Mediolanum Group - European Embedded Value 2005

Supplementary information

INTRODUCTION

In May 2004, the CFO Forum, a group then representing the Chief Financial Officers of 19 major European insurance groups published the European Embedded Value ("EEV") Principles with the aim of improving the transparency and consistency of embedded value reporting. Mediolanum is adopting the EEV Principles with the publication of its results for the financial year ending 31 December 2005, including a restatement of its 2004 values.

An embedded value is an actuarially determined estimate of the value of a company, excluding any value attributable to future new business. Embedded value is defined as the sum of shareholders' net assets, valuing assets at market value, and the value of in-force business. The value of in-force life business is the present value of the stream of future after-tax statutory profits that are expected to be generated from all the existing policies at the valuation date, adjusted for the cost of maintaining a level of required capital. The value of in-force asset management (mutual funds, real estate funds and managed accounts) business is calculated in a similar way to the value of in-force life business.

In order to provide more complete information, the embedded values now consolidate the value of life and asset management business distributed via Fibanc in Spain, and similar information is also provided on the most significant parts of the Italian banking business, namely current account, deposit account and mortgage business.

Mediolanum has worked closely with consulting actuaries Tillinghast to develop appropriate methodology and Tillinghast has continued to calculate the embedded value of the Group at December 31, 2005.

Mediolanum has chosen to adopt an approach which maintains consistency with the embedded value reporting which has been a characteristic of the Group's transparent reporting since 1994. The value of in-force business continues to represent the discounted value of a stream of best estimate profits adjusted for the cost of holding a certain level of capital. The key differences between Traditional Embedded Value ("TEV") reporting used in prior reporting years and EEV reporting are in the determination of the level of required capital, and in the allowance for risk, which uses a framework based on market-consistent methodology, from which equivalent risk discount rates are derived.

In calculating the embedded value of the Group, numerous assumptions (some of which are shown below) are required concerning the Mediolanum Group's lines of business with respect to industry performance, business and economic conditions and other factors, many of which are outside the group's control. Although the assumptions used represent estimates that Tillinghast and the Mediolanum Group believe are appropriate for the purpose of embedded value reporting, future operating conditions may differ, perhaps significantly, from those assumed in the calculation of the embedded value. Consequently, the

inclusion of embedded value herein should not be regarded as a statement by the Mediolanum Group, Tillinghast or any other entity, that the stream of future after-tax profits discounted to produce the embedded value will be achieved.

EMBEDDED VALUE

The following table shows the embedded values as at December 31, 2005 and 2004 determined under the EEV Principles, together with the published value for 2004 developed using the traditional methodology.

Embedded value at December, 31

Euro millions	**2004 (TEV)**	**2004 (EEV)**	**2005 (EEV)**
published shareholders' net assets [1]		662	808
adjustments to net assets		(161)	(160)
Adjusted shareholders' net assets [2]	518	501	648
value of in-force life business [3]	1,477	1,552	1,793
value of in-force asset management [3]	359	368	410
value of in-force banking business [4]		72	100
Value of in-force business	1,836	1,992	2,303
EMBEDDED VALUE	2,354	2,493	2,951

[1] determined on an IFRS basis
[2] after elimination of goodwill
[3] includes values for Spain consolidated for the first time under EEV
[4] valued for the first time under EEV

Shareholders' net assets shown above are equal to the consolidated net assets of the Group, determined on an IFRS basis, before the distribution of dividends payable in the following year. Adjustments are required primarily to reflect the after-tax impact of (i) marking to market value any assets not considered on a market value under IFRS, (ii) the elimination of goodwill, primarily those related to the acquisitions of Fibanc, Gamax, B.A. Lenz and MILL in prior periods, (iii) the exclusion of the accounting items relating to unrealised gains in the life segregated funds, whose projected emergence over time is included in the value of the in-force life insurance business, (iv) the reversal of accounting items related to life insurance products classified under IAS 39 for which the value of in-force business is determined using the statutory profits, and (v) the impact of the taxation of life reserves.

To calculate the values shown above, projected future after-tax profits were discounted at 6.60% for the traditional valuation as at December 31, 2004. The discount rates used under the EEV methodology vary between lines of business, since they reflect, using the methodology outlined later in this document, the risk profile of the underlying business. The average discount rates, weighted by value of in-force business are 6.27% and 5.80% as at December 31 2004 and 2005 respectively.

Impact of first-time adoption of EEV Principles

The impact of first time adoption of the EEV Principles at December 31, 2004 is an increase in embedded value of 139 million Euro, of which 72 million Euro relates to the inclusion for the first time of the value of in-force banking business, and 19 million Euro for the consolidation of the Spanish life and asset management business. The remaining increase of 48 million Euro is primarily due to the revised allowance for risk, particularly in the unit-linked life insurance business, offset by certain elements arising from the conversion to IFRS of the adjusted net assets.

Sensitivity to the risk discount rate

The discount rate appropriate for any shareholder or investor will depend on his or her specific requirements, tax position and perception of the risks associated with the realisation of future profits. To allow potential investors to analyse the effect of using various discount rates to reflect differing views on risk, the embedded value for the Group as at December 31, 2005 was calculated at discount rates respectively 1% higher and lower than the central rates. All other assumptions, in particular inflation rates and investment returns, were kept unchanged when calculating the values at alternative discount rates. Further sensitivity tests are shown later in this document.

Analysis of the sensitivity to the discount rate of embedded value at December 31, 2005
Euro millions

Discount rate	-1%	central	+1%
Adjusted shareholders' net assets	648	648	648
value of in-force life business	1,975	1,793	1,635
value of in-force asset management	430	410	392
value of in-force banking business	106	100	95
Value of in-force business	2,511	2,303	2,122
EMBEDDED VALUE	3,159	2,951	2,770

EMBEDDED VALUE EARNINGS

Embedded value earnings, which are defined as the change in embedded value for the year, adjusted for the payment of dividends and other capital movements, provide a measure of performance during the year. The following table shows the embedded value earnings of the Mediolanum Group in 2005, using the restated opening value. For comparison purposes, published embedded value earnings for 2004, based on the traditional reporting basis, are also shown.

Embedded value earnings for the year
Euro millions

	2004 (TEV)	2005 (EEV)
Change in embedded value for the year	325	458
Dividends paid or accrued	80	163
Other capital movements		(7)
EMBEDDED VALUE EARNINGS	405	614

Embedded value earnings for the year consist of the following components:

- The expected return on embedded value at the start of the year ("expected return"), equal to the after-tax investment return assumed at the start of the year on shareholders' net assets less solvency capital, plus a return at the discount rate on the sum of in-force business and solvency capital at the start of the year.
- Variances during the year ("experience variances"), caused by differences between the actual experience of the year and the assumptions used to calculate the embedded value at the start of the year, before the impact of new sales during the year.
- The impact of changes in assumptions at the end of the year for operating experience, excluding economic or fiscal assumptions ("operating assumption changes").
- Changes in assumptions regarding future experience used to calculate the value of in-force business at the end of the year relating to economic conditions ("economic assumption changes"), including the discount rate and investment returns.
- The effect in 2004 of the change in the taxation of life insurance reserves introduced by Law Decree 168/2004 ("tax assumption changes").
- The "value added by new business", initially calculated at the moment of sale using year-end assumptions, and then capitalised at the discount rate to the end of the year.
- The effect due to the elimination of the additional goodwill associated with the increase in the interests held in Fibanc during 2004.

The following table shows the components of the embedded value earnings of the Mediolanum Group in 2005. For comparison, the table also shows published embedded value earnings for 2004, based on the traditional methodology.

Components of embedded value earnings

Euro millions	**2004 (TEV)**	**2005 (EEV)**
Expected return	132	143
Experience variances	106	259
Operating assumption changes	(10)	(43)
Economic assumption changes	38	31
Tax assumption changes	(5)	-
EARNINGS ON INITIAL EMBEDDED VALUE	261	390
New life business	151	162
New asset management business	25	52
New banking business	-	10
VALUE ADDED BY NEW BUSINESS	176	224
EARNINGS BEFORE PURCHASE AND SALES	437	614
Effect of purchases and sales in the year	(32)	-
EMBEDDED VALUE EARNINGS	405	614

Description of key embedded value elements for 2005
Experience variances gave rise to an increase in the embedded value earnings for the year of 259 million Euro. The most important variances were 213 million Euro associated with the higher investment performance of unit-linked funds and asset management business compared to the assumptions used at the start of the year, as well as of the shareholding in Mediobanca, and significantly higher performance commissions than those assumed, particularly on Irish funds (102 million Euro), as well as improved business mix in the banking business (10 million Euro). Counterbalancing these positive effects were higher expenses in all lines of business (28 million Euro, of which 23 million Euro were related to expenses considered as extraordinary or to development costs), lower persistency that expected, particularly in the managed account business, and to a lesser extent life business (28 million Euro in total) and a restructuring of the internal rebates between Ireland and Italy (20 million Euro). The remaining effects comprise a series of smaller positive and negative items.

Changes in operating assumptions which generated a decrease in embedded value earnings of 43 million Euro, are mainly due to an increase in projected expenses on all lines of business.

The positive impact of changes to economic assumptions (approximately 31 million Euro) is due to the combined effect of the reduction in the discount rate and in the projected rates of investment return.

The value added by new life business was 162 million Euro of which 8 million Euro related to business distributed by Fibanc in Spain included in the consolidated results for the first time in 2005.

The value added by new asset management business of 52 million Euro was almost entirely related to Italian business and reflects higher new business volumes compared to 2004 and in particular the strong performance of the new products Portfolio and Real Estate.

New banking business, included in the consolidated results for the first time in 2005 added 10 million Euro, with a similar contribution from current account business and mortgages.

VALUE OF NEW BUSINESS

New business comprises new life insurance policies sold during the year, excluding those resulting from the transformation or switch of existing policies, together with discretionary increases in the level of regular premiums on existing policies. New asset management business is defined as the sum of retail gross inflows net of internal switches within the mutual funds and managed accounts. New banking business comprises the new money collected in the year relating to current accounts and deposit accounts opened in the year and the volume of new mortgages issued.

The value of new business has been determined at the moment of sale using the end-year economic and operating assumptions. The following table shows the value added by new business in 2005 and 2004 determined under the EEV Principles, together with the corresponding values for 2004 developed using the traditional methodology.

Value of new business at moment of sale

Euro millions	2004 (TEV)	2004 (EEV)	2005 (EEV)
Unit-linked life business [1]	122	130	133
Index-linked life business [2]	24	25	25
Asset management business [3]	24	23	50
Banking business [4]			10
VALUE OF NEW BUSINESS	170	178	218

[1] of which Spain 4 million Euro consolidated for the first time under EEV 2005
[2] of which Spain 4 million Euro consolidated for the first time under EEV 2005
[3] of which Spain 1 million Euro consolidated for the first time under EEV 2005
[4] valued for the first time under EEV

To calculate the values shown above, projected future after-tax profits were discounted at 6.60% for the traditional valuation as at December 31, 2004. The discount rates used under the EEV methodology vary between lines of business, since they reflect, using the methodology outlined later in this document, the risk profile of the underlying business. The average risk profile of the new business was similar to that of the in-force business and so the same discount rates were used, namely 5.65% for life business (6,15% in 2004), 6.50% for asset management business (6.80% in 2004) and 5.60% for banking business, giving an average, weighted by new business value of 5.85% in 2005.

In order to evaluate the effect of alternative discount rates on new business, the value of 2005 new business was calculated using discount rates 1% lower and higher than the central rates. In calculating these values with alternative discount rates, all the other assumptions, including in particular those relating to inflation and return on investments, were kept unchanged.

Analysis of the sensitivity to the discount rate of the value added by new business

Euro millions

Discount rate	-1%	central	+1%
Unit-linked life business	152	133	118
Index-linked life business	26	25	24
Asset management business	53	50	47
New banking business	10	10	9
Total	241	218	198

New business margins

New business margins for the Italian life and asset management business in 2005 and 2004 are shown in the tables below. Profitability is expressed both in terms of a margin on APE (annual premium equivalent defined as annualised regular premiums plus 10% of single premiums) and as a percentage of PVNBP (present value of new business premiums) calculated using the expected lapse and other exit assumptions.

New business margins for 2005 (EEV) – life and asset management

Euro millions	Unit-linked	Index-linked	Asset mgmt
Value of new business at moment of sale	129	21	49
Regular premiums / pac	145		85
Single premiums / pic	311	835	1,408
APE	176	84	226
New business margin (% APE)	73.5%	25.1%	21.7%
PVNBP	1,551	835	1,891
New business margin (% PVNBP)	8.3%	2.5%	2.6%

New business margins for 2004 (EEV) – life and asset management

Euro millions	Unit-linked	Index-linked	Asset mgmt
Value of new business at moment of sale	130	25	23
Regular premiums /pac	143		34
Single premiums / pic	224	1,020	805
APE	166	102	114
New business margin (% APE)	78.4%	24.4%	20.6%
PVNBP	1,471	102	1,005
New business margin (% PVNBP)	8,8%	2,4%	2,3%

The margin on APE for new life business in Spain is approximately 65% in 2005.

The margin of new current accounts as a percentage of the money invested in current accounts opened in the year is 1.3%. The profitability of new mortgages sold in 2005 reflects a mix between mortgages intermediated for third parties and Mediolanum's proprietary mortgage book, including those sold to employees on advantageous terms.

METHODOLOGY

The traditional embedded value calculations which Mediolanum has used in the past were based on detailed models of the in-force and new business developed in a deterministic environment, using a single set of best estimates for both economic and operating assumptions. In the traditional embedded value framework, risk was allowed for by the use of a single discount rate and an allowance for the cost of holding solvency capital equal to the minimum EU solvency margin. The cost of solvency capital was determined as the present value of the differences between the assumed after-tax return on the assets (mainly bonds) backing solvency capital and the discount rate applied to the projected solvency margin.

In adopting the EEV Principles, Mediolanum has chosen to adopt an approach which maintains consistency with the prior approach to embedded value reporting. The value of in-force business continues to represent the discounted value of a stream of best estimate profits adjusted for the cost of holding a

certain level of capital. The key differences between the traditional reporting and EEV reporting are in the determination of the level of required capital, and in the allowance for risk, which uses a framework based on market-consistent methodology.

The embedded value has been determined using a market-consistent framework to value financial risks, an allowance for non-financial risks, and the deduction of a frictional cost of required capital. To maintain consistency with the previous approach used to report embedded values and embedded value earnings and allow like-for-like comparisons, equivalent risk discount rates have then been derived so as to produce the same results when input into the traditional deterministic models, which use best estimate assumptions, after the cost of solvency capital. This produces an average derived risk discount rate for homogeneous blocks of business.

In theory discount rates can vary between new business and in-force business, according to the respective risk profiles. In practice the derived risk discount rates for new business were very close to those calculated for in-force business, and so the same discount rates by line of business were used for both in-force and new business.

Allowance for risk

Appropriate allowance for risk in the projected profits is a key component of the EEV Principles and Guidance. Risk has been allowed for in three main ways:

Explicit risk margins in the discount rate, to allow for:
- a market-consistent approach to financial risk, which reflects the level of market risk in each cash flow;
- an allowance for non-financial risks which reflects the potential asymmetry of operational risks and the capital requirements for banking business;

Deduction of the cost of holding a level of required capital for life business;
- using EU minimum margins for unit-linked and traditional business
- using risk-based capital for counterparty risk on index-linked business
- assuming a frictional cost of double taxation on the required capital

Explicit deduction for the cost of financial options and guarantees:
- relevant for the traditional life business only

Covered business

The covered business includes all the life insurance and asset management business written in Italy and in Spain, together with the main retail banking business in Italy, consistent with these business segments under IFRS reporting. No value has been attributed to in-force or new business for the remaining lines of business, including in particular Gamax, B.A. Lenz and that part of the Irish operations MILL and MIF not related to Italy and Spain, nor to the other minor lines of business of the Mediolanum Group.

Values are reported on a look-through basis, considering all profits and losses emerging in the Group associated with the relevant line of business.

Required capital and cost of capital

In compliance with EEV Principle 5, Mediolanum has made an assessment of the amount of required capital to be attributed to the covered life business. The approach used varies by line of business. For all life business other than index-linked business, EU minimum solvency requirements have been considered appropriate. For index-linked life business, account has been taken of the counterparty risk, using a risk-based capital approach which considers the rating of the structured bonds underlying the index-linked guarantees. This gives rise to capital requirements of approximately 4.7% of reserves for business where Mediolanum bears the full investment risk and approximately 2.4% for business where investment risk is passed to policyholders.

Total required capital for the life business as at December 31, 2004 and 2005 is respectively 180 million Euro and 186 million Euro, which correspond to approximately 165% of the EU minimum margin in both years.

For banking business, the minimum capital requirements based on risk weighted assets for mortgages and loans have been considered as part of the risk margin for non-financial risks, as have the requirements associated with the Basle II regulations regarding operational risk.

To determine the embedded value, the cost of required capital has been determined based on the frictional costs of holding this capital. Since financial risks are allowed for on a market-consistent basis, these costs are represented by the taxation incurred on locked-in shareholder assets.

As noted, the derived risk discount rates have been calculated so as to reproduce the value of in-force business after cost of capital using the traditional framework.

Risk discount rate – margin for financial risk

Mediolanum has adopted a bottom-up approach to allow for risk, which uses market-consistent methodology to calibrate the risk discount rate to allow for financial, or market-related risk. In principle, under a market-consistent approach each cash flow is valued in line with its specific profile in terms of financial risk, and thus in a consistent fashion with the market prices of similar cash flows which are traded in the open markets. In practice, Mediolanum has used the certainty-equivalent technique; this is an approach commonly used in the pricing of financial instruments and consists in adjusting the individual cash flows to remove the effects of financial risks, and which then allows for the resulting stream of risk-adjusted profits to be discounted at the risk-free rate. The relevant Euro swap curve was used as the appropriate risk-free rate at each valuation date.

Converting the aggregate impact of financial risks into a margin on the discount rate captures the increase in risk associated with the level of equity investments, but is also influenced by the level of underlying margins in the business, and the relative size of projected expenses compared to income.

Risk discount rate – margin for non-financial risk

In theory, an investor can diversify away the uncertainty around non-financial risks, and, according to modern finance theory, would not require an additional return for such diversifiable risk. Allowance for non-financial risk is made through the choice of best estimate assumptions, taking into account the impact that the potential variability of the assumptions has on the level and therefore cost of capital. Although Mediolanum considers that the best estimate assumptions are appropriate in this context, it is possible that the use of best estimate assumptions may fail to capture the full impact on future shareholder profits where there is the potential for asymmetry in the results, in other words where the adverse experience has a higher impact than favourable experience. Mediolanum has identified that such asymmetry may exist in the area of operational risks, including administrative expenses, management fees, and persistency.

Practice is evolving regarding the appropriate approach for considering non-financial risk, and Mediolanum is monitoring closely developments in this area, with particular regard also to the potential impacts of Solvency II on the levels of required capital.

In practice, the following approach has been taken for all lines of business. In the first instance, the amount of capital required to meet the Basle II criteria for operational risks has been determined. Secondly, using economic capital techniques, an amount of value of in-force business "at risk" has been determined by applying stress tests on the value of in-force business to the key parameters identified, namely administrative costs, management fees and persistency. The resulting amount of "economic risk capital" has been subjected to a frictional cost of capital charge equal to the impact of taxation.

In addition, the allowance for non-financial risk also incorporates the cost of holding regulatory minimum capital in respect of mortgages and loans in the banking business.

Derived risk discount rates

The following table shows the components of the derived risk discount rates used as at December 31, 2004 and 2005.

Derived discount rates at December 31,

s	**Unit-linked**		**Asset management**		**Banking Business**	
	2004	**2005**	**2004**	**2005**	**2004**	**2005**
Average risk-free rate	4.10%	3.60%	3.65%	3.40%	3.65%	3.45%
Margin for financial risk	0.55%	0.85%	2.20%	2.30%	-	-
Margin for non-financial risks	1.50%	1.20%	0.95%	0.80%	2.45%	2.15%
Risk discount rate	6.15%	5.65%	6.80%	6.50%	6.10%	5.60%

The derived risk discount rates are those which reproduce the value of in-force business in the traditional deterministic framework, using best estimate assumptions, after cost of solvency capital. The average risk-free rate has been determined based on the term structure of the projected profits from the

certainty equivalent projections, using the risk-free curve. The allowances for financial and non-financial risks as described above have been converted into an equivalent margin on the discount rate, to determine the final derived discount rate used in the models.

The reduction in the average risk free rates from 2004 to 2005 is due to the general reduction in the forward yield curve. The increase in the margin for financial risk on life business is mostly associated with an increase in the equity content of the assets, as well as a leverage effect associated with the increased level of expenses. On the other hand, the margin for non-financial risks on all lines of business reduces between 2004 and 2005, primarily as a result of the reduction and the flattening of the forward curve, which has the effect of reducing the cost of required capital because of the lower annual taxation charge on the projected locked-in economic capital.

The average derived risk discount rates have also been compared with the results of a top-down approach using the capital asset pricing model and Mediolanum's observed market beta. After allowing for the effect of franchise value and excess capital, the implicit weighted average cost of capital for the in-force business which was determined was in aggregate consistent with the derived discount rates used above. The results obtained did not, however, permit any more detailed subdivision by line of business.

Financial options and guarantees

The only material financial options and guarantees in Mediolanum's business relate to the traditional revaluable business linked to segregated funds, which have been closed to new business since 1998. The main risk to shareholders is that the return on the assets in the segregated fund is insufficient to meet the financial guarantees during the period to policy maturity, and, for deferred annuities, also during the annuity payout period.

Given the overall materiality to the group a simplified approach has been taken, by constructing a replicating portfolio comprising risk free assets for the market value of the segregated fund assets, and simulating the purchase of floors at market prices to cover the reinvestment risk, after allowing for the effects of the reinsurance treaties in force. It has been assumed that all the deferred annuity policyholders will exercise their annuity take-up options. The time value of financial options and guarantees has been defined as the difference between a certainty-equivalent valuation and the overall valuation. The time value of financial options and guarantees, which has been deducted from the overall embedded values is equal to approximately 34 million Euro in the 2004 valuation and 41 million Euro in 2005. The increase in the time value of options and guarantees is primarily associated with the increase in the volatility of swaption prices during 2005.

Expenses and development costs

Expense assumptions are actively reviewed, and are based on the entire consolidated company costs, including all holding company and service company costs. Mediolanum has excluded 37.5 million Euro of extraordinary items and development costs, from the expenses allocated to the lines of business in 2005. Of these, 14 million Euro represent one-off accruals to provisions related to the salesforce, as noted in the primary accounting

statements. An amount of 15.6 million Euro is associated with the extraordinary publicity activity and launch events associated with the 4 Freedoms campaign. The remaining 7.9 million Euro are related primarily to the setting up of the proprietary mortgage lending operation and have been considered as development costs.

After the exclusion of the extraordinary items and development costs, the remaining costs have been allocated to the separate lines of business and then fully allocated to acquisition, maintenance and investment activities.

Tax

Projected profits have been subjected to normal tax rates in the country of emergence. Account has been taken of the taxation treatment of profits projected to be remitted to Italy.

Participating business

For the Italian traditional revaluable business, policyholder profit participation has been assumed to continue to follows current company practice.

Residual assets

There are no projected residual assets.

Definition of new business

New life business relates to new policies issued during the year excluding those resulting from the transformation or switch of existing policies, together with discretionary increases in the level of regular premiums on existing policies. New life business volumes used to calculate the value of new business in 2005 in Italy were 145 million Euro of annualised regular premiums (of which 18 million Euro related to discretionary increases), 311 million Euro of unit-linked single premiums, and 835 million Euro of index-linked single premiums. Additional index-linked premiums of 123 million Euro have been excluded from the new business volumes as they arise from the contestual redemption of old-generation DiPiù policies.

New asset management business is defined as the sum of retail gross inflows net of internal switches within the mutual funds and managed accounts, and totals 85 million Euro for mutual fund instalment plans, 1.346 million Euro of lump-sum investments in mutual funds and 62 million Euro for managed accounts. Of the total mutual fund production shown above, real estate funds accounted for 29 million Euro of instalment plans and 192 million Euro of lump-sum investments. Portfolio accounted for 103 million Euro of new lump-sum investments; in calculating the volume and value of new business, the switches of 50 million Euro from managed accounts to Portfolio in the final months of the year have been excluded.

New life business in Spain comprised 90 million Euro of single premium business, of which index-linked comprise 84 million Euro, and regular premium unit-linked business for 3.5 million Euro. New asset management business in 2005 comprised lump-sum investments of 137 million Euro in Spanish funds, and 42 million Euro in Irish mutual fund products.

New banking business comprises new current accounts and deposit accounts in the year, for 411 million Euro, and new mortgages issued for 291 million Euro, of which 111 million Euro proprietary mortgages.

ASSUMPTIONS

The following section sets out the main assumptions used in the embedded value calculations at December 31, 2004 and 2005.

Best-estimate economic assumptions

Best-estimate economic assumptions are actively reviewed and are based on the market yields on risk-free instruments at different durations at the respective valuation dates. The projected total returns on equities have been assumed to yield a 3% margin over the 10-year Euro AAA government bond yield. The return on other assets was set using benchmarks consistent with the base scenario. The following table shows the main economic assumptions.

Economic assumptions

December 31,	2004	2005
Pre-tax investment returns:		
Benchmark 10-year BTP	3.85%	3.50%
Liquidity	2.25%	2.40%
Equity	6.65%	6.30%
Inflation		
Consumer prices	2.00%	1.75%
Expenses	2.50%	2.25%
Taxation		
Italy	38.25%	38.25%
Ireland	12.5%	12.5%
Spain	35%	35%
Average risk discount rate (in-force business)	6.27%	5.80%

Pre-tax rates of returns on assets backing technical reserves were set consistent with the above benchmark rates, taking into consideration the related asset mix, resulting in assumptions for the Italian segregated funds of 4.00% for the 2004 valuation and 3.70% for 2005. These rates of return already include the impact of unrealised capital gains/losses in segregated fund assets. Investment returns on unit-linked funds, and mutual funds and managed accounts business, were determined on the basis of the asset mix of each fund, with average results for the Italian business before costs and taxes, of 5.00% for unit-linked funds (4.95% for 2004) and of 5.20% for Asset management products (5.35% for 2004).

The consumer price inflation rate shown above is used to determine the projected automatic premium increases, generally equal to the growth in the consumer price index plus 3%, for products with this characteristic.

Management expenses expressed as a per-policy amount are assumed to increase at the expense inflation rate.

Market-consistent economic assumptions

The risk-free rates used in the certainty-equivalent projections are calibrated to the Euro swap curve, and the implied swaption volatilities to market prices of swaptions for various tenors and option terms. The following table shows selected data.

Sample swap rates and implied volatilities

		Term to Maturity				
	December, 31	1	5	10	15	20
Swap rates	2004	2,37%	3,16%	3,75%	4,06%	4,24%
Swap rates	2005	2,88%	3,22%	3,45%	3,64%	3,73%
15 year Swaption	2004	14,2%	12,6%	10,9%	9,6%	9,3%
15 year Swaption	2005	16,2%	15,9%	14,5%	13,7%	13,4%

Source: Bloomberg

Other assumptions

Assumed future rates of mortality, lapse, failure to maintain recurrent premiums and other exits, including total and partial disinvestment rates for the asset management business, were derived from an analysis of the Mediolanum Group's recent operating results and, where appropriate, took into consideration the experience of the life, asset management and banking sectors.

After exclusion of certain one-off and development expenses, the general and administrative costs incurred by the Group, including depreciation costs, were subdivided by business line, and within each line into the costs pertaining to investment, the acquisition of new business and the management of the in-force business.

Assumed levels of future commission and override payments to agents and sales-people were based on the Mediolanum Group's recent operating experience.

Participation rates and other charges on Life policies and management fees on funds were assumed to be maintained in the future at the prevailing levels on each valuation date. Likewise the charging structure on banking products was assumed to be maintained in the future.

It was assumed that no changes will be made in the principles and technical bases used to calculate technical reserves and surrender values.

For performance fees, a series of conservative rates, based on experience to date, were assumed. Experience variances, in the analysis of the components of embedded value earnings, have included positive contributions of 28 million Euro in 2004 and 102 million Euro in 2005, as a result of actual experience exceeding the assumptions used at the beginning of the year.

Allowance was made for reinsurance of in-force Life policies outside the Mediolanum Group, and mainly relates to various quota share financing

treaties written in the years up to 1994. No new financing reinsurance arrangements have been made since 1995.

The cost of maintaining solvency capital in the traditional framework was determined on the assumption that assets (mainly bonds) backing solvency capital yielded an average annual pre-tax return of 4% in the 2004 valuation and 3.7% in 2005. Based on these assumptions, the cost of solvency capital which was deducted from the discounted value of future after-tax statutory profits to determine the value of in-force Life business reported above, 32 million Euro in 2005 and 33 million Euro in 2004 (EEV). The cost, which is already allowed for in the value added by Life new business for 2005, is approximately 1.5 million Euro.

Statement by Directors

The directors confirm that the embedded values as at 31 December 2004 and 2005, and the embedded value earnings including the value added by new business in 2005 have been determined using methodology and assumptions which are compliant with the EEV Principles.

External opinion

Tillinghast, the global insurance and financial services consulting business of Towers Perrin has assisted the Mediolanum Group regarding the methodology and assumptions to be used, and has calculated the European Embedded Value of the Group as at 31 December 2004 and 31 December 2005, together with the embedded value earnings in 2005. The estimates of value determined by Tillinghast are based on information provided by the Mediolanum Group which has been reviewed for reasonableness and consistency with industry knowledge, but Tillinghast has not undertaken independent checks of the data and other information supplied.

Tillinghast has reported that it considers that the methodology and assumptions used comply with the EEV Principles and Guidance as published by the CFO Forum, and in particular:

- that the methodology makes allowance for the aggregate risks in the covered business through:
  - (i) the incorporation of risk margins in the discount rate used to discount projected future profits determined using best estimate assumptions, using
    a) a market-consistent valuation of financial risk,
    b) an allowance for non-financial risk based on the frictional cost of an amount of capital that would be required to cover operational risk requirements under Basle II and the value at risk with respect to key operating variables such as persistency, costs and management fees,
  - (ii) the deduction of the cost of required capital based on minimum EU solvency margins for non-index-linked life business, and a risk-based capital allowance for index-linked business; and

(iii) the deduction of the time value of financial options and guarantees for traditional business;

- that the operating assumptions are reasonable in the context of recent available experience and the expected future operating environment;
- that the economic assumptions used are internally consistent and consistent with observable market data.
- for revaluable business, the assumed revaluation rates, and the retrocession rates, are consistent with the projection assumptions, established company practice and local market practice.

Tillinghast considers that the reported results for the embedded value, embedded value earnings and the value of new business are reasonable in the context of embedded value reporting under the EEV Principles.

APPENDIX 1 - SEGMENTAL REPORTING

The following tables show the value of in-force business as at December 31, 2005 and the value of 2005 new business, broken down by business segment.

Value of in-force business as at December 31, 2005 by segment

Euro millions	**Italy**	**Spain**	**Total**
Life insurance (excluding index-linked)	1,776	9	1,785
Index-linked life insurance	9	(1)	8
Asset management	399	11	410
Current and deposit accounts	94	n/a	94
Mortgages	6	n/a	6
Total	2,284	19	2,303

Value of 2005 new business by segment

Euro millions	**Italy**	**Spain**	**Total**
Life insurance (excluding index-linked)	129	4	133
Index-linked life insurance	21	4	25
Asset management	49	1	50
Current and deposit accounts	5	n/a	5
Mortgages	5	n/a	5
Total	209	9	218

APPENDIX 2 - SENSITIVITY TESTS

This section shows the sensitivity of the value of in-force business as at December 31, 2005 and the value of 2005 new business to changes in key assumptions. For each sensitivity test, all the other assumptions remain unchanged, except for those tests which directly affect economic conditions; in these cases the derived risk discount rate has also been recalculated, given the use of market-consistent methodology to set the allowance for financial risk. The sensitivity to the increase on equity and property returns has no effect, given the use of market-consistent methodology to set the discount rates. The following tables show the sensitivity separately for the life, asset management and banking businesses.

Sensitivity analysis – Life business

Euro millions	**Value of in-force business**	**Value of new business**
Base value	1,793	158
1% increase in discount rates	(158)	(16)
1% increase in return on equity and property	0	0
1% reduction in risk free rates	99	13
10% decrease in maintenance expenses	12	1
10% decrease in acquisition expenses	-	4
10% decrease in lapse and premium renewal rates	82	8

It should be noted that:

- for the sensitivity to the risk free rates, the calculation has been performed only for linked business (including recalibration of the discount rate) and for the projected values only; all the other assumptions, including the inflation rates, remain unchanged
- the sensitivity to maintenance expenses does not include a reduction in investment expenses
- for the sensitivity to decrements both the lapse rates and the premium renewal rates have been decreased

Sensitivity analysis – Asset management business

Euro millions	**Value of in-force business**	**Value of new business**
Base value	410	50
1% increase in discount rates	(18)	(3)
1% increase in return on equity and property	0	0
1% reduction in risk free rates	2	0
10% decrease in maintenance expenses	9	2
10% decrease in acquisition expenses	-	2
10% decrease in lapse and premium renewal rates	16	3

It should be noted that:

- the sensitivity test to maintenance expenses does not include a reduction in investment expenses
- for the sensitivity to decrements the decrease has been applied to total lapse rates on contracts, but not to partial withdrawals

Sensitivity analysis – Banking business

Euro millions	**Value of in-force business**	**Value of new business**
Base value	100	10
1% increase in discount rates	(5)	(1)
1% increase in return on equity and property	0	0
10% decrease in maintenance expenses	23	5
10% decrease in acquisition expenses	-	1
10% decrease in lapse and premium renewal rates	6	1