Part E – Information on risks and relative hedging policies

INTRODUCTION

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

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

Basic principles

The Intesa Sanpaolo Group attaches great importance to risk management and control to ensure reliable and sustainable value creation in a context of controlled risk.
The risk management strategy aims to achieve a complete and consistent overview of risks, given both the macroeconomic scenario and the Group's risk profile, by fostering a culture of risk-awareness and enhancing the transparent and accurate representation of the risk level of the Group's portfolios.
Risk-acceptance strategies are summarised in the Group's Risk Appetite Framework (RAF), approved by the Board of Directors. The RAF, introduced in 2011 to ensure that risk-acceptance activities remain in line with shareholders' expectations, is established by taking account of the Intesa Sanpaolo Group's risk position and the economic situation. The framework establishes the general risk appetite principles, together with the controls for the overall risk profile and the main specific risks.
The general principles that govern the Group's risk-acceptance strategy may be summarised as follows:

- The Intesa Sanpaolo Banking Group is focused on a commercial business model in which domestic retail activity remains the Group's structural strength;
- the Group does not aim to eliminate risks, but rather attempts to understand and manage them so as to ensure an adequate return for the risks taken, while guaranteeing the Company's solidity and business continuity in the long term;
- Intesa Sanpaolo has a moderate risk profile in which capital adequacy, earnings stability, a sound liquidity position and a strong reputation are the key factors to protecting its current and prospective profitability;
- Intesa Sanpaolo aims at a capitalisation level in line with its main European peers;
- Intesa Sanpaolo intends to maintain strong management of the main specific risks (not necessarily associated with macroeconomic shocks) to which the Group may be exposed;
- the Group attaches great importance to the monitoring of non-financial risks, and in particular:
  - it adopts an operational risk assumption and management strategy geared towards prudent management and, also by establishing specific limits and early warnings, it focuses on achieving an optimal balance between growth and earnings objectives and the consequent risks;
  - for compliance risk, it 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;
  - it works to ensure formal and substantive compliance with the provisions in terms of legal liability with the aim of minimising claims and proceedings that it is exposed to and that result in outlays.
  - with regard to reputational risk, it actively manages its image in the eyes of all stakeholders and seeks to prevent and contain any negative effects on its image, including through robust, sustainable growth capable of creating value for all stakeholders.

The general principles apply both at Group level and business unit or company level. In the event of external growth, these general principles must be applied, by adapting them to the specific characteristics of the market and the competitive scenario.

The Risk Appetite Framework thus represents the overall framework in which the risks assumed by the Group are managed, with the establishment of general principles of risk appetite and the resulting structuring of the management of:
- the overall risk profile; and
- the Group's main specific risks.

Management of the overall risk profile is based on the general principles laid down in the form of a framework of limits aimed at ensuring that the Group complies with minimum solvency, liquidity and profitability levels even in case of severe stress. In addition, it aims to ensure the desired reputational and compliance risk profiles.
In detail, management of overall risk is aimed at maintaining adequate levels of:
- capitalisation, also in conditions of severe macroeconomic stress, in relation to both Pillar 1 and Pillar 2, by monitoring the Common Equity Ratio, the Total Capital Ratio, the Leverage Ratio and the Risk Bearing Capacity;
- liquidity, sufficient to respond to periods of tension, including extended periods of tension, on the various funding sourcing markets, with regard to both the short-term and structural situations, by monitoring the internal limits of the Liquidity Coverage Ratio, Net Stable Funding Ratio, Funding/Lending Gap 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 and reputational risk so as to minimise the risk of negative events that jeopardise the Group's economic stability and image.

In compliance with the EBA guidelines (EBA/GL/2015/02) on the "Minimum list of quantitative and qualitative recovery plan indicators", during the 2016 update of the RAF the Group added new indicators (mainly asset quality, market and macroeconomic indicators) as early warning thresholds, in accordance with its Recovery Plan.
Management of the main specific risks is aimed at determining the risk appetite that the Group intends to assume with regard to exposures that may represent especially significant concentrations. Such management is implemented by establishing specific limits, management processes and mitigation measures to be taken in order to limit the impact of especially severe scenarios on the Group. These Risks are assessed also considering stress scenarios and are periodically monitored within the Risk Management systems.
In detail, the main specific risks monitored are:
- especially significant risk concentrations (e.g., concentration on individual counterparties, sovereign risk or commercial real estate);
- the individual risks that make up the Group's overall risk profile and whose operating limits, as envisaged in specific policies, complete the Risk Appetite Framework.

As already disclosed, a specific Credit Risk Appetite Framework (CRA) had already been established in 2015. The CRA identifies areas of growth for loans and areas to be monitored, using an approach based on ratings and other useful predictive statistical indicators, to guide lending growth by optimising the management of risk and expected loss. In 2016, the CRA was implemented with binding instructions for the credit process by setting specific limits identifying the maximum tolerated risk for the riskiest transactions. The limits set are approved within the RAF and are continuously monitored by the Credit Risk Management Head Office Department.
During the 2016 update of the RAF, the framework was further extended to Divisions and Group companies, allocating specific limits according to the:
- extent of the risks assumed (in terms of capital requirements, total assets, and contribution to Group earnings);
- specific nature of the business model (e.g. Banca IMI);
- presence of local regulations (International Subsidiary Banks) or industry sector regulations (e.g. companies in the insurance segment).

Particular attention was also given to the governance of the limits specifically assigned to the Divisions and companies during the review of the Guidelines for the Group's Risk Appetite Framework approved by the Board of Directors in July 2016.
Defining the Risk Appetite Framework is a complex process headed by the Chief Risk Officer, which involves close interaction with the Chief Financial Officer and the Heads of the various Business Units, is developed in line with the ICAAP, ILAAP and Recovery Plan processes, and represents the risk framework in which the Budget and Business Plan are developed. Consistency between the risk-acceptance strategy and policy and the Plan and Budget process is thus guaranteed.
The definition of the Risk Appetite Framework and the resulting operating limits for the main specific risks, the use of risk measurement instruments in loan management processes and controlling operational risk, the use of capital-at-risk measures for management reporting and assessment of capital adequacy within the Group represent fundamental milestones in the operational application of the risk strategy defined by the Board of Directors along the Group's entire decision-making chain, down to the single operational units and to the single desks.
The Group sets out these general principles in policies, limits and criteria applied to the various risk categories and business areas, in a comprehensive framework of governance and control limits and procedures.

The assessment of the total Group risk profile is conducted annually with the ICAAP, which represents the capital adequacy self-assessment process according to the Group's internal rules.
The Group prepares a Recovery Plan according to indications from the Supervisory Authorities. The process that governs the preparation of that plan is an integral part of the regulatory response to cross-border resolution for "too-big-to-fail" banks and financial institutions. The Recovery Plan (governed by the Bank Recovery and Resolution Directive, transposed into Italian law by Legislative Decree 180 of 16 November 2015) establishes the methods and measures to be used to take action to restore the long-term economic stability of an institution in the event of serious deterioration of its financial situation.
Within the annual preparation process for the Recovery Plan, the Chief Risk Officer Governance Area identifies the stress scenarios capable of highlighting the main vulnerabilities of the Group and its business model (e.g. significant exposure to the domestic market) in addition to measuring its potential impact on the Group's risk profile. The final results showed that the Group has a high level of resilience. In addition, as per the Road Map agreed with the Joint Supervisory Team, the subsidiaries within the SSM scope (VUB Group, Banka Koper, ISPB Ireland and ISPB Luxembourg) were included within the Group Recovery Plan. Additional scope extensions are planned for 2017 (CIB, PBZ and ISP Romania), while the other international subsidiaries will continue to be managed according to the regulations in their countries.

Risk culture

The utmost attention is devoted to the sharing and internalisation of risk awareness, by confirming the principles through periodic updates of the reference documents drown up (Tableau de Bord, ICAAP, and Risk Appetite Framework), and by taking specific actions for the implementation of development plans based on the guidance issued by the corporate bodies.
The risk management approach aims to achieve an integrated and consistent system of measures, considering both the macroeconomic scenario and the Group’s risk profile, by fostering a risk-awareness through a transparent, thorough representation of the risk level of portfolios. The efforts made in recent years with the Basel 2 and 3 Project in order to obtain authorisation from the Supervisory Authorities for the use of internal ratings to calculate credit risk requirements and in order to secure validation of internal models for operational and market risks should be seen in this context.
The Group promotes the spread of risk-awareness through extensive training efforts aimed at ensuring the proper application of the internal risk management models.
The measures taken in pursuit of this goal are established through a systematic and coordinated approach to risk management, in accordance with the provisions of the supervisory regulations, with ongoing support from the Parent Company for the strengthening of the local risk assessment and monitoring systems within the international subsidiaries.

To that end, the CRO Forum was set up in 2015, consisting of quarterly meetings of the Chief Risk Officers of the Group's international subsidiary banks with the corresponding structures of the Parent Company. These meetings aim to favour the discussion of common issues and problems, by leveraging the experiences within the Group and by improving the knowledge of the specific characteristics of the local markets, in relation to the operational and regulatory aspects. The development guidelines for risk governance are also illustrated during these occasions, with reporting on the strategic projects conducted at Group level, in order to facilitate subsequent opportunities for dialogue and the leveraging of synergies.
Also with a view towards the internalisation of a Group risk-awareness, the Risk Academy was promoted, mainly aimed at the international subsidiaries, in order to strengthen the quality of Risk Governance at Banking Group level.
Particular attention was devoted to perform an extensive and in-depth assessment of the Group’s risk culture, a topic of increasing prominence for the market and the Regulators. From a core perspective, the Group’s good positioning was confirmed: a conservative risk profile with sound capital and liquidity levels, ongoing attention given to the internal control system and compliance rules that seek to ensure adherence to the substance of the regulations. It was also decided to add to these evidences through a survey on the perceptions and the behaviour of the managers involved in decision making and the transmission – from top management through to the responsible of small group of people – with a view to comparing the consistency between the desired guidelines and the day-to-day company operations. The Group profile in term of risk culture emerging from the assessment was compared both internally against the Group's Divisions, and with respect to international peers, to supplement the results with remarks collected through a programme of interviews with top management and the first-line managers. Periodic reporting was provided to the Management Control Committee and the Board on the initiative’s developments, for the subsequent submission of a plan of targeted measures to further enhance the comprehensive programme of actions designed for the internalisation of the desired behavioural profiles in terms of risk culture.

Risk governance organisation

The risk acceptance policies are defined by the Board of Directors, with strategic supervision and management functions, and by the Management Control Committee with control functions. The Board of Directors carries out its activity through specific internal committees, among which the Risk Committee. The Corporate Bodies are assisted by the action of management committees, among which mention should be made of the Group Risk Governance Committee, as well as by the Chief Risk Officer, reporting directly to the Chief Executive Officer.
The Chief Risk Officer, to whom the Governance Area in charge of the risk management functions as well as the controls on the risk management and internal validation process reports, represents a “second line of defence” in the management of corporate risks that is separate and independent from the business functions.
The Chief Risk Officer is responsible for proposing the Risk Appetite Framework, setting the Group’s risk management guidelines and policies in accordance with the company's strategies and objectives and coordinating and verifying the implementation of those guidelines and policies by the responsible units of the Group, including within the various corporate departments. The Chief Risk Officer ensures management of the Group’s overall risk profile by establishing methods and monitoring exposure to the various types of risk and reporting the situation periodically to the corporate bodies. The CRO implements level II monitoring and controls of credit and other risks, and ensures the validation of internal risk measurement systems.
In 2015, the Chief Compliance Officer was established, directly reporting to the Managing Director and CEO, in a position that is independent from operating departments and separate from internal auditing, which ensures the management of Group compliance risk, both in the operational and reputational risk components, including the risk of sanctions, losses or damage arising from improper conduct towards customers or such as to jeopardise the integrity and orderly functioning of the markets (so-called conduct risk). Furthermore, in line with corporate strategies and objectives, the CCO defines guidelines and policies, including statements and limits for the Risk Appetite Framework, and works with the corporate control functions to effectively integrate the risk management process.

The Group Risk Governance Committee, chaired by the Managing Director and CEO, is a body with decision-making, consultative and reporting powers. It was established with the aim of ensuring the monitoring and management of risks and the safeguarding of corporate value at Group level, including internal control systems, in implementation of the strategic guidelines and management policies defined by the corporate bodies. The Committee is also responsible for Basel 2 and 3 project governance and supervising the projects and measures necessary to guarantee compliance.
The Group Financial Risks Committee is a technical body with decision-making and reporting powers, focused both on the banking business (proprietary financial risks for banking and trading books, as well as Active Value Management) and the life insurance business (result exposure to the trend in market variables). The functions of said Committee are set out in two sessions:

– the Risk Analysis and Assessment Session, chaired by the Chief Risk Officer, is responsible for evaluating, in advance of approval by the Corporate Bodies, the methodological and measurement guidelines for financial risks and proposals for operational limits, in addition to defining the distribution thereof amongst the Group’s major units; in addition, the session verifies the financial risk profile of the Group and its main operational units;

- the Management Guidelines and Operating Choices Session, chaired by the Chief Financial Officer, provides operational guidelines in implementation of the strategic guidelines and risk management policies laid down by the Corporate Bodies in respect of management of the banking book, liquidity, interest rate and exchange risk and periodically verifies the Group’s overall financial risk profile, as well as appropriate measures aimed at mitigating it.

The Group Control Coordination and Operational Risk Committee is a technical body that operates with the aim of stepping up coordination and interdepartmental cooperation mechanisms:
- as part of the Group internal control system, facilitating the integration of the risk management process;
- in relation to operational risks, including ICT risk, facilitating its effective management.

The Committee operates within the scope of the guidelines set by the Corporate Bodies, based on the operational and functional powers delegated by the Board of Directors of the Parent Company. The Functions of the Group Control Coordination and Operational Risk Committee are organised into specific, separate sessions:
- Integrated Internal Control System Session, for reporting and consulting purposes;
- Operational Risk session, with decision-making, reporting and consulting purposes (in this context, the Committee's duties include periodically reviewing the overall operational risk profile, authorising any corrective measures, coordinating and monitoring the effectiveness of the main mitigation activities and approving operational risk transfer strategies).

The Parent Company performs a steering and coordination role with respect to the Group Companies, aimed at ensuring effective and efficient risk management at Group level. For the corporate control functions in particular, there are two different types of models within the Group: (i) the centralised management model based on the centralisation of the activities at the Parent Company and (ii) the decentralised management model that involves the presence of locally established corporate control functions that conduct their activities under the direction and coordination of the same corporate control functions of the Parent Company, to which they report in functional terms.
Irrespective of the control model adopted within their company, the corporate bodies of the Group companies are aware of the choices made by the Parent Company and are responsible for the implementation, within their respective organisations, of the control strategies and policies pursued and promoting their integration within the group controls.
The Chief Risk Officer Governance Area is responsible for operational implementation of the strategic and management guidelines along the Bank’s entire decision-making chain, down to individual operational units. Specifically, it performs the following functions:
- it governs the macro-process of definition, approval, control and implementation of the Group's Risk Appetite Framework (RAF) with the support of the other corporate functions involved;
- consistent with corporate strategies and objectives, it assists the Corporate Bodies in defining guidelines and policies on risk management;
- it coordinates the implementation of guidelines and policies on risk management by the relevant Group business units, also in the various corporate contexts;
- it ensures the measurement and control of Group exposure to the various types of risk, also verifying the implementation of guidelines and policies as above;
- it ensures credit quality monitoring and the observance of credit guidelines and strategies through the constant monitoring of risk, and submitting proposals on the structure of delegated powers of the Corporate Bodies.
- it monitors capital absorption (capital requirements), supporting the Planning and Active Value Management Head Office Department in actively managing capital;
- it proposes to the top management, along with the other competent corporate bodies, the definition of the structure of operating limits, including the rights to grant and manage credit, in line with the RAF and the allocated capital;
- it oversees regulatory developments and ensures that statutory reports are sent to the Supervisory Bodies with regard to internal models;
- it develops and maintains risk measurement, management and control systems in line with current regulations and international best practices, interacting, for such purposes, with the functions in charge of said corporate processes;
- it adopts capital-at-risk measurements for management reporting and assessment of the Group’s Economic Capital adequacy;
- as part of the Tableau de Bord and on a quarterly basis, it reports to the corporate bodies on the situation of the Group's overall risk profile; it compares that situation with the Risk Appetite Framework, highlighting any situations that require action by the Board of Directors;
- it draws up the annual update of the criteria for identifying significant transactions and provides a prior opinion on such transactions.
- it ensures coverage of II level risk monitoring and controls, also contributing to design I level controls and checking that they are effectively performed;
- it carries out II level monitoring and controls on credit quality, composition and evolution of the various loan portfolios also through risk-based controls on proper classification and provisioning of single positions (“single name” controls);
- for the purpose of correctly classifying and assessing single names;
- it also monitors and analyses the structure of level II controls for monitoring risks other than credit risk, in order to verify the completeness and continuity of level I controls;
- it identifies any critical issues based on its control/monitoring activities and the results of I level controls, requesting and monitoring the implementation of specific mitigation actions, ensuring prompt reporting to the corporate bodies in the event of breaches or significant shortcomings;
- It validates internal risk measurement systems.

To that end, the Chief Risk Officer Governance Area is broken down into the following Organisational Units:
- Credit Risk Management Department;
- Financial and Market Risks Department;
- Enterprise Risk Management Department;
- Internal Validation and Controls Department;
- Coordination of Risk Management Initiatives.

The internal control system

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

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

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

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

The Company's organisational solutions also 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, on 27 April 2016 Intesa Sanpaolo adopted the one-tier corporate governance system, pursuant to Articles 2409-sexiesdecies and following of the Italian Civil Code. It therefore conducts its operations through a Board of Directors, certain members of which are also members of the Management Control Committee
The Board of Directors is responsible for corporate management. The Board may undertake all transactions considered necessary, useful or appropriate in achieving the corporate purpose, relating to both ordinary and extraordinary administration.
The Board of Directors elects a Managing Director from its members, other than the Chairman of the Board, the members of the Management Control Committee or the minimum number of Independent Directors. Subject to the powers that cannot be delegated, the Board of Directors delegates to the Managing Director the necessary and appropriate powers to ensure consistency with day-to-day management, in implementation of the guidelines decided by the Board. The Board clearly and precisely establishes the content, the quantitative and/or value limits and the implementation procedures for the delegation to the Managing Director. The Board of Directors performs all the strategic supervision duties required by the law currently in force. The Management Control Committee carries out all the tasks assigned to the control body pursuant to the law.
The Intesa Sanpaolo Group adopts an internal control system based on three levels, in line with the legal and regulatory provisions in force.
Such a model provides for the following types of control:

- Level I: line controls which are aimed at ensuring proper performance of operations (for example, hierarchical, systematic and sample-based controls) and which, to the extent possible, are incorporated in the IT procedures. These are conducted by the same operating and business structures, also through a unit dedicated exclusively to control duties or carried out by the back office;
- Level II: risk and compliance controls for the purpose of ensuring, inter alia:
  - the correct implementation of the risk management process;
  - compliance with the operating limits assigned to the various functions;
  - compliance of company operations with the rules, including self-governance rules.

The functions assigned to such controls are separate from the ones in charge of production and contribute to the definition of the risk governance policies and the risk management process. In the Intesa Sanpaolo Group, Level II includes the following Parent Company structures and the equivalent local units of the Group companies, where established:

  - Chief Risk Officer Governance Area, which is assigned the role of risk management and validation function, as defined by the applicable regulations.
  - Chief Compliance Officer, who is assigned the duties and responsibilities of the "compliance" function, as defined in the reference regulations. The Chief Compliance Officer's area also includes the Anti-Money Laundering Department, which is tasked with the duties and responsibilities of the "anti-money laundering function", as defined by the reference regulations;
- 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 organisational structure of the other components of the internal control system and the IT system at Group level, at scheduled deadlines in relation to the nature and intensity of the risks. In the Intesa Sanpaolo Group, internal auditing is carried out by the Internal Auditing Department of the Parent Company and the equivalent local units of Group companies, where established.

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

The Risk Management and Internal Validation Function

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

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

The internal control system implemented by the Bank includes the validation function, the purpose of which is ongoing evaluation, in accordance with the Supervisory Regulations for banks[7], of the compliance of internal risk measurement and management systems over time as regards determination of the capital requirements with regulatory provisions, Company needs and changes in the market of reference. The validation function is entrusted to the Internal Validation and Controls Head Office Department, which is responsible for the activity at the Group level in accordance with the requirements of supervisory regulations governing uniform management of the control process on internal risk measurement systems.
Within this Department, which reports directly to the Chief Risk Officer, the Internal Validation Sub-Department ensures that internal models, whether already operational or in development, are validated with regard to all risk profiles covered by Pillars 1 and 2 of the Basel Accord, in accordance with the independence requirements established by the applicable regulations[8].

The validation process is mainly driven by Intesa Sanpaolo's roll-out plan and any requests coming from the Regulator. On an annual basis, the Internal Validation Sub-Department prepares a validation plan that is submitted to the Board of Directors for approval.

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

With respect to Pillar 2 risks, the Internal Validation Sub-Department conducts analyses of methodologies, verifying in particular that the measurement or assessment metrics adopted in quantifying significant risks are economically and statistically consistent, the methodologies adopted and estimates produced to measure and assess significant risks are robust and comparing alternative methodologies for measuring and aggregating individual risks. The analyses are conducted both in advance, when adopting/modifying the internal systems used for Pillar 2 purposes, and ex post as part of the prudential control process. The latter are summarised in the ICAAP report while, for substantial or significant modifications of internal systems, the Internal Validation Sub-Department produces a report to be submitted to the competent Managerial Committees and the Governance Bodies[9].
The function also manages the internal validation process at the Group level, interacting with the Supervisory Authorities, the Corporate Bodies of reference and the functions responsible for the level III controls provided for in regulations. The Internal Validation Sub-Department adopts a decentralised approach for companies with local validation functions[10] (certain international companies), coordinating and supervising the activities of such companies, and a centralised approach for the others. The adopted methodologies were developed in implementation of the principles that inspire the Supervisory Provisions for banks, UE directives

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

[8] The validation function became the owner of the calculation of the default rate for the Group from the second half of 2016.

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

[10] Note that the functional reporting of local validation units to the Internal Validation Sub-Department has been formalised.

and regulations, general guidelines of international committees and best practices in the area and take the form of documentary, empirical and operating practice analyses.
The function generally also provides advice and suggestions to company and Group functions on an ongoing basis, with the aim of improving the efficacy of the processes of risk management, control and governance of internal risk measurement and management systems for determining capital requirements.

Finally, the Internal Validation Sub-Department is responsible for the validation of the internal systems used for management purposes and contributes to the development of the model risk framework[11] for both Pillar 1 and Pillar 2 risks.

In 2016, the main validation activities in the area of credit risks pertained to analyses for the submission of the following applications:
- adoption of the internal estimates of the CCFs for the calculation of the EAD for the Corporate segment;
- adoption of the internal estimates of the CCFs for the calculation of the EAD for the Retail SME segment;
- adoption/model change of the internal estimates for PD, LGD and the CCFs for the calculation of the EAD for the Retail segment.

In 2016, the validation function also:
- conducted the review required by the Regulator for the adoption of the AIRB Corporate model change;
- calculated the default rates required to update the Central Tendency of the validated models/models being validated/re-estimated;
- started the validation work on the alignment of the PD and LGD models for IFRS 9.

The following ongoing analyses were also conducted, and their results were summarised in the annual validation report:
- half-yearly backtesting analyses of regulatory segments authorised to use internal systems (residential mortgages for individuals, Corporate and Retail SME segments);
- half-yearly analyses on guarantees used to mitigate credit risk (mortgage, personal and financial guarantees).
- yearly quantitative and qualitative analyses (performance analyses and empirical analyses of use tests) for regulatory segments authorised to use internal systems.

In the cases of the international subsidiaries, Internal Validation conducted its own assessments in collaboration with the local validation functions, where present. In detail, analyses of the adequacy of internal credit risk measurement systems were conducted for the following subsidiaries:
- BIB (Serbia): validation report for the application for the adoption of the FIRB Corporate approach (SME&LC model and slotting for structured finance transactions);
- VUB (Slovakia): validation report for the application for the adoption of the IRB Other Retail approach, and validation report for the application for the amendment of the definition of default (with effect on all the portfolios);
- Banka Koper (Slovenia): validation report for the operational adoption of the PD Small Business model;
- CIB (Hungary): validation report for the operational adoption of the new Corporate PD model, validation report for the operational adoption of the EAD Corporate model, and opinion on the governance document and organisational aspects;
- AlexBank (Egypt): validation report for the operational adoption of the PD Corporate and SME model;
- PBZ (Croatia): validation report for the operational adoption of the PD Retail Unsecured model and recalibration of the PD Small Medium and Large Corporate model;
- Intesa Sanpaolo Bank Luxembourg: application for extension of the new Parent Company Corporate model.

Validation activities for operational risk conducted in 2016 took the form of:
- verification of the strength of the model in the event of updating of the loss data during 2015 (internal and external data);
- ongoing validation analyses for the purpose of drawing up the annual report including the activity of replicating and verifying the database used by the calculation engine to quantify capital requirements. To this end, the information from the documentary and empirical analyses (using Isidoro data) was supplemented by specific on-site inspections, aimed at verifying the effective implementation of the monitoring and management process for operational risks, and by methodological analyses[12], as well as the remote verification process on the Organisational Units/Legal Entities within the AMA scope.

The activity of the Internal Validation Sub-Department relating to the market risk component focused on the following areas:
- periodic quantitative and qualitative analysis as part of the ongoing valuation activity (in particular, backtesting of the Value at Risk (VaR) model and stress testing of the Incremental Risk Charge (IRC) model);
- monitoring of the existing model for calculating stressed VaR, which entails a half-yearly revision of the adequacy of the historical stress period to be used in the calculation.

In addition, the Internal Validation Sub-Department carries out ongoing activities concerning pricing issues (for example, verification of the consistency of non-contributed bonds pricing among the end of quarter measurements carried out by the Financial and Market Risks Department, and operational pricing, monitored by Product Control of Banca IMI). The validation function was involved in the preparations for the inspection visit scheduled for 2017 under the TRIM (Targeted Review of Internal Models) and monitored the execution of the benchmarking requested by the EBA.

In relation to counterparty risk, the Internal Validation Sub-Department periodically monitors the progress of corrective measures implemented for the findings reported in the authorisation letter and conducts periodic quantitative and qualitative analyses, whose results are summarised in the annual validation report. Following the authorisation for the model change for the simulation model for interest rates, which enables the management of negative rates, the function monitored and analysed the additional

[11] Model risk is intended as the risk that the model could become unsuitable or could be used incorrectly to describe - in a simplified but accurate manner - the real phenomenon for which it was developed.

[12] In 2016, the on-site inspections were conducted, with the aid of the local validation functions, on the international subsidiary banks within the AMA scope (VUB and PBZ, already authorised to use the AMA approach, and CIB, where the AMA framework has been implemented, but currently only for operational purposes).

measures on the model proposed by the development function in the plan of corrective measures requested by the ECB. The analyses involved rate simulations (with possible inclusion of euro-OIS bases, and additional amendments to the volatility scaling), the addition of a hybrid model to refine the simulation for the equity asset class, currently limited to the indices, and further refinements proposed for the simulation for the foreign exchange asset class (also with the possible addition of a specific driver for exchange rate volatility). The Bank was also involved in an initial meeting under the TRIM, for which the validation function examined the evolution of the forwarding curves and the convergence analyses (and the Monte Carlo error estimate).

For the Pillar 2 Risks, the main areas of analysis in 2016 were:
- follow-ups of the methods used for the determination of the Economic Capital for credit risk (in particular, the portfolio model and the non-performing loans model);
- analyses of the methods used for the calculation of the Economic Capital for banking book interest rate risk under ordinary and stress conditions;
- general review of the stress testing framework and examination of the methods used for the determination of the scenarios (Oxford model, G-VAR). Further analyses were conducted by the validation function under the internal project, initiated in the second half of 2016, to determine the Bank's level of alignment with the EBA "Draft Guidelines on stress testing and supervisory stress testing" published in December 2015;
- analyses of the methods for determining the Economic Capital and AFR for equity risk and banking book foreign exchange risk;
- start of the analyses for the assessment of the methods for calculating Economic Capital for pension risk, added as a significant risk in the 2015-2018 ICAAP&ILAAP Book;
- validation of the adequacy of the behavioural models for banking book interest rate risk: specifically, the validation function was involved in the re-estimation of the model for the core deposits for the contribution to the fair value shift sensitivity for Intesa Sanpaolo, Fideuram – ISPB and the Group's main International Subsidiary Banks (BIB, PBZ and BIH, BK, ISPRO), estimate of the model for the core deposits for the contribution to the net interest income under ordinary and stress conditions (for Italy) and update of the prepayment model (for Italy);
- review of the framework for the management and measurement of liquidity risk. With regard to stress testing in particular, the contribution to the liquidity outflows from the behavioural model for the committed credit lines was analysed.

The analyses conducted by the Internal Validation Sub-Department are reported in specific detailed memos, summarised in the 2015-2018 ICAAP&ILAAP Book and in the section on the methods used for operational purposes[13] in the annual validation report prepared, as usual, in June 2016.

In addition, in 2016, the validation function continued the work for the development and implementation of the framework for the identification and management of model risk, in collaboration with the Enterprise Risk Management Department. Specifically, the development of the components of the framework for the assessment of model risk for the "pilot" model (PD Mortgage model) was completed. The work will continue in 2017 according to the internal planning, extending the framework to other credit risk methods and periodically implementing the analyses for the models for which the framework has been established and customised.

Compliance

The governance of compliance risk is of strategic importance to the Intesa Sanpaolo Group as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust. The responsibilities and duties of the compliance function are assigned to the Chief Compliance Officer, who is independent and autonomous in relation to the operational structures, reports directly to the Governing Bodies and has access to all activities within the Bank, as well as any significant information for the performance of his/her duties.

The Group's Compliance Model is set out in the Guidelines approved by Intesa Sanpaolo's Corporate Bodies, which indicate the responsibilities of the various company structures and macro processes to mitigate compliance risk:
- identifying and assessing compliance risk;
- proposing the functional and organisational measures for mitigation of this risk;
- assessing the consistency of the company's bonus system;
- conducting pre-assessments of the compliance of innovative projects, operations and new products and services;
- providing advice and assistance to the governing bodies and the business units in all areas with significant compliance risk;
- monitoring, including through the use of information provided by the other control functions, of ongoing compliance;
- promoting a corporate culture founded on the principles of honesty, fairness and respect for the spirit and the letter of the rules.

The regulatory scope and the procedures for monitoring regulatory areas that present significant risks of non-compliance for the Group are defined in the Group Compliance Guidelines. The Chief Compliance Officer submits periodic reports to corporate bodies on the adequacy of compliance control, with regard to all regulatory aspects applicable to the Bank which show compliance risks. On an annual basis, these reports include an identification and assessment of the primary compliance risks to which the Group is exposed and a schedule of the associated management measures, and on a half-yearly basis they include a description of the activities performed, critical issues noted, and remedies identified. A specific notice is also given when events of particular significance occur.

The Compliance Guidelines call for the adoption of two distinct models in relation to direction and control of the Group. These models are organised in such a way as to account for the Intesa Sanpaolo Group's structure in operational and territorial terms. In particular:
- compliance supervision activities for specifically identified Network Banks and Italian Companies whose operations show a high degree of integration with the Parent Company are centralised with the Chief Compliance Officer structures;
- for the other Companies, specifically identified on the basis of the existence of a legal obligation or due to the importance of their material size and/or risk, as well as for International Branches, an internal compliance function is established and a local

[13] In accordance with the regulatory requirements implemented by the Group in the "Guidelines for the adoption, management and control of internal risk measurement systems used for management purposes".

Compliance Officer is appointed, which are assigned compliance responsibilities. The local Compliance Officers of the subsidiaries functionally report to the Chief Compliance Officer structures, while those of the International Branches, except where not permitted by local regulations, hierarchically report to the Chief Compliance Officer structures.

Anti-Money Laundering

The duties and responsibilities of the Anti-Money Laundering Function, as envisaged by regulations, are assigned to the Anti-Money Laundering Department, which reports directly to the Chief Compliance Officer.

Specifically, the Anti-Money Laundering Department ensures monitoring of compliance risk in the area of money laundering, combating financing of terrorism and embargo management by:

– laying down the general principles to be adopted within the Group for the management of compliance risk;
– conducting ongoing monitoring, with the support of the competent functions, of developments in the national and international context of reference, verifying the adequacy of company processes and procedures with respect to applicable regulations and proposing appropriate organisational and procedural changes;
– providing advice to the functions of the Parent Company and subsidiaries on a centralised basis and establishing adequate training plans;
– preparing appropriate periodic reporting for corporate bodies and top management;
– discharging the required specific obligations on behalf of the Parent Company and subsidiaries on a centralised basis, including, in particular, enhanced customer reviews, controls of proper management of the Single Electronic Archive and the assessment and monthly submission to the Financial Reporting Unit of data relating to aggregated anti-money laundering reports, and the assessment reports of suspicious transactions received from operating departments for the submission to the Financial Reporting Unit of reports deemed accurate.

Internal Auditing

Internal auditing activities are performed by the Internal Auditing Department, which reports directly to the Board of Directors. It also functionally reports to the Management Control Committee and has no direct operating responsibilities.

The Department has a structure and a control model which is organised consistently with the evolution of the organisational model of Intesa Sanpaolo and of the Group.

The Internal Auditing structures of the Group's Italian and international companies report to the Internal Auditing Department in terms of functions.

The Internal Auditing Department performs overall level 3 assessment of the internal control system, reporting possible improvements to the corporate bodies, with specific regard to the RAF, the risk management process and risk measurement and control instruments.

In particular, the Department assesses the completeness, adequacy, functionality and reliability of the components of the internal control system, the risk management process and the corporate processes, also with regard to their ability to identify and prevent errors and irregularities. In this context, amongst others, it audits the risk control and regulatory compliance corporate functions, also through participation in plans so as to generate added value and improve the effectiveness of the control and corporate governance processes.

The audit action directly concerns Intesa Sanpaolo and the Group companies.

The Internal Auditing Department is also responsible for assessing the effectiveness of the corporate RAF definition process, the internal consistency of the overall framework and compliance of Bank operations with the RAF.

The Head of the Internal Auditing Department enjoys due autonomy and independence from the operating departments. The Department has free access to the activities, data and documents of all company functions.

The Department uses personnel with the appropriate professional skills and expertise and ensures that its activities are performed in accordance with international best practices and standards for internal auditing established by the Institute of Internal Auditors (IIA).

The Department has earned the maximum rating ("Generally Compliant") in the external Quality Assurance Review envisaged by the international standards.

In performing its duties, the Department uses structured risk assessment methods to identify existing situations of greatest interest and the main new risk factors. Based on the assessments emerging from risk assessment and the resulting priorities, as well as on any specific requests for further enquiry expressed by top management and corporate bodies, it prepares and submits an Annual Intervention Plan for prior examination by the Management Control Committee, and subsequent approval by the Board of Directors, on the basis of which it conducts its activities during the year, in addition to a Long-Term Plan.

Auditing was performed directly for the Parent Company, Intesa Sanpaolo, the Network Banks and other subsidiaries under an outsourcing contract. For the other Group companies with their own internal audit departments steering and practical coordination of the local departments was performed to guarantee control consistency and adequate attention to the different types of risks, also verifying the effectiveness and efficiency levels under both structural and operational profiles. Direct auditing and review activities, in the capacity of Parent Company, were also performed for those companies, as mentioned above.

Any weaknesses detected during control activities have been systematically notified to the company functions involved for prompt improvement actions, which are monitored by follow-up activities to verify their effectiveness.

Summary Internal control system assessments from the checks have been periodically submitted to the Management Control Committee and the Board of Directors. The main weaknesses detected and their development over time have been included in the Audit Tableau de Bord (TdB) so that they may be systematically monitored. The reports relating to the actions completed with a negative opinion or which highlight major shortcomings were submitted in full to the Board of Directors of the Parent Company as well as to the Boards of Directors and Statutory Auditors of the subsidiaries concerned.

Lastly, the Internal Auditing Department ensured constant assessment of its own effectiveness and efficiency in line with the internal "quality assurance and improvement" plan drafted in accordance with the recommendations of international standards for professional audit practice. In this regard, during 2016 it continued an evolutionary path with the aim of strengthening the audit model in line with the new European supervisory standards laid down by the EBA (SREP framework).

Manager responsible for preparing the Company's financial reports

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

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

- issues the instructions for the correct and uniform application of the accounting standards and measurement criteria, formalised as part of the Group Accounting Rules, which are subject to regular periodic updates;
- prepares appropriate administrative and accounting procedures regulating the preparation of the separate financial statements, the consolidated financial statements and all other relevant financial communications pursuant to Article 154-bis of the Consolidated Law on Finance, monitoring their adequacy and ensuring their alignment to the corporate disclosure requirements applicable from time to time;
- oversees the correspondence between the corporate reporting to the market with the accounting records; to this end, it has the right to promptly obtain any information deemed necessary for the performance of his/her duties and coordinates the exchange of information with the independent auditors;
- submits public disclosures to the Board of Directors and certifies the compliance of financial documents and reports in accordance with the provisions of Article 154-bis of the Consolidated Law on Finance.

With specific regard to the financial reporting processes, the Manager responsible for preparing the Company's financial reports:

- maintains a system of information reports and flows with the Parent Company functions and the Group companies, in order to ensure the adequacy of balance sheet, income statement and financial positions and the descriptions of the main risks and uncertainties to which the Group may be exposed, monitoring the reliability of the data acquisition process and the process of disclosure of the relevant information;
- oversees the internal control system for the financial reporting process, drawing up audit plans to ensure the adequacy and effective application of management and accounting procedures over the period. Specific audits are also conducted on the subsidiaries governed by the laws of non-EU countries, as part of the requirements established by the Consob Market Regulation (Article 36).
  Upon completion of the audits, he/she reports periodically to the Board of Directors on their scope and results, following a preliminary examination together with the Board Committees of the matters under their responsibility;
- acquires any recommendations formulated by the independent auditors at the end of the process of auditing the Parent Company's financial statements and the consolidated financial statements, as well as the related feedback in terms of measures to improve the procedures that influence accounting data, monitoring their implementation and effectiveness;
- shares with the Surveillance Body pursuant to Law 231/01 the findings of the audit plan carried out in implementation of the monitoring of the financial reporting process, with specific focus on preventing the criminal and administrative offences described in the "Organisation, Management and Control Model pursuant to Legislative Decree No. 231 of 8 June 2001".

The Manager responsible for preparing the company's financial reports contributes to supervising the independence of the independent auditors, in accordance with the procedures governed by specific Company Regulations, in line with the provisions of law (Legislative Decree 39/2010 amended by Legislative Decree 135/2016, which transposed Directive 2014/56/EU into the Italian legal framework, and EU Regulation 537/2014). The above-mentioned Company Regulations assign to the Manager responsible for preparing the Company's financial reports the role of supervising, overseeing and monitoring the accounting audit engagements and other services entrusted by the Parent Company departments and the Group companies to independent auditors, their networks and their affiliates, in addition to the task of regularly informing the Management Control Committee in this regard.

The Manager responsible for preparing the Company's financial reports ensures periodic reporting to the Board of Directors regarding the legal and regulatory obligations assigned to the Board for the monitoring of the adequacy of powers and means granted to the Manager responsible for preparing the Company's financial reports and of the effective observance of administrative and accounting procedures. This reporting is discussed beforehand with the Management Control Committee and the other Board Committees, for the aspects under their responsibility.

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

In relation to the supervisory and monitoring functions assigned, the Manager responsible for preparing the Company's financial reports:

- signs, jointly with the Managing Director and CEO, the certifications of the Parent Company's and consolidated financial statements pursuant to Article 154-bis, paragraph 5, of the Consolidated Law on Finance on the adequacy and actual application of administrative and accounting procedures, compliance with the international accounting standards, the compliance of the documents with the records, books and accounts and their capacity to give a true and fair view of the Group's financial position and results, as well as a reliable analysis of the performance, results of operations and the main risks to which the Group is exposed;
- certifies the correspondence of the documents and announcements disclosed to the market with the records, books and accounting entries, pursuant to Article 154-bis, paragraph 2, of the Consolidated Law on Finance.

The monitoring of the accounting and financial reporting process is based on the review of:
- the completeness and consistency of the information disclosed to the market through a structured system of information flows coming from the functions of the Parent Company and the companies on the significant events for the purposes of accounting and financial reporting, especially as regards the main risks and uncertainties to which they are exposed;
- the suitability of the processes and procedures used for the preparation of the company accounting reports and all other relevant financial communications pursuant to Article 154-bis of the Consolidated Law on Finance. Particular attention is given to examining the adequacy of the accounting controls and the proper performance of the work required for the financial reporting process. The focus of the checks consists of the work phases that, within the various company processes, involve the recording, production, assessment and presentation of the data and information. In addition to the adequacy of the structure of procedures and the effective application of related controls, the IT architecture and applications, operating processes and development interventions on the summary systems instrumental to financial reporting are taken into consideration.

The organisational model for the supervision of the adequacy of the administration, accounting and financial reporting procedures and the related internal control system is governed by the Company "Guidelines for Administrative and Financial Governance" and entails:
- the determination of the existence and compliance of the internal control system at corporate level, through the examination, conducted by the internal audit function, of the governance systems, the presence and dissemination of standards of conduct inspired by ethics and integrity, the consistency of the organisational structures and transparent attribution of powers and responsibilities, the effectiveness of risk policies, the soundness of fraud prevention systems and the impact of codes of conduct and personnel disciplinary systems;
- the formalisation of relevant business processes for financial reporting purposes, with special focus on the risks and controls that define the stages of recording, processing, evaluation and presentation of data and information conducive to the preparation of Company financial reports and financial market disclosures; in addition to financial reporting processes (e.g. accounting, budget, reporting, management control, risk control), with regard to the material facts presented in the company documents, the business processes (e.g.: credit, finance, asset management, insurance etc.) and the operational processes are also taken into consideration;
- the performance of an annual audit plan to certify the adequacy of the procedures and the effectiveness of the controls in place, by verifying the methodologies that govern the management of transactions within the scope of business processes and the forms of monitoring of the stages associated with the recording, evaluation and presentation of accounting data and financial information;
- the conduct of an annual audit plan to certify the application of IT architecture governance rules with reference to the processing steps instrumental to the preparation of accounting and financial reports;
- the periodic preparation, for each significant Group company, of a "Report on the internal control system for the financial reporting process" which sets out the scope of the controls implemented during the year and the results of the audits conducted, highlighting the shortcomings found and the measures adopted to resolve them;
- the formulation of an opinion on the adequacy of the internal control system for the financial reporting process, upon the outcome of the monitoring over the correct implementation of the regulations, the audits conducted on the scope of companies and the performance of the evaluation process according to standard opinion-forming criteria, considering the significance of the shortcomings found;
- the management of the communication processes between the Manager responsible for preparing the Company's financial reports and the control bodies, the corporate control functions and internal auditing function, in accordance with the provisions set out in the Regulations on the integrated internal control system;
- the communication processes between the Manager responsible for preparing the Company's financial reports and the Corporate Bodies and the Independent Auditors, regarding the applicable legal and regulatory requirements.

To conclude the preparation of the Company's financial reports according to the rules and criteria set out in Part A of the Notes to the financial statements, and the supervisory activities conducted on the financial reporting processes, according to the guidelines described herein, the Managing Director and CEO and the Manager responsible for preparing the Company's financial reports sign the certifications required by Art. 154 bis, paragraph 5, of the Consolidated Law on Finance.

These certifications are included in the reporting packages for the Parent Company's financial statements and the consolidated financial statements, and are provided to the public according to the model established by the Consob Regulation (Annex 3c-ter of the Issuers' Regulation).

Report pursuant to Art. 36 of the Market Regulation

Consob (the Italian Securities and Exchange Commission), in accordance with Law 262/2005 governing the protection of savings and the regulation of financial markets, has set certain conditions for the listing of companies that control companies incorporated and subject to the laws of non-EU member states (art. 36 of the Market Regulation). As a result, Intesa Sanpaolo has set up an action plan to ensure the existence of the conditions required for companies that are of material significance, identified in compliance with the criteria established in the rules:
- determining that the companies' administrative and accounting systems are suited to regularly providing the competent department within the Parent Company and its Independent Auditors with the income statement, balance sheet and cash flow data required for the preparation and audit of the consolidated financial statements;
- regularly obtaining the company information required by the rules (Articles of Association, powers and composition of corporate bodies) and ensuring that the public is provided access to the accounting positions prepared by the companies for the purposes of drafting the consolidated financial statements.

On conclusion of the activities performed and the verifications conducted, compliance with the conditions required by Article 36 of the Market Regulation is confirmed.

The Management Control Committee and Board of Directors have been informed of compliance with those regulatory provisions governing companies incorporated in and subject to the laws of non-EU Member States, in the aforementioned "Report on the internal control system of the financial reporting process" drafted in order to illustrate the overall governance and control activities performed in accordance with the various provisions of laws and Group regulations governing the supervision of financial reporting, organically coordinated by the Manager responsible for preparing the Company's financial reports.

Scope of risks

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

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

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

Main risks of the Banking Group and insurance risk

The Group's main risks, including credit, market, banking book financial, operational and insurance risks, are discussed in detail in the paragraphs below, as required by the Bank of Italy instructions.

Other risks

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

Strategic risk

The Intesa Sanpaolo Group defines current or prospective strategic risk as risk associated with a potential decline in profits or capital due to changes in the operating context, misguided Company decisions, inadequate implementation of decisions, or an inability to react sufficiently to changes in the competitive scenario.
The Group's response to strategic risk is represented first and foremost by policies and procedures that call for the most important decisions to be deferred to the Board of Directors, supported by a current and forward-looking assessment of risks and capital adequacy. The high degree to which strategic decisions are made at the central level, with the involvement of the top corporate governance bodies and the support of various company functions ensures that strategic risk is mitigated.
An analysis of the definition of strategic risk leads to the observation that this risk is associated with two distinct fundamental components:
- a component associated with the possible impact of misguided Company decisions and an inability to react sufficiently to changes in the competitive scenario: this component does not require capital, but is one of the risks mitigated by the ways in which strategic decisions are reached and by their centralisation with top management, where all significant decisions are always supported by specific activities aimed at identifying and measuring the risks implicit in the initiative;
- the second component is more directly related to business risk; in other words, it is associated with the risk of a potential decline in profits as a result of the inadequate implementation of decisions and changes in the operating context. This component is handled not only by using systems for regulating Company management, but also via specific internal capital, determined according to the Variable Margin Volatility (VMV) approach, which expresses the risk arising from the business mix of the Group and its Business Units.

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

Reputational risk

The Intesa Sanpaolo Group attaches great importance to reputational risk, namely the current and prospective risk of a decrease in profits or capital due to a negative perception of the Bank's image by customers, counterparties, shareholders, investors and Supervisory Authorities.

The reputational risk governance model of Intesa Sanpaolo envisages that management and mitigation of reputational risks is pursued:

– systematically and independently by the corporate structures with specific tasks aimed at preserving corporate reputation, through a structured system of organisational monitoring measures;
– across the various corporate functions, through the Reputational Risk Management process governed by specific Guidelines.

The 'systematic monitoring of reputational risk envisages:

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

A fundamental tool for reputational risk monitoring is the Code of Ethics adopted by the Group. This contains the basic values to which the Group intends to commit itself and enunciates the voluntary principles of conduct for dealings with all stakeholders (customers, employees, suppliers, shareholders, the environment and, more generally, the community) with broader objectives than those required by mere compliance with the law. The Group has also issued voluntary conduct policies (environmental policy and arms industry policy) and adopted international principles (UN Global Compact, UNEP FI, Equator Principles) aimed at pursuing respect for the environment and human rights.

In order to safeguard customers' interests and the Group's reputation, specific attention is also devoted to establishing and managing customers' risk tolerance, through the identification of their various risk appetite profiles according to subjective and objective traits of each customer. The assessments of adequacy during the process of structuring products and rendering advisory services are supported by objective assessments that contemplate the true nature of the risks borne by customers when they undertake derivative transactions or make financial investments.

More specifically, the marketing of financial products is also governed by specific advance risk assessment from the standpoint of both the Bank (along with risks, such as credit, financial and operational risks, that directly affect the owner) and the customer (portfolio risk, complexity and frequency of transactions, concentration on issuers or on foreign currency, consistency with objectives and risk tolerance profiles, and knowledge and awareness of the products and services offered). The Group aims to achieve constant improvement of reputational risk governance also through an integrated compliance risk management system, as it considers compliance with the regulations and fairness in business to be fundamental to the conduct of banking operations, which by nature is founded on trust.

The "cross-function" monitoring of reputational risk is entrusted to the Reputational Risk Management (RRM) process, conducted yearly and aimed at integrating and consolidating the main findings provided by the organisational structures more directly involved in monitoring the company's reputation. The objective of that process is to identify and mitigate the most significant reputational risk scenarios to which the Intesa Sanpaolo Group is exposed through:

– the identification of the main risk scenarios to which the Group is exposed, by the Enterprise Risk Management Department, along with the Governance and Controls Compliance Department as regards the compliance risks and with the cooperation of the other relevant corporate functions;
– the assessment of said scenarios by the Top Management;
– the definition and monitoring of adequate communication strategies and specific mitigation measures.

The Enterprise Risk Management Department has also established a risk framework consisting of:

– a common methodological approach, structured into Dimensions, Expectations and Scenarios;
– the Reputational Clearing activities, i.e. the set of processes, tools and methods aimed at detecting and analysing the reputational risk within business operations;
– the Reputational Monitoring activities aimed at collecting and analysing information to define reputational risk profile of the Intesa Sanpaolo Group.

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

The Intesa Sanpaolo Group carefully considers all the risks associated with climate change that may result in additional costs for the Bank or its customers. Specifically, with regard to changes in national and international regulations which could have significant financial effects on its customers, through the subsidiary Mediocredito Italiano, Intesa Sanpaolo has set up an Energy Desk specialising in supporting customer companies in energy efficiency projects and advanced advisory services on legal developments and how to suitably prepare for compliance with such regulations.

Furthermore, with regard to the risk of extreme weather events or emergencies due to climate changes, to meet the needs of customers that have incurred damages, following such events Intesa Sanpaolo shall suspend payment of mortgage loans and instalments of loans for retail customers and businesses in areas seriously impacted by weather events.

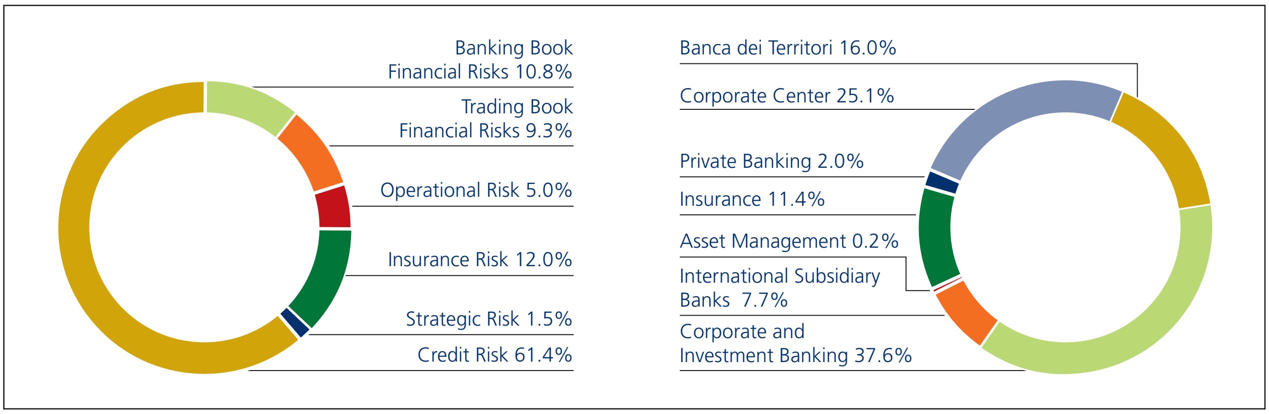
Risk on owned real-estate assets

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

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

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

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



The absorption of Economic Capital by Business Unit reflects the distribution of the Group's various activities and the specialisations of the business areas.
The majority of risk is concentrated in the "Corporate & Investment Banking" Business Unit (37.6% of the total Economic Capital): this is attributable to the type of customers served (Corporate and Financial Institutions) and Capital Market activities. This Business Unit is assigned a significant share of credit risk and trading book risk.
The "Banca dei Territori" Business Unit (16% of the total Economic Capital) is a significant source of absorption of Internal Capital, in line with its role as core business of the Group, serving Retail, Private and Small/Middle Corporate customers. It is assigned a sizeable portion of credit risk and operational risk.
Most of the insurance risk is assigned to the "Insurance" Business Unit (11.4% of the total Economic Capital).
The "International Subsidiary Banks" Business Unit is assigned 7.7% of the total risk, predominantly credit risk.
In addition to credit risk, the "Corporate Centre" is attributed with the risks typical of this Business Unit, namely those resulting from investments, the risks pertaining to the Capital Light Bank, the Banking Book interest rate and exchange rate risk, the risks arising from the management of the Parent Company's AFS portfolio, and the residual portion of insurance risk (25.1% of the total Economic Capital).
Absorption of Economic Capital by the "Private Banking" and "Asset Management" Business Units is marginal (2% and 0.2%, respectively) due to the nature of their business, which is predominantly aimed at asset management activities.

Basel 3 regulations and the Internal Project

In view of compliance with the reforms of the previous accord by the Basel Committee ("Basel 3"), the Intesa Sanpaolo Group has undertaken adequate project initiatives, expanding the objectives of the Basel 2 Project in order to improve the measurement systems and the related risk management systems.

With respect to credit risks, the Group received authorisation to use internal ratings-based approaches effective from the report as at 31 December 2008 on the Corporate portfolio for a scope extending to the Parent Company, network banks in the Banca dei Territori Division and the main Italian product companies.
Progressively, the scope of application has been gradually extended to include the Retail SME and Retail Mortgage portfolios, as well as other Italian and international Group companies, as shown in the following table.

Company	Corporate FIRB	Corporate AIRB LGD	SME Retail IRB LGD	Mortgage IRB LGD
Intesa Sanpaolo Banco di Napoli Cassa di Risparmio del Veneto Cassa di Risparmio in Bologna Cassa di Risparmio del Friuli Venezia Giulia Cassa dei Risparmi di Forlì e della Romagna	Dec - 2008	Dec - 2010	Dec - 2012	Jun - 2010
Mediocredito Italiano	Dec - 2008	Dec - 2010	Dec - 2012	n.a.
Gruppo Cassa di Risparmio di Firenze	Dec - 2009	Dec - 2010	Dec - 2012	Jun - 2010
Banca Prossima	n.a.	Dec - 2013	Dec - 2013	n.a.
Banca IMI	n.a.	Jun - 2012	n.a.	n.a.
Intesa Sanpaolo Bank Ireland	Mar - 2010	Dec - 2011	n.a.	n.a.
Vseobecna Uverova Banka	Dec - 2010	Jun - 2014	Jun - 2014	Jun - 2012

Compared to the situation as at 31 December 2015, the merger by incorporation of Banca dell'Adriatico and Cassa di Risparmio dell'Umbria into the parent company Intesa Sanpaolo S.p.A. was completed

Dedicated rating approaches have been developed for the Banks and Public Entities Portfolio according to the type of counterparty to be assessed. This was the subject of a pre-validation inspection by the Supervisory Authority conducted in December 2013, followed by an additional validation visit in March 2015. The Group is awaiting the AIRB authorisation on this portfolio from the Supervisory Authority.
In 2016, the Supervisory Authority made a pre-validation inspection visit for the authorisation for the use of internal models for determining the PD (Probability of default), LGD (Loss Given Default), and EAD (Exposure at default) for the Retail segment. During this inspection, the parameters for the residential mortgage portfolio were also reviewed, for which authorisation had been obtained for the use of internal models starting from June 2010.
During the same year, a pre-validation inspection visit was also made for the determination of the EAD (Exposure at default) for the Corporate and Retail SME portfolios.
The Group is also proceeding with development of the IRB systems for the other segments and the extension of the scope of companies for their application in accordance with a plan presented to the Supervisory Authority.

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

With regard to Operational Risk, the Group obtained authorisation to use the Advanced Measurement Approach (AMA – internal model) to determine the associated capital requirement for regulatory purposes, with effect from the report as at 31 December 2009.

The adequacy of the internal control system for risks is also illustrated in the annual Internal Capital Adequacy Assessment Process Report, based on the extensive use of internal approaches for the measurement of risks and for the calculation of internal capital and total capital available. The document was approved and sent to the Supervisor in April 2016.

The Intesa Sanpaolo Group participated in the 2016 EU-wide stress test, the exercise conducted by the European Banking Authority on the financial statements of European banks as at 31 December 2015.
The test consisted of the simulation of the impact of two scenarios – baseline and adverse – and covers a time horizon of three years (2016-2018). The 2016 EU-wide stress test provides crucial information as part of the prudential review process of 2016. The

results thus allowed the competent authorities to assess banks' ability to comply with the established minimum and additional own funds requirements in stress scenarios based on shared methodology and assumptions.
Intesa Sanpaolo acknowledges the results of the 2016 EU-wide stress test announced by the EBA on 29 July 2016, which were extremely positive for the Group. The Common Equity Tier 1 ratio (CET1 ratio) for Intesa Sanpaolo resulting from the stress test for 2018, the final year considered in the exercise, was 12.8% in the baseline scenario and 10.2% in the adverse scenario, compared to the starting-point figure of 13% recorded as at 31 December 2015, and included a 50 basis-point reduction - in both scenarios - for the transition from the calculation criteria applicable in 2015 to those in force for 2018.

As part of its adoption of Basel 3, the Group publishes information concerning capital adequacy, exposure to risks and the general characteristics of the systems aimed at identifying, monitoring and managing them in a document entitled "Basel 3 - Pillar 3" or simply "Pillar 3".
The document is published on the website (www.group.intesasanpaolo.com) each quarter.

SECTION 1 – RISKS OF THE BANKING GROUP

As required by the instructions provided by the Bank of Italy, the information in this section - Risks of the Banking Group - is provided solely with respect to the Banking Group, as defined in the Supervisory Instructions, except when it is expressly indicated to the contrary that all companies within the scope of consolidation are considered.
The tables that refer to the Banking Group alone include the share proportional to the interest held of the assets and liabilities of jointly controlled banking, financial and instrumental companies consolidated proportionally for regulatory purposes. Amounts are stated gross of transactions with other companies within the scope of consolidation.
Where the contribution of transactions between the Banking Group and the other companies in the scope of consolidation is material, the details of such transactions are provided.

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

(millions of euro)

Assets		31.12.2016 Financial Statements	Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)	31.12.2016 Regulatory-scope balance sheet
10.	Cash and cash equivalents	8,686	91	8,777
20.	Financial assets held for trading	43,613	-489	43,124
30.	Financial assets designated at fair value through profit and loss	63,865	-62,493	1,372
40.	Financial assets available for sale	146,692	-79,280	67,412
50.	Investments held to maturity	1,241	-	1,241
60.	Due from banks	53,146	-611	52,535
70.	Loans to customers	364,713	3,557	368,270
80.	Hedging derivatives	6,234	-	6,234
90.	Fair value change of financial assets in hedged portfolios (+/-)	321	-	321
100.	Investments in associates and companies subject to joint control	1,278	5,008	6,286
110.	Technical insurance reserves reassured with third parties	17	-17	-
120.	Property and equipment	4,908	-79	4,829
130.	Intangible assets	7,393	-665	6,728
	of which: goodwill	*4,059*	*-470*	*3,589*
140.	Tax assets	14,444	-517	13,927
150.	Non-current assets held for sale and discontinued operations	312	-132	180
160.	Other assets	8,237	-3,166	5,071
Total Assets		**725,100**	**-138,793**	**586,307**

Liabilities and Shareholders' Equity		31.12.2016 Financial Statements	Effects of the deconsolidation and consolidation of counterparties other than those in the banking group (*)	31.12.2016 Regulatory-scope balance sheet
10.	Due to banks	72,641	-86	72,555
20.	Due to customers	291,876	4,588	296,464
30.	Securities issued	94,783	2,600	97,383
40.	Financial liabilities held for trading	44,790	-53	44,737
50.	Financial liabilities designated at fair value through profit and loss	57,187	-57,183	4
60.	Hedging derivatives	9,028	-	9,028
70.	Fair value change of financial liabilities in hedged portfolios (+/-)	773	-	773
80.	Tax liabilities	2,038	-723	1,315
	a) current	*497*	*-86*	*411*
	b) deferred	*1,541*	*-637*	*904*
90.	Liabilities associated with non-current assets held for sale and discontinued operations	272	-272	-
100.	Other liabilities	11,944	-1,740	10,204
110.	Employee termination indemnities	1,403	-7	1,396
120.	Allowances for risks and charges	3,427	-108	3,319
	a) post employment benefits	*1,025*	*-2*	*1,023*
	b) other allowances	*2,402*	*-106*	*2,296*
130.	Technical reserves	85,619	-85,619	-
140.	Valuation reserves	-1,854	-	-1,854
150.	Redeemable shares	-	-	-
160.	Equity instruments	2,117	-	2,117
170.	Reserves	9,528	-	9,528
180.	Share premium reserve	27,349	-	27,349
190.	Share capital	8,732	-	8,732
200.	Treasury shares (-)	-72	-	-72
210.	Minority interests (+/-)	408	-190	218
220.	Net income (loss)	3,111	-	3,111
Total Liabilities and Shareholders' Equity		**725,100**	**-138,793**	**586,307**

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