Annex 1: Further information on principle 17

A) UniCredit Group's Risk Philosophy

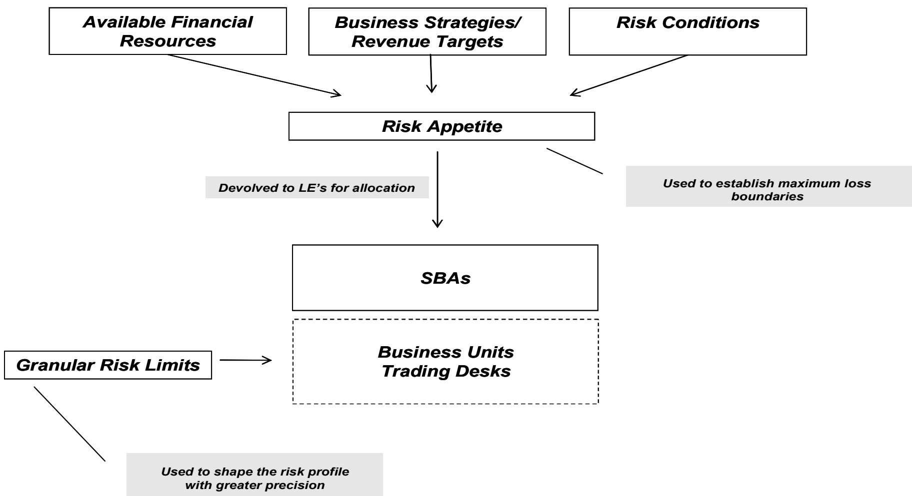
UniCredit Group's overall risk philosophy is to assume risks, in support of its client businesses, which have been independently **analyzed** by the risk function, **approved** by the appropriate authority, and which can be **monitored** on a regular basis through appropriate infrastructure. Such risk-related activities must conform to approved risk policies.

Risk-related businesses must provide a fair return so that UniCredit Group's **risk/return profile remains in balance**. Risk-related businesses which do not provide a fair return represent an inefficient use of risk capital and may expose the bank to an excess of losses.

As a general rule, UniCredit Group is not in the business of pure proprietary risk-taking; risks taken from client activities are managed within limits or reduced/eliminated when possible.

The bank's risk appetite (elaborated below) is formally defined through available financial resources, cost of risk and revenue budgets. A clear and justifiable link between revenue expectations and allocated risks must exist in order to prevent a misbalancing of the risk profile.

Fig. 1 Illustration of the factors defining UniCredit Group's *Risk Appetite*



B) Structure of UniCredit Group's Risk Limits & Risk Appetite Framework

UniCredit Group relies on a variety of risk limits to control its maximum loss boundaries and shape the specific profile of individual businesses. Limit setting begins with an understanding of the Group's available financial resources, business strategies/revenue targets and risk conditions. It is refined by dialogue between Risk Management and Business Units (SBAs).

Limits are approved by the bank's relevant governance bodies:

✓ Risk appetite limits are set by the Board of Directors
✓ Granular limits (managerial/operational), under the purview of Risk Management, are ratified pre- or post-deal by the appropriate Risk Committee.

Limits are monitored regularly and wilful breaches are flagged and analysed (with relevant corrective actions taken at that time). Though limits follow a strict governance process, limit setting must also be seen as dynamic; the Group must be flexible enough in its behaviour to change its risk limits to protect against an "impending storm" or to take advantage of a sensible and profitable opportunity – with appropriate pre- or post-ratification by the relevant governance body.

Risk Appetite - Controlling Aggregate Risks

To control its aggregate risks, UniCredit has developed an overarching **Risk Appetite framework**.

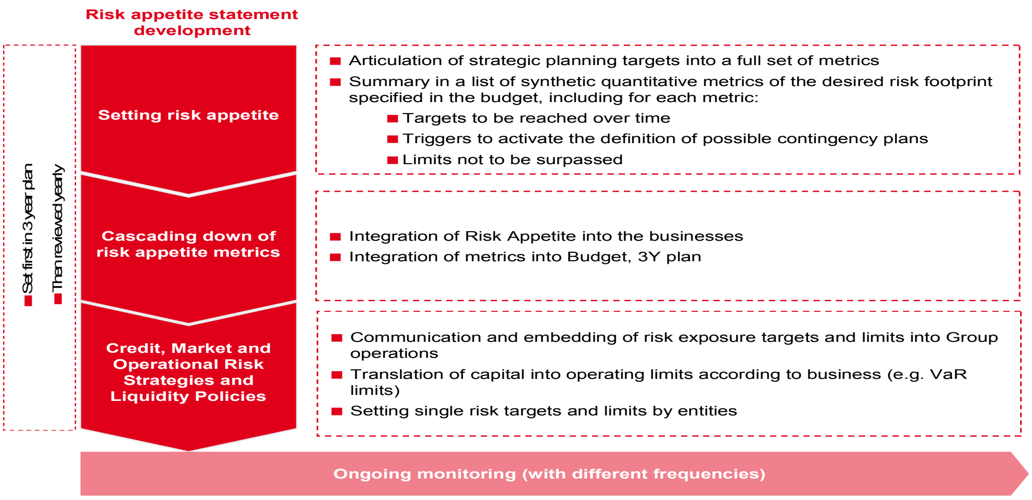
Risk Appetite is defined as the *variability in results, on both a short and a long term basis, which UCG is prepared to accept in support of a stated strategy* – this is effectively an "outer boundary" on how much risk the Group can take.

Establishment of the Risk Appetite is based on understanding and relating 3 variables, namely (1) the size of UniCredit Group's financial resources, (2) the relevant business strategies/revenue targets, and (3) the cost of risk.

Numerous metrics are used, including those set by the Chief Financial Officer and Group Risk Management. Group Risk Management's focus is primarily on Loss Absorption Capacity and Risk-Taking Capacity. These higher level metrics can, in some cases, be converted into "business-relevant" risk limits (e.g. desk-level value-at-risk, expected losses) and are typically supplemented by granular risk limits for additional specificity.

Note that the Risk Appetite Framework is a key component of the Internal Capital Adequacy Assessment Process, under Pillar II, Basel 2.

Fig. 2 UniCredit Group's Risk Appetite development flow



It should be noted that the outer perimeter established by the Risk Appetite is then supplemented by granular limits that control specific dimensions of risk by client, trading product/market, etc. These limits allow UniCredit Group to guard against specific risks, concentrations, correlations and so forth.

C) UniCredit Group Risk Management Organisational Structure

UniCredit Group's risk organisational structure is a reflection of its risk philosophy – meaning it is aligned to ensure a thorough understanding of risks from **all relevant perspectives**.

Divisional and **legal entity** (**LE)** risk functions are considered as "granular" risks, such as specific clients/credits and specific markets/trading transactions. They are primarily responsible for analyzing, deciding and monitoring transactional level risks (e.g. credit, market), within overall limits set by the portfolio functions. Divisional and LE risk functions are the primary communication link to the businesses which generate risks.

Portfolio risk functions are considered as "aggregate" risks, taking an overall view on broad risk factors and providing intelligence on "at risk" sectors, industries and risk types. They are primarily responsible for setting overall portfolio risk limits (which are devolved to the divisional and LE risk functions) and recommending "protective" actions as needed.

All three organisations (Portfolio, Division, LE) work in close cooperation with other risk holding functions (e.g., risk management and control, operating office) which together provide consistency related to policy, capital management, reporting and infrastructure.

How Do We Build and Strengthen our Risk Culture?

Building, and ultimately strengthening, a risk culture is a multi-focus, multi-step process that is implemented over time. It can be done on the basis of 10 key steps:

- ✓ Defining, communicating, updating a common risk philosophy/risk appetite
- ✓ Reinforcing the "three Cs": communication, coordination, cooperation
- ✓ Operating with a high degree of professionalism
- ✓ Injecting "new blood" selectively from outside the bank
- ✓ Rotating personnel within CRO and other competence lines
- ✓ Creating a consistent base level of technical knowledge
- ✓ Demanding common sense in actions
- ✓ Assigning accountability
- ✓ Linking to performance
- ✓ Establishing credibility/promoting mutual respect

<u>Planned Actions:</u>

Though measuring "risk culture" is notoriously difficult, UCG will begin measuring success by implementing certain key performance indicators. These will be instituted within the next three months and tracked regularly thereafter.
On an annual basis we shall also draw some qualitative observations:

- ✓ Respect, cooperation, communication between CRO and businesses
- ✓ Adherence by businesses to risk policies, limits
- ✓ An efficient and proactive risk process