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SUPERVISION  
RISKS &  
PROFITABILITY

INTESA  SANPAOLO

## Climate/ESG integration into Risk Strategies: Few steps to get closer

June 22<sup>nd</sup>, 2022

*Fabio Verachi, FRM*

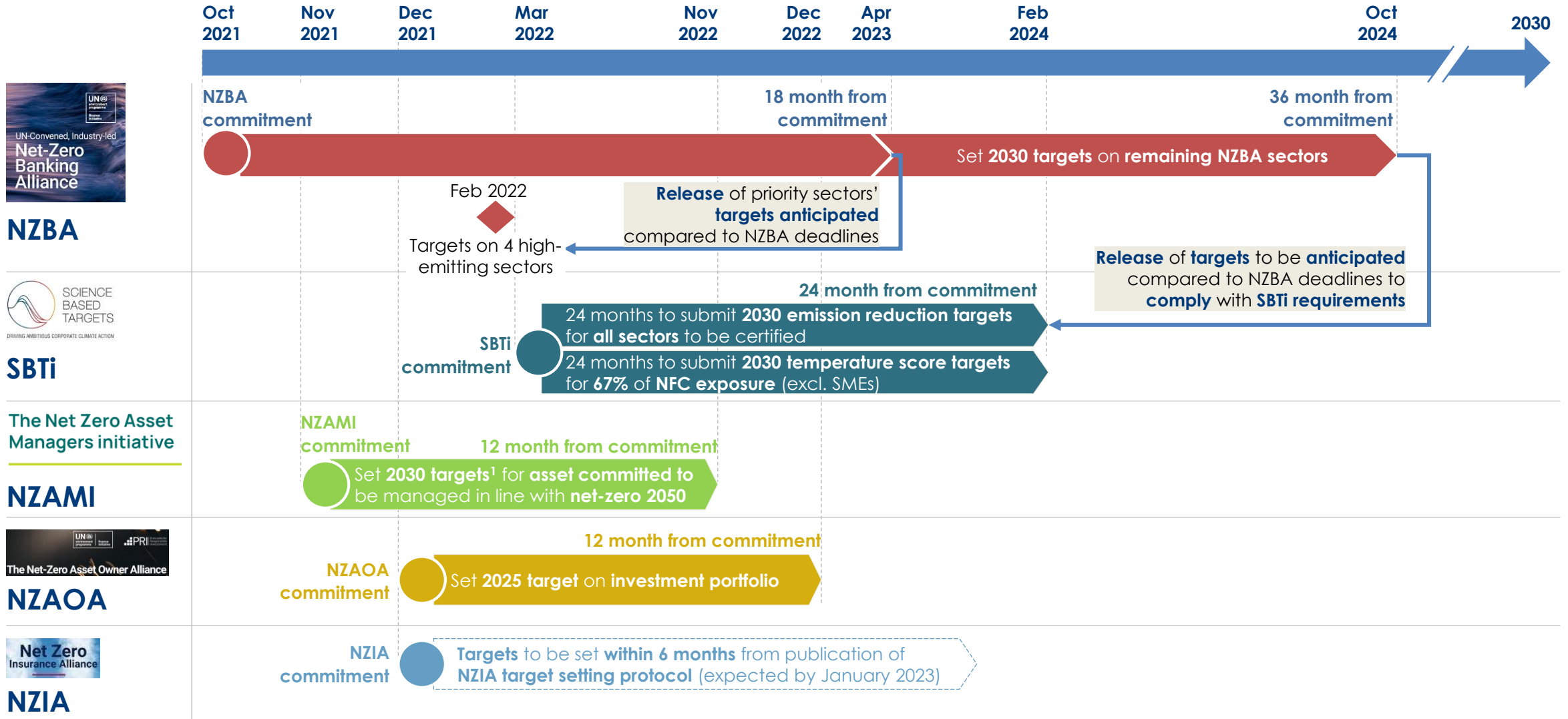
Enterprise Risk Manager – Risk Clearing



INTESA  SANPAOLO

# ISP GROUP DECIDED TO ADHERE TO ALL THE RELEVANT NET ZERO ALLIANCES IN Q4 2021

■ NZBA ■ SBTi ■ NZAMI ■ NZAOA ■ NZIA



# ISP TARGET SETTING IS BASED ALSO ON A BENCHMARKING ANALYSIS

**Related to Exp 1  
Business Environment -  
ECB Guide**

Sector coverage and numerical targets disclosure    
 \* Paris Aligned / SDS aligned, Not Net Zero    
 Committed to SBTi certification    
 Only sector coverage    
 **P** Coal Fired policy

	1 <sup>st</sup> interim target horizon	Oil & Gas	Power	Automotive	Shipping	Aviation	Cement	Steel	Coal	Mortgages	Corp. Real estate	Agriculture
<b>ING</b> *	2022 <sup>1</sup>								<b>P</b>			
	2030								<b>P</b>			
	2030								<b>P</b>			
*	2025								<b>P</b>			
*	2025											
	2030								<b>P</b>			
	2024								<b>P</b>			
	2030								<b>P</b>			
	2030								<b>P</b>			
J.P.Morgan *	2030								<b>P</b>			
	2030								<b>P</b>			
*	2025								<b>P</b>			
*	2025								<b>P</b>			
	2030								<b>P</b>			
	2030								<b>P</b>			
* <sup>2</sup>	2030								<b>P</b>			
Morgan Stanley	2030								<b>P</b>			
	2030								<b>P</b>			
	2030								<b>P</b>			



1. Glidepath until 2040    
 2. Net-Zero aligned for mortgages and agriculture  
 Source: Based on Public announcements and reports

# KEY GOVERNANCE MILESTONES ON **ISP NET ZERO COMMITMENT PATH**

Related to Exp 3  
Governance - ECB Guide

## Commitment to Net Zero and adherence to NZ Alliances

## Target Setting on priority sectors

### ESG Control Room

### Steering Committee "Business Plan and Sustainability (ESG)" session

### Risks Committee

### Board of Directors

- **7 meetings in 2021** on Climate strategy and on the response to the ECB Guide on climate and environmental risks

- **8<sup>th</sup> October 2021**: Business Plan discussion

- **4 meetings in 2021** on Climate strategy and on the response to the ECB Guide on climate and environmental risks
- **14<sup>th</sup> October 2021**: presentation and discussion on the implications of Net Zero commitment and adherence to the NZBA

- **18<sup>th</sup> October 2021**: Board of Directors induction
- **19<sup>th</sup> October 2021**: Board of Directors approval

- **3 meetings** on **Business Plan (Pillar ESG) and Net Zero commitments** (e.g. Own Emissions Plan and sectorial target setting analysis)

- **2<sup>nd</sup> February 2022**: Business Plan discussion

- **2<sup>nd</sup> February 2022**: Business Plan discussion<sup>1</sup>

- **3<sup>rd</sup> February 2022**: Business Plan approval

On 20<sup>th</sup> October 2021

← announcement of adherence to NBZA →

On 4<sup>th</sup> February 2022

← new Business Plan presentation →



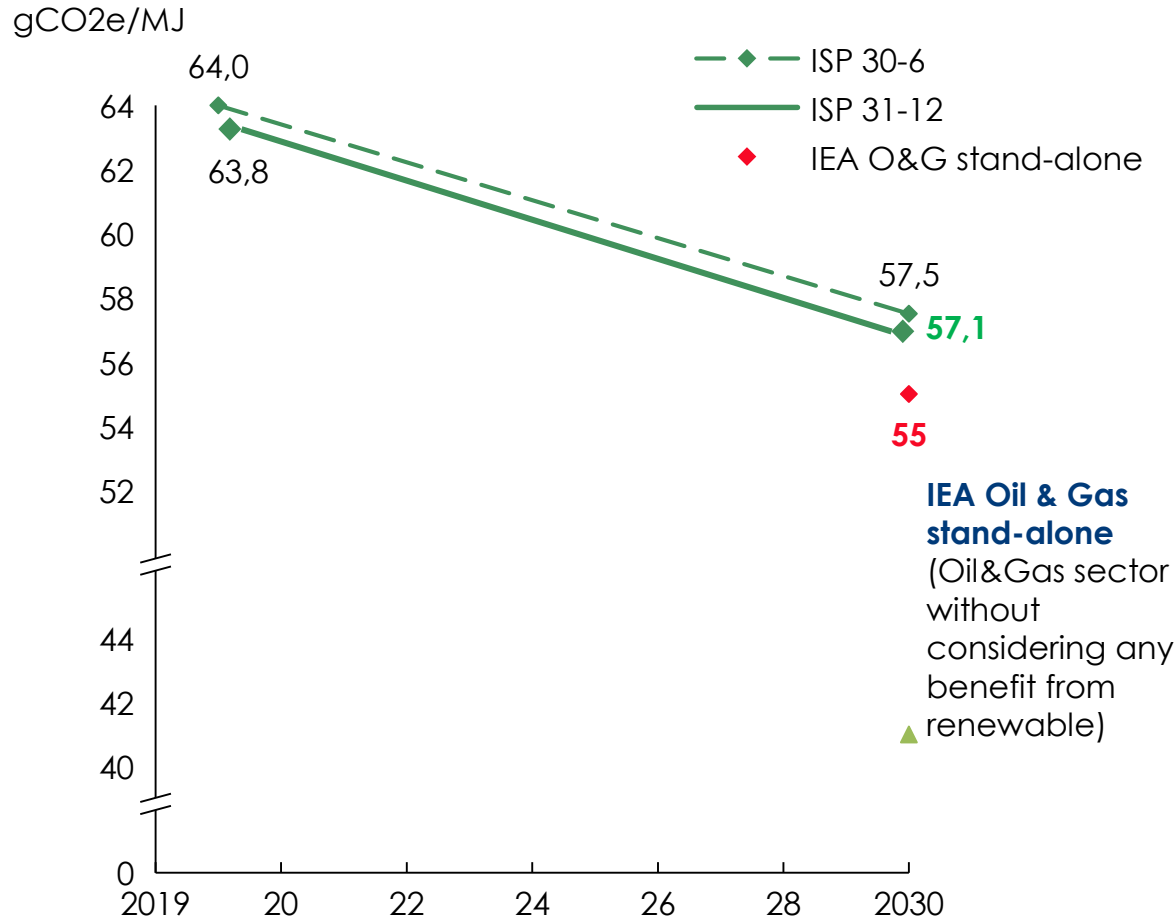
1. In the sessions dated 2 feb 2022 the Risk Committee has examined the industrial Plan 2022-25 and the RAF 2022. In Raf document: i) the limits of some sectors have been redefined (ie. Oil & Gas) plan discussion; ii) has been introduced a new threshold of Early Warning for Orange Sectors (mining, gambling and tobacco); iii) has been reinforced the processes ESG & Reputational Risk Clearing and Major Operations

# OIL&GAS – ISP 2030 ESTIMATE (BASED ON CURRENT CLIENT PORTFOLIO) IS WITHIN THE 2030 RANGE TARGET ANNOUNCED IN THE BUSINESS PLAN

ILLUSTRATIVE

NOT EXHAUSTIVE BENCHMARK

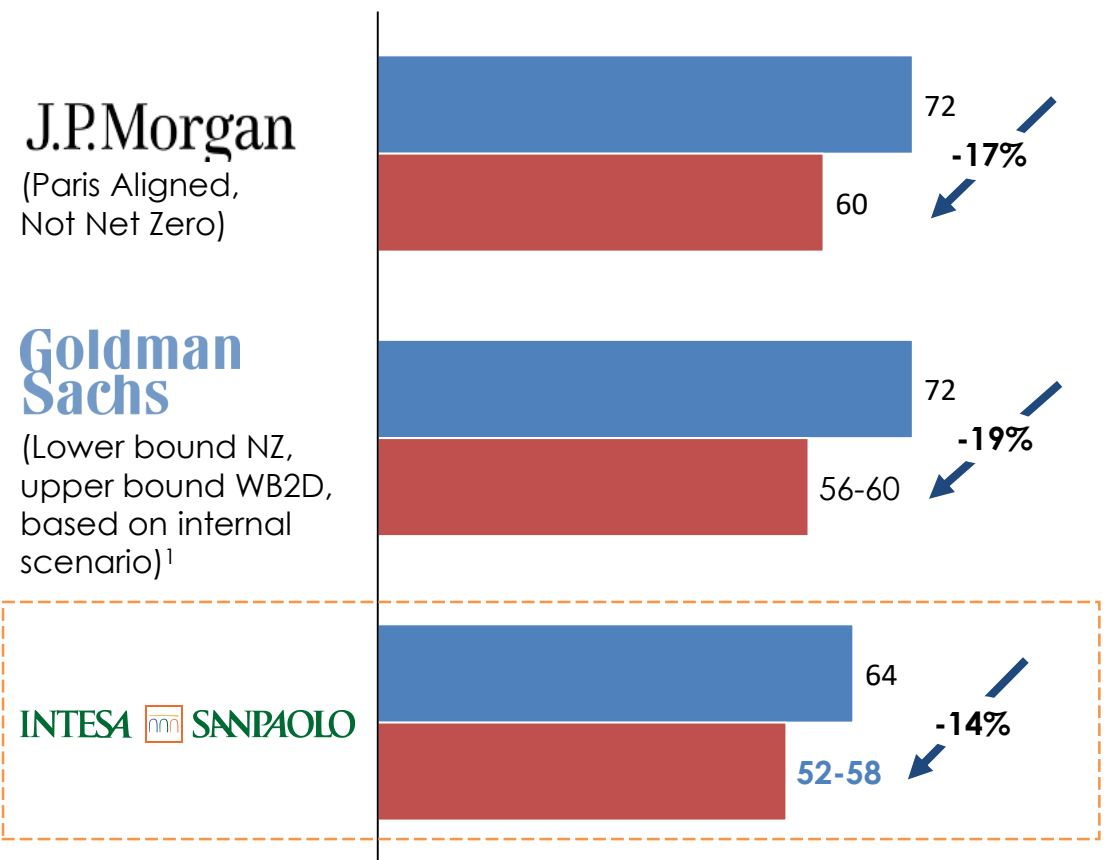
## Curve ISP vs. scenario Net-Zero



## Benchmark target ISP vs. peers

Emission intensity, gCO2e/MJ

2019 2030





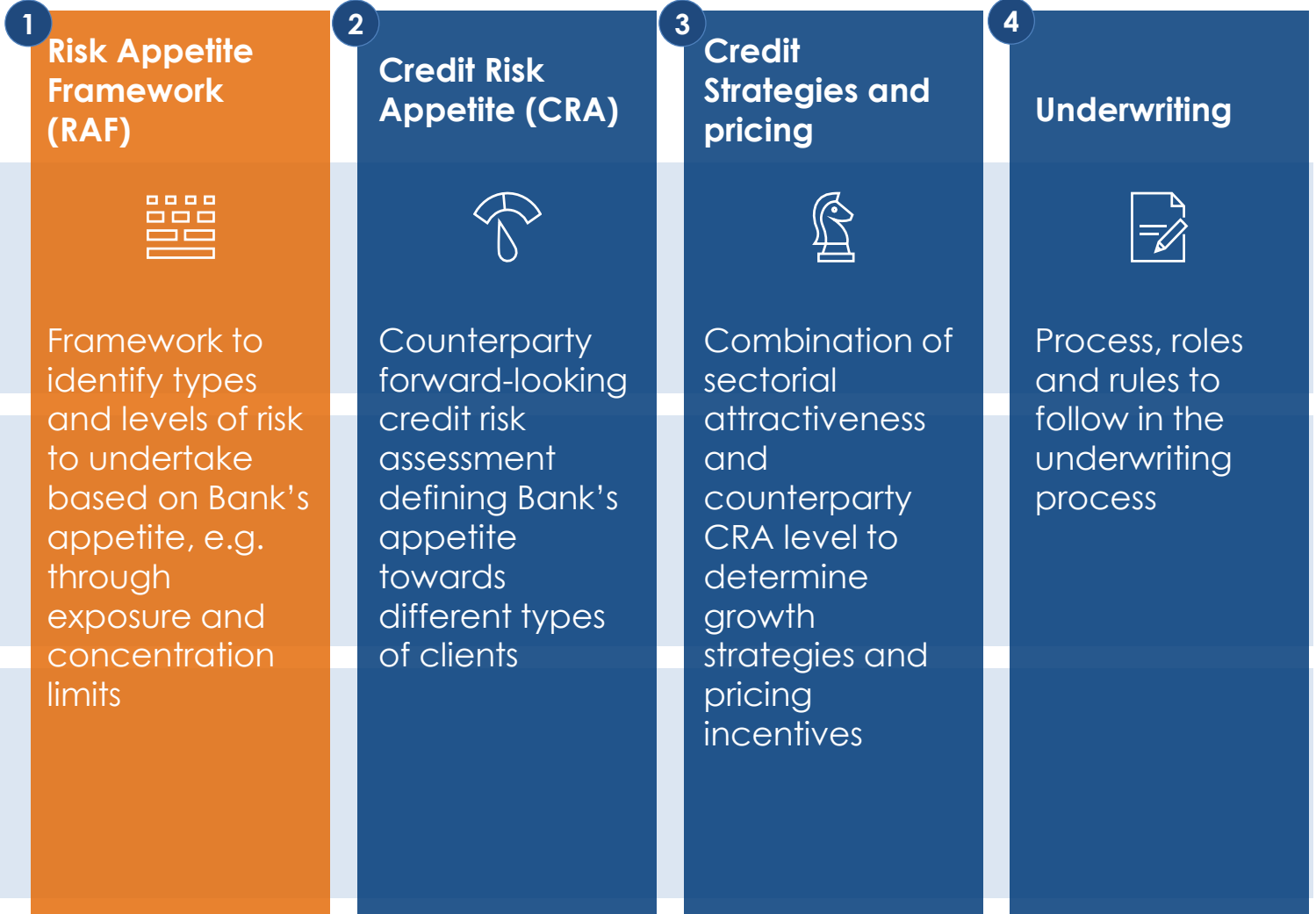
1. "The lower bounds of our targets are aligned to net zero pathways from Goldman Sachs' Carbonomics. The upper bounds for all sectors reflect a rapid decarbonization in the context of evolving policy and technology dynamics. In all three sectors, our proposed target ranges are aligned with the goals of the Paris Agreement to limit the increase in global average temperature to well below 2°C above pre-industrial levels"

# CLIMATE & ESG METRICS HAVE BEEN INCLUDED WITH THREE LEVELS OF GRANULARITY ACROSS THE WHOLE RISK FRAMEWORK

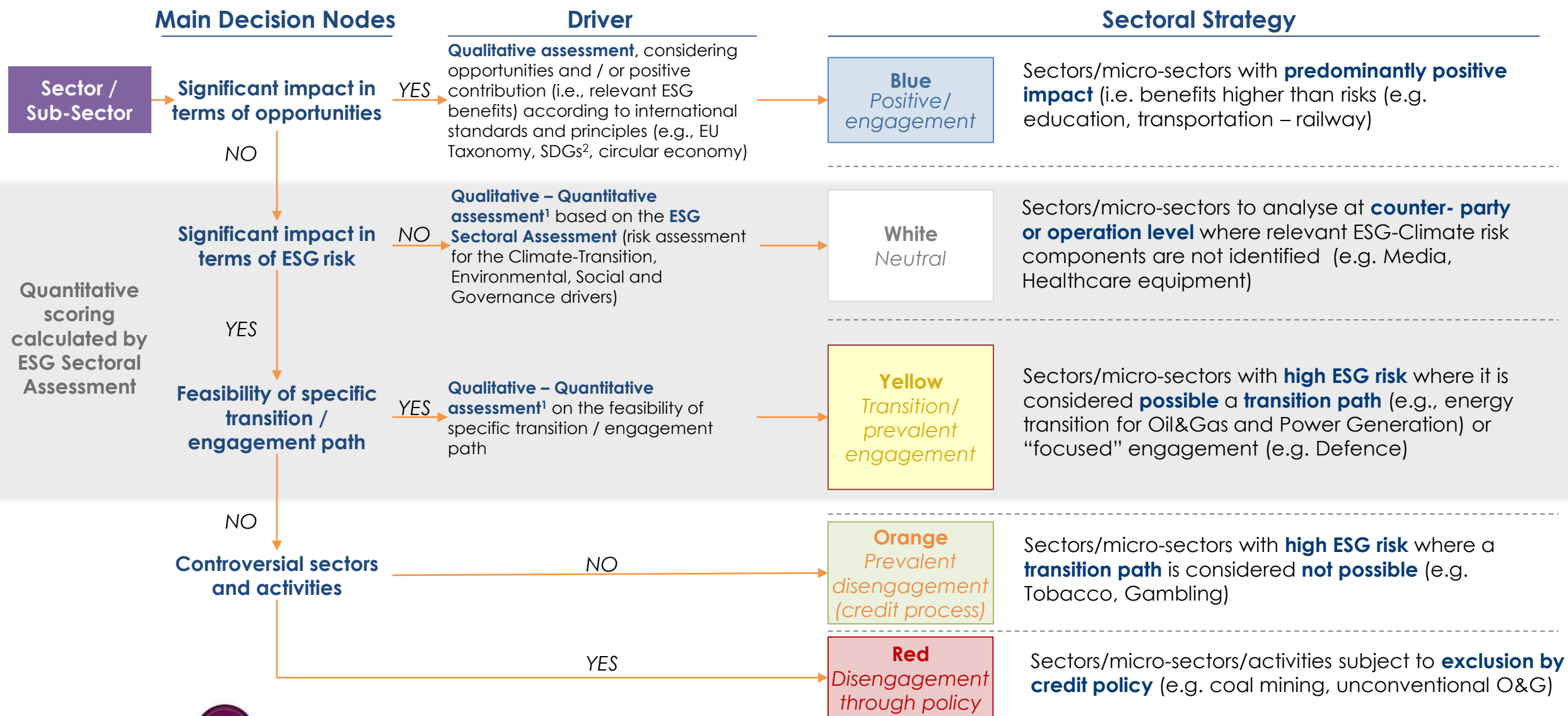
## Description of ESG Framework processes

### New ESG-Climate metrics

Granularity	Description
<b>A</b>  <b>Sector/ Micro-sector</b>	<b>ESG Sectorial Heatmap Assessment<sup>1</sup></b>
<b>B</b>  <b>Counter-party</b>	Internal <b>ESG Score<sup>2</sup></b> at counterparty level
<b>C</b>  <b>Transaction</b>	<b>Sustainable Products framework<sup>3</sup></b> vs. standard products/operations



# A A SECTORIAL HEATMAP ALLOWED TO IDENTIFY 5 ESG-CLIMATE SECTORAL STRATEGY CATEGORIES



# A ESG SECTORAL ASSESSMENT AND ESG/CLIMATE SECTORAL STRATEGY: FIRST INSIGHTS FOR OIL&GAS AND POWER GEN

ILLUSTRATIVE

Climate Sensitive micro-sector are identified based on **Transition risk**  $\geq 2$   
High risk micro-sectors are identified based on either **Transition risk**  $\geq 4$  and **ESG risk**  $\geq 4$

SECTOR / Sub-Sector	Physical Risk	Transition Risk	E	S	G	ESG	Climate Sensitive <sup>1</sup>	High risk <sup>2</sup>	Strategy
<b>OIL AND GAS</b>	2	4	4	3	4	4	☑	☑	Yellow
Oil and Gas - Gas	2	3	4	3	5	4	✓	✓	●
Oil and Gas - General	2	5	5	3	5	4	✓	✓	●
Oil and Gas – Manufacture of coke oven product	2	5	5	3	5	4	✓	✓	●
Oil and Gas – Oil	2	5	5	3	5	4	✓	✓	●
Oil and Gas – Refinery	2	5	5	3	5	4	✓	✓	●
Oil and Gas – Retail	2	2	2	3	3	3	✓		○
Oil and Gas – Transport via pipeline	2	4	5	3	5	4	✓	✓	●
Oil and Gas – Wholesale	2	2	2	3	3	3	✓		○
Oil and Gas – Agents	1	1	1	3	3	2			○
<b>POWER GENERATION<sup>3</sup></b>	3	4	5	4	4	4	☑	☑	Yellow
Power Generation – Nuclear Energy	2	3	4	4	4	4	✓	✓	●
Power generation - Electricity, gas, steam and air condit.	3	4	5	4	4	4	✓	✓	●



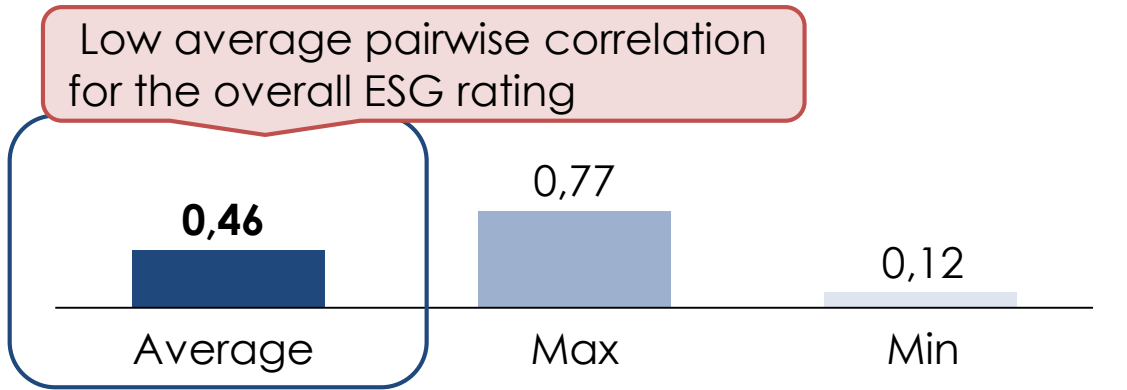
# B DESPITE THE WIDE RANGE OF VENDORS, NO STANDARD APPROACH FOR ESG SCORING RESULTS IN LOW CORRELATION AMONG PROVIDERS

ILLUSTRATIVE | NOT EXHAUSTIVE



ESG market players approaches differ due to various methodological and data-driven choices

Methodologies	Inputs / KPIs
Aggregation and weighting approach	Data sources used
Normalisation (e.g. cross-sector or within sector)	Selected KPIs (#, thematic coverage)
Standardisation	Data pre-processing



# 1 STARTING FROM 2021, ESG AND CLIMATE CHANGE RISKS HAVE BEEN SPECIFICALLY INCLUDED INTO RISK APPETITE FRAMEWORK

From 2022 Group RAF

A **specific focus on ESG and climate change risks was introduced in 2021 RAF**. The key elements were:

- a Group **limit -on the additional net granted amount towards the Oil&Gas sector** equal to 3.3 € Bn
- the introduction of a **sectoral policy on unconventional Oil&Gas**, within the ESG Guidelines framework
- the definition of a **shortlist of controversial companies**, subject to the MST process without materiality threshold

In 2022 RAF, a dedicated section for ESG, Climate Change and Reputational risks was taking into consideration:

## Commitment to net zero

The **Oil&Gas limit** was enhanced leveraging on the activities conducted in order to set the Net Zero Commitment. The analysis allowed to identify, within ISP credit portfolio, counterparties more exposed to transition risk from those that could be considered 'best in class' in terms of transition strategy. The latter are therefore not subject to the limit



- ✓ Fine tune the **O&G limit** (stock of total granted amount) to contain exposures towards players more vulnerable focusing on counterparties with a high emission intensity and without significant transition plan. Counterparties "best in class" will not be subject to the limit as long as the risk level assigned by the ESG and Reputational risk clearing process is no higher than 'medium'. Net Zero KPI's and benchmark will be applied to assess the climate risk profile. Facilities with specific purposes (e.g. ESG facilities, green loans, brown to green operations and sustainability loans) will not subject to the limit
- ✓ Looking at **KPI's** (i.e., Co2/MJ emissions level) to verify the positioning vs the sector and transition scenarios both for **O&G** and **PowGen** counterparties to guide the limit setting and the ESG and reputational clearing assessment

## ESG sectoral Assessment ESG Sectoral Strategy

Leveraging on the outcome of activities related to the New Credit Framework and in order to extend the Section scope beyond C/E risks, a limit (early warning) was set for '**orange sector**', where counterparties may often present other relevant issues (social dimension)

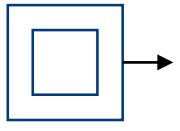


- Lower the current limit of the **Coal mining** sector with the aim of a **complete phase-out by 2025**
- Introduce, according to the color-coding approach, a **new limit for the orange sectors** (mining, gambling and tobacco) characterized by relevant issues especially on social dimension
- Extend the **MST** process to **all** the **sectors** subject to **ESG & reputational risk clearing** (e.g. chemical and pharmaceutical)
- Develop further **sectoral policies**, over the ISP business Plan horizon. The new policies will focus on energy production, transportation, biodiversity
- Confirm the subjection to the **MST** process of all credit lines of the "**controversial names**" shortlist

# 2 CLIMATE/ESG RISK SCORE CAN BE COMBINED WITH THE CREDIT RISK APPETITE AND RATINGS THROUGH THREE DIFFERENT APPROACHES

## Methodologies to combine Climate/ ESG score with Credit Risk Appetite

Integration of Climate/ESG score in internal rating model

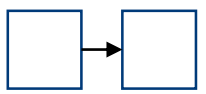


The **Climate/ESG score fully integrated in the rating** model with **dedicated modules** and quantitative and qualitative **variables capturing climate risk**

### Pros and Cons

- + Unique integrated model that **avoids double counting** of risks/elements
- + **Integrated across all credit processes without** need of significant **process design changes** and interventions
- Need of **rating model re-development** and **internal validation process**
- **Limited data availability** and **observed connection to credit performance** to match typical internal **rating model data quality standards**
- Potentially **limited impact** of climate risk components on **overall rating score**

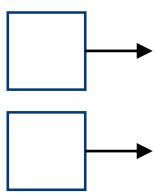
Notch-up/down of internal rating based on Climate/ESG score



The **Climate/ESG score impacting** the credit rating with a **notch-down and notch-up of the rating** based on the Climate/ESG score value

- + **“Separate” and “visible” C&E** impact on credit risk assessment
- + **Flexibility for the use** of scores **in different components of the credit processes**
- **Potential double-counting** of risks/model elements between the two scores (only relevant if the final rating feeds all “use test relevant” credit processes)

Separate Climate/ESG score and credit rating



Two separate scores, i.e. the **Climate/ESG score** and the **credit rating**, integrated in the **underwriting and monitoring process** with **rules combining climate and credit risk assessment**

- + **Flexibility in methodology for the combination** of climate score and rating, e.g. through **decision-making rules** within the credit processes
- **Lack of integrated score** with **overall risk profile** of the counterpart capturing both climate and credit risk assessment and, as a consequence, **need for climate-related overlays** in the credit UW processes



### 3 CREDIT STRATEGIES ARE ASSIGNED BASED ON SECTOR ATTRACTIVENESS AND CRA RISK PROFILE

#### Methodological framework

##### Target portfolio identification

Evaluation of **sectors attractiveness** based on specific KPIs (e.g., Revenues / RWAs), forward looking elements and other specific factors (e.g. ESG)

##### Definition of Strategic Guidelines

Definition of specific **Credit Strategies** applied in origination, based on the combination of **sectorial attractiveness level** and **risk CRA** areas, e.g.:

- **Strategy 1:** low risk (CRA green) and high attractiveness, where the **origination growth** should be focused
- **Strategy 6 or 7:** medium risk (CRA yellow) and low attractiveness or high risk (CRA red), where new **originations** should be **progressively reduced**

##### Pricing adjustments definition (Credit Strategy Adjustment)

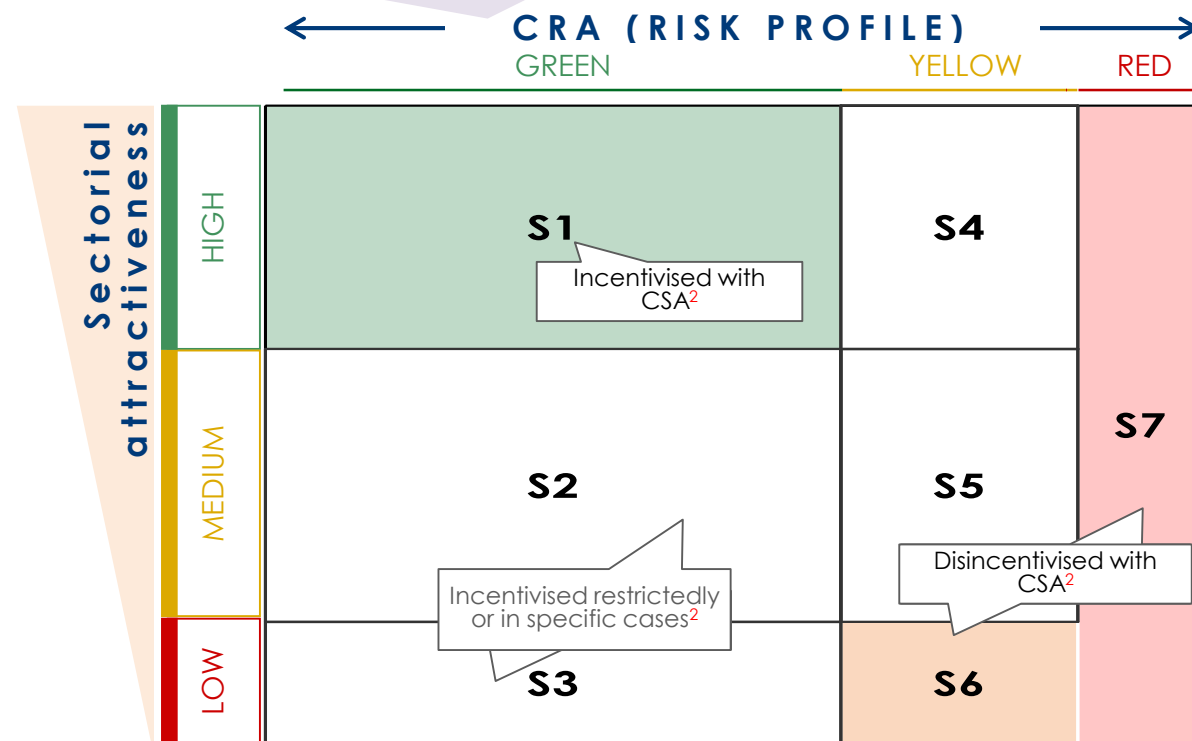
Application of **Credit Strategy Adjustment («CSA»)**, i.e. discounts (S1)<sup>1</sup> or increase (S6 and S7) applied in pricing to new originations

##### Monitoring of new origination and use of plafond

**Quarterly monitoring of evolution of new originations** to verify the coherency with Portfolio Target and use of plafond

#### Credit strategies matrix

ESG/Climate considerations at counterparty level are integrated in CRA score



**Sectorial heatmap** is integrated within the sectorial attractiveness with a **cap at low** for red sectors, **notch down** for orange sectors and **notch up** for blue sectors

# ANY QUESTION?



**Thanks for your attention!**  
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