Risk Management and Compliance

Risk is at the very heart of what we do and how we do it: managing risk is the core of our business. Risk management and compliance must be foremost in the daily thoughts and actions of every employee, informing our collective and individual efforts of the current and future risks our organisation may face.

Guarantee strong risk management

Our strategic plan prioritises decisive actions that resolve legacy issues, transform the bank and build on our existing competitive advantages. In doing so, we can seize opportunities and secure sustainable levels of profitability for our enterprise.
Our Chief Executive Officer confirmed that we will take risks, that is the essence of our business, but only the right kinds of risk and we will manage them very carefully.

In this effort, Group Risk Management, which is responsible for controlling Group risks as defined by UniCredit's Board of Directors, is continuing with its prudent approach to risk. An activity plan to further enhance the full effectiveness of risk controls is ongoing, especially with reference to liquidity and credit risk second level controls (SLC).

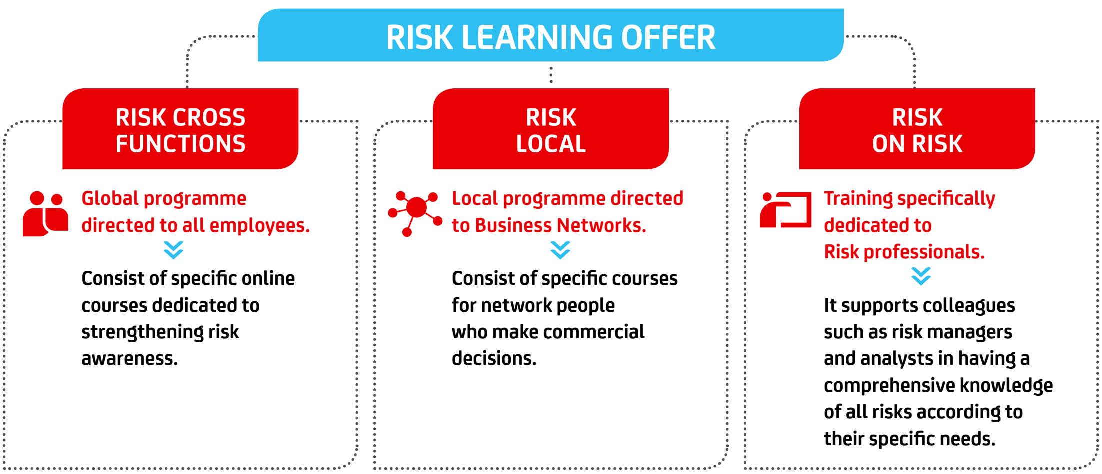
Following last year's reorganisation within the Risk Management function, clear roles were defined within the risk management and the credit-related operational functions: Group Risk Management (GRM) and Group Lending Office (GLO).

GRM manages risk strategies such as the Risk Appetite Framework (RAF) definition, the Internal Capital Adequacy Assessment Process (ICAAP) and the Non-Performing Exposures (NPEs). Meanwhile, GLO, in compliance with risk management strategies, oversees credit activities including developing policies and guidelines.

Reinforcing risk awareness

Our Group has adopted a structured and comprehensive approach to strengthening its risk culture. In 2018, we launched an induction programme for the Board members with the aim of ensuring tailored training, on a continuous basis, which takes into account both individual and collective Board members' needs.
In order to establish an awareness of risk management, UniCredit has developed a new *Group Risk Learning Framework*.

This new learning framework is characterised by digital, modular and freestanding solutions and is based on adaptive learning methods. Three main streams ensure that all participants are fully aware of the different risks. These streams are differentiated according to the target population and the required risk knowledge. At the same time, those in specific positions and risk professionals will receive further training specifically tailored to the requirements and challenges of their jobs.



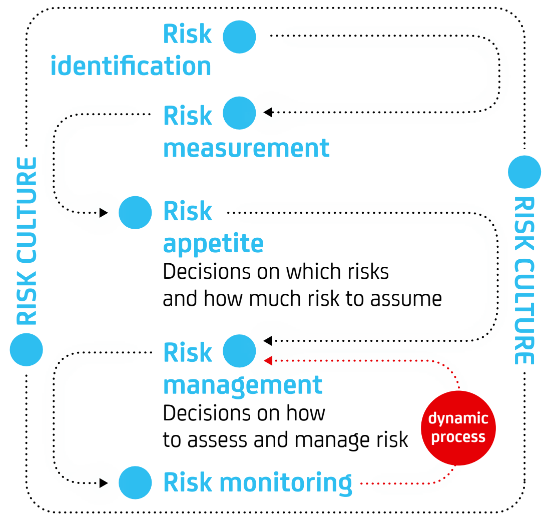
More than 97,700 hours of training within the Risk Learning Offer were provided to more than 17,500 colleagues in 2018.[1]

Identifying and measuring risks

UniCredit's risk management process begins by identifying the risks the bank is potentially exposed to, before measuring those risks.

With this in mind, our Group decides how much risk it is willing to assume, establishing its RAF.[2] UniCredit's businesses pursue sales targets within these defined risk limits. We identify and measure risk with a set of rules, methods and policies that are also used to support the Group's strategic planning processes.

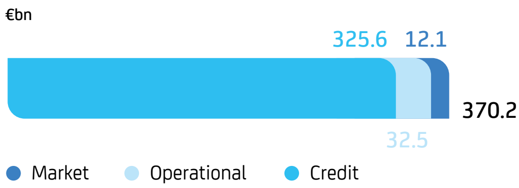
Our risk methodology



Managing and monitoring risks

Risks constantly evolve and must be monitored so they can be properly managed. Whenever our Group updates its RAF, the Risk Management function incorporates it into a set of operational Key Performance Indicators (KPIs) in order to closely monitor UniCredit's activities and the risks it has assumed. These KPIs can then be applied to various management techniques to either tolerate, mitigate, transfer or even eliminate risk.
As a pan-European commercial bank, UniCredit's main risk exposure is reflected in its share of Risk Weighted Assets (RWA). Its **credit risk**, at 88 percent, is diversified by geographic areas and asset classes, while its operational risk RWA and its market risk RWA account for €32.5 billion (8.8 percent) and €12.1 billion (3.3 percent), respectively, of its total RWA.

RWA by type 2018



Over the course of 2018 we continued to pursue the strategy underlying the *Transform 2019* plan in terms of risk deleveraging. This year performance was sustained by a sharp reduction in gross non performing exposure (NPE), down €7.5 billion (-16 percent) during the period, with a gross NPE ratio decreasing 212 bps to 7.7 percent, half of the ratio when we launched *Transform 2019.* Since 2016, the decrease amounts to €18.2 billion (-32 percent) coupled with an NPE coverage increase from 55.6 percent to 61 percent (+534 bps) thus confirming the strong focus on the NPE.

Moreover, the accelerated rundown of the Non Core portfolio announced last year is well on track and has been confirmed thanks to the €5.2 billion reduction already delivered in 2018. The significant improvement of Asset Quality in 2018 is also due to stricter underwriting policies with a good quality of new business Expected Loss (EL) in line with our RAF.[3]

Loan classification[A]	Amount as of Dec 31st, 2018	Y/Y change	Coverage ratio
Bad loans	€21,154 m	-17%	72.6%
Unlikely to pay	€16,196 m	-16%	47.3%
Past Due loans	€840 m	-17%	31.3%
Performing loans	€459,470 m	+9%	0.6%

Risk profile

A. Loan Classification includes:
Bad Loans: exposures to borrowers in a state of insolvency (even when not recognized in a court of law) or in an essentially similar situation, regardless of any loss forecasts made by the bank; Unlikely to Pay: classification in this category is the result of the judgment of the bank about the unlikeliness, without recourse to actions such as realizing collaterals, that the obligor will pay in full (principal and / or interest) its credit obligations; Past Due Loans: problematic exposures that are more than 90 days past due on any material obligation; Performing loans: exposures which are not past due for more than 90 days or to borrowers in a problematic state.

1. Training is referred to Italian legal entities.
2. Refer to the 2017 Integrated Report for more information.
3. Refer to the Strategic Plan chapter for more information.

UniCredit also faces risks related to liquidity, interest rates, reputation, compliance, the environment, society and other emerging areas.

It remains a fundamental concern that we ensure a sufficient level of **liquidity** to honour the Group's payment obligations; this must be done not only on an ongoing basis, but also under stressed conditions. The Group is organised into Liquidity Reference Banks (LRB).[4]
Each LRB monitors and oversees the liquidity position of the legal entities it relates to and ensures that they all have a sufficient level of liquidity to meet their individual and consolidated obligations, as they arise.

Liquidity risk management is performed in ongoing concern and in contingency situations. Ongoing concern refers to normal day-to-day business including the execution of normal market operations within risk limits in line with the predefined plans (e.g., the Funding Plan) and according to the decisions taken by the competent bodies and relevant operational functions. Liquidity management in a contingent situation refers to managing liquidity in an abnormal environment by activating special mechanisms and activities performed by the different functions involved. The main activities focus on the execution of a particular managerial mode once a crisis begins to unfold. The main aim is to withstand a crisis and continue business during and after the crisis.

FOCUS
2018 EU-Wide Stress Test
UniCredit was subject to the 2018 EU-Wide Stress Test conducted by the European Banking Authority (EBA) in cooperation with the Single Supervisory Mechanism (SSM), the European Central Bank (ECB) and the European Systemic Risk Board (ESRB).
Results:
- **Baseline scenario:** 2020 CET1 ratio at 13.76 percent, corresponding to 96bps higher than CET1 ratio transitional (IFRS9-restated) as of December 2017.
- **Adverse scenario:** 2020 CET1 ratio at 9.34 percent, corresponding to 346bps lower than CET1 ratio transitional (IFRS9-restated) as of December 2017.

UniCredit Group's capital depletion is basically in line with the 2016 financial year (-334 bps vs -329 bps). The SSM sample shows a worse capital depletion compared to 2016 (-413 bps vs -366 bps).[5]

At the end of 2018, as a result of the internal liquidity adequacy assessment process (ILAAP) and the constant dialogue with the Supervisor, the Group reinforced its three lines of defence through the reallocation of activities between Group Finance, Group Financial Planning and Group Risk Management. Moreover, in 2019 several initiatives will further strengthen the liquidity management framework in the area of risk identification, measurement and monitoring and the combination of a regulatory and economic view in the definition of the liquidity strategy.
As a part of the strategy, all the Group legal entities will increasingly become self-funded, by progressively minimising intra-group exposure.

In order to manage **operational risk**, our Group maintains a series of measurement, control and mitigation policies and procedures. In accordance with the UniCredit operational risk framework, we identify and assess the risks inherent to all our material products, activities, processes and systems. This is a regular process of monitoring risk profiles, material risk exposure and risk mitigation strategies, which are also implemented by the legal entities through permanent workgroups, authorised to identify and prioritise initiatives and mitigation measures.

Over the course of the year, a new dedicated structure has been created in order to further strengthen the **Information and Communication Technology (ICT) and cyber risk** management. Its main responsibilities are assessing all relevant business processes from an IT risk view, defining tailored indicators and setting-up an enhanced ICT risk assessment method to reduce operational risk. This model was established through an exchange of knowledge and cooperation between the Risk Management, IT and Security functions. In Italy, a course was put in place and completed by roughly 35,800 employees. The inclusion of ICT indicators within the 2018 RAF has been further consolidated. Insurance covering cyber events at Group level was purchased.

It remains vital to safeguard against **reputational risks**. Since 2015, we have deployed a monitoring system to strongly reinforce the Group's capacity to identify and analyse the salient reputational risks in the financial sector. This system, which monitors external events that may pose reputational risks, is updated monthly and is

4. LRB are legal entities that have a treasury which is empowered to access the wholesale/interbank market even on behalf of the legal entities within their country or reference perimeter.
5. Refer to https://eba.europa.eu/-/eba-publishes-2018-eu-wide-stress-test-results for more information.

available to several internal functions (e.g., Investor Relations, Compliance, Corporate & Investment Banking). Furthermore, at the end of 2018 we worked to reinforce our reputational risk governance through the implementation of a new Reputational Risk Council. The Council involves the proposing Business function together with GRM, GLO, Group Compliance, Group Sustainability & Foundation and the participation of other relevant functions on a case-by-case basis.
Since 2015, we have started using a governance system to reinforce our management of **environmental and social risks**, which has been supported by the assignment of sustainability issues to the Corporate Governance, HR and Nomination Committee, which was subsequently renamed the Corporate Governance, Nomination and Sustainability Committee.[6]

Two Group statements, our Environmental Commitment and our Human Rights Commitment, describe the approach, roles and responsibilities, principles, rules, procedures and systems adopted by UniCredit to prevent and manage environmental and social impact and risks in our operations and value chain.

In addition, we have adopted detailed guidance policies for sectors relevant to UniCredit that could pose environmental and social risks.[7] These policies are regularly reviewed and reinforced with specific employee training. A revision of some policies, including the policy relating to the coal-fired power generation sector, has already been planned for 2019. With regard to the defence sector, in 2018, we developed an online course with a specific focus on Law 185/1990[8] this year, which is available to all employees of UniCredit SpA. It has been completed by roughly 1,000 colleagues, including relationship managers, risk managers and members of other functions involved in due diligence processes.

Over the years, we have continued to reinforce our approach to human rights and we have evolved to respond to the expectations of our stakeholders. The most updated version of UniCredit Human Rights Commitment is available on the UniCredit website and summarizes the Group's approach to human rights, focusing on stakeholder categories such as employees, customers, suppliers and communities. It is based on international declarations and conventions, standards, principles, guidelines and recommendations, including The Universal Declaration of Human Rights and the International Labour Organization's Fundamental Human Rights Convention. We are committed to fighting modern slavery and human trafficking in our business and supply chains; in this regard, UniCredit is also compliant with section 54 of the United Kingdom's Modern Slavery Act 2015.[9]

In 2018 more than 69,000 colleagues received human rights training.

MATERIAL TOPICS

FOCUS

Human rights: specific initiatives for employees/violence against women

At UniCredit, we want to support all our employees. As a result we have launched several measures, including a system in Italy where women can voice their concerns. As an important feature of this system, we set up a crisis line this year for employees in need of support. Colleagues can call a freephone number that is managed anonymously by an external specialist psychology group. From 2019 onwards, employees in Italy, who are victims of violence, will be granted special leave.
Furthermore, to mark the International Day for the elimination of violence against women and to raise awareness of this topic, a specific workshop was organised, attended by roughly 250 employees.

6. Refer to the Governance chapter for more information.
7. Refer to the Supplement - Risk Management and Compliance section and to the Sustainability section on our website (www.unicredit.eu) for more information.
8. Italian Law 185/1990 regulates all import, export and transit activities relating to the defence sector and associated banking activities.
9. The Modern Slavery Act 2015 is an Act of the Parliament of the United Kingdom, designed to combat modern slavery in the UK.