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**REPORT BY THE BOARD OF STATUTORY AUDITORS OF FONDIARIA-SAI SPA  
PURSUANT TO ARTICLE 2408 paragraph 2 of the Italian Civil Code RELATIVE TO  
THE COMPLAINT RECEIVED FROM SHAREHOLDER  
FINLEONARDO SPA**

On 25 May 2012, the Board of Statutory Auditors of Fondiaria-Sai Spa (hereinafter simply Fonsai) received a complaint pursuant to Article 2408, paragraph 2 of the Civil Code, dated 22 May 2012, from Finleonardo S.p.A. (hereinafter simply Finleonardo), shareholder of Fonsai, regarding reprehensible facts specified therein, with a simultaneous request to the Board of Statutory Auditors to carry out a series of inquiries listed expressly therein.

In this report, the Board of Statutory Auditors recounts the outcome of the inquiries conducted.

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## **§ 1. THE COMPLAINT PURSUANT TO ARTICLE 2408 OF THE CIVIL CODE**

In its complaint pursuant to Article 2408 of the Civil Code (**which is attached to this report as Doc. 1**), Finleonardo, given that on 14 July 2011 it subscribed part of the capital increase of EUR 450 million decided by Fonsai on the previous 14 May, stated that it was misled into making the investment in question on account of what was proposed to the shareholders by the Board of Directors in the resolution of 14 May 2011, based on the information contained in the separate financial statements ending 31 December 2010 and based on the risk elements contained in the information prospectus disclosed to the market.

Finleonardo thus complained that – although the said documents led one to believe that the capital increase was suitable for endowing the company with the liquidity necessary to strengthen it in terms of income and equity – on 19 March 2012 another capital increase became necessary aimed at strengthening the same solvency indices and consequent – the shareholder stated – for the most part upon the need for greater coverage for the auto TPL claims reserves of previous years.

Deeming the explanations received at the shareholders' meeting insufficient, in the complaint attached here Finleonardo requested the following, in short, of the undersigned Board of Statutory Auditors:

- a) verify the size of the individual components that led the Board of Directors to revalue the auto TPL class claims reserve by EUR 800 million overall, indicating (i) the irregularities and dysfunctions deriving from the lack of formalised procedures and adequate control systems; (ii) the inventory made by the settlement network; (iii) observations on the calculations of actuarial models and their adjustment; (iv) compliance with the dominant case law, all through annual training classes, showing the portion of the said revaluation that is attributable to the 2011 claims reserve and those relative to previous periods;
- b) verify whether the information in the Board of Directors' possession at the time of the preparation of the 2010 separate financial statements, and those of previous years, and of all the disclosures and information prospectuses provided to the market and to the shareholders concomitantly with the 2011 capital increase was not sufficient to engender an obligation for the Board of Directors to inform shareholders and the market of the need for a more adequate revaluation of the auto TPL claims reserve;
- c) attest to the ability of the 2010 financial statements, the subsequent reports, the information prospectus disclosed at the time of the 2011 capital increase and the subsequent periodic disclosures to the market and the shareholders, to faithfully represent the company's real standing and therefore verify the accuracy of the information provided by the Board of Directors in the said documents.

The Board of Statutory Auditors began immediate inquiries with respect to shareholder Finleonardo's request for an investigation.

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For this purpose, it obtained the necessary documentation, including the reports by the relevant business units, the correspondence with the Oversight Institution, the official documentation of the actuary engaged by the insurance company, and the minutes of the Board of Directors meetings at which the subject of the revaluation of the auto TPL claims reserve was discussed.

The investigation requested by shareholder Finleonardo proved furthermore to be particularly intricate, due not only to the objective complexity of the “matter” to be investigated, i.e. the claims reserve formation procedure, but also due to the numerous and well-known fronts on which the Board of Statutory Auditors has been involved in recent months, requiring it to expend its energy on many relevant issues.

The investigation is thus not completed, and with this report, the undersigned Board of Statutory Auditors intends to provide an initial analysis of the situation and a response to some of the questions posed by Finleonardo.

Naturally, this Board of Statutory Auditors will complete its investigation as soon as possible, making the outcome public.

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## **§ 2. THE REFERENCE REGULATORY FRAMEWORK**

### **2.1 The reference regulatory framework**

Before going into the specifics on the procedures adopted by Fonsai for the quantification of the auto TPL claims reserve and verifying in detail the reasons why the reserve in question was revalued, we believe that a brief examination of the reference regulations is necessary.

Based on the provisions of Article 37, paragraph 5 of No. 209 of 7 September 2005 (hereinafter Private Insurance Code) *"The claims reserve includes the overall amount of the sums which, from a prudent valuation made based on objective elements, prove necessary to pay claims occurring during the same year or in previous years, and not yet paid, along with the respective settlement costs. The claims reserve is to be valued at the last cost, in order to take into account all foreseeable future expenses, based on historical and forward-looking data and on the specific characteristics of a company."*

It therefore involves a provision earmarked to ensure payment of compensation for claims incurred but not yet paid.

As is known, the Private Insurance Code introduced a profound delegation on the subject<sup>1</sup>, setting only the general principles and leaving the task of determining the criteria for computing reserves in detail to ISVAP.

Among the said general principles, for what is of interest here, it is worth mentioning the criterion of adequacy, according to which technical reserves must be adequate to guarantee the obligations assumed by the insurance company. With specific reference to non-life insurance, the said Article 37, paragraph 1 specifies that said adequacy is to be determined *"as far as reasonably foreseeable "*.

In general, calculating a claims reserve is somewhat easy for claims already settled, but not yet paid; in this case, it is just a matter of adding up the commitments assumed by the insurer.

For claims reported but not yet settled, on the other hand, it is necessary to make an estimate of their likely cost.

It is an operation, as is evident, that entails a fluctuation margin, due to several factors: imperfect estimation of loss; lengthy investigations, especially if judicial; changes in the case law on the subject of loss settlement, and others.

The claims reserve valuation criteria referred to in Article 37, paragraph 1 of the Private Insurance Code are the subject of a specific ISVAP regulation (Regulation 16) issued on 4 March 2008.

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<sup>1</sup> For non-life classes, see Article 37, paragraph 1, Private Insurance Code, which stipulates that *"A company engaging in non-life classes has the obligation to create technical reserves for contracts in the Italian portfolio, which must always be adequate, as far as reasonably foreseeable, to meet the commitments deriving from the insurance contracts. The reserves are to be created, including reinsurance cessions, observing ISVAP regulatory provisions and valuation methods. "*

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In particular, Articles 26 et seq. of Regulation 16 deal precisely with the topic of reserves for claims that have occurred and been reported, stipulating – in Article 26 – the general principles according to which *"companies are to create the claims reserve separately for each claim that has occurred and been reported, for which the settlement process has not yet been completed at yearend or for which the compensation for loss, the direct expenses and the settlement expenses have not yet been fully paid"*, as well as the principle according to which *"companies are to value claims reserves in keeping with the last cost, taking into account all foreseeable future expenses"*.

Specific claims reserve calculation criteria are then set in the next Article 27, which basically introduces two methods.

A first method, which is the general rule on the subject, is the inventory method, consisting – in practice – in classifying all claims reported<sup>2</sup>. For claims occurring in years prior to the valuation year (i.e. *"previous generation"* claims), the cost of the claim must be valued observing the principle of the foreseeable last cost, based on reliable historical and forward-looking data, also taking into account the outcome of the audits that companies are required to make on their claims reserves at the end of every year.

That rule need not be applied to so-called *"current generation"* claims, for which companies may determine the claims reserve using the average cost method (see Article 27, paragraph 5 of ISVAP Regulation 16). Specifically, in this case the company prepares an adequate model for identifying categories of claims that, *"being sufficiently numerous and homogeneous quantitatively and qualitatively, can be valued at average cost"* (Article 28, paragraph 2, ISVAP Regulation 16). Then if a current generation claim does not fit in any of the homogeneous categories identified, the company can proceed according to the inventory method.

Still speaking in general, it should be borne in mind that – for classes characterised by slow settlement processes (such as auto TPL) or in which an analytical valuation does not allow in any case for taking into account all foreseeable future expenses, companies – for purposes of determining the last cost – resort to actuarial statistical methods or to cost trend forecasting valuation systems (see Article 27, paragraph 4 of ISVAP Regulation 16).

Lastly, we note that, pursuant to Article 25 of Regulation 16, companies are to *"verify, for each class, that the claims reserve set aside at the end of the previous year proved adequate during the course of the year to pay claims from previous years and the respective settlement expenses."*

This analysis is a time for verifying the reliability of the claims reserve estimation criteria adopted during the previous year, since it provides information on the savings/loss component deriving from the claims trend. In addition, based on the outcome of such a verification, it can revisit its claims reserve formation and estimation process.

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<sup>2</sup> Article 27, paragraph 1 of ISVAP Regulation 16/08 provides literally that *"Companies must determine the claims reserve based on a separate analytical valuation by the inventory method of the cost of each claim reported not fully paid."*

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The outcome of the valuations made by the company in terms of quantifying the claims reserve are then turned over to an actuary (i.e. Responsible Actuary), whom, pursuant to Article 34 of the Private Insurance Code and Article 50 of ISVAP Regulation 16, the insurance company has the obligation to engage to evaluate the adequacy of the claims reserve prepared.

The law assigns this professional the following tasks on the subject of technical reserves:

- evaluate the adequacy of the reserves at the start of the company's business;
- continually monitor this requirement throughout the life of the company;
- inform the administrative bodies or the general manager any time he believes that the technical reserves are in danger of becoming inadequate;
- prepare a report to be attached to the financial statements which: (i) describes in detail the procedures carried out and the evaluations made, with reference to the technical basis adopted, for the calculation of the technical reserves, with specific evidence of any implied valuations and their respective reasons; (ii) attests to the accuracy of said procedures; (iii) reports on controls carried out regarding the procedures employed for calculating the reserves and for proper recognition of the portfolio, and expresses a judgment finally on the adequacy of all the technical reserves, including any additional reserves, entered on the financial statements.

In addition to the Responsible Actuary, there is the Actuarial Auditor (engaged by the auditor), whose report is attached to the report by the party that has audited the separate financial statements.

After having made these general comments, the Board of Statutory Auditors finds it indispensable to make some comments on the specific characteristics of the three methods described above (the inventory method; the average cost method; and the actuarial statistical method), comments which are useful for a full understanding of the interventions then made by the company on its auto TPL claims reserve at 31 December 2011.

## **2.2 The inventory method**

As mentioned in the previous section, the inventory method consists in the valuation – analytically and separately – of each claim made by examining the documentation on each individual loss adjustment.

This activity – which, as we have seen, is the main criterion for calculating claims reserves – is left up to the settlement network, which network thus represents the first ring in the complex procedure of quantifying the reserve.

Naturally, as is evident, it is a strictly evaluative activity and therefore, given that nature, can be influenced by several factors, including:

- settlement times;

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- the time for the actual severity of the loss to emerge;
- the information available on the valuation date;
- the changes in monetary value which may occur between the valuation date and the settlement date;
- changes in the laws on personal injury valuation tables;
- judgments issued relative to claims in litigation.

The significant degree of uncertainty characteristic of the settlers' valuation activity therefore has prompted backing the inventory method up with additional methods (such as the actuarial statistical method, which will be discussed below), in order to contain the effect of random factors affecting the settlers' valuation.

In accordance with industry regulations, analytical valuations are to be updated each year through a new analytical examination of the files for each claim by the settlement network, which makes a new valuation of the cost foreseen for claims still open, taking into account additional information received in the meantime and all other elements that may in any way affect the valuation.

This activity can lead to a revaluation or a write-down of the claims reserve.

### **2.3 The average cost method**

As already mentioned, the average cost method applies to current generation claims and involves identifying groups of claims that are homogeneous and sufficiently numerous, to which an average cost is applied, as estimated based on the information known at the time of the valuation.

The peculiarity of the average cost method consists of the fact that it applies only to the so-called "current generation," with the result that the claims valued at average cost in a given year will fall into the so-called "previous generation" the next year, when they will be valued by the settlers according to the inventory method and thus based on a method which - using greater information on the characteristics of the individual claim - allows for more accurately estimating the last cost of the reserve claims.

An obvious consequence of this method is that any limits on the benchmark parameters chosen for estimating the average cost, emerging based on new elements arising in successive years and on the corrections used to circumvent any emerging limits, may be used only on the new current generation that has come to be formed, since it, being subject in turn to analysis, as we have seen, has meanwhile become part of the "previous generation claims".



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#### **2.4 Actuarial statistical methods**

These methods are used in addition to the other valuation methods, when the classes involved are characterised, as auto TPL is, by slow settlement processes, in order to attenuate the impact of random factors normally inherent to the other valuation processes.

Actuarial methods are closely correlated with historical series of previous claims parameters available at the time of the valuation and require continual updating, so as to transpose within them any new elements emerging (legislative changes, changes in technical reserve or settlement policies).

For example, one factor strongly affecting the Italian auto TPL market and the historical series used in making the actuarial models was the introduction of direct compensation, which occurred in 2007.

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### **§ 3. THE PROCEDURE ADOPTED BY FONSAI FOR CALCULATING THE AUTO TPL CLAIMS RESERVE**

In accordance with the regulatory provisions mentioned above, Fonsai has adopted a complex multi-phase technical valuation process for claims reserves, a procedure that begins with an initial valuation by the settlement network - through an analytical examination of the individual positions open - which follows the process of determining the last cost, entrusted to the company's managerial departments, which use actuarial statistical methods for that purpose.

It basically involves a standardised procedure, aimed at organising and structuring the information and documentary flows that support the claims inventory and reserve determination process.

As noted by Fonsai in the Notes to the Annual Financial Report for the year ending on 31 December 2011, dated 19 April 2012, in recent years (in an unchanging manner) the claims inventory operation by the Claims Division is carried out starting at the beginning of the second half of the year. The procedure's start is preceded by specific notices containing the guidelines, the timing and the instructions given to the IT department for extracting the inventory forms. In general:

- for Previous Years, the forms concern all claims, falling under the responsibility of the Claims Division, opened at the time of starting the inventory regardless of class or type of loss. All claims open are therefore inventoried at the time when the inventory session is started;
- for the Current Year, the forms concern only some types of loss, falling under the responsibility of the Claims Division, relative to those claims open at the time of starting the inventory, but reported by 30 September.

Very succinctly, within the pre-defined time frame, the settlers review the residual technical reserves for each claim, based on their expectation of the settlement cost. This activity is then verified by the Central Claims Office also through spot-checks.

Next, the company's business units determine the last cost of each claim by applying actuarial statistical models or future claim cost trend development valuation systems. This multi-phase process for determining the auto TPL claims reserve is fed by multiple concomitant parameters and variables, including: the settlement network's initial valuation; the settlement network's subsequent valuation; the average cost of the amount paid per closed claim; the portion of claims closed without follow-up and claims reopened; the size of the initial reserve; case law guidelines on the subject of compensation for loss; the rate of inflation; and the different weight attributed to the actuarial statistical methods by industry practice.

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As already explained in the previous paragraph, this procedure does not apply to current generation claims, for which the valuation is made instead using the different criterion set by Article 28 of ISVAP Regulation 16.

The claims reserve determined by the company is then submitted to the Responsible Actuary, who - based on the information received - prepares his own actuarial statistical model and in turn simulates the value of the claims reserve at last cost. The Responsible Actuary therefore evaluates the adequacy of the claims reserve proposed by the company and expresses his opinion in the Final Report, which is attached to the separate financial statements.

It is to be considered finally that the correctness of the methodologies and the valuations made is then verified by the Actuarial Auditor, whose summary valuation is attached to the report by the audit firm called upon to certify the separate financial statements, while the analytical findings are sent separately to the Oversight Institution.

In sum, as provided for in ISVAP Regulation 16, with reference to the auto TPL claims reserves, the company uses the inventory method and the actuarial statistical method for previous generations and the average cost method for current generation claims.

\*

In 2011, the company made a series of interventions on its auto TPL claims reserve formation procedure, as a result of an inspection begun by ISVAP during 2011 and the outcome of which was reported on 29 September 2011<sup>3</sup>. In a letter dated 6 December 2011, Fonsai provided the Oversight Institution with the explanations and justifications requested, but nevertheless decided to take into account some of the observations by ISVAP, starting actions by the end of 2011 aimed at satisfying the Institution's requests.

In the document "*Supplement to the Report by the Statutory Auditors to the Shareholders' Meeting on the results of the financial statements of Fondiaria-Sai Spa ending on 31 December 2011 and on the activities carried out*", dated 18 April 2012 and published the following 19 April, the company Board of Statutory Auditors then in office provided a summary - in point 7 - of the observations notified to it by ISVAP on 29 September 2011 and the corrective measures adopted by Fonsai.

These elements were disclosed in detail by Fonsai as well in the Notes to the Annual Financial Report dated 19 April 2012, which the company made public on the same date<sup>4</sup>, mentioning the dysfunctions and irregularities noted by ISVAP and with respect to which the company provided specific evidence and reasons. In the same document furthermore, Fonsai expressed its willingness and intention (implemented on that date or in progress) to:

- intervene strengthening and intensifying the Claims Division's oversight of the network's operations;

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<sup>3</sup> For the sake of completeness, we note that on 3 April 2012, ISVAP served a notice of objection on the company, against which Fonsai has prepared articulate counterclaims, deeming the violations detected by the Oversight Institution as basically non-existent.

<sup>4</sup> See the press release of 19 April and the Notes published on the same date.

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- prepare a control model included in a special organisational procedure focused on all cases of operating deficiencies flagged by ISVAP;
- define an operations manual (published meanwhile) with all the provisions issued in relation to the different phases of the claims cycle;
- extend the inventory period dedicated to analytical review of the amounts put on reserve for each claim in previous years, from the beginning of July to the whole month of November (and not instead until mid-October, as happened previously);
- perform interventions as well on the information system in order to better oversee the settlers' valuation activity;
- prepare a new table for purposes of determining average cost values with greater accuracy and precision.

It should be borne in mind that the interventions implemented or planned by Fonsai in relation to the observations made by ISVAP have been entrusted to a special department, started in December 2011, which reports periodically on the subject to the company's Internal Control Committee.

During the Shareholders' Meeting on 24 April 2012, the company's chief executive officer, in responding to a question from shareholder Finleonardo, then noted that in March 2011 Fonsai had already implemented some organisational changes in the claims area, deeming it advisable to subject more complex claims to centralised oversight.

Thus the Headquarters Technical Department was created, which is assigned fatal claims, claims valued in excess of EUR 300 thousand for auto TPL and EUR 100 thousand for non-auto claims, as well as all court litigation cases dating from at least 10 years ago.

#### **§ 4. THE REVALUATION OF THE AUTO TPL CLAIMS RESERVE MADE IN 2011**

With respect to the auto TPL claims reserve, Finleonardo has asked the Board of Statutory Auditors to verify the "*size of the individual components leading the Board of Directors to revalue that claims reserve by EUR 800 million*". Finleonardo adds that such components (as identified by the Board of Directors) would include:

- irregularities and dysfunctions deriving from the lack of formalised procedures and adequate control systems;
- the settlement network's inventory;
- adjustment of the actuarial models;
- adjustment of the dominant case law.

Finleonardo has also asked for evidence of the "*portion of the said revaluation ascribable to the 2011 claims reserves and the portion relative to previous periods*".

Before going into the merits of the question posed by the shareholder, some remarks are necessary for understanding what the Board of Statutory Auditors has been able to ascertain. Firstly, it should be borne in mind that the revaluation issue mentioned by shareholder Finleonardo refers not only to Fonsai, but also to the subsidiaries Milano Assicurazioni Spa and other small companies in the Group.

Secondly, we note that the revaluation of the residual load of the claims reserves is not a separate item on the financial statements, but is one of the components of the cost of previous generation claims.

In general, the revaluation of the residual load (understood as the residual amount of the claims reserve set aside in previous years net of the payments made) represents a recurring physical operation made annually in order to be able to transpose the deviation between the forecasts made the year before and budget data for the next year.

In particular, it has already been seen, pursuant to Article 25 of Regulation 16, that companies are required to verify, for each class, that the claims reserve set aside at the end of the previous year has proven sufficient during the year to pay claims from previous years and the respective settlement expenses. Each year insurance companies accordingly ascertain the so-called "cost of previous generation claims," which – as reported by the business units to the Board of Statutory Auditors – is in practice the result of the algebraic sum of the different items identified at the time when the size of the claims reserve for the previous year is verified.

Starting in fact from the initial reserve set aside, several factors are taken into account, such as: the cost paid, the trend with claims without follow-up and claims reopened; and the estimate of late claims. The revaluation of the residual load is therefore only one of the components of the cost of claims.

Thirdly, in light of what was just stated, it should be considered that the revaluation, by its nature, involves the valuations made in previous years, since – as seen in the previous pages – for "current generation" claims (i.e. claims in the year to which the separate financial statements refer), the valuation is made according to the average cost method.

As also described above, these claims – the next year – are examined in detail according to the inventory method and the respective reserve may be revalued at that time based on the analytical valuation made by the business unit in charge.

##### **4.1 Organisational interventions, changes in case law and their impact on the inventory method.**

Having clarified this by way of introduction, we can examine the circumstances indicated by the Board of Directors as the underlying reasons for the revaluation of the 2011 auto TPL claims reserve and indicate the respective size, as it appears on the separate financial statements.

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During the Shareholders' Meeting on 24 April 2012, the chief executive officer noted that "the revaluation of the 2011 Auto TPL reserves is the result of a significant revaluation of the inventory reserve by the network of claims settlers itself, as a result of a series of regulatory and case law updates, in addition to organisational changes".

In other words, according to Fonsai, the revaluation resulted significantly from the application of the inventory method by the network of settlers, whose judgments were inevitably affected both by trends in case law and organisational changes.

From the first standpoint, express reference was made to a decision by the Court of Cassation which, in providing for recourse to the compensation quantification tables adopted by the Court of Milan, modified the settlement network's valuation parameters; from the second standpoint, mention was made at the Shareholders' Meeting of "the institution of the headquarters technical department that is in charge of fatal claims, those with a higher value and claims in litigation".

Both these factors thus apparently influence the valuations resulting from the inventory made by the settlers' network.

In particular, the Court of Cassation, in decision No. 12408 of 25 February 2011, published however on 7 June 2011, ruled on the legal principle that "since fairness is also understood as equal treatment, settlement of non-pecuniary loss to the person for an injury to psycho-physical integrity presupposes the adoption by all judges on first instance of uniform valuation parameters which, in the absence of regulatory provisions ... are identified in those tables prepared at the Court of Milan, to be modulated according to the circumstances of the specific case".

In other words, the decision in question established that the reference values adopted by the Court of Milan constitute the so-called "fair value," the one, in other words, that is able to ensure equal treatment and that is to be applied in all cases in which the circumstances of the specific case do not lend themselves to increasing or reducing the amount.

Extending the tables in question to all of Italy would have implied the adoption – by the settlers – of different valuation criteria for injuries exceeding 9% permanent disability and fatal injuries, with the consequent revaluation of previous claims<sup>5</sup>.

From the second standpoint, the company mentioned the institution in spring 2011 of the Headquarters Technical Department, called upon – in the settlers' stead – to examine the most serious claims.

This entailed a re-examination during 2011 of the most serious cases and a new technical valuation of losses more in line with the parameters of the Court of Milan tables.

Added to the creation of the Headquarters Technical Department then were the interventions (listed in summary form in the previous section) that Fonsai adopted as a result of the observations made by the ISVAP as a result of the abovementioned inspection and which also had an influence – to an extent which the business units have said is impossible to quantify, however, since the claims subsystem does not distinguish the cause

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<sup>5</sup> We note in particular that in the Notes to the Annual Financial Report of 19 April 2012 that the company made public on the same date, Fonsai stated that "with the extension of the use of the non-pecuniary loss settlement tables (so-called Court of Milan Tables). These tables, issued in the first half of 2009, led during 2010 and 2011 to a progressive adjustment of reference average values with regard to fatal claims. The Milan Tables, introduced in June 2009, provide for new parameters for the economic valuation of losses with injuries exceeding 9% Permanent Disability and fatal injuries: the impact of the possible application of these tables to the entire portfolio was estimated in 2010 as amounting to an overall Auto TPL claims reserve revaluation of around 14%. In 2010, the two units most affected by the criteria described above, the Serious Loss Professionals and the Litigation Professionals, went further with the analysis by analysing the individual forms in their claims portfolio to be inventoried (for the areas where the tables were applied), for purposes of simulating the impact on the revaluation of the reserves by the estimate of these losses if the application of the more burdensome valuations provided for by the Milan Tables were taken into account: following this review, an initial adjustment was made to the sums put on reserve. This revaluation process was brought to completion, however, only with the inventory of the following year, as a result of the Cassation decision of June 2011 adopting the Court of Milan Tables as the criteria of reference for fair valuation of compensation, extended at this point to all of Italy".

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of the revaluation – on the overall revaluation of the previous generation claims reserve made by the settlement network in execution of the inventory method.

According to what can be inferred from the financial statements at 31 December 2011 and according to what has been confirmed to the Board of Statutory Auditors by the business units, the revaluation by the settlers of the residual reserve on the financial statements was EUR 341 million for Fonsai and EUR 94 million for Milano Assicurazioni (for a total of EUR 435 million).

#### **4.2 The adjustment of actuarial statistical models**

As already mentioned in the previous sections, for purposes of defining the claims reserve for the auto TPL class to be set aside on the financial statements, the company backs the inventory method up with actuarial statistical methods.

During the Shareholders' Meeting on 19 March 2012, the chief executive officer clarified that the revaluation of the auto TPL claims reserve was the result also of the *"Company's utilisation of a different actuarial model as a backup to the inventory process for the valuation of the last cost"*, in light also of the fact that – according to the argument stated by ISVAP – actuarial statistical models must *"... be more specific with claims portfolio situations"*.

In particular, in the notice of observations dated 29 September 2011, ISVAP focused on some assumptions made by the company, deeming them imprudent. These observations, although deemed disputable by Fonsai, led the company to be more careful and prudent in the choice of parameters.

As is evident from the Notes to the Annual Financial Report dated 19 April 2012, which the company made public on the same date (and to which we refer for a more detailed description of the interventions made by Fonsai), in 2011, among other things, a more careful and weighted choice of actuarial statistical models was made, standardising the same approach both for Fonsai and for Milano Assicurazioni Spa. More specifically, the Fischer Lange (weighted at 35%) and Chain Ladder Paid (weighted at 65%) models were applied.

In addition, a careful choice was made also of the benchmark data base and of the data base for selecting the parameters used within the models, beginning – precisely from the 2011 financial statements – to estimate the claims reserve separately for ordinary TPL claims (i.e. those occurring until 2006), for No CARD claims and for CARD Handler claims (after 2007), deeming that, in the fifth year since the start of direct compensation, an adequate level of maturity has been reached with these historical series.

It should be considered that in 2007, the introduction of the so-called Direct Compensation system caused a strong break with the past, not just in terms of historical series of statistical parameters, but also in the type of claims managed by the company. In fact, while before the company had to value and liquidate the claims caused by its policyholders, since 2007 it has also had to handle the claims suffered by its customers.

In his actuarial report of 2 March 2012 and relative to the financial statements of Fonsai at 31 December 2011, the Responsible Actuary described the technical reserve calculation methods adopted by the company, noting that *"This process, which in its main steps is unchanged from the previous year, provided for substantial re-visitation with the objective of overcoming the irregularities noted by ISVAP in the notice of observations in terms of:*

- *operating methods for claims accounting and the formation of reserves by the network;*
- *criteria and procedures for determining reserves at last cost"*.

Specifically, the actuary noted that: *"the company has made every effort to define a new procedure for determining the claims reserve at last cost, which provides for the implementation of methods taking into account both managed and economic costs.*

*In particular, after having mapped the actuarial models, it proceeded to:*

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- *choose which of these is most consonant with the company's situation;*
- *remodel it to also take into account the current market situation (separation between types of business), paying special attention to the selection of parameters".*

On pages 8 et seq. of the said report, the Responsible Actuary includes a summary of the methods adopted.

According to what appears in the financial statements at 31 December 2011 and as confirmed to the Board of Statutory Auditors by the business units, the weight of the adoption of these different actuarial statistical assumptions on the revaluation of the claims reserve in 2011 amounted to EUR 135 million for Fonsai and EUR 214 million for Milano Assicurazioni, for a total of another EUR 349 million.



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It is to be considered that the phenomena described in this section and in section 4.1 above have had a combined impact for the Group's smaller companies of another EUR 26 million.

Therefore, indicating to shareholder Finleonardo the "*size of the individual components leading the Board of Directors to revalue that claims reserve by EUR 800 million*", it is noted that the amount of EUR 810 million, the subject of the revaluation of the claims reserve of the Auto TPL class made by the company on the 2011 financial statements with reference to previous generation claims, is provided by the sum of the following factors:

- EUR 435 million overall, of which EUR 341 million for Fonsai and EUR 94 million for Milano Assicurazioni, as the effect of the revaluation of the residual reserve on the financial statements by the settlers;
- EUR 349 million overall, of which EUR 135 million for Fonsai and EUR 214 million for Milano Assicurazioni, as the effect of the implementation of the new actuarial statistical methods;
- EUR 26 million overall, as the combined effect of the above two phenomena for the Group's smaller companies.

With specific reference then to Fonsai and Milano Assicurazioni Spa, we note that the adequacy of the auto TPL claims reserve has been certified by the Responsible Actuary, who stated in his report that he deemed this amount: "*adequate overall for meeting commitments deriving from insurance policies in accordance with current legal and regulatory provisions and other provisions issued on the subject*".

This adequacy was further confirmed by the Actuarial Auditors.

We note lastly that in a letter dated 20 June 2011, the Consob questioned the "*Auto TPL Class claims reserve accounting method*," with the possibility of non-compliance by the consolidated financial statements of Fonsai at 31 December 2011 with the provisions of Article 154 ter TUF (Consolidated Finance Act).

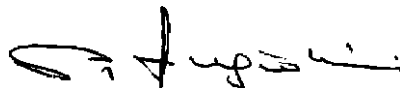
The chief executive officer has indicated that a report will be provided to the shareholders on this notice at the Shareholders' Meeting.

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Attachments: 1) copy of complaint pursuant to Article 2408 of the Civil Code sent by shareholder Finleonardo.

Milan, 25 June 2012

For the Board of Statutory Auditors of  
Fondiarria Sai Spa  
The Chairman, Dr. Giuseppe Angiolini



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## FINLEONARDO S.p.A.

VIA CAPPUCCINI, 2 - 20122 MILAN  
VIA VITTORIO VENETO, 96 - 00187 ROME  
REA INDEX NO 1210556 - SHARE CAPITAL €10,000,000  
(FULLY PAID-UP).  
VAT NO AND TAX CODE 08233100158  
TEL. +39 06 42016165 - FAX +39 06 42016005 EMAIL:  
[segreteria@finleonardo.it](mailto:segreteria@finleonardo.it)

Rome, 22/5/2012

**FONDIARIA SAI Spa**  
Corso Galileo Galilei, 12  
10126 Turin

**Attn. Mr Giuseppe Angiolini, Chairman**

**Attn. Mr Antonino D'Ambrosio, Standing Auditor**

**Attn. Mr Giorgio Loli, Standing Auditor**

Registered letter with advice of receipt, forwarded in advance via email to [fondiarai-sai@fondiarai-sai.it](mailto:fondiarai-sai@fondiarai-sai.it)

**Re.: Memorandum pursuant to Article 2408 of the Italian Civil Code – Omitted information on the actual risks underlying the capital increase approved on 14 May 2011 – Undervaluation of technical reserves to cover auto TPL claims.**

Dear Sirs,

Further to our previous letters of 16 March, 23 March and 19 April of this year – all of which remain without response – we are writing pursuant to and in accordance with Article 2408 of the Civil Code to raise the following issues.

As you know, on 14 July 2011 our company subscribed part of the €450 million capital increase approved by the Board of Directors of Fondiaria SAI S.p.A. on 14 May 2011, in accordance with the mandate granted by the Extraordinary Shareholders' Meeting of 26 January 2011.

As a result, we now hold 1.5 million new shares in the company. This means that we are entitled to assert all rights inherent to minority shareholders of joint stock companies, including the right to report any objectionable actions of the company to the Board of Statutory Auditors, in accordance with Article 2408 paragraph 1 of the Civil Code.

We would like to point out, in this regard, that between the amounts paid to subscribe the capital increase – €2,250,000 – and to acquire the related option rights – €1,256,452 – our investment stands at a total of €3,506,452.

We were led to make this investment based on: the contents of the report to shareholders by Fondiaria SAI's Board of Directors on the aforesaid resolution of 14 May 2011; the information that was available and set out in the 2010 financial statements; and the risk exposures described in the prospectuses distributed to the market in relation to the capital increase.

The most prominent point made in these documents was the certainty that the capital increase would easily be sufficient to give the company the necessary liquidity to definitively rebalance its solvency ratios, and hence to definitively re-launch the company in economic and financial terms.

On this issue, Article 94 paragraph 2 of the TUF (Consolidated Finance Act) clearly states that: "*The prospectus shall contain the information that, depending on the characteristics of the financial products and the issuer, is necessary for investors to make an informed assessment of the issuer's assets and liabilities, profits and losses, financial position and prospects and of the financial products and related rights.*"

However, in the Shareholders' Meeting held on 19 March 2012 – and therefore only a few months after the previous capital increase – our company witnessed the approval of another, wholly unexpected capital increase of €1,100 million. The purpose of this was once again to shore up solvency indices and, as far as we could make out,

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was caused mostly (€800 million) by the need to provide greater coverage for previous years' auto TPL claims reserves.

According to the Directors' Report for 2011, this capital increase is justified in order *"to strengthen the capital base of the Fondiaria SAI insurance group (the "Group"), in light of the recent results within the overall difficult conditions in the insurance and financial market. It is aimed – in conjunction with other initiatives – at increasing the consolidated solvency margin to the level indicated in the Risk Tolerance objectives set by the Board of Directors (120%)."*

*During its meeting of 29 January 2012 – the date of the present report – the Board of Directors of the Company revised these estimated preliminary results to an expected post-tax loss of €1,105 million and, bearing this in mind, an estimated solvency ratio of approximately 75%.*

*Despite the strong current operating performance in the final part of 2011, confirming the trend established earlier in the year, the updated forecasts stem primarily from non-recurring items – principally: adjustments of the Auto TPL claims reserves of approx. €790 million related to the combined effect of two factors: (i) updating the figures for the last financial year (December 2011); and (ii) the completion of processes for refining the actuarial statistical model based on the principal parameters of the claims portfolio historical data. This non-recurring effect is at least partly offset by: - the further improvement of the technical performance in December 2011 following a further reduction in the auto TPL claims frequency; - adjustments to the value of the "for-sale" equities portfolio and the bond portfolio (exclusively comprising Greek government bonds) totalling approx. €350 million; property write-downs for a total of approx. €310 million following the Group property valuations in light of the new surveys carried out; - goodwill write-down estimated at approx. €120 million."*

During the Extraordinary Shareholders' Meeting of 19 March 2012 and in our letter of 19 April 2012, we asked the management bodies and this Board of Statutory Auditors to clarify why the likelihood of such a sizable – not to mention additional – revaluation of the technical reserves to cover auto TPL claims (in which the company had already intervened heavily in the 2010 financial statements with an adjustment exceeding €600 million) was not set out as a risk factor in the aforementioned prospectus. It now seems, by contrast, that this revaluation was the main cause of the loss made by the company in 2011 and the consequent need to increase share capital once again.

We also asked – in the Shareholders' Meeting and in our letter – for clarifications on the correctness of the company's valuations when determining the capital reserve to cover auto TPL claims in earlier years.

If it transpires that the company was aware of the inadequacy of the revaluations of the technical reserve for auto TPL claims carried out in previous years as far back as when it was preparing the 2010 financial statements – and then in the periodic and repeated communications to the market and to shareholders – then it is totally self-evident that such information should not have been left unsaid. Rather, it ought to have been disclosed in order to allow investors to properly evaluate the company's circumstances and hence thoroughly assess whether or not it is worth investing in the company and to what extent.

As it stands, we believe that we have not yet received a clear, proper and thorough response to our request for clarifications from you – the body charged with checking the information provided to the market by the Board of Directors – or from Fondiaria SAI's management bodies, whom we also contacted before sending this letter.

During the Shareholders' Meeting of 19 March 2012, the company's CEO merely referred to a judgment of the Italian Supreme Court of Cassation, extending the tables implemented by the Court of Milan for the payments of auto claims to the whole of Italy. He did not, however, report on the content or details of this judgment, nor explain why the Board of Directors had not effected such a revaluation already. Above all, the CEO made no mention of our requests for clarifications on the correctness of the valuations of such reserves when approving previous financial statements.

While your report accompanying the approval of the 2011 financial statements only mentions that *the company's financial statements as at 31.12.2011 close with a loss of €1,020,400,000 and that the causes of this extremely bad result are mainly due to extraordinary events such as bolstering auto TLP reserves for previous years*, this Board of Statutory Auditors failed, once again, to describe the steps taken to verify the correctness of the company's previous valuations of these reserves.

The report mentions that you checked the correctness of the criteria used to calculate these reserves but does not expand on any checks you made on whether the criteria used in previous years were correct, as would have been expected given the extent of the 2011 revaluation.

Frankly, increasing auto claims reserves by €800 million cannot be explained in a few lines of text and a casual reference to applying the claims tables of the Court of Milan to the whole of Italy, much less by simply referring to the need to bolster these reserves without even checking whether they had been calculated correctly in the past or

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whether the company already needed to carry out such a revaluation even earlier. Bearing this in mind, we note that even up to 30 August 2011 Mr Erbetta and Mr Peluso said in interviews that FY 2011 would end with €50 million in profit. This all changed in the statements made in December 2011, when a huge loss of €750 million was forecast, before being revised down again in early 2012 to a loss of €1,100 million.

Regarding the claims reserves, it is quite astonishing that even though the company's CEO had to have noted the major impacts on previous years brought about by the courts' now widespread practice of applying the Court of Milan's tables, he was unable to explain why the administrative bodies had not already increased these reserves in previous years.

What is even more astonishing is that the notes to the 2010 Financial Statements already highlighted that *"the increasingly widespread use of the new physical injury compensation tables, originally adopted by the Court of Milan, will result in an increase in the average claims paid and require a particularly prudent reserve policy"*. Therefore, either:

(i) the Board of Directors acted imprudently at the approval of the 2010 financial statements (and even in the previous years) in assessing whether the technical reserves were adequate – initially not increasing them and then limiting itself to increasing them by (just) €600 million – when it ought to have increased them much more substantially. In this case it is clear that those responsible for underestimating these reserves must be made personally accountable for the loss caused to our company by the devaluation of our stake caused by the new capital increase decision; or

(ii) the revaluation required with this new capital increase was caused by new factors, that could not have been known when the 2010 financial statements were approved or at the time when the repeated communications to the market were made after the financial statements had been approved. However, in this case, the explanations we have had so far are utterly inadequate because none of the letters from Mr Erbetta sent to us in reply, nor your reports or those of the Board of Directors, make clear what these factors were, since the generic explanations such as the inefficient inventory and claims management system do not add up to the individual factors that could have been known or were knowable when the 2010 financial statements were being prepared or the capital increase that we subscribed was approved.

\* \*\*

Bearing in mind the foregoing, we ask this Board of Statutory Auditors to move speedily, given the seriousness of the current situation, to investigate as necessary. We ask the Board of Statutory Auditors to:

a) assess the importance of the individual factors that led the Board of Directors to revalue the auto TPL claims reserve by €800 million, namely – bearing in mind the statements of the Board of Directors: irregularities and failings deriving from the absence of formalised and adequate control systems; the settlement network's inventory; observations in the calculations of the actuarial models and adjustment thereof; compliance with the dominant case law, all through annual training classes, showing the portion of the revaluation that is attributable to the revaluation of reserves for 2011 claims and those relative to previous years;

b) verify whether the information that the Board of Directors had when preparing the financial statements for 2010 and previous years – and all notices and prospectuses sent out to the market and shareholders prior to, concurrently with, or after the approval and execution of last year's capital increase – were not sufficient to oblige the Board of Directors to inform shareholders and the market of the need for a more suitable revaluation of auto TPL reserves in each of these documents;

c) conclude whether the 2010 financial statements, the quarterly reports thereafter, the prospectus accompanying the approval of last year's capital increase and the successive periodic market and shareholder communications truthfully represent the company's actual circumstances throughout 2011;

d) check whether the information contained in each of these documents sent to the market and to shareholders by the Board of Directors was correct;

e) report on what action it will take in relation to the checks described above, not only to us but to all shareholders, bearing this letter in mind during the next Shareholders' Meeting, as required by Article 2408 of the Civil Code.

Yours faithfully,

  
Finleonardo SpA