INTESA SANPAOLO

Banks and climate change risk

December 1st, 2021

Elena Kral,
Head of ESG & Reputational Risks

elena.kral@intesasanpaolo.com

INTESA SANPAOLO

AGENDA

1 Climate Change risk at a glance

2 Integrating C/E risks within the bank's business model

- Set the overall ambition & emissions strategy
- Strengthen resilience and climate risk management
- Ensure capabilities for execution

Climate change risk at a glance

An evolving context

The world is at an inflection point towards a resource efficient economy – Europe as first mover yet other regions following

European Union	**Front-runner in enforcement mode**	EU green deal, EU Taxonomy, Green funding
United States	**Fast-follower with new political focus**	net zero emissions by 2050 and 100% carbon-free electricity by 2035
China	**Leap-frogging with rigorous execution power**	Carbon neutrality target by 2060, but ability to move fast on policies promoting efficiency

1.5C pathway: possible, but requires stark change across sectors that banks finance: effort required is an industrial topic that may vary considerably from sector to sector

2019

Exclusion policies

Green financing

Measure of financed emissions

2020/21

Net-Zero initiatives (NZBA, NZAMI)

Advisory services for green products

End-to end strategy to quantify climate risk

Today

2022 →

Increased CEO aspirations

Transformational logic, not a compliance or communications topic

2030 emission reduction target for priority sector

Acceleration to seize a large share of the green finance market

ECB stress test, GAR

Climate change risk at a glance

The financial sector

Given the catalytic nature of banks, several external forces are increasing the pressure on banks to act

NGOs and general public: Increasing number of green activism situations against banks

Investors: Shareholders are increasingly requested from banks to act on climate

~25% Of professionally managed funds in 2020, or ~€1.2Tr in Europe, integrated Sustainability in investment decisions

Regulators/supervisors Banking regulation is now emerging in many jurisdictions with significant constraints:

>30 Regulatory guidelines, transparency exercises, and impact studies globally since 2018

The regulatory framework

ECB general timeline on C/E risks

An increased number of initiatives / regulations have emerged with direct implications for financial institutions. Among these, the **ECB Guide on C/E risks** is particularly relevant for EU Banks.

Overview

20/05 (2020)	ECB launches **public consultation on** Guide on climate-related and environ-mental risks
27/11 (2020)	ECB publishes **Final Version of** Guide on climate-related and environ-mental risks
15/01 (2021)	**ECB letter** requesting to fill in questionnaire A and B on C&E Risks
26/02 (2021)	Submit **self-assessment/ gap analysis** to ECB (question-naire A)
15/05 (2021)	Submit **action plan** to ECB (questionnaire B)
7/06 (2021)	First **meeting with ECB** to discuss action plan
3Q – 4Q (2021)	**Gap analysis** carried out by the ECB
1H (2022)	ECB Climate Risk **Stress Test**

- Initially, ECB **does not intend to fully reflect** the results of the self-assessment **in the quantitative part of the 2021 SREP**, but could consider selected quantitative and qualitative aspects in **specific cases**
- ECB has **planned to integrate** climate risks into the **SREP 2022** methodology to be provided by the ECB in 2021 (along with a specific stress test on climate)

AGENDA

1 Climate Change risk at a glance

2 Integrating C/E risks within the bank's business model

- Set the overall ambition & emissions strategy
- Strengthen resilience and climate risk management
- Ensure capabilities for execution

Integrating C/E risks within the bank's business model

From ambition to execution

In order to comply with the regulations and contribute to the transition to a low carbon economy, 4 key lines of action can be identified

Set the overall ambition & strategy

Formulate an overall ambition

Measure emissions and set targets per sector in the portfolio

Establish disclosures

Build and capture business opportunities

Build new businesses and define go-to-market strategies

Develop unique sustainability products & services

Identify potential **partnerships**

Strengthen resilience and climate risk management

Perform a materiality assessment of C/E risks

Integration of C/E risks within the Risk Appetite framework

Stress test lending portfolio

Integrate climate into banking processes

Ensure capabilities for execution

Design organisation and Target Operating Model

Build climate data architecture

Focus in the following pages

Set the overall ambition & strategy

Net zero commitment

As part of the global effort to limit global warming, **banks will need to focus on decarbonizing their financed emissions toward Net-Zero**

What Net-Zero Means

- **Net zero** means **limiting global warming to 1.5°C vs pre-industrial levels** (Paris Agreement set less stringent limits at well below 2°C) by 2100
- Committing to Net Zero **implies reaching GHG Net-Zero[1] emissions globally by 2050**
- **Key countries** have already **officialized these commitments** during COP26 (e.g. EU, US, UK)

What this implies for banks

- Banks need to **decarbonize emissions for which they are directly** and **indirectly** responsible for, across three macro categories:
  - **Financed emissions (indirect)**:
    - Emissions from the **lending and investments[2]** (i.e. clients' Scope 1,2 and if material scope 3)[3]
    - Emissions related to other non-banking businesses (i.e. **Asset Management**, **Insurance**)
  - **Facilitated emissions (indirect):**
    - Emissions derived from activities related to **sales and trading, ECM, DCM**
  - **Own emissions (direct):**
    - Emissions from **own operations** (Bank scope 1 and 2)[3]

1. Net zero emissions' refers to achieving an overall zero balance between greenhouse gas emissions produced and greenhouse gas emissions taken out of the atmosphere, either by removal carbon dioxide (often through carbon offsetting) or by eliminating emissions from society (the transition to the "post-carbon economy")
2. I.e. on-balance sheet equity ("partecipazioni") and bonds (held to collect, not held for trading or HTCS)
3. I.e. Scope 1: direct emissions from owned operations; Scope 2: indirect emissions from the generation of purchased electricity, steam, heating and cooling; Scope 3: all other indirect emissions that occur in a company's value chain. Scope 3 materiality if they represent >40% of total emissions

Source: MCC, Paris Agreements, EU commission

Set the overall ambition & strategy

Recently established alliances

As of November, 2021

NOT EXHAUSTIVE	Description	Members	Examples
A. Net Zero Banking Alliance (NZBA)	Alliance committed to align their **lending book, investments[1] and bank's own operations** with **net-zero emissions** by **2050**, setting a first interim target, within 18 months of joining, on the most GHG-intensive sectors to be achieved by 2030	**95 Banks** (43 founders + 52 followers)	BNP PARIBAS, INTESA SANPAOLO, SOCIETE GENERALE, standard chartered, UBS, ING, LLOYDS BANKING GROUP, CRÉDIT AGRICOLE
B. Net Zero Asset Managers Initiative (NZAMI)	Network of asset managers[2] controlling **~57,000 bln EUR** of **AuM**, committed to ensure their **investment portfolios** are **carbon neutral** by **2050**, setting a first interim target[3], within 12 months of joining, to be achieved by 2030	**220 Asset managers** (57 trillion USD AuM)	AVIVA INVESTORS, Nordea ASSET MANAGEMENT, Amundi ASSET MANAGEMENT, Legal & General, EURIZON ASSET MANAGEMENT, AXA Investment Managers, FIDEURAM Asset Management, HSBC Asset Management, Fidelity INTERNATIONAL, UBS
C. Net Zero Asset Owner Alliance (NZAOA)	Network of institutional investors (i.e. **pension funds and life insurers**)controlling more than **10,000 bln USD** of **AuM**, committed to ensure their **investment portfolios** are carbon neutral by **2050**, setting a first interim target to be achieved by 2025	**61 Institutional investors** (10 trillion USD AuM)	Univest Company, Unilever, Allianz, DAVID ROCKEFELLER FUND, AVIVA, AXA, GENERALI, Legal & General, Nordea Life and Pension
D. Net Zero Insurance Alliance (NZIA)[4]	Network of insurers committed to align their **insurance and reinsurance underwriting portfolios** (e.g. property and casualty insurance) to **net-zero emissions** by **2050**, setting a first interim target, within 24 months of joining, to be achieved by 2030	**15 Insurance companies**	AXA, Allianz, AVIVA, GENERALI, Munich RE, SCOR The Art & Science of Risk, Swiss Re, ZURICH

1. I.e. on-balance sheet equity ("partecipazioni") and corporate bonds (held for investment, not for market-making purposes)
2. Including also insurers and pension funds for the portion of investments on behalf of clients
3. Interim targets con cover just a portion (%) of the total AuM portfolio
4. Joiner should *"transition its investment portfolio to net-zero GHG emissions by 2050 and consider joining relevant initiatives (e.g. NZAOA) in order to achieve, within my company, a consistent approach to net zero"*

Strengthen resilience and climate risk management

From Strategy to Underwriting

A **sectoral heatmap in order to assign each sector** to a color (red, orange, yellow, white, blue), based on the degree of ESG risk identified, is fundamental in determining which sectors to engage in, disengage from or support in their transition. Based on the color allocation, each **sector** has been **assigned to a sectoral strategy**

ESG-Climate Strategy by Sector (Sector ranks color coding – e.g. blue, white, yellow, orange, red), including emissions targets by sector

Blue sectors	White sectors	Yellow sectors	Orange sectors	Red sectors
▪ **Positive engagement**	▪ **Neutral**	▪ **Transition selective engagement**	▪ **Prevalent disengagement through credit process**	▪ **Disengagement through policy**
▪ net positive contribution to transition ▪ positive impact in terms of ESG factors (e.g. EU Taxonomy)	▪ no prevailing material ESG/climate risks ▪ assessment to be carried out by transaction	▪ material ESG and climate risks but transition is possible ▪ reputational risk to be assessed in the loan underwriting process	▪ ESG/climate risks relevant	▪ material ESG/climate risks ▪ disengagement/exclusion on the basis of the bank's policies

Risk Appetite Framework	CRA	Credit Strategies	Underwriting
Sectoral policies **Phase-out targets** **Sectoral limits** **KRIs** (e.g. high transition risk)	**Counterparty ESG Score** feeding into CRA **Sector-level measures**	**Up-notching on sectorial attractiveness** for blue sectors **Sectoral attractiveness capped at "low" for red/orange sectors**	**Sectoral policies** **Clearing at counterparty/transaction level (1st LoD, 2nd LoD) differentiated by sector, products (i.e. brown vs green), ESG score**

INTESA SANPAOLO

Strengthen resilience and climate risk management

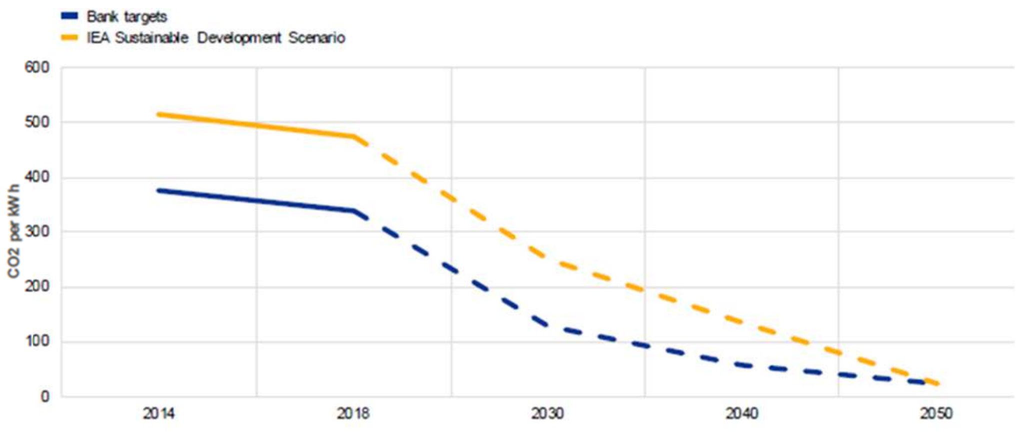
Integration of C/E risks within the Risk Appetite Framework

- Developments are expected within the Risk Appetite Framework consistently with ECB expectations and stratecic goals (e.g. Net zero):
  - Enhancement of metrics/limits in order to integrate **key risk indicators relevant** for climate-related and environmental risks
  - Widening of the set of limits, consistently with materiality assessment/sectoral assessment and credit strategies
  - Development of sectoral policies

Observed practice

✓ Several institutions aim to keep the carbon content of their financed energy mix in line with the target of remaining well below 2° C

✓ Other institutions, for each sector with a large carbon footprint, measure and benchmark how lending to these sectors contributes to climate resilience, and adjusting the lending portfolio accordingly



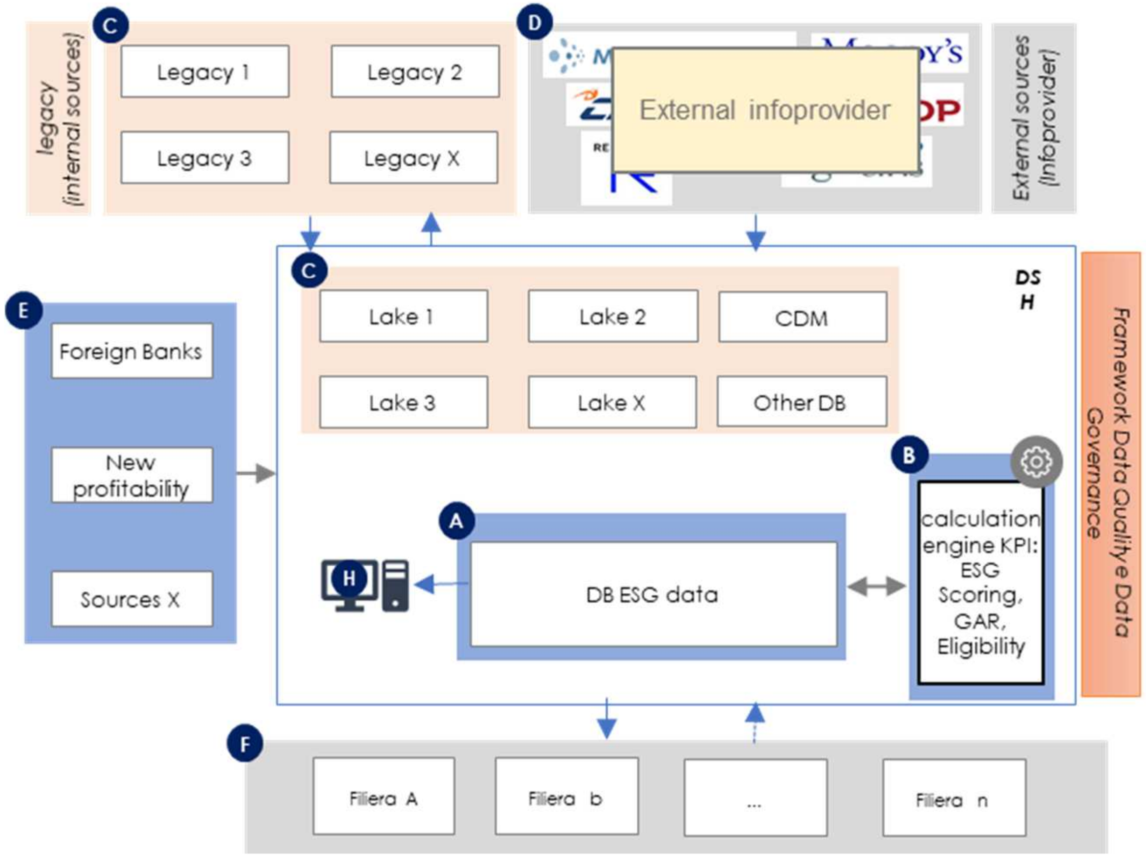
Source: World Energy Outlook 2019

Ensure capabilities for execution

Build ESG/climate data architecture

A full integration of the management of ESG risks require a structured integration of new relevant data new data into the ICT system and in all the relevant processes, not only the risk management ones.

ILLUSTRATIVE



The ESG database A will receive input from:

- C Legacy
- D External sources (infoprovider)
- E Other sources (DSH)
- F Output from relevant processes (filiere), already fed from the common database

H The ESG database will be the data source for various uses also with direct user access through integrated tools on DSH (eg SAS, MSBI)

Closing remarks

- Managing the risk of **climate change is currently the main goal**, in managing ESG risks, but it is **not the only one**

- As highlighted by the **European Green Taxonomy**, the management of **environmental risks** with particular reference to the protection of environmental resources and biodiversity represents another important objective also due to its **connection with climate change risk**
- Furthermore, as **pointed out by the EBA**, **banks** are required not to limit themselves to climate-related risks alone, but **should improve in the identification and understanding of social and governance risks**, also over a medium-long term time horizon in order to better understand their evolutions

INTESA SANPAOLO