. Perimeter and operations with related parties

a) Parent Company

Direct control of the Bank is held by Banca CR Firenze, which is entirely controlled by Intesa Sanpaolo, which consequently exercises management and coordination activities over Banca CR Firenze and, through the latter, over its subsidiaries.
Special contracts regulate the provision of services, on a continuous basis, in a centralised manner by Intesa Sanpaolo S.p.A., Intesa Sanpaolo Group Services S.c.p.A. and Banca CR Firenze S.p.A.
The Parent Bank provides the main management and professional services, including those necessary to ensure that the Bank's operations comply with the strategic and risk management policies of the Group to which it belongs. The total cost of these services in 2018 is approximately €2.9 million, plus VAT on statutory measures.

The Parent Company also provides a Contact Unit service, i.e. the provision of banking, financial and insurance brokerage services to customers on behalf of the Bank through the telephone channel. The charge for 2018 amounts to approximately €213,000, to which VAT is added for some items in the legal measures.

The Group, always with a view to maximising value, manages financial resources and liquidity in an integrated manner. In particular, treasury activities relating to the management of the Bank's liquidity are centralised at the Parent Bank. The related transactions are mostly regulated at the conditions under which the Parent Company enters the reference markets, which are not necessarily the same as those that would be applicable if the subsidiaries had to operate autonomously. These conditions are, in any case, applied in compliance with criteria of substantial correctness and with the aim of creating value for the Group.
The provision of services for the support activities of the 231 Supervisory Body has been contracted with Banca CR Firenze.

The 2018-2021 business plan, presented in February 2018, envisages the completion of the process of simplifying the corporate structure of the Banca dei Territori Division launched with the 2014-2017 Business Plan. In this context, the process of incorporation of Banca CR Firenze and Cassa di Risparmio di Pistoia e della Lucchesia into Intesa Sanpaolo is included.
On 12 October 2018, the Extraordinary Shareholders' Meeting of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. approved the merger by incorporation into Intesa Sanpaolo S.p.A., which will be completed in 2019.

b) Persons exercising significant influence over the Company

Following the exit of the Fondazione Cassa di Risparmio di Pistoia e Pescia from its corporate structure in 2017, there are no individuals who exercise significant influence over the company.

c) Subsidiaries

This section includes equity investments classified as "subsidiary companies" in accordance with Part A - Accounting policies of this document.

d) Associated companies

This section includes the company Sviluppo Industriale S.p.A. in composition with creditors. The latter was put into liquidation by resolution of the extraordinary shareholders' meeting of 1 June 2012.

e) Joint ventures
There are no relationships with companies that fall into this category.

f) Managers with strategic responsibilities
This definition includes the members of the Administrative and Control Bodies and the General Manager and any other Executives with strategic objectives of the Bank.
Information on the remuneration paid to such persons for various reasons is provided in point 1.
This category also includes the members of the corporate and management bodies of the Parent Company Intesa Sanpaolo, considered by the latter in various capacities as managers with strategic responsibilities. At 31 December 2018 there were no significant transactions with these parties.

g) Other related parties
This residual category includes, in accordance with IAS 24, the other subsidiaries and associated companies of Intesa Sanpaolo, all pension funds set up in favour of Related Parties, as well as close family members of executives with strategic responsibilities as per point f) above and economic activities relating to family members or executives.
This category includes the consortium company Intesa Sanpaolo Group Services, which, in line with the model that distinguishes the Group's organisational structure and which is mentioned in point a) above, provides operational services.
The total cost for 2018 of Intesa Sanpaolo Group Services' services amounted to approximately €12.8 million, in addition to recoveries for seconded personnel of approximately €200,000.

During 2018, in line with the 2018-2021 Business Plan, which foresees a strong acceleration of de-risking at Group level, Cassa di Risparmio di Pistoia e della Lucchesia SpA participated, as mentioned in the Management Report, in the operation carried out in partnership between the ISP Group and the Intrum Iustitia Group. As part of the operation, and again with specific reference to the participation of Cassa di Risparmio di Pistoia and Lucchesia SpA in it, the assignment, governed by a ten-year service contract, of the impaired credit management service to Tersia S.p.A., a company 51% owned by Intrum and 49% by Intesa Sanpaolo, and therefore included in the list of associates of the parent company, falls within the scope of the operation.

3. Information on transactions with related parties

Transactions of ordinary or recurrent nature

	31/12/2018	
	Amount (in thousands of	Impact (%)
Total financial assets	376,646	13.2%
Total other assets	20,001	38.7%
Total financial liabilities	555,559	20.7%
Total other liabilities	11,712	12.1%

	31/12/2018	
	Amount (in thousands of	Impact (%)
Total interest income	-3,280	-5.9%
Total interest expense	-1,953	67.4%
Total commission income	33,234	52.8%
Total commission expense	-730	5.2%
Total operating costs	-17,200	20.4%

The item "interest income" is negative as it includes the differentials related to hedges with related parties (Banca IMI) for approximately -€4.6 million.
"Operating costs" essentially refer to "Personnel expenses" posted net of the related recoveries (approximately €2 million) and "Other administrative expenses" mainly related to services provided by Intesa Sanpaolo S.p.A. and Intesa Sanpaolo Group Services S.c.p.A., amounting to approximately €3.6 million (including VAT as required by law) and €12.6 million, respectively, as described in point 2(a) above.

(thousands of EUR)

	Financial assets held for trading	Other financial assets mandatorily measured at fair value	Financial assets measured at fair value through other comprehensi	Financial assets measured at amortised cost	Other assets	Due to banks	Due to customers	Financial liabilities held for trading	Other liabilities	Guarantees issued/ received and commitments
Parent company (a)	76		-	365,627	16,879	447,777		168	4,227	
Subsidiaries companies										
- 100% owned subsidiaries belonging to the banking group										
- non-100% owned subsidiaries belonging to the banking group										
- subsidiaries not belonging to the banking group										
Jointly controlled entities										
Linked companies										
Management with strategic responsibilities and control bodies (b)										38
Pension funds					8					
Other related parties (c)	4,160		-	6,773	3,114	100,330	1,156	6,127	7,484	599
Total	**4,236**	**-**	**-**	**372,400**	**20,001**	**548,108**	**1,156**	**6,296**	**11,712**	**636**
Shareholders (*)										
Companies with which the Group has significant equity and financial links (**)										

(*) This item includes the shareholders of Intesa Sanpaolo and related groups of companies with a shareholding in the share capital with voting rights of more than 3%, calculated solely on the shares they own or manage.

(**) Companies with at least two of the following indicators: i) counterparty's stake in the capital of Intesa Sanpaolo with a stake of between 1% and the minimum threshold provided for by the regulations on the communication of significant shareholdings in listed companies; ii) stake by ISP Group entities in the counterparty of more than 10% of the voting rights; iii) significant credit exposure of the Group to the counterparty.

(a) All balances refer to transactions with the parent company Intesa Sanpaolo S.p.A.

(b) The category "Management with strategic responsibilities and control bodies" includes the entities relating to the key managers.

(c) Other related parties include the companies of the ISP Group, with the exception of the Parent Company and the companies directly controlled by the Bank. Amounts due to banks mainly refer to transactions with Intesa Sanpaolo Bank Ireland Plc

Part I – Share-based payments

INFORMATION OF A QUALITATIVE NATURE

1. Description of share-based payments

1.1 Long-term share-based instruments: PAD and LECOIP

The long-term instruments of widespread shareholding are aimed at supporting the motivation and loyalty of all the Group's resources, in conjunction with the launch of the 2014-2017 Business Plan. In particular, these instruments aim to ease the identification (ownership) and the alignment with medium/long-term objectives and sharing the value created over time.

The long-term instruments offered during 2014 to the general employees were two: a Widespread Shareholding Plan (PAD) and the co-investment plans in multiannual financial instruments (Leveraged Employee Co–Investment Plans – LECOIP). The intention was, on the one hand, to reinforce the sense of belonging and cohesion (PAD) and, on the other, to seek the explicit sharing of the "challenge of value creation" represented by the Business Plan (LECOIP).
The proposed shareholding was divided into two phases:

1. the launch of a Widespread Shareholding Plan that allows each employee to share part of the value of Intesa Sanpaolo (ownership), thereby increasing their sense of belonging;
2. the possibility for each employee to freely manage the received shares and:
   - to keep them in their securities account, to eventually resell them later, or to dispose of them immediately;
   - to invest them in Co-Investment Plans through multiannual financial instruments, the "LECOIP Certificates", with a duration in line with the Business Plan.

These financial instruments come from both purchases on the market and from capital increases.
The free allocation of Intesa Sanpaolo common shares (PAD) provide for the purchase of such shares on the market – Free Shares – while the Lecoip Certificates - issued by a third non-Group financial company - will be backed by additional newly issued Intesa Sanpaolo ordinary shares allocated to the employee against a free capital increase - Matching Shares - and the subscription by the employee of newly issued Intesa Sanpaolo common shares deriving from a paid capital increase to the employees, at a discounted price compared to the market value – Discounted Shares.
The Lecoip Certificates are divided into three categories and have different characteristics depending on whether they are intended for employees known as Risk Takers, for the Executives, or for the general employees. In general, the Lecoip Certificates incorporate:

- the right to receive at maturity an amount in cash (or in Intesa Sanpaolo ordinary shares) equal to the original reference value (determined as the average of the market values recorded during November 2014) of the Free Shares and Matching Shares ("protected capital") and
- the right to receive, also at maturity, a portion of any appreciation of the shares' value (of the Free Shares, of the Matching Shares, and of the Discounted Shares) compared to the original reference value described above.

The enrolment in the Plans did not entail any disbursement of money by the employees. At the same time as the Certificates were subscribed, the employees concluded with the Certificates' issuer a fixed-term sale contract for the Free Shares, Matching Shares, and Discounted Shares. The consideration of the sale was used by the employees for the subscription of the discounted shares and, for the remainder, for the purchase of the Certificates.

The Co-Investment Plans were submitted to the shareholders' Meeting of May 8, 2014. The Ordinary Shareholders' Meeting of the Bank also approved the purchase of treasury shares (pursuant to art. 2357, paragraph 2 of the Italian Civil Code), which is functional to the allocation of free shares. The Extraordinary Shareholders' Meeting of ISP, also of May 8, 2014, approved delegating the Management Board to:

- increase the capital (free increase in share capital) for the allocation of free shares to employees (Matching Shares), and
- increase the paid capital for employees, excluding the option right, by issuing shares at a discounted price compared to the market price of ordinary ISP shares.

The Co-Investment Plans were authorized by the Bank of Italy on September 30, 2014; following this measure, on October 2, 2014 the Management Board took the necessary decisions to implement the Plan.

The enrolment offer period for the Co-Investment Plans by employees ended on October 31, 2014. The date of assignment of the shares to the employees is on December 1, 2014, which corresponds to the beginning of the vesting period ended in April 2018.

In application of the international accounting standard IFRS 2 Share-Based Payments, the PAD and LECOIP are represented as "equity settled" plans in the Group's consolidated financial statements, as the Group assigned its representative instruments of capital as an additional remuneration for the services received (the work performance). However, the Group has not taken any liabilities to be liquidated with cash or other assets towards employees.
Given the impossibility of reliably estimating the fair value of the services received by the employees, the cost of the benefit to employees is represented by the fair value of the shares assigned, calculated at the date of assignment, attributed to the income statement, under item 150a "Administrative expenditure: expenditure for personnel", in offset to an increase in equity through the valuation of a special reserve. For Free Shares and Matching Shares, the fair value was set on the basis of the market price of the shares at the date of allocation. As regards the Discounted Shares, the fair value of the subscription discount was calculated considering the stock exchange price of the shares at the date of allocation. For the shares assigned solely to the Risk Takers, the stock exchange price was adjusted to take account of the transfer constraint following the maturity period (holding period).
For employees who subscribed solely to the Widespread Shareholding Plan without subscribing to the LECOIP Investment Plans (and who, therefore, received solely the Free Shares), the cost was entirely expensed at the time of the assignment in December 2014, as the shares were not subject to vesting period.
For employees who subscribed to the LECOIP Co-Investment Plans, the condition of staying in service for the duration of the Plan and additional performance conditions for the Risk Takers and Executives (i.e. the attainment of certain targets related to the company's equity and to the attainment of income results). In the event of non-compliance with the vesting conditions, Intesa Sanpaolo takes over the rights that would have been recognized to the employees against the Certificates.

The economic and equity effects of the Plan, estimated by adequately pondering the defined vesting conditions (including the probability that the employee will remain in the Group for the duration of the Plan), were accounted for during the benefit vesting period, i.e. along the duration of the Plan.

1.2 Long-term incentive plans 2018-2021: POP Plan and LECOIP 2.0 Plan

In conjunction with the launch of the 2018-2021 Business Plan, two new long-term incentive plans for different population clusters were launched:

- POP Plan (Performance-Based Option Plan) intended for Top Management, Risk Takers and Strategic Managers;
- LECOIP 2.0 Plan intended for Managers and the other personnel.

With reference to the Top Management, Risk Takers and Strategic Managers, who have a direct impact on the Group's results, we considered it necessary to adopt an instrument explicitly linked to the attainment of the Business Plan targets and with a risk/return profile appropriate to their role and the levels of ambition and challenge of the new Business Plan.

The POP Plan is based on financial instruments linked to shares ("Call Options") and subject to the achievement of key performance conditions of the Business Plan and subordinated to activation and individual access conditions (so-called compliance breach).

The entire vested amount will be liquidated in shares and on a time horizon of 3/5 years, according to the beneficiary's membership cluster, after verifying the malus conditions, defined in a manner mirroring the conditions of activation, over the years in which they are envisaged.

In addition, the Group signed with JP Morgan a novation agreement, with which it transferred to JP Morgan the obligation to deliver to the employees of the Intesa Sanpaolo Group any ordinary shares that will be due at the expiration of the POP Options and, consequently, to the counterparty the assumption of all the Plan's volatility risks.

With reference to the Managers and the remaining personnel, essentially in continuation of the LECOIP 2014-2017, a 2018 – 2021 LECOIP 2.0 retention plan was introduced instead.

The LECOIP 2.0 plan, intended to facilitate sharing at all of the organization's levels the value created over time as a result of achieving the targets of the Business Plan and promoting the identification and spirit of belonging to the Group, is assigned in Certificates issued by JP Morgan, which are stock-based financial instruments. In particular, the LECOIP 2.0 Plan sets forth:

- the free allocation to the employees of newly issued Intesa Sanpaolo ordinary shares deriving from a free capital increase ("Free Shares");
- the free allocation to the employees of further ordinary Intesa Sanpaolo shares, newly issued against the same free capital increase ("Matching Shares") and the subscription by the employees of Intesa Sanpaolo's newly issued ordinary shares deriving from an increase in paid capital reserved for employees, with the issuance of shares at a discounted price compared to the market value ("Discounted Shares").

The Certificates are divided into two categories and have different characteristics depending on whether they are intended for the "Professional" or "Manager" employees of the Italian perimeter of the Group. The Certificates reflect the terms of certain options backed by Intesa Sanpaolo ordinary shares and allow the employee to receive, at vesting, unless certain events occur, an amount in cash (or in Intesa Sanpaolo ordinary shares) equal to the original market value of the Free Shares and Matching Shares for "Professional" employees and 75% of the same for "Manager" employees, plus any appreciation, compared to the original market value connected to the amount of Free Shares, Matching Shares and Discounted Shares.

The POP and LECOIP 2.0 Plans were submitted for approval by the Shareholders' Meeting on April 27, 2018.

With particular reference to the LECOIP 2.0 Plan, the extraordinary part of the same Shareholders' Meeting approved giving a delegation to the Board of Directors to increase the share capital according to art. 2443 of the Italian Civil Code, functional to the implementation of the LECOIP 2.0 Plan. These capital gains were executed on July 11, 2018, at the same time as the start of the 2018-2021 Long-Term Incentive Plans.

Both long-term incentive plans (POPS and LECOIP 2.0) fall within the scope of IFRS 2 and are eligible as equity-based payment transactions with Equity instruments (known as equity-settled plans).

With reference to the POP Plan, the fair value of the plan's equity instruments was defined at the date of assignment (represented by the fair value of the options adjusted for the availability constraint to which the shares will be subject following the exercise of the options) and no longer changed. The Plan sets forth the conditions of service and non-market performance (the activation conditions and the performance conditions), which were taken into account in order to determine the number of shares for the valuation of the plan's cost. These estimates will be reviewed during the vesting period and until maturity. The plan's cost, as defined, is attributed to the income statement (as labour cost) pro rata temporis during the benefit's period of maturity, offsetting a specific Equity reserve. Upon the occurrence of the events that cause the employees to lose the entitlement to the POP Plan benefits (performance conditions, activation conditions, and failing to stay in service), Intesa Sanpaolo records a cash inflow in the balance sheet. With regard to the novation right - this essentially being the operative mode adopted by the Group to fulfil the obligation of physical delivery of the shares deriving from the Plan - the accounting representation is that of a capital instrument offseting the equity.

As regards the LECOIP 2.0 Plan, the fair value of the equity instruments covered by the Plan was calculated at the date of assignment (equivalent to the sum of the fair value of the shares assigned for free and the fair value of the discount for the paid shares) and no longer changed. The Plan sets forth the conditions of service and non-market performance (the trigger events), which were taken into account in order to determine the number of shares for the valuation of the plan's cost. These estimates will be reviewed during the vesting period and until maturity. The plan's cost, as defined, is attributed to the income statement (as labour cost) pro rata temporis during the benefit's period of maturity, offsetting a specific Equity reserve.

When the events that cause the employees to lose their entitlement to the benefits of LECOIP 2.0 Certificates occur (trigger events and failure to remain in service), Intesa Sanpaolo records a financial asset in its balance sheet (the "transferred receivable" representative of the Certificates) offsetting the Equity. In particular, the Certificates entered in the group's financial statements under IFRS 9 are classified among the Financial Assets compulsorily valued at fair value.

B. QUANTITATIVE INFORMATION

2.1 Long-term widespread shareholding instruments: LECOIP and LECOIP 2.0

The total economic effects of 2018 related to LECOIP and LECOIP 2.0 amount to 800,000 euros (including reimbursement of the tax burden - sell to cover - charged to the assignees).
Since it is a settled equity plan, no payables are recorded for cash settled payments.

The tables below summarize the evolution of the LECOIP and LECOIP 2.0 Plans from their respective enrolment dates as at December 31, 2018.

	LECOIP plan												
	Free Shares at December 2014		**Matching Shares at December 2014**		**Discounted Shares at December 2014**		**Shares Sell to cover at December 2014**		**Total number of assigned shares at December 2014**	**Number LECOIP Certificates at 31.12.2017**	Variations of the period (c)	**Number LECOIP Certificates at 31.12.2018**	Fair value average at 31.12.2018
	Number of shares	Average fair value per unit	Number of shares	Average fair value per unit	Number of shares	Average fair value per unit (b)	Number of shares	Average fair value per unit (b)					
Total employees	224,493	2.3442	291,680	2.3310	2,064,692	0.3736	355,118	2.4007	2,935,983	509,955	-1,588	-	-

(a) Assigned shares allocated to cover the disbursement of taxes payable by the employee.
(b) Fair value of the subscription discount.
(c) Number of certificates involved in Intesa Sanpaolo's takeover of the rights that would have been recognised to employees for the Certificates arising from non-compliance with the condition of remaining

	LECOIP plan												
	Free Shares at July 2018		**Matching Shares at July 2018**		**Discounted Shares at July 2018**		**Shares Sell to cover at July 2018 (a)**		**Total number of assigned shares at July 2018**	**Number LECOIP Certificates at July 2018 (c)**	Variations of the period (d)	**Number LECOIP Certificates at 31.12.2018**	Fair value average at 31.12.2018
	Number of shares	Average fair value per unit	Number of shares	Average fair value per unit	Number of shares	Average fair value per unit (b)	Number of shares	Average fair value per unit					
Total Employees	250,504	2.4750	253,013	2.4750	3,524,619	0.3771	582,033	2.5416	4,610,169	503,517	-3,484	500,033	2.4699

(a) Assigned shares allocated to cover the disbursement of taxes payable by the employee.

(b) Fair value of the subscription discount.

(c) Number of Certificates signed on July 11, 2018 by the Group's employees who enrolled in the LECOIP 2.0 Plan

(d) Number of Certificates involved in Intesa Sanpaolo's takeover of the rights that would have been recognised to employees for the Certificates arising from non-compliance with the condition of remaining in service and other vesting conditions.

Attachments

Criteria for reclassification of the income statement

For the income statement, the reclassifications concerned:
- dividends relating to shares or units held in the portfolio, which have been reallocated within the framework of the – profits (losses) on financial assets and liabilities measured at fair value
- the interest rate differentials receivable and payable accrued and received on currency interest rate swaps involving the exchange of two variable rates, classified in the trading portfolio, entered into to hedge floating rate foreign currency funding transactions, which have been reclassified as net interest, on the basis of the close correlation that exists;
- net trading income, Net hedging gains (losses), Net profit (loss) on financial assets and liabilities at fair value through profit or loss and gains and losses on disposal or repurchase of financial assets at fair value through profit or loss with an impact on comprehensive income and on disposal or repurchase of financial liabilities, which are reallocated to the single item Net profit (loss) on financial assets and liabilities at fair value, with the exception of those securities purchased as part of transactions to maintain the stability of the banking system which have been allocated to the item "Taxes and other charges relating to the banking system (net of taxes)";
- the recovery of indirect taxes classified under other operating income, which are deducted from other administrative expenses;
- Net adjustments for credit risk associated with financial assets measured at amortised cost and financial assets measured at fair value with an impact on profit and loss, the economic effects of the contractual amendments and the net provisions for risks and charges for credit risk associated with commitments and financial guarantees given,
as part of the single item Net adjustments to loans;
- the re-entry of the time value of the staff severance indemnity and of the provisions for risks and charges, which is included under Net interest, since the phenomenon derives directly from the application of the amortised cost criterion, as there are no changes to the forecast of expected future cash flows, consistently with the treatment of the time value of financial assets measured at amortised cost;
- net value adjustments for credit risk relating to financial assets measured at amortised cost other than loans and value adjustments for impairment of equity investments as well as tangible and intangible assets (including property and other assets deriving from enforcement of guarantees or purchase by auction and held for sale on the market in the near future), which are reclassified under Other net provisions and Net value adjustments on other assets, which therefore include - in addition to provisions for risks and charges - the valuation effects of assets other than loans;
- realised gains (losses) on financial assets carried at amortised cost other than loans, equity investments and on other investments, which are carried forward to other income (expense), net. In addition to income and expenses not strictly related to operations, the item also includes a summary of the effects of the sale of assets other than receivables,
- integration costs and leaving incentives, which have been reclassified, net of the tax effect, under Personnel expenses, Administrative expenses and Other operating income and expenses - taxes and other charges aimed at maintaining the stability of the banking system, which have been included, net of taxes, in the specific item.

Balance sheet reclassification criteria

In order to provide a more immediate representation of the balance sheet and financial position, a summary statement of assets and liabilities has been prepared by means of appropriate groupings, which concerned:

- the inclusion of Cash and cash equivalents under the residual item Other asset items;

- separate disclosure of financial assets constituting loans to banks and loans to customers, regardless of the respective accounting portfolios to which they were allocated;
- the inclusion of assets held for sale, consisting entirely of loans to customers, in aggregate loans to customers;
- separate disclosure of financial assets that do not constitute loans, distinguishing between financial assets measured at amortised cost, financial assets measured at fair value through profit or loss and financial assets measured at fair value with an impact on comprehensive income, net of the reclassification to Loans to banks and Loans to customers;
- the inclusion of the value of hedging derivatives and the value adjustment of macro-hedged financial assets/liabilities under Other assets/Other liability items;
- the aggregation of tangible and intangible assets under a single item;
- the aggregation into a single item of the amount of the due to customers items at amortised cost and of Outstanding securities;
- the grouping under a single item (Provisions for Risks and Charges) of the provisions with specific destination (Severance indemnity, Provisions for risks and charges, Provisions for commitments and financial guarantees issued);
- aggregate indication of the Reserves, net of any treasury shares.

Reconciliation between reclassified income statement and Bank of Italy income statement

Reclassified income statement items		Model income statement items	
Net interest			**52,861**
	Item 30	Interest margin	52,692
	- Item 30 (partial)	Interest margin (impact of Savoy funding)	373
	+ Item 160 a) (partial)	Personnel expenses (Reentry of time value of employee severance indemnities and other staff provisions)	-203
Net fee and commission income			**59,240**
	Item 60	Net fee and commission income	59,622
	+ Item 160 a) (partial)	Other administrative expenses: costs of investigating recovered loans	-383
Net results of financial assets and liabilities measured at fair value with impact on the income statement and on assets measured at			**914**
	Item 80	Profit (losses) on trading	1,055
	Item 90	Net hedging result	-245
	Item 110 a)	Profits (losses) on other financial assets and liabilities measured at fair value with impact on the income statement a) assets and liabilities designated at fair value	-2
	Item 110(b)	Profits (losses) on other financial assets and liabilities measured at fair value with impact on the income statement b) assets measured at fair value	-876
	Item 110(b)	Write-down of CARIGE bonds reclassified under charges relating to the banking system	832
	+ Item 70 (partial)	Dividends and similar income on equity instruments held for trading, measured at fair value through profit or loss or for which the option to measure at fair value is exercised with an impact on comprehensive income (including dividends on UCIs)	150
Other net operating income (expense)			**-974**
	Item 70	Dividend and similar income	150
	Item 200	Other operating income/expenses	6,410
	- Item 70 (partial)	Dividends and similar income on equity instruments held for trading, measured at fair value through profit or loss or for which the option to measure at fair value is exercised with an impact on comprehensive income (including dividends on UCIs)	-150
	- Item 200 (partial)	Other operating income/expenses (Recovery of indirect expenses and taxes)	-6,340
	- Item 200 (partial)	Other operating income/expenses (integration costs)	-1,045
Net operating income			**112,041**
Personnel expenses			**-44,975**
	Item 160 a)	Personnel expenses	-46,740
	- Item 160 a) (partial)	Personnel expenses (Integration costs and leaving incentives)	1,562
	- Item 160 a) (partial)	Personnel expenses (Reentry of time value of employee severance indemnities and other staff provisions)	203
Administrative expenses			**-28,438**
	Item 160(b)	Other administrative expenses	-37,666
	- Item 160 a) (partial)	Other administrative expenses (integration costs and leaving incentives)	94
	- Item 160 a) (partial)	Other administrative expenses (Contributions to resolution funds and deposit protection)	2,411
	- Item 160 a) (partial)	Other administrative expenses: costs of investigating recovered loans	383
	+ Item 200 (partial)	Other operating income/expenses (Recovery of indirect expenses and taxes)	6,340
Amortisation of intangible and tangible fixed assets			**-1,576**
	Item 180	Net adjustments/write-backs to tangible assets	-1,576
Operating costs			**-74,989**
Result from operating activities			**37,052**
Net adjustments to loans			**-31,832**
	- Item 100 a) (partial)	Profits (losses) on disposal or buy back of financial assets measured at amortised cost - Loans	-208
	- Item 130 a) (partial)	Net adjustments/write-backs for credit risk associated with financial assets measured at amortised cost - Loans	-31,818
	Item 170 a)	Net provisions for risks and charges for credit risk associated with commitments and financial guarantees given	194
Other allocations and net adjustments to other assets			**-820**
	Item 130 a) (partial)	Net adjustments/write-backs for credit risk associated with financial assets measured at fair value through other comprehensive income - Debt securities	-1
	Item 230	Valuation differences on property, equipment and intangible assets measured at fair value	-459
	Item 170(b)	Net provisions for risks and charges - Other net provisions	-361
Other net income (expense)			**1,329**
	Item 220	Profits (losses) on equity investments	0
	Item 250	Profits (Losses) on disposal of investments	1,702
	+ Item 30 (partial)	Interest margin (impact of Savoy funding)	-373
	- Item 220 (partial)	Profits (Losses) on investments (measured at equity)	0
Current profit (loss) before taxes			**5,729**
Income taxes			**1,160**
	Item 270	Period taxes on income from current operations	2,430
	- Item 270 (partial)	Period taxes on income from current operations (discontinued operations)	0
	- Item 270 (partial)	Period taxes on income from current operations (Integration cost)	-208
	- Item 270 (partial)	Tax on write-down of CARIGE bonds restated under charges relating to the banking system	-270
	- Item 270 (partial)	Period taxes on income from current operations (Contributions to resolution and deposit protection funds)	-792
Integration costs and leaving incentives (net of taxes)			**-404**
	+ Item 160 a) (partial)	Personnel expenses (Integration costs and leaving incentives)	-1,562
	+ Item 160 a) (partial)	Other administrative expenses (integration costs and leaving incentives)	-94
	+ Item 200 (partial)	Other operating income/expenses (Recovery of costs from Group companies)	1,045
	+ Voce 270 (parziale)	Imposte sul reddito del periodo dell'operatività corrente (Oneri di integrazione)	208
Tributi e altri oneri riguardanti il sistema bancario (al netto delle imposte)			**-2,181**
	+ Item 110 a) (partial)	Write-down of CARIGE bonds reclassified under charges relating to the banking system	-562
	+ Item 160 a) (partial)	Other administrative expenses (Contributions to resolution funds and deposit protection)	-2,411
	+ Voce 270 (parziale)	Imposte sul reddito di periodo dell'operatività corrente (Contributi ai Fondi di risoluzione e tutela depositi)	792
	+ Voce 270 (parziale)	Imposte sul reddito di periodo dell'operatività corrente (Rettifiche di valore su attività finanziarie - Investimenti per la stabilità del sistema bancario)	0
Net result			**4,304**

Reconciliation between the reclassified balance sheet and the Bank of Italy balance sheet

Reclassified balance sheet		Total 31.12.2018
Assets		
Loans to banks		**368,476,324**
	Item 40a (partial) Financial assets measured at amortised cost - Loans to Banks	368,466,848
	Item 20c (partial) Other financial assets mandatorily measured at fair value - Bank loans	9,476
Loans to customers		**2,427,069,856**
Loans to customers measured at amortised cost:		2,427,069,856
	Item 40b (partial) Financial assets measured at amortised cost - Loans to Customers	2,427,069,856
	Item 40b (partial) Financial assets measured at amortised cost - Debt securities (public entities, non-financial companies and others)	
Financial assets measured at fair value through profit or loss		**11,208,840**
	Item 20a (part) Financial assets held for trading - Debt securities + Equity securities + UCIs + Derivatives	10,284,287
	Item 20c (partial) Other financial assets mandatorily measured at fair value - Non-bank loans	108,609
	Financial Item 20b (partial) Financial assets measured at fair value - debt securities	
	Item 20c (partial) Other financial assets mandatorily measured at fair value - Debt securities + Equity securities + UCIs	815,944
Financial assets measured at fair value through other comprehensive income		**36,044,557**
	Item 30 (partial) Financial assets measured at fair value through other comprehensive income - Debt securities + Equity securities	36,044,557
Equity Investments		**10,000**
	Item 70 Equity Investments	10,000
Tangible and intangible assets		**75,669,696**
	Item 90 Tangible assets	58,569,696
	Item 100 Intangible assets	17,100,000
Tax assets		**83,960,905**
	Item 110 Tax assets	83,960,905
Non current assets and disposal groups held for sale		0
	Item 120 Non current assets and disposal groups held for sale	
Other asset items		**81,698,094**
	Item 10 Cash and cash equivalents	29,981,325
	Item 50 Hedging derivatives	2,050,093
	Item 60 Changes in fair value of macro-hedged financial assets (+/-)	1,631,694
	Item 80 technical insurance reserves reassured with third parties	
	Item 130 Other assets	48,034,981
Total assets		**3,084,138,271**
Liabilities		
Due to Banks at amortised cost		**548,136,752**
	Item 10(a) Due to banks	548,136,752
Due to customers at amortised cost and outstanding securities		**2,126,825,040**
	Item 10(b) Due to customers	2,126,067,040
	Item 10 c) Outstanding securities	758,000
Financial liabilities held for trading		**10,495,869**
	Item 20 Financial liabilities held for trading	10,495,869
Tax liabilities		**9,721,423**
	Item 60)Tax liabilities	9,721,423
Other liabilities		**96,850,699**
	Item 40) Hedging derivatives	4,565,442
	Item 50) Adjustment of macro-hedged financial liabilities	829,382
	Item 80) Other liabilities	91,455,875
Technical reserves		
	Item 110) Technical reserves	
Provisions for Risks and Charges		**38,499,064**
	Item 90) Staff severance pay	16,774,322
	Item 100(a) risks and charges - guarantees and commitments	1,086,732
	Item 100(b) risks and charges - post employment and similar benefits	755,461
	Item 100 c) Provisions for Risks and Charges - Other provisions for risks and charges	19,882,550
Share capital		**171,846,280**
	Item 170) Share capital	171,846,280
Reserves		**66,675,220**
	Item 130) Redeemable shares	
	Item 150) Other reserves	-6,902,667
	Item 160) Share premiums	73,577,887
	Item 180) Treasury shares	
Valuation reserves		**10,783,804**
	Item 120) Valuation reserves	10,783,804
Net result		**4,304,119**
	Item 200) Profit (Loss) for the year	4,304,119
Total liabilities and shareholders' equity		**3,084,138,271**

List of financial assets measured at fair value through other comprehensive income consisting of minority shareholdings acquired for investment purposes, that were held at the closing date

(amounts in euro)

Designations	PERCENT % OF ISSUED CAPITAL	NOTIONAL AMOUNT	CARRYING VALUE
BANK OF ITALY	0.375%	28,150,000	28,150,000
C.I.I. PISTOIA SCRL	3.860%	52,420	1
FIDITOSCANA S.p.A.	1.483%	2,375,724	1,619,967
S.W.I.F.T.	0.001%	125	4,665
VISA INC.	-	-	24,298
			29,798,931

LIST OF ENDORSED ACCOUNTING STANDARDS AT THE END OF THE FINANCIAL YEAR

ACCOUNTING PRINCIPLES		Homologation Regulation
IFRS 1	First-time Adoption of International Financial Reporting Standards	1126/2008 mod. 1260/2008 - 1274/2008 - 69/2009 - 70/2009 -254/2009 - 494/2009 - 495/2009 - 1136/2009 - 1164/2009 - 550/2010 - 574/2010 - 662/2010 - 149/2011 - 1205/2011 - 475/2012 - 1254/2012 - 1255/2012 - 183/2013 - 301/2013 -1174/2013 - 2173/2015 - 2343/2015 - 2441/2015 - 1905/2016 - 2067/2016 - 182/2018
IFRS 2	Share-Based Payment	1126/2008 mod. 1261/2008 - 495/2009 - 243/2010 - 244/2010 - 1254/2012 - 1255/2012 - 28/2015 - 2067/2016 - 289/2018
IFRS 3	Business Combinations	1126/2008 mod. 495/2009 - 149/2011 - 1254/2012 - 1255/2012 - 1174/2013 - 1361/2014 - 28/2015 - 1905/2016 - 2067/2016
IFRS 4	Insurance Contracts	1126/2008 mod. 1274/2008 - 494/2009 - 1165/2009 - 1255/2012 - 1905/2016 - 2067/2016 - 1988/2017
IFRS 5	Non-current Assets Held For Sale and Discontinued Operations	1126/2008 mod. 1274/2008 - 70/2009 - 494/2009 - 1142/2009 - 243/2010 - 475/2012 - 1254/2012 - 1255/2012 - 2343/2015 - 2067/2016
IFRS 6	Exploration and Evaluation of Mineral Resources	1126/2008
IFRS 7	Financial instruments: Disclosures	1126/2008 mod. 1274/2008 - 53/2009 - 70/2009 - 495/2009 - 824/2009 - 1165/2009 - 574/2010 - 149/2011 - 1205/2011 - 475/2012 - 1254/2012 - 1255/2012 - 1256/2012 - 1174/2013 - 2343/2015 - 2406/2015 - 2067/2016
IFRS 8	Operating Segments	1126/2008 mod. 1274/2008 - 243/2010 - 632/2010 - 475/2012 - 28/2015
IFRS 9	Financial instruments	2067/2016 - 498/2018 (*)
IFRS 10	Consolidated Financial Statements	1254/2012 mod. 313/2013 - 1174/2013 - 1703/2016
IFRS 11	Joint Arrangements	1254/2012 mod. 313/2013 - 2173/2015
IFRS 12	Disclosure of Interests in Other Entities	1254/2012 mod. 313/2013 - 1174/2013 - 1703/2016 - 182/2018
IFRS 13	Fair Value Measurement	1255/2012 mod. 1361/2014 - 2067/2016
IFRS 15	Revenue from Contracts with Customers)	1905/2016 - 1987/2017
IFRS 16	Leasing	1986/2017 (*)
IAS 1	Presentation of the financial statements	1126/2008 mod. 1274/2008 - 53/2009 - 70/2009 - 494/2009 - 243/2010 - 149/2011 - 475/2012 - 1254/2012 - 1255/2012 - 301/2013 - 2113/2015 - 2406/2015 - 1905/2016 - 2067/2016
IAS 2	Inventories	1126/2008 mod. 70/2009 - 1255/2012 - 1905/2016 - 2067/2016
IAS 7	Statement of Cash flows	1126/2008 mod. 1260/2008 - 1274/2008 - 70/2009 - 494/2009 - 243/2010 - 1254/2012 - 1174/2013 - 1990/2017
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	1126/2008 mod. 1274/2008 - 70/2009 - 1255/2012 - 2067/2016
IAS 10	Events After the Reporting Period	1126/2008 mod. 1274/2008 - 70/2009 - 1142/2009 - 1255/2012 - 2067/2016
IAS 11	Construction Contracts	1126/2008 mod. 1260/2008 - 1274/2008 - 1905/2016
IAS 12	Income taxes	1126/2008 mod. 1274/2008 - 495/2009 - 475/2012 - 1254/2012 - 1255/2012 - 1174/2013 - 1905/2016 - 2067/2016 - 1989/2017
IAS 16	Property, plant and equipment	1126/2008 mod. 1260/2008 - 1274/2008 - 70/2009 - 495/2009 - 1255/2012 - 301/2013 - 28/2015 - 2113/2015 - 2231/2015 - 1905/2016
IAS 17	Leasing	1126/2008 mod. 243/2010 - 1255/2012 - 2113/2015
IAS 18	Revenues	1126/2008 mod. 69/2009 - 1254/2012 - 1255/2012 - 1905/2016
IAS 19	Employee Benefits	1126/2008 mod. 1274/2008 - 70/2009 - 475/2012 - 1255/2012 - 29/2015 - 2343/2015
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	1126/2008 mod. 1274/2008 - 70/2009 - 475/2012 - 1255/2012 - 2067/2016
IAS 21	Effects of changes in foreign currency exchange rates	1126/2008 mod. 1274/2008 - 69/2009 - 494/2009 - 149/2011 - 475/2012 - 1254/2012 - 1255/2012 - 2067/2016
IAS 23	Borrowing Costs	1126/2008 mod. 1260/2008 - 70/2009 - 2113/2015 - 2067/2016
IAS 24	Related Party Disclosures	1126/2008 mod. 1274/2008 - 632/2010 - 475/2012 - 1254/2012 - 1174/2013 - 28/2015
IAS 26	Accounting and Reporting by Retirement Benefit Plans	1126/2008
IAS 27	Consolidated and Separate Financial Statements	1126/2008 mod. 1274/2008 - 69/2009 - 70/2009 - 494/2009 - 1254/2012 - 1174/2013 - 2441/2015
IAS 28	Investments in Associates and Joint Ventures	1126/2008 mod. 1274/2008 - 70/2009 - 494/2009 - 495/2009 - 1254/2012 - 1255/2012 - 2441/2015 - 1703/2016 - 2067/2016 - 182/2018
IAS 29	Financial Reporting in Hyperinflationary Economies	1126/2008 mod. 1274/2008 - 70/2009
IAS 32	Financial instruments: Presentation	1126/2008 mod. 1274/2008 - 53/2009 - 70/2009 - 494/2009 - 495/2009 - 1293/2009 - 475/2012 - 1254/2012 - 1255/2012 - 1256/2012 - 301/2013 - 1174/2013 - 1905/2016 - 2067/2016
IAS 33	Earnings Per Share	1126/2008 mod. 1274/2008 - 494/2009 - 495/2009 - 475/2012 - 1254/2012 - 1255/2012 - 2067/2016
IAS 34	Interim Financial Reporting	1126/2008 mod. 1274/2008 - 70/2009 - 495/2009 - 149/2011 - 475/2012 - 1255/2012 - 301/2013 - 1174/2013 - 2343/2015 - 2406/2015 - 1905/2016
IAS 36	Impairment of Assets	1126/2008 mod. 1274/2008 - 69/2009 - 70/2009 - 495/2009 - 243/2010 - 1254/2012 - 1255/2012 - 1374/2013 - 2113/2015 - 1905/2016 - 2067/2016
IAS 37	Provisions, Contingent Liabilities and Contingent Assets	1126/2008 mod. 1274/2008 - 495/2009 - 28/2015 - 1905/2016 - 2067/2016
IAS 38	Intangible Assets	1126/2008 mod. 1260/2008 - 1274/2008 - 70/2009 - 495/2009 - 243/2010 - 1254/2012 - 1255/2012 - 28/2015 - 2231/2015 - 1905/2016
IAS 39	Financial Instruments: Recognition and Measurement (except certain provisions on hedge accounting)	1126/2008 mod. 1274/2008 - 53/2009 - 70/2009 - 494/2009 - 495/2009 - 824/2009 - 839/2009 - 1171/2009 - 243/2010 - 149/2011 - 1254/2012 - 1255/2012 - 1174/2013 - 1375/2013 - 28/2015 - 1905/2016 - 2067/2016
IAS 40	Investment Property	1126/2008 mod. 1274/2008 - 70/2009 - 1255/2012 - 1361/2014 - 2113/2015 - 1905/2016 - 400/2018
IAS 41	Agriculture	1126/2008 mod. 1274/2008 - 70/2009 - 1255/2012 - 2113/2015

(*) Companies shall apply the provisions of these Regulations at the latest from the start of their first financial year starting after 1 January 2019.

Statement of property, equipment and financial assets subject to revaluation

(thousands of euro)

	Revaluations								Total
	L. 823/1973	L. 576/1975	L. 72/1983	L. 413/1991	L. 218/1990	L. 408/1990	L. 342/2000	L. 266/2005	
Tangible assets	**-**	**143**	**5,684**	**10,686**	**3,397**	**2,259**	**-**	**22,400**	**44,569**
a) Real estate assets		143	5,684	10,686	-	2,259	-	22,400	41,172
b) Works of art					3,397				3,397
Equity Investments	**-**	**-**	**-**	**-**		**-**	**-**	**-**	**-**
a) Subsidiaries									-
b) Other equity investments									-
AFS - reclassification of equity investments									**-**
Assets held for sale	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Properties		-	-	-	-	-	-	-	-
Total	**-**	**143**	**5,684**	**10,686**	**3,397**	**2,259**	**-**	**22,400**	**44,569**

Services provided to the independent auditors and by entities belonging to the independent auditors' network (information provided pursuant to Article 149 - duodecies of the Consob Issuers' Regulations)

(thousands of euro)

Type of service	KPMG SpA
Statutory Audit	106
Certification services	70
Other services	-
Total	**176**

Intesa Sanpaolo S.p.A.balance sheet and income statement at 31 December 2017

Balance sheet

Assets		31.12.2017	31.12.2016	Changes amount	%
10.	Cash and cash equivalents	5,749,702,612	6,213,061,883	-463,359,271	-7.5
20.	Financial assets held for trading	18,264,452,315	19,577,097,879	-1,312,645,564	-6.7
30.	Financial assets designated at fair value through profit and loss	322,287,851	371,284,919	-48,997,068	-13.2
40.	Financial assets available for sale	36,911,639,839	38,982,566,972	-2,070,927,133	-5.3
50.	Investments held to maturity	334,879,246	334,833,432	45,814	-
60.	Due from banks	157,439,934,737	126,634,511,488	30,805,423,249	24.3
70.	Loans to customers	232,692,765,694	200,548,518,866	32,144,246,828	16.0
80.	Hedging derivatives	3,822,813,304	5,720,102,749	-1,897,289,445	-33.2
90.	Fair value change of financial assets in hedged portfolios (+/-)	-130,633,072	160,047,319	-290,680,391	
100.	Equity investments	30,558,013,553	30,589,126,130	-31,112,577	-0.1
110.	Property and equipment	4,399,954,385	2,758,072,076	1,641,882,309	59.5
120.	Intangible assets	2,454,495,926	2,378,906,198	75,589,728	3.2
	of which				
	- goodwill	*858,532,215*	*858,532,215*	*-*	*-*
130.	Tax assets	13,012,846,576	10,588,545,954	2,424,300,622	22.9
	a) current	*2,950,336,388*	*2,562,704,416*	*387,631,972*	*15.1*
	b) deferred	*10,062,510,188*	*8,025,841,538*	*2,036,668,650*	*25.4*
	- of which convertible into tax credit (Law no. 214/2011	*7,172,434,760*	*6,758,409,444*	*414,025,316*	*6.1*
140.	Non-current assets held for sale and discontinued operations	265,849,446	1,365,205	264,484,241	
150.	Other assets	3,278,434,392	2,834,453,572	443,980,820	15.7

Liabilities and shareholders' equity		31.12.2017	31.12.2016	absolute changes	%
10.	Due to banks	173,709,711,661	139,035,582,228	34,674,129,433	24.9
20.	Due to customers	170,914,110,169	147,364,280,391	23,549,829,778	16.0
30.	Securities issued	82,665,715,208	84,823,937,105	-2,158,221,897	-2.5
40.	Financial liabilities held for trading	14,579,631,354	16,669,826,899	-2,090,195,545	-12.5
50.	Financial liabilities designated at fair value	9,133,072	7,966,878	1,166,194	14.6
60.	Hedging derivatives	5,555,327,525	6,517,246,619	-961,919,094	-14.8
70.	Adjustment of financial liabilities hedged generically (+/-)	323,857,059	528,416,248	-204,559,189	-38.7
80.	Tax liabilities	1,284,667,901	811,518,875	473,149,026	58.3
	a) current	*102,626,726*	*189,891,442*	*-87,264,716*	*-46.0*
	b) deferred	*1,182,041,175*	*621,627,433*	*560,413,742*	*90.2*
90.	Liabilities associated with assets held for sale	-	-	-	-
100.	Other liabilities	7,194,999,999	5,761,906,598	1,433,093,401	24.9
110.	Staff severance pay	767,146,054	736,374,747	30,771,307	4.2
120.	Provisions	3,900,901,688	1,947,847,258	1,953,054,430	
	f) post employment and similar benefits	*883,579,918*	*835,550,285*	*48,029,633*	*5.7*
	b) other provisions - other	*3,017,321,770*	*1,112,296,973*	*1,905,024,797*	
130.	Valuation reserves	773,748,333	-425,109,781	1,198,858,114	
140.	Redeemable shares	-	-	-	-
150.	Equities	4,102,750,714	2,117,321,664	1,985,429,050	93.8
160.	Reserves	3,843,194,689	3,816,072,856	27,121,833	0.7
170.	Share premiums	26,164,131,214	27,507,513,386	-1,343,382,172	-4.9
180.	Share capital	8,731,984,116	8,731,984,116	-	-
190.	Treasury Shares (-)	-25,863,278	-19,708,272	6,155,006	31.2
200.	Profit (Loss) for the year	4,882,289,326	1,759,516,827	3,122,772,499	
Total liabilities and shareholders' equity		**509,377,436,804**	**447,692,494,642**	**61,684,942,162**	**13.8**

Income statement

Captions	2017	2016	absolute changes	%
10. Interest and similar income	6,458,141,888	6,580,673,834	-122,531,946	-1.9
20. Interest and similar expense	-3,647,250,788	-4,066,869,038	-419,618,250	-10.3
30. Interest margin	**2,810,891,100**	**2,513,804,796**	**297,086,304**	**11.8**
40. Fee and commission income	3,793,854,801	3,482,123,330	311,731,471	9.0
50. Fee and commission expense	-825,520,418	-653,990,646	171,529,772	26.2
60. Net fee and commission income	**2,968,334,383**	**2,828,132,684**	**140,201,699**	**5.0**
70. Dividend and similar income	1,888,660,731	1,845,156,349	43,504,382	2.4
80. Profits (Losses) on trading	46,821,374	-106,060,586	152,881,960	
90. Net hedging result	-17,328,451	-25,210,954	-7,882,503	-31.3
100. Profit/loss from disposal or buyback of:	181,248,529	129,989,209	51,259,320	39.4
a) loans	*-10,886,814*	*-52,084,805*	*-41,197,991*	*-79.1*
b. financial assets available for sale	*212,407,293*	*208,575,050*	*3,832,243*	*1.8*
c) investments held to maturity	*-*	*-*	*-*	*-*
d) financial liabilities	*-20,271,950*	*-26,501,036*	*-6,229,086*	*-23.5*
110. Profits (losses) on other financial assets and liabilities measured at fair value	2,366,331	12,975,097	-10,608,766	-81.8
120. Intermediation margin	**7,880,993,997**	**7,198,786,595**	**682,207,402**	**9.5**
130. Net value adjustments/write-backs due to impairment of:	-2,017,498,209	-1,788,042,361	229,455,848	12.8
a) loans	*-1,599,745,798*	*-1,586,917,634*	*12,828,164*	*0.8*
b. financial assets available for sale	*-476,221,727*	*-231,780,004*	*244,441,723*	
c) investments held to maturity	*46,858*	*66,662*	*-19,804*	*-29.7*
d) other financial transactions	*58,422,458*	*30,588,615*	*27,833,843*	*91.0*
140. Net income from financial operations	**5,863,495,788**	**5,410,744,234**	**452,751,554**	**8.4**
150. Administrative expenses:	-6,384,782,140	-5,115,466,013	1,269,316,127	24.8
a) Personnel expenses	*-3,775,235,832*	*-2,576,593,491*	*1,198,642,341*	*46.5*
b) other administrative expenses	*-2,609,546,308*	*-2,538,872,522*	*70,673,786*	*2.8*
160. Net provisions for risks and charges	-818,539,821	-107,838,666	710,701,155	
170. Net adjustments/write-backs to tangible assets	-123,334,124	-124,302,815	-968,691	-0.8
180. Net adjustments/write-backs to intangible assets	-12,895,800	-2,521,643	10,374,157	
190. Other operating expenses/income	5,328,341,445	246,791,642	5,081,549,803	
200. Operating costs	**-2,011,210,440**	**-5,103,337,495**	**-3,092,127,055**	**-60.6**
210. Profits (Losses) on equity investments	166,969,444	-315,403,030	482,372,474	
220. Valuation differences on property, equipment and intangible assets measured at fair value	-16,560,861	-	16,560,861	-
230. Impairment losses	-	-	-	-
240. Profits (Losses) on disposal of investments	77,195,893	324,620,741	-247,424,848	-76.2
250. Profit (loss) from current operations before taxes	**4,079,889,824**	**316,624,450**	**3,763,265,374**	
260. Taxes on income from current operations	802,399,502	368,110,138	434,289,364	
270. Profit (loss) from current operations after taxes	**4,882,289,326**	**684,734,588**	**4,197,554,738**	
280. Profit (loss) after taxes on disposal groups held for sale	-	1,074,782,239	-1,074,782,239	
290. Profit (Loss) for the year	**4,882,289,326**	**1,759,516,827**	**3,122,772,499**	

THE TERRITORIAL NETWORK OF CASSA DI RISPARMIO DI PISTOIA E DELLA LUCCHESIA

(Retail Branches, Enterprise Branches and Treasury Centres)

LUCCA AND PROVINCE	
Castelnuovo Garfagnana	Via F. Azzi, 51
Capannori	Piazza Aldo Moro, 54
Filiale Imprese Lucca	Via di Poggio, 3
Lucca Piazza S. Michele	Piazza San Michele, 4
Lammari	Viale Europa, 1
Marlia Viale Europa	Viale Europa, 366
Altopascio Via Cavour	Via Cavour, 57
Lucca Via Vecchia Pesciatina	Via Vecchia Pesciatina, 336
Barga Via Roma	Via Roma, 4
Viareggio Aurelia Nord 2	Via Aurelia Nord, 254
Forte dei Marmi	Via Risorgimento, 7
Marina di Pietrasanta	Via Versilia, 26
Viareggio Via Parri	Via Parri, 42
Lido di Camaiore	Viale Colombo Ang. Via Veneto
Filiale Imprese Viareggio	Via San Francesco, 3
Viareggio Via Cervi	Via F.lli Cervi
S. Anna Sportello	Via Puccini, 32
Porcari	Via Roma, 31
Seravezza	Via Roma, 57
Borgo Giannotti	Via Delle Tagliate Terza, 252
Pietrasanta	Piazza Carducci, 6
Lucca San Concordio	Viale San Concordio, 323
Viareggio V.san Francesco	Via San Francesco, 1

PISTOIA AND PROVINCE	
Filiale Imprese Monsummano Terme	Piazza Giusti
Pistoia Porta Carratica	Via IV Novembre, 2 - ang. Via Gorizia
Borgo a Buggiano	Corso Indipendenza, 39
Filiale Imprese Pistoia	Corso Gramsci, 8
Pescia Sede	B.go della Vittoria, 2
Collodi	Via delle Cartiere, 150
Bottegone	Via Statale Fiorentina, 729/A
Masotti	Strada Statale Lucchese, 18
Cutigliano Sportello	Piazza Umberto I, 6
Pistoia Sede	Via Roma, 3 - ang. Via S. Matteo
Casalguidi	Via E.Pollacci, 2
Monsummano Terme	Piazza Giusti
Olmi	Via Statale Fiorentina, 296
Sambuca Pistoiese	Via Nazionale, 180
Montecatini Terme	Viale Verdi, 13
Pistoia Porta al Borgo	Via di Porta al Borgo, 95 - 97
Centro Tesorerie Pistoia	Via San Matteo
Chiesina Uzzanese	Via Dante Alighieri, 22
Abetone Sportello	Via Brennero, 287
Margine Coperta	Piazza Resistenza, 14
Pistoia Stabilimento Breda	c/o Breda Costruzioni Ferroviarie SpA - Via Ciliegiole
Larciano	Piazza Vittorio Veneto, 27
Cintolese	Piazza dei Martiri, 17-18
Quarrata	Piazza Risorgimento, 37
Pistoia Porta San Marco	Via Porta S.Marco, 234
Lamporecchio	Via Gramsci, 28
Agliana	Via Roma, 72
San Marcello Pistoiese	Piazza G. Matteotti, 147
Chiazzano	Via Provinciale Pratese, 445
S.Agostino	Via Galvani ang. Via Fermi
Campo Tizzoro Sportello	Viale L. Orlando, 625
Pistoia Viale Adua	Viale Adua, 157 ang. Via Don Minzoni
Montale	Piazza Giovanni XXIII, 10
Pieve a Nievole	Piazza XXVII Aprile, 20
Pistoia Ospedale Riuniti	Via Ciliegiole, 97 - Osp. S. Jacopo
Pistoia Porta Lucchese	Via Porta Lucchese 1 - ang. Via Puccini
Ponte Buggianese	Via Buggianese, 45-47

MASSA-CARRARA AND PROVINCE	
Aulla	Strada Statale Del Cerreto, 51
Massa Via Puccini	Via Giacomo Puccini, 18
Carrara Via Roma	Via Roma, 18/A
Marina di Carrara	Viale Giovanni Da Verrazzano, 11/I
Avenza	Viale XX Settembre, 252
Marina di Massa	Via Zolezzi, 6
Filiale Imprese Carrara	Via Roma 18A

Report by the Management Control Committee of Intesa Sanpaolo S.p.A. to the Shareholders' Meeting on the activities carried out by the Board of Statutory Auditors of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. during the 2018 financial year pursuant to Article 2429 of the Italian Civil Code.

Distinguished Shareholders,
the draft financial statements as at 31 December 2018 of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. ("C.R. Pistoia" or "Bank") were approved by its Board of Directors on 18 February 2019. Since the merger by incorporation of C.R. Pistoia into Intesa Sanpaolo S.p.A. ("Parent Company") has had legal effect as from 25 February 2019, these financial statements must be submitted to the Shareholders' Meeting of the Parent Company for approval.
In consideration of the above, the Board of Statutory Auditors of C.R. Pistoia ("Board of Statutory Auditors") handed a report to the Management Control Committee of Intesa Sanpaolo ("Committee") on the results of the activity carried out during 2018 as control body, also assigned the role of Surveillance Body pursuant to Legislative Decree 231/2001.
On the basis of the considerations expressed by the Board of Statutory Auditors, the Committee prepared this Report, taking into account - where compatible - the indications provided by CONSOB Communication no. 1025564 of 6 April 2001 and subsequent updates.

1. RESULTS OF THE FINANCIAL YEAR

The financial statements as at 31 December 2018 show net income of 4,304,119.91 euro.

2. ACTIVITY OF THE BOARD OF STATUTORY AUDITORS

2.1. Frequency and number of meetings of the Board of Directors and the Board of Statutory Auditors

During 2018, the Board of Statutory Auditors was present at all the meetings of the Board of Directors which were always held in compliance with regulatory and legislative provisions and with the Articles of Association. During these meetings, the General Manager reported on the activity carried out and the exercising of powers within the Bank, informing the Board of Statutory Auditors on performance and the periodic financial results.

During 2018, the Board of Statutory Auditors held 13 meetings and, in carrying out the duties attributed to it by the Shareholders' Meeting, it held 6 meetings, in its role as the Surveillance Body pursuant to Legislative Decree 231/2001.

The Board of Statutory Auditors performed the self-assessment required by the Supervisory Provisions issued by the Bank of Italy, concerning the organisation and corporate governance of banks, checking, in this regard, its own adequacy in terms of powers, operation and composition, including taking into account the size, complexity and business carried out by the Bank over the course of 2018.

2.2. Considerations on the most significant transactions with economic, financial and capital impact performed by the company and their compliance with the law and the deed of incorporation

The Board of Statutory Auditors examined the most significant transactions with economic, financial and capital impact which affected the 2018 financial year, ascertaining their compliance with the law and the Articles of Association. The Board of Statutory Auditors acknowledged that it did not find any manifestly imprudent or risky transactions, or any transactions that could compromise the integrity of the corporate assets or which assume significance in terms of possible conflicts of interests, in accordance with the facts set out by the Board of Directors in its own report on operations.

Amongst the most significant events and affairs of the company during the financial year, the Board of Statutory Auditors reported the following:

- ✓ Merger by incorporation of C.R. Pistoia into the Parent Company. In its meeting of 6 March 2018, the Board of Directors of C.R. Pistoia approved the "Plan for the Merger by incorporation of Cassa di Risparmio di Firenze Società per Azioni and Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. into Intesa Sanpaolo S.p.A.", approved on the same date by the competent Bodies of the Parent Company as well as, on 27 March 2018, by those of Banca CR Firenze. After the adoption of the respective resolutions, the Parent Company sent a request to the European Central Bank for authorization of the merger, as well as of the amendments to the articles of association relating to the capital increase, for the purposes of incorporation of C.R. Pistoia. The latter, in fact, still had a minority share of 0.1% in the share capital which, in case of failure to exercise the right of withdrawal, should have received, in exchange, newly issued shares in the Parent Company. With a decision notified on 25 June 2018, the ECB announced that it had, inter alia, authorised the merger by incorporation of C.R. Pistoia into the Parent Company, pursuant to Article 4 (1) (d)-(e) and Article 9(1) of (EU) Regulation 1024/2013, as well as of Article 57 of the Consolidated Law on Banking, a merger subsequently authorised by the extraordinary Shareholders' Meeting of C.R. Pistoia on 12 October 2018. On 2 November 2018, the deadline having expired for exercising the right to sell pursuant to Article 2505-bis of the Italian Civil Code, no. 8 declarations of sale had been received, for a total of 80,100 ordinary shares. There were 23 remaining "uninvolved" shareholders in total, the owners overall of 104,150 ordinary shares, to which must be added, as a further constituent part of the share capital, no. 90,000 "non-dematerialised" ordinary shares arising from the conversion of savings bearer shares (July 2012) held by "untraceable" shareholders. Therefore, the Parent Company's capital increase at the service of the merger, will involve the conversion of a total of 194,150 C.R. Pistoia ordinary shares.

- ✓ "Omega" and "Savoy" transaction. On the 17 April 2018 the Parent Company's Board of Directors approved a transaction that involved, inter alia, the sale of loans classified as non-performing, aimed at the subsequent structuring of securitisation, and the sale to the Intrum Justitia AB Group of a 51% stake in the company Tersia S.p.A. (whose share capital was 100% owned by Intesa Sanpaolo S.p.A.) with the task of servicing non-performing loans on behalf of third parties and for the Intesa Sanpaolo Group. As regards, more specifically, C.R. Pistoia, the sale transaction of the bad loans portfolio ("Savoy" transaction), the value of which at Group aggregate level was approximately 11.8 billion euro, involved a portfolio which, as at the date of execution (30 November 2018), had a Gross Book Value and Net Book Value of, respectively, 182 million euro and 51 million euro.

Option to set up a VAT Group. With the introduction of the new Title V-bis into Presidential Decree 633/72 (Articles from 70-*bis* to 70-*duodecies*), Law 232/2016 (2017 Budget Law) also implemented the Institution in Italy of the so-called "VAT Group", envisaged by Article 11 of Directive 2006/112/EC, although its adoption by the Member States is optional. In particular, as from 1 January 2019, with an option to be exercised by 15 November 2018, a group of companies were allowed to create a VAT single taxable person, while each maintaining unchanged their own tax liability in relation to the other taxes laid down by tax legislation. In this case, the Parent Company assumes the role of "*Group Representative*" in regard to the requirements prescribed by VAT legislation. Compliance with the obligations and the exercising of the rights arising from the application of the VAT rules are the responsibility of the Group Representative, usually identified as the party that exercises control by right. In particular, with regard to C.R. Pistoia, in view of the benefits no particular charges are recognised, considering that the Parent Company has undertaken to prepare the technological infrastructures required to allow participating companies to contribute with their data to the fulfilment of the obligations imposed on them and to carry out subsequent maintenance and updating. From an administrative point of view as well, the activities related to the management and preparation of the relevant information for VAT tax purposes are not substantially changed, with reference to which the filing of an individual return also ceases to be **necessary.**

2.3. Indication of the existence, if any, of atypical and/or unusual transactions, including intragroup ones or with related parties and adequacy of the information given in the report on operations

The Board of Statutory Auditors acknowledged that it did not receive information of nor did it find any atypical and/or unusual transactions. Intragroup transactions were mainly put in place - including in the Bank's interest - with Companies reporting directly to the Parent Company, with the aim of optimising business and rationalising the Group's structure. The Board of Statutory Auditors acknowledged the opinions submitted in Board of Directors' meetings by the Committee for Transactions with Related Parties and Associated Entities about transactions which, pursuant to the Regulations, come under the "special" decision-making procedure", not finding anything of particular relevance. During the financial year, the Board of Statutory Auditors expressed its consent, pursuant to Article 136 of the Consolidated Law on Banking, about the transactions undertaken directly or indirectly by board members of the Bank.

The notes to the financial statements describe the transactions put in place with Group related parties and associated entities pursuant to the Group Regulations in force on this subject.

2.4. Indications on the content of the report issued to the Independent Auditors and opinion on the financial statements

On 21 February 2019, pursuant to Article 14 of Legislative Decree 39/2010 and Article 10 of EU Regulation 537/2014, the Independent Auditors issued the report on the audit of C.R. Pistoia's financial statements for the year ended 31 December 2018. In particular, the Independent Auditors:

- issued an opinion in which they affirm that the financial statements provide a true and fair presentation of the balance sheet and financial position of C.R. Pistoia, of the profit and loss and the cash flows for the year ended at that date;
- presented the key aspects of the audit which, in their own professional opinion, are most significant and are used in forming their overall opinion of the financial statements;
- certified that the report on operations is consistent with the accounts to which it refers and has been drawn up in accordance with the provisions of law and that no material misstatements were identified.

Moreover, on 21 February 2019, the Independent Auditors provided the Board of Statutory Auditors, in its role as the Internal Control and Audit Committee, with the additional report prepared pursuant to Article 11 of EU Regulation 537/2014, according to which no significant shortcomings were found in the internal control system in relation to the financial reporting process which should be brought to the attention of those responsible for governance activities. The annual confirmation of independence was issued, as an annex to this report, pursuant to Article 6, paragraph 2, letter a) of EU Regulation 537/2014 and paragraph 17 of the International Standards on Auditing (ISA Italia) 260.

2.5. Comments and proposals on the remarks and emphases of matters in the independent auditors' report

The report submitted by the Independent auditors does not contain any observations and/or emphases of matters.

2.6. Indication of any complaints submitted pursuant to Article 2408 of the Italian Civil Code, of any actions taken and the relative outcomes

No complaints were submitted to the Board of Statutory Auditors pursuant to Article 2408 of the Italian Civil Code during the financial year.

2.7. Indication of any reports submitted, of any actions taken and the relative outcomes

No reports were submitted to the Board of Statutory Auditors during the financial year.

2.8. Indication of any further appointments granted to the independent auditors and relevant costs

No further appointments were granted to the Board of Statutory Auditors during the financial year.

2.9. Indication of any appointments granted to persons linked to the independent auditors by ongoing relationships and relevant costs

No appointments pursuant to Article 17, paragraph 3, of Legislative Decree 39/2010 were granted to the entities belonging to the network, shareholders, directors, members of control bodies and employees of the independent auditors and companies controlled by them or associated to them.

2.10 Indication of the existence of opinions issued pursuant to law during the financial year

The Board of Statutory Auditors issued the opinions it is required to issue according to the applicable regulations. In particular it expressed a favourable opinion on the criteria followed by the Board of Directors in determining the sale value of the Bank's shares, for the plan for the merger by incorporation into the Parent Company described in paragraph 2.2. above. Given the presence, in the shareholding structure of C.R. Pistoia, of minority shareholders not related to the Group (equivalent to 0.10% of the share capital), the latter were granted – pursuant to the provisions of Article 2505-bis of the Italian Civil Code - the right to have their shares purchased by the surviving company at a price determined according to the criteria provided for withdrawal. The Board of Statutory Auditors therefore examined:

- the merger plan subject to approval by the Board of Directors of C.R. Pistoia;
- the report by the Board of Directors of C.R. Pistoia on the merger by incorporation into the Parent Company;
- the document issued by the independent Advisor Deloitte Financial Advisory S.p.A., on the assessment of the value of the shares of C.R. Pistoia, the exchange ratio and the price per share to be paid to any minority shareholders who decide to exercise their right to sell.

The Board of Statutory Auditors then assessed the choices of methods adopted that complied with criteria of reasonableness and not of arbitrariness, acknowledging the objectivity and adequacy of the valuation process used to determine the sale value of the shares held by third-party shareholders of C.R. Pistoia, for the purposes mentioned under Article 2505-bis of the Italian Civil Code.

Moreover, the Board of Statutory Auditors expressed an opinion on: i) adoption of the Group's main internal regulations, prepared - inter alia - in compliance with the regulatory provisions of the Bank of Italy; ii) exercising the power not to prepare the individual non-financial statement pursuant to Article 3 of Legislative Decree 254/2016, making use of the exemptions pursuant to Article 6 of said decree; iii) integration of the fees to be paid to the independent auditors, for any activities not included in the appointment previously granted to them, with particular reference to new tasks introduced by Legislative Decree 135/2016 and EU Regulation 537/2014, as well as the issuing of an approval on the 2017 Income returns and the 770/2018 returns.

2.11. Comments on compliance with the principles of correct management

The Board of Statutory Auditors supervised, within its own remit, compliance with the principle of correct management, by attending the meetings of the Board of Directors, and through direct observation and verification, acquisition of information flows and regular meetings with the General Manager and the Heads of the main corporate functions, and finally through meetings and discussions with the independent auditors, responsible for the statutory audit of the financial statements. In particular, the Board of Statutory Auditors was able to verify that the Directors did not carry out any transactions:

- that were unrelated to the corporate purpose;
- that were manifestly imprudent or risky;
- that were such as to compromise the integrity of the corporate assets;
- that were aimed at suppressing or amending the rights attributed by Law or by the Articles of Association to individual shareholders;
- that were in contrast with the resolutions adopted by the Shareholders' Meeting or the Board of Directors;
- without having complied with the rules aimed at guaranteeing the transparency and substantial and procedural correctness of transactions with related parties.

The Board of Statutory Auditors also verified, within its own remit and on the basis of the information obtained, the correct fulfilment of corporate, tax and social security obligations.

2.12. Observations on the adequacy of the organisational structure

The Board of Statutory Auditors, through various meetings with the Managers of the Bank and the Departments involved, acknowledged that during the year it carefully monitored, within its own remit, the changes that occurred

in the Bank’s organisational structure. In this context, the Board of Statutory Auditors has always paid the greatest attention especially with a view to ensuring the presence of liaison processes with the corporate functions of the Parent Company, in particular over the risk governance mechanisms and the suitability of the regular reporting information flows. With reference to the adequacy of the organisational structure with respect to its area oversight and governance ability, the Board of Statutory Auditors considered that the structure itself can be deemed consistent and functional, taking into account the peculiarities of the Bank's business.

2.13. Observations on the adequacy of the internal control system and in particular on the activity carried out by the persons in charge of internal control. Highlighting of any corrective measures undertaken and/or to be undertaken

The Board of Statutory Auditors paid particular attention to the changes in the internal control system, taking into account the indications given in the regulatory provisions issued by the Bank of Italy. The Bank’s internal control structure is supervised, as well as by the “Integrated Internal Control System Regulations” (IICS), also by the entire body of supporting documentation (governance documents relating to the Group’s operation and more strictly operational rules disciplining the corporate processes and activities). During 2018, the activity to monitor and assess the aforesaid internal rules continued, with particular attention to risk management in its different forms and levels. The Board of Statutory Auditors oversaw the changes in the Compliance Department’s activities, by examining the regular reports received from it and through *ad hoc* meetings with the Head of the Department. It received ongoing information on the audits performed by the Internal Auditing Department, through regular meetings with the Head of the Department and discussion of the regular reports and other results transmitted. It also obtained a systematic disclosure on the audits performed on the central departments which provide centralised services to the territorial parts of the Banca dei Territori.
Through the Controls Unit of the Toscana-Umbria Regional Governance Centre, the Board of Statutory Auditors received regular disclosures about the results of the first level controls performed, with practically total coverage at the Bank’s Branches, with the result that none of them were classified as “critical” in the various areas of expertise (anti-money laundering, compliance, credit and operations).
In relation to adapting to the new legal and regulatory provisions in the matter of Anti-money laundering organisation, processes and internal controls, implementing Legislative Decree 231/2007 (as recently amended by Legislative Decree 90/2017), the Board of Statutory Auditors acted in particular by continuously verifying, on the basis of the reports and information flows received by the competent Parent Company Department, the overall effectiveness of the function, taking care in particular to ascertain that it was from time to time aligned with the legal and supervisory requirements.
In conclusion and in consideration of the supervisory activity carried out by the Board of Statutory Auditors, there is no reason to report any significant shortcomings in the internal control system.

2.14. Observations on the adequacy of the administrative / accounting system and its reliability to correctly represent the affairs of the company

The Board of Statutory Auditors monitored the adequacy of the administrative and accounting system, through regular meetings with the competent Parent Company offices and with the independent auditors, ascertaining its reliability and suitability to correctly represent the affairs of the company.
The Board of Statutory Auditors took steps to verify the existing controls, aimed at ensuring the reliability, completeness and timeliness of the information flows envisaged by the Guidelines for Administrative and Financial Governance.
As part of its monitoring activity, the Board of Statutory Auditors was able to verify the efficiency and functionality of the system, including through the exchange of information with the independent auditors and the analysis of the results of the work carried out by them.

2.15. Observations on the adequacy of the instructions given by the Company to the subsidiaries pursuant to Article 114, paragraph 2, of the Consolidated Law on Finance.

This does not apply in this case.

2.16. Observations on any significant matters that emerged during the meetings held with the Independent Auditors pursuant to Article 150, paragraph 3, of the Consolidated Law on Finance

The Board of Statutory Auditors had several meetings and exchanges of information with the independent auditors KPMG S.p.A. on matters within their respective remits; no significant facts emerged from these exchanges that it is considered appropriate to report. The Board of Statutory Auditors had a discussion with the Independent Auditors about the plan for the statutory audit activities for 2018, with particular reference to the changes introduced by Legislative Decree 135/2016 and EU Regulation 537/2014.
The Board of Statutory Auditors acknowledged the adequacy of the audit plan of the financial statements and its compliance with an approach based on the risk of material misstatement or reprehensible conduct.

2.17. Indication of the Bank's possible adoption of the corporate governance code of the Corporate Governance Committee for listed companies

This does not apply in this case.

2.18. Conclusive assessments on the supervisory activity carried out, as well as on any omissions, reprehensible matters or irregularities found during same

The Board of Statutory Auditors confirmed that supervisory activity was conducted in a normal manner and did not bring to light material circumstances worthy of mention in this report.

2.19. Indication of any proposals to be submitted to the Shareholders' Meeting pursuant to Article 153, paragraph 2, of the Consolidated Law on Finance in matters pertaining to the Board of Statutory Auditors

The Board of Statutory Auditors did not deem it necessary to make any specific comments.

3. COMMENTS AND PROPOSALS REGARDING THE FINANCIAL STATEMENTS AND THEIR APPROVAL

Taking into account all the above remarks, having considered the content of the opinion issued by the Independent Auditors, the Committee has not reported - in as far as it is within its remit - any impediment to the approval of the financial statements of Cassa di Risparmio di Pistoia e della Lucchesia S.p.A. as at 31 December 2018 accompanied by the report on operations and the notes thereto, as approved by the Bank's Board of Directors on 18 February 2019.

Milano, 7 March 2019

For the Management Control Committee

The Chairman - Marco Mangiagalli

"This is an English translation of the original Italian document. In cases of conflict between the English language document and the Italian document, the interpretation of the Italian language document prevails."

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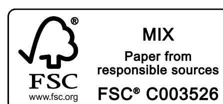

GALLERIE D'ITALIA.
THREE MUSEUM VENUES: AN ITALIAN CULTURAL NETWORK.

Through the Gallerie d'Italia, Intesa Sanpaolo intends to share its artistic and architectural heritage with the public at large: 1,000 works of art displayed in historic palazzi in three cities creating a unique museum network.

Set in an architectural context of great value, **Gallerie d'Italia - Piazza Scala in Milan** displays a selection of two hundred nineteenth-century works of the Lombard school of painting, coming from the art collections of Fondazione Cariplo and Intesa Sanpaolo, along with a collection representative of twentieth-century Italian art.

Gallerie d'Italia - Palazzo Leoni Montanari in Vicenza exhibits works of eighteenth-century Veneto art and a collection of Attic and Magna Graecia pottery. Moreover, one of the most important collections of Russian icons in the West is safeguarded here.

Gallerie d'Italia - Palazzo Zevallos Stigliano in Naples houses *The Martyrdom of Saint Ursula*, Caravaggio's last documented painting, as well as a collection of over one hundred and twenty artworks representative of Neapolitan artistic output from the early seventeenth century to the beginning of the twentieth century.

Cover photo:

ANGELO INGANNI
(Brescia, 1807 - 1880)
Piazza della Scala under the snow, seen from the Gallery 1874
oil on canvas, 65,5 x 55,5 cm
Intesa Sanpaolo Collection
Gallerie d'Italia - Piazza Scala, Milan

Angelo Inganni's vedute are fine works offering a valuable insight into the urban transformations that Milan experienced during the 19th century. In *Piazza della Scala under the snow, seen from the Gallery*, the artist depicts Teatro alla Scala before the square it faces was opened, which involved the demolition of a housing block next to the Palazzo Marino, and subsequently led to the construction of the Galleria Vittorio Emanuele II and the erection of the Leonardo da Vinci monument.

Despite the structural balance of the work, the resulting image - created with free and vibrant brushstrokes with no concern for defined outlines - seems somewhat random, almost like a snapshot of the path running between the snowy square and the Galleria.

The work is part of the permanent collection at the **Gallerie d'Italia**, Intesa Sanpaolo's museum complex located in **Piazza Scala, Milan**. The exhibition dedicated principally to 19th century art opens with Neoclassical works and continues through to the turn of the 20th century, with a century's worth of Italian paintings depicting historical events, battles of the Risorgimento (the Italian Unification), vedute and landscapes, as well as genre paintings and masterpieces of Symbolism.