

Action plans for the integration of climate-related and environmental risks into LSI business processes: main findings and good practices

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1. Introduction

In 2024, the supervisory dialogue with the less significant banks (LSIs) on climate and environmental risks (C&E) focused on monitoring the implementation of the 2023-2025 action plans for alignment with Supervisory Expectations ('Expectations'),¹ including on-site reviews. The information collected for each bank was taken into account as part of the SREP process.

The analysis of the action plans made it possible to identify elements to focus on at individual level and any potentially significant delays for a significant number of banks. It also highlighted some good practices mostly developed by institutions that had already shown greater sensitivity to ESG issues in previous surveys.

Hereafter, in continuity with what was done in the previous years,² an update on the state of play of the LSI system for each section of the Expectations (section 2) and 'good practices' observed (section 3) in the thematic areas listed in Table 1 is provided.

Banca d'Italia has continued to monitor LSIs' action plans in 2025, stepping up its dialogue with institutions in view of the approaching end of the three-year cycle of action plans in order to align them with supervisory expectations.

Table 1. Examples of actions identified as good practices

Expectation	Category	Initiative
1	Governance and organizational systems	Role of the Board of Directors (BoD) and action plans
		Professionalism and skills
		Internal control systems
		Remuneration policies
3		Organization
2	Business models and strategies	Strategic planning
		Broadening commercial supply
4	Risk management	Risk Appetite Framework (RAF)
		Optimizing the risk-return profile of the portfolio to take transition and physical risk into account
		Conducting materiality analysis using internal and external information sources
5		Data governance
		Information systems
6		Internal Capital Adequacy Assessment Process (ICAAP)
8		Credit risk
9		Market risk
10		Operational risk
11		Internal Liquidity Adequacy Assessment Process (ILAAP)
12	Reporting	Reporting information on sustainability

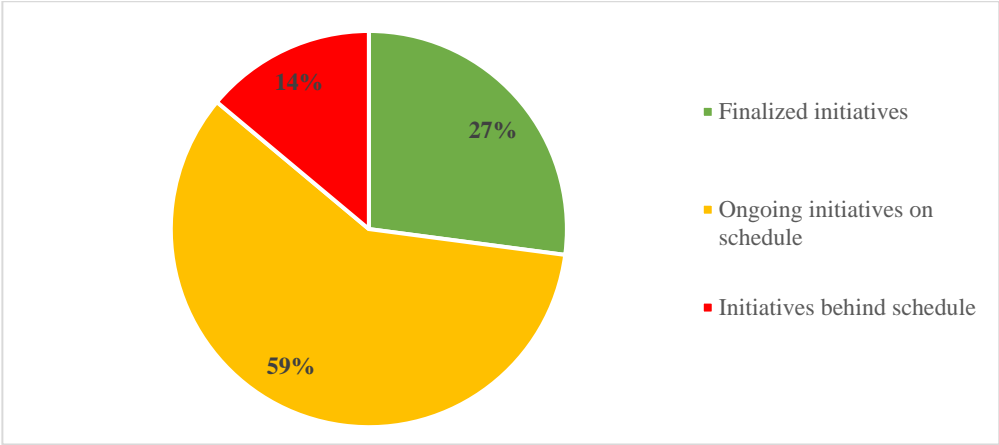
¹ In April 2022, Banca d'Italia, in line with similar initiatives by the ECB and other national supervisory authorities, prepared 12 [supervisory expectations](#) regarding the integration of climate and environmental risks into the corporate strategies, governance systems, risk control and management, and market disclosure of supervised intermediaries.

² For more details, please refer to Banca d'Italia's website: <https://www.bancaditalia.it/focus/sostenibilita/vigilanza-sostenibilita/index.html?com.dotmarketing.htmlpage.language=1>.

2. Main findings

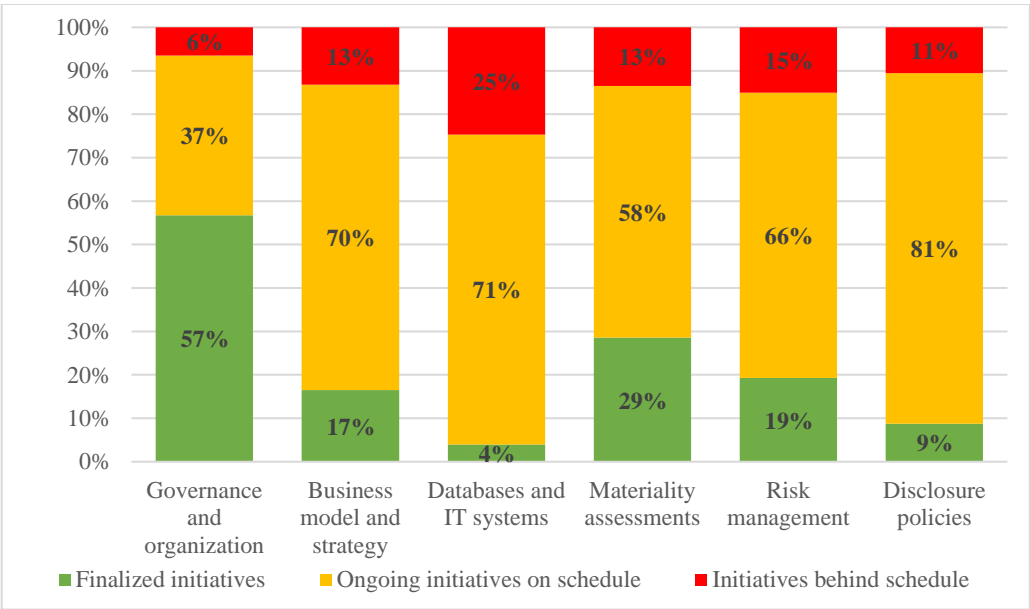
At aggregate level, the LSIs have completed 27% of the planned measures, while 59% of the initiatives were launched within the timeframe of their action plan and are expected to be finalized in 2025, a deadline set by Banca d’Italia to achieve full alignment with the Expectations, while 14% of planned activities are behind schedule (Figure 1).

Figure 1 - Overall progress of actions



Regarding the different thematic areas of the Expectations, activities relating to corporate governance and organization profiles have the highest rate of completion (57%), while the most common delays (25%) concern the construction of a sufficiently complete and reliable database and/or the updating of IT systems to make them more effective (Figure 2).

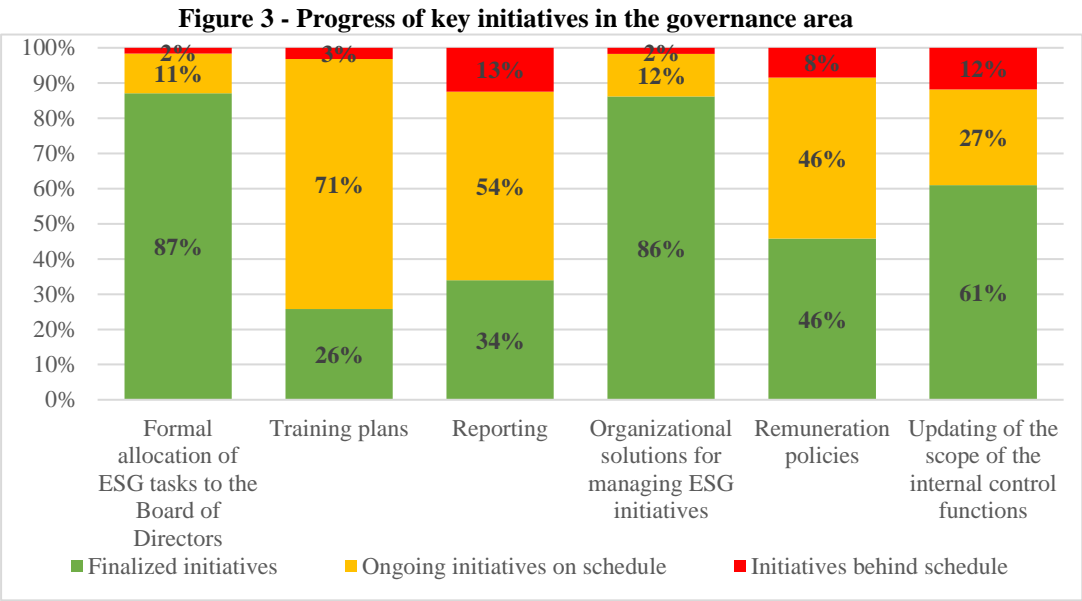
Figure 2 - Progress of initiatives by thematic area



Governance and organization

Interventions in these areas are proceeding broadly in line with planning. In more detail, around 90% of institutions have: 1) assigned C&E risk responsibilities to the governing bodies, 2) adopted organizational solutions for the governance of these issues (existing or ad hoc committees/business units) and 3) initiated training plans. About 60% of banks have updated the scope of their internal control functions.

ESG factors have been introduced into the reporting system and remuneration policies to a lesser degree, and most banks expect to define them in the course of 2025 (Figure 3).



Business model and strategy

Banks have mostly declared that the integration of ‘green’ issues into the overall corporate strategy is steadily being achieved in line with the action plans; only 13% of the sample highlights delays in launching the initiatives planned to integrate ESG factors into strategic planning and for defining Key Performance Indicators (KPIs).

Some 69% of banks have started (in line with the plan) their activities to expand their product offering in terms of ESG, in addition to a further 18% of LSIs which have already completed this. Similar percentages are observed for the banks that have defined (15%) or started to define (72%) KPIs to address or verify their business strategy (Figure 4).

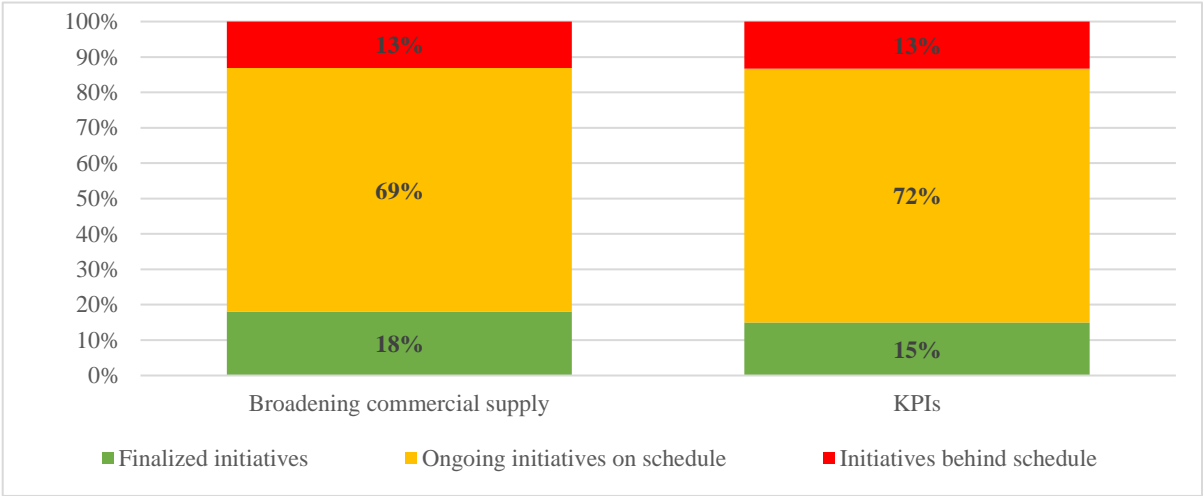
A number of LSIs have developed long-term plans to guide companies along the path towards gradually containing the transition risk, relying, where available, on simplified transition plans produced by their borrowers. The medium and long-term objectives have been experimentally reflected in credit allocation policies, the Risk Appetite Framework (RAF), strategic plans and remuneration policies through specific KRIs and KPIs.

To achieve these objectives, the product offering has also been broadened, for example through new ‘sustainable’ retail and corporate customer products aimed at providing financial support for the achievement of sustainability objectives (e.g. reducing firms’ carbon footprint, improving their energy autonomy and resilience to energy price shocks), for example through the purchase or renovation of energy-efficient properties (EPC classes A or B), the installation of sustainable photovoltaic systems and other forms of renewable energy, and the purchase of more sustainable means of transport (electric and/or hybrid vehicles).

It should be pointed out (see also ‘good practices’) that: (i) some institutions have introduced incentives in terms of reducing the loan rate to achieve certain objectives for improving the carbon footprint or the ESG score assigned to the debtor; (ii) others have broadened their product offering by starting to distribute insurance products for protection against physical risks (e.g. catastrophe policies); and (iii) banks that have issued or planned to issue green or social bonds are increasing.

Albeit to a lesser extent, many initiatives are also planned on the savings product front, particularly in the provision of sustainable investment consistent with the increased sustainability preferences expressed by customers.³

Figure 4 - Progress of key initiatives in the business model and strategy area



Databases and IT systems

Initiatives to set up a database and adjust information systems are behind schedule for about one quarter of the sample compared with planning (Figure 5), which can also be attributed to difficulties in obtaining fully reliable data on SMEs’ exposure - the main counterparts of LSIs - to C&E factors.

Specifically, very few LSIs (7%) declare that they have completed the construction of a climate-related database, in which to collect relevant information on the impact of ESG factors on credit, market and operational risk profiles in a structured and usable way.⁴ Furthermore, 22% of LSIs reported delays in the definition of safeguards for verifying the accuracy of data from external suppliers - widely used by LSIs (45% exclusively, 55% supplement the automatic rating with qualitative questionnaires; see below); these initiatives are only deemed to be completed by 5% of the sample.

A widespread approach is the adoption of a policy of data governance, which includes automated processes and professional figures for the verification of data quality; as a transitional solution, some banks have entrusted the carrying out of data validity and plausibility checks to Risk Management and provided for verifications of the data acquisition process by the Internal Audit.

In some cases, the quality checks on data obtained from specialized providers - mostly based on sector averages, especially for SMEs - are carried out by assessing their consistency with internal evidence, acquired via routine relationships with customers; in this regard, some LSIs - aware of the need to acquire specific information on borrowers to assess their actual transition risk exposure - are trying to raise awareness of the importance of providing adequate feedback to qualitative questionnaires, as the information it provides could ‘adjust’ and make the automatic rating produced by external providers more reliable (some banks currently report a low response rate from customers). A useful tool to facilitate the collection of data among its clients could be the document produced by the ‘Platform for Sustainable Finance’, in order to support SMEs that are not subject to sustainability reporting obligations in mapping

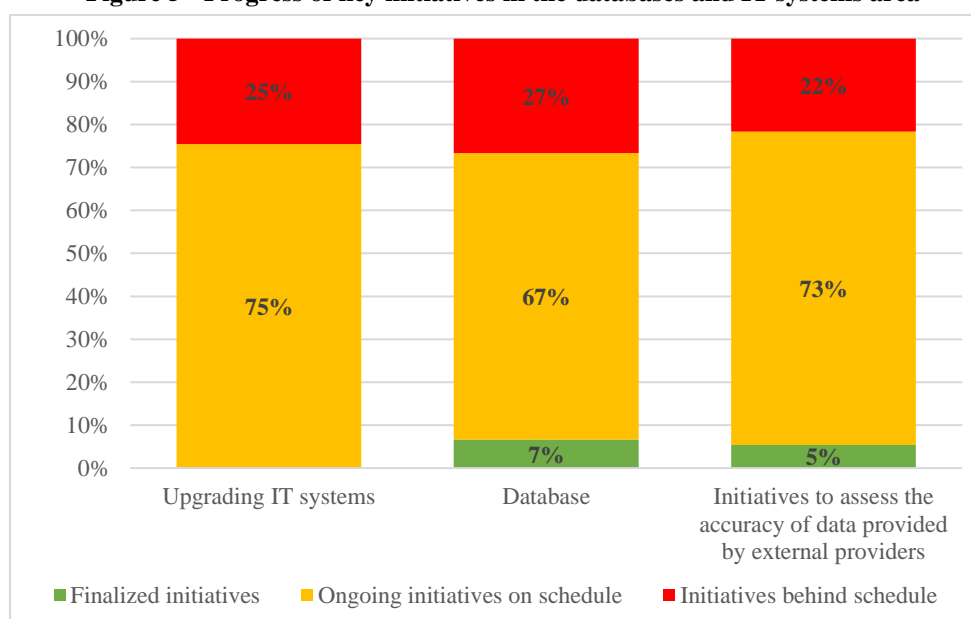
³ E.g. placement of shares of funds with high ESG scores; exclusion of issuers operating in sectors deemed non-socially responsible, in line with the SFDR standards under Articles 8 and 9.

⁴ For example, databases collect information on: ESG scores on credit use and financial investments (sometimes separate E-S-G indicators, integrated into a unique score), energy performance statements in real estate collateral (often estimated based on the year of construction of buildings), geolocation of counterparties and bank real estate assets, and debtors’ carbon footprint.

the ESG information to be provided to the different actors in the economic system, including the financial system.⁵

No LSI has declared that it has fully completed the integration of climate data into information systems. In fact, the integration of ESG factors into credit processes (e.g. loan application, rating model, loan loss provisions) and investment services (customer profiling, products recommended to customers) is under way, as well as, in some cases, the creation of centralized ESG data archives to preserve the information acquired by providers in a usable way. In this context, some LSIs report delays compared with plans because of the IT provider, which had not complied with the timelines for the release of certain products.

Figure 5 - Progress of key initiatives in the databases and IT systems area



Materiality assessment

Initiatives are generally proceeding in line with planning and most LSIs plan to finalize them in 2025 (see Figure 6).

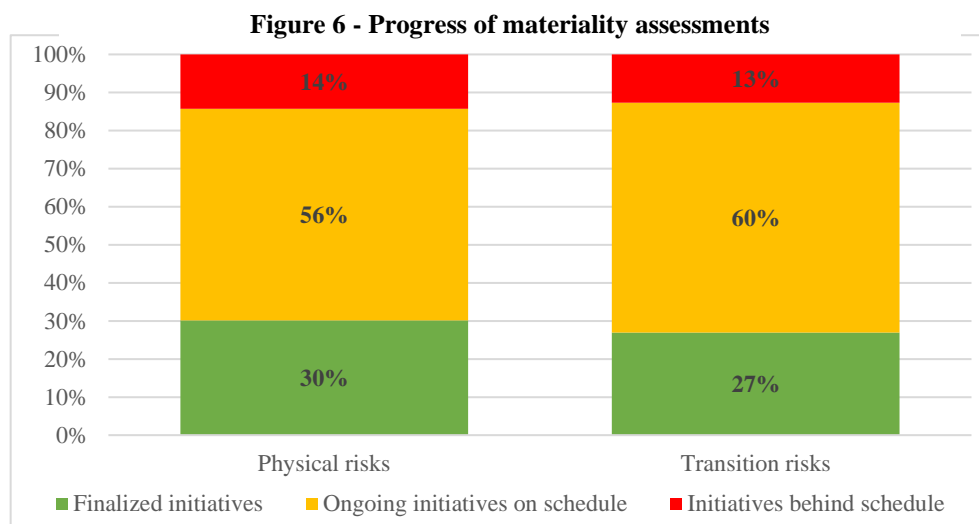
The first materiality assessments have been completed, with reference to physical risks, by 30% of institutions and, for transition risks, by 27%. Banks are generally aware of the limitations of these analyses, conditioned by the still unsatisfactory quantity and quality of the available data and the need to update the analyses based on more robust data. In contrast, about 15% started their analyses behind schedule.

For the credit risk profile, the materiality assessment is carried out in most cases by means of a portfolio mapping, on a geographical basis for physical risk and on a sectoral basis for transition risk; few banks have adopted scenario analyses that consider time horizons until 2050. Some banks conducted structured materiality analyses on operational risk as well - combining the information on physical risk in the different territorial areas with the location of its operational and data centres - and on liquidity (see ‘good practices’).

All traditional banks regard credit risk as being materially affected by ESG factors; around half of the banks also consider the effect on liquidity, reputational, operational and market profiles to be significant.

⁵ The document is available at the following link:

https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_it/sistema_bancario/dialogo_sostenibilita/Documento-per-il-dialogo-di-sostenibilita-tra-PMI-e-Banche.pdf.



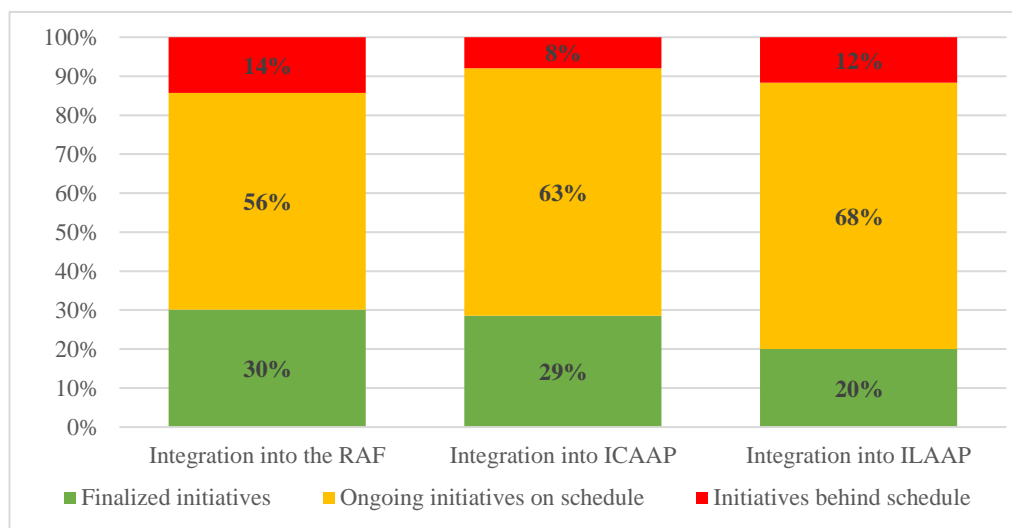
Integration into the RAF, ICAAP and ILAAP

With regard to the integration of climate risks into the RAF and ICAAP, more than 80% of the initiatives have been concluded or initiated in line with planning, while around 15% of the LSIs are still behind in adjusting the ILAAP report and the RAF (Figure 7).

As regards the ICAAP, the number of banks that factor C&E risks by quantifying internal capital under stressed conditions, mainly in credit risk and, to a lesser extent, in operational/reputational risk, increased compared with the end of 2023 (see ‘good practices’).

For the ILAAP, some LSIs included estimates of C&E-related cash outflows in their models (impacts on the liquidity coverage ratio - LCR), sometimes referring to the scenarios indicated in the Climate Scenarios for Central Banks and Supervisors of the Network for Greening the Financial System (NGFS). In some cases, analyses on extinguished deposits were initiated to explore the possible correlation between liquidity risk and ESG risks (see ‘good practices’), as well as assessments of potential limits on access to ECB funding as a result of the reduced availability of green collateral.⁶

Figure 7 - Progress of initiatives to integrate C&E factors into the RAF, ICAAP and ILAAP



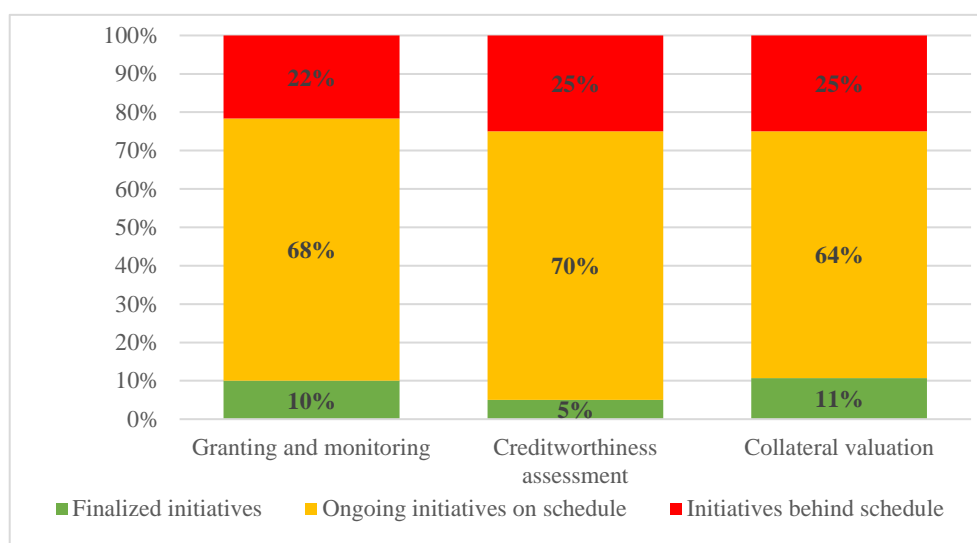
⁶ See <https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220704~4f48a72462.en.html>.

Risk management

Regarding credit risk, initiatives to include C&E factors in business processes have been finalized by a small number of banks; there is also a significant percentage (approx. 25%; Figure 8) of institutions reporting delays compared with planning, often due to longer-than-expected timelines for adjusting IT procedures and/or completing the database (see above).

LSIs typically receive ESG ratings/scores for borrowers from external providers, often based on proxies, which they use to support credit granting and assessment policies. In this respect, banks are called upon to carry out in-depth analyses to assess the robustness of the information received and to check its significance for an appraisal of the riskiness of the counterparty.

Figure 8 - Progress of the key initiatives for the integration of C&E factors into credit risk management



As regards financial risk management (Figure 9), initiatives are aligned with planning for almost all institutions. Most banks (about 90%) in fact started, according to the plan's schedule, the activities needed to introduce ESG factors into the investment policies of their own portfolio or managed portfolios, mainly using data (i.e. a rating/score) from external providers; around one quarter of the LSIs stated they had concluded their planned initiatives.

Also with regard to the integration of C&E factors into liquidity risk management, around 90% of LSIs show progress in line with planning: around one fifth of banks have finished their planned activities,⁷ while only a limited number have not yet started their pre-established initiatives.

As regards operational risk, around 15% of LSIs report delays. Compared with the 2023 survey, an increasing number of banks have considered or intend to consider C&E factors in their Business Continuity Plans, including the occurrence of extreme climate events in possible scenarios that could lead to the impossibility of accessing operational venues or using technological infrastructures, envisaging the use of alternative sites as a remedial action.⁸

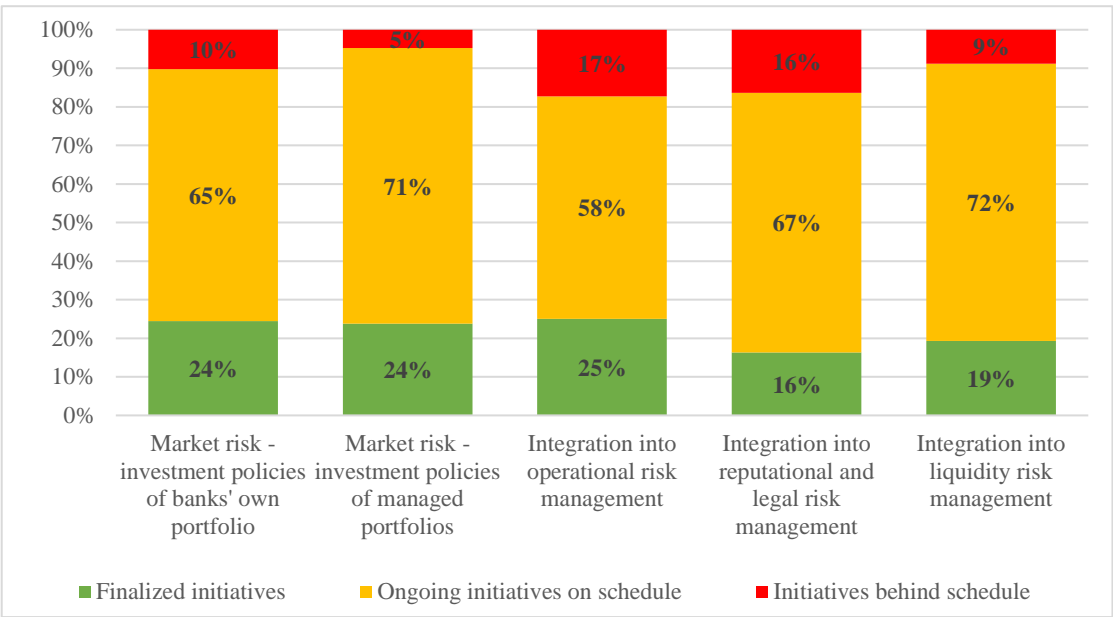
Among the new 'good practices' are LSIs that are integrating the database of operating losses with the loss events determined by C&E events. Finally, some banks have introduced sustainability and exposure

⁷ For example, some banks have estimated possible outflows in the collection of client firms relating to investments for the mitigation of physical and transition risks; in other cases, stress scenarios have been defined using simplified techniques to estimate the possible reduction of deposits relating to damage repair costs if physical events occur.

⁸ To this end, as indicated in 'good practices', some banks have mapped the available properties, giving each bank an ESG score according to its geographical location and the information available publicly on the historicity of climate events.

to physical risk as one of the requirements under assessment for identifying suppliers of goods and services (including those of ‘essential or important functions’).

Figure 9 - Progress of initiatives to integrate C&E factors into market, operational and liquidity risk management



Reporting

An increasing number of banks provide information on Scope 1, Scope 2 and Scope 3 emissions in their sustainability report, in their management report included in the financial statements or in the non-financial declaration (NFD); several institutions have reported information on their website regarding the guidelines adopted to limit the environmental impact of their business.

Moreover, some institutions to which the Corporate Sustainability Reporting Directive (CSRD) will apply in the coming years (from the reporting as at 31.12.2025 or later) have begun a verification of compliance (gap analysis) with the relevant IT requirements.⁹ Finally, some banks, as part of consortium initiatives, voluntarily published information on sustainability integrated into the Financial Report or in a separate document (see ‘good practices’).

⁹ The regulatory framework on Pillar 3 obligations could also change. In fact, on 22 May, the EBA [made](#) the amendments to the Third Pillar ESG reporting rules available for consultation which, in line with the objectives of the European Commission's Omnibus proposal, aim to simplify the prudential reporting requirements on sustainability for banks; the EBA proposes the adoption of a proportionate approach based on the size and complexity of the subject, introducing simplified information requirements for banks other than large ones, especially small and unlisted ones.

3. Good practices

In its report published in December 2023,¹⁰ Banca d'Italia provided a list of 'good practices' observed in its dialogue with institutions, which it may integrate in subsequent surveys.

The following is the updated list of 'good practices'; those derived from the analysis of the action plans carried out in 2024 are highlighted as 'new'. It should be pointed out that the 'good practices' are described for illustrative purposes only, are not binding indications and do not cover all the ways in which LSIs can achieve alignment with supervisory expectations. Each intermediary is therefore invited to assess the coherence of the specific solutions with the business model, the corporate governance system and the organizational system that characterize it, on the basis of the materiality analyses of climate and environmental risks.

3.1. Governance and organizational systems

Expectation 1

The management body of intermediaries plays an active role in steering the integration of climate-related and environmental risks into the corporate culture and strategy, the corporate risk appetite framework and the risk limits of the portfolios managed, consistently defining the main corporate policies and the adaptation of organizational and management systems. In this regard, the management body approves an appropriate action plan.

3.1.1. Role of the Board of Directors (BoD) and action plans

Good practice: updating the powers of the BoD and integrating them into the governance systems

Review of the corporate governance structure and plan, of the regulations of the BoD and of its sub-committees, assignment of sustainability mandates and inclusion of the potential impacts of climate risk factors among those subject to oversight. For example, roles and responsibilities have been assigned by some banks as follows:

- the BoD is in charge of drawing up and approving risk management policies, which specifically include sustainable finance and risk control goals and the ESG factors to be integrated into corporate decision-making processes, and setting operational and supervisory guidelines;
- the Control and Risk Committee supports the BoD in its steering function as well as in strategy execution, based on ESG considerations;
- the Credit Committee conducts preliminary assessments, performs advisory functions and plays a proactive role in relation to lending. In fulfilling its duties, it specifically takes ESG factors into account.

Sustainability sub-committees are also frequently set up.

Good practice: detailed action plans

Detailed action plans provide granular information on the measures designed to implement all the potential enabling factors contained in the Expectations, broken down by area of activity; the actions for each area are described analytically and clearly indicate the intermediate and final objectives, the departments' functions and the implementation schedule.

These plans clearly identify the interdependencies between the different project strands and the measures to prevent and manage bottlenecks, especially those relating to the development and adjustment of applications designed to integrate ESG data into operational processes.

¹⁰ <https://www.bancaditalia.it/focus/sostenibilita/vigilanza-sostenibilita/01-Piani-di-azione-LSI.pdf>.

The best action plans include an estimate of the human and financial resources needed to implement them. This information is essential for verifying the feasibility of meeting the Expectations within three years, the economic viability of projects, and the capacity of institutions to execute them.

Good practice: managing and monitoring action plans

There is clear evidence of planning for the implementation of the alignment plan, the procedures for interaction with the corporate bodies, and the monitoring framework. For example, a steering committee and an operational coordination team have been set up, a project management officer (PMO) appointed, and regular progress meetings scheduled.

The BoD is fully involved in both the preparation and implementation phases. As part of a broader business plan monitoring practice, standard procedures have been identified by the BoD to review the performance of ESG projects and analyse individual areas of interest. Updates on sustainable development plans are also brought to the attention of the relevant sub-committee, if any. The frequency of reporting to the BoD is generally quarterly, while that to the steering committee is usually monthly.

3.1.2. Professionalism and skills

Good practice: professional skills of the board of directors

The BoD's ESG competences have been strengthened through the appointment of advisors with specific expertise.

The document on the 'qualitative and quantitative composition' of the BoD and the board of auditors (BoA) includes environmental skills among the professional requirements for appointment to the boards (regulatory and financial aspects, investment activity). For example, specific skills are requested in:

- ESG, climate change and decarbonization;
- EU taxonomy for sustainable finance;
- renewable energy and energy efficiency;
- environmental certifications and their legislative framework;
- organic and biodynamic agriculture, sustainable farming;
- environmental impact measurement.

Good practice: training for executive directors, auditors and employees

Training programmes have been established to increase the ESG skills of BoD and BoA members, and also to raise awareness of greenwashing.

Similar programmes have been introduced or planned for employees, with a particular focus on those working in credit and investment services. Some banks have supported their private investment advisors and managers in achieving ESG advisor certifications.

Good practice: training and support for transitioning clients

Training courses have been launched for client companies, with the aim of raising awareness of ESG issues and providing assistance in the transition and adaptation process.

3.1.3. Internal control systems

Good practice: internal control function activities

The responsibilities of the control functions have been expanded and the relative annual activity plans have been supplemented with targeted C&E risk checks, including:

- compliance with the reference legislation through gap analyses on the degree of alignment with Delegated Regulation (EU) 2019/2088 (Sustainable Finance Disclosure Regulation), with the European Banking Authority (EBA) guidelines on the management and supervision of ESG risks, and with the Taxonomy Regulation;
- consistency between clients' MiFID profile and the ESG products they offer;
- extension of ordinary audits on compensation and incentive schemes and on the ICAAP report to ESG risks and factors, when they are included in these documents;
- coherence of the C&E risk management plan with the supervisory expectations and the corporate code of ethics;
- risk of greenwashing.

3.1.4. Remuneration policies

Good practice: inclusion of ESG factors in the recognition of variable remuneration

The introduction of qualitative and quantitative sustainability objectives for top managers and risk takers into remuneration policies, with different weights depending on the beneficiaries and in line with the KPIs set out in the strategic plan. Some examples of the indicators used are shown in Table 2.

Table 2 – Examples of ESG targets in remuneration policies

- | |
|--|
| <ul style="list-style-type: none"> • Reduction of the bank's carbon footprint, which includes objectives to contain both direct (e.g. through a gradual switch to energy from renewable sources) and funded emissions (e.g. by supporting the green transition of customers) • Maintenance/achievement of a given ESG rating for the bank • Introduction of green products • Achievement of the objectives of providing 'sustainable loans' or ESG investments in the management of the proprietary or third-party portfolio • Percentage of loan applications accompanied by a socio-environmental assessment • Implementation of the multi-annual plan for alignment with the supervisory expectations • Adoption of a home-work commuting plan • Achievement of ISO 14001 environmental certification • Reduction in residual waste, electricity and paper consumption • Implementation of ESG training programmes for both boards and employees (the target may be expressed in terms of number of participants) • Maintaining commitments in terms of gender equity, diversity and inclusion, and youth inclusion • Launch of a corporate welfare platform for employees • Communication plans on sustainable initiatives for internal and external stakeholders |
|--|

3.1.5. Organization

Expectation 3

The management body adapts the different interventions on the organization and on operational processes to address climate-related and environmental risks in a manner that is consistent with and proportionate to their materiality.

Good practice: organizational and/or process-based solutions that can act positively on the bank's energy efficiency

Creation of internal guidelines to steer efforts to measure and mitigate a bank's environmental impact, that are communicated in the Non-Financial Disclosure together with an initial measurement of direct and indirect emissions, as defined by the Greenhouse Gas Protocol (Scope 1, 2 and 3).

The most common examples include:

- measures to offset the environmental impact of the LSIs, such as redeveloping local parks and other green areas;
- shifting purchasing processes towards green procurement, by developing a model that produces an ESG classification of potential suppliers (see also the risk management section);
- interviews with employees to analyse travel patterns and habits, following which a mobility policy was adopted to reduce the use of fossil-fuel vehicles, suggesting new lifestyle and transport habits for employees and collaborators (e.g. public transport subsidies; car pooling or car sharing; gradual replacement of the corporate fleet with electric vehicles);
- digitalization of processes, favouring paperless approaches and/or using paper from renewable sources;
- improvement of energy efficiency and use of renewable energy, for example by replacing gas boilers with heat pumps, gradually increasing self-produced energy, and using electricity that is 100 per cent from certified renewable sources;
- use of low environmental impact facilities and energy efficiency upgrades of premises and branches.

3.2. Business model and strategy

Expectation 2

In order to ensure the resilience of their business model and to guide its development prospects, when drawing up and implementing their business plan, intermediaries identify climate-related and environmental risks that could affect the business environment, and they can understand and measure their potential impacts.

3.2.1. Strategic planning

Good practice: business environment analysis - physical and transition risk

Regarding physical risk, mapping of the most likely extreme climate events (e.g. heat waves, heavy rains, flooding) and the most exposed areas, with analysis of the potential impacts on people (evacuation, fatalities) and territory (infrastructure, residential buildings, historical and archaeological heritage).

With regard to transition, analysis of certain scenarios and the related risks. For example, starting with the objectives of the Paris Agreement, some transition scenarios (Orderly, Disorderly, Hot House World – source: Network for Greening the Financial System-NGFS.) based on the scientific studies formulated by the Intergovernmental Panel on Climate Change (IPCC) have been analysed and supplemented by the already visible consequences of climate change.

Good practice: drawing up of long-term plans to accompany customers along the emission reduction path

In some cases, transition risk – measured in terms of the carbon footprint of the credit portfolio – was taken into account in the production of the business plan, also considering compensatory measures (e.g. tree plantings), and measures were taken to accompany borrowers on a long-term emission reduction path. This framework has included regular monitoring activities (e.g. half-yearly) on the emissions of the firms financed, the measurement of which will be subject to gradual methodological refinements.

Good practice: strategic planning process

Updating of the strategic process regulation, in which environmental sustainability targets (KPIs) are defined at the planning stage, based on the results of materiality analyses, and their achievement is monitored throughout the life cycle of the plan.

Self-assessment of climate and environmental positioning in order to define appropriate corporate strategies. In defining and assessing the steps to be taken, banks have identified two main lines of action: a ‘direct’ one, relating to the bank’s business organization and operations, and an ‘indirect’ one, relating to the banking and investment products and services provided to customers.

This self-assessment formed the basis for the definition of ESG policies, ESG working groups and training programmes, and for updating key business processes and policies.

3.2.2. Expanding business portfolios

Integration of sustainable finance lending and funding instruments into the business portfolio, as well as advisory services to support businesses in their ecological transition. Table 3 shows some examples found in the action plans, with a more specific focus on some products below.

Table 3 - Examples of sustainable products/services

- | |
|--|
| <ul style="list-style-type: none">• Mortgage loans for the purchase of energy-efficient properties or for the renovation of buildings with an improvement of at least one energy class• Unsecured mortgage loans for firms to support sustainable investment projects• Personal loans to support green investments on favourable terms• Paperless current accounts only accessible through digital channels• Issuance of green bonds / sustainability bonds• Plafond with the EIB - European Investment Bank - dedicated to small and medium-sized enterprises, part of which is earmarked for climate action projects• Support for companies in accessing NRRP tenders, with a particular focus on green investments• Collateral facility from EU funds to support financing for green companies• Leasing contracts for the procurement of machinery powered by renewable energies• Advice to firms to support the green transition• Investment advice focusing on clients' sustainability preferences• Sale of non-life insurance products covering photovoltaic systems or electric vehicles |
|--|

Good practice: financing products with a reduced rate upon achieving ESG objectives - NEW

Provision of financing products that provide for a reduction in the rate applied on the residual life of the loan upon the achievement of certain ESG objectives negotiated with the borrowers. These objectives (KPIs' ESG) can be defined case by case on the basis of the project funded or selected from a catalogue; examples of KPIs' ESG are the reduction of direct/indirect CO₂ emissions, energy or water consumption or the increase in recycled materials used in the company's production or in electric or hybrid corporate vehicles.

In order to monitor the progress of projects that should enable the achievement of KPIs, visits to production sites may be carried out. The achievement of the KPI is validated by the banks after having acquired suitable documentation, and the borrowers highlight it in the financial statements or in the NFD; this approach is encouraging greater awareness among borrowers so that they voluntarily draft a non-financial report.

Good practice: insurance products offer - NEW

Distribution of insurance products to cover against climate risks, such as catastrophe policies, protecting houses or industrial buildings (and, if applicable, their contents) from damage caused by earthquakes, floods and landslides.

Good practice: asset management products - NEW

Banks have signed the UN's Principles for Responsible Investments and adopted a new approach in which clients are directed to select the financial instruments to be included in the portfolio in a manner consistent with their ESG preferences. The adequacy assessment carried out by the bank also includes a consistency check between the sustainability preferences expressed by the customer and the ESG score of the financial product to be purchased.

3.3. Risk management system

Expectation 4

The institutions map the events that could occur as a result of climate and environmental risks (physical and transition) and then incorporate them into the risk management system and identify the potential impact of this on the risks themselves and the implications of a prudential nature.

3.3.1. Risk Appetite Framework (RAF)

Good practice: indicators reported in the RAF – **UPDATED INDICATORS**

Table 4 - Examples of indicators in the RAF¹¹

Area	Key Risk Indicators
Credit risk - transition risk	ESG score thresholds for defined portfolio segments (e.g. mortgages, corporate customers), based on assessments obtained from external suppliers at single counterparty level
	% of exposures to sectors at high risk of transition and to carbon-intensive sectors (green asset ratio - GAR) ¹²
	Banking book taxonomy alignment ratio (BTAR)
	% of green credit exposures (i.e. to individuals and companies with sectors qualified by the bank as less climate-impacted)
	% of exposures to sectors with a high intensity of greenhouse gas emissions (GHGs)
Credit risk - physical risk	% of mortgage loans with a real estate guarantee in the worst energy classes (classes E, F and G)
	% of exposure with physical risk associated with real estate collateral across the mortgage loan portfolio, qualified as 'high' and 'very high', based on data obtained from external suppliers
	% of exposure to companies with an acute/chronic physical risk, qualified as 'high' and 'very high' ¹³
	Indicators of the insurance situation of the borrower
Operational, legal and reputational risk	Own CO ₂ emissions
	Sustainability rating attributed by an external supplier
	Reputational indicators (e.g. media exposure, complaints)
	% of complaints and litigation relating to ESG issues
	Operating losses generated by ESG factors
Market risk	Carbon footprint of companies included in own securities portfolios
	% of concentration of owner's or managed portfolio investments with high-risk counterparties or ESG sectors ¹⁴
	% of securities in the portfolio (owner and managed) with the characteristics set out in Articles 8 to 9 of the Sustainable Finance Disclosure Regulation (SFDR) ¹⁵

¹¹ Some of these indicators are also used as KPIs.

¹² The GAR measures, with respect to total assets, the percentage of exposures included in the banking book that meet two requirements: i) they are provided to large or small and medium-sized enterprises with listed securities that publish the NFD under the CSRD, or to households and local authorities, and ii) they finance 'aligned' assets under the Regulation. However, discussions are under way to introduce changes to the GAR metric, which has room for improvements, relating in particular to the exclusion of firms not subject to ESG reporting obligations from the numerator (i.e. SMEs and microenterprises), the inconsistency between the numerator and the denominator and the incompleteness of the Taxonomy framework. See [Notes on Financial Stability and Supervision, No 45](#).

¹³ Specifically, exposure to several risk factors (floods, droughts, heat waves) is mapped by geolocation of the production units of the borrowers, resulting in the attribution of a synthesis indicator for each company (low, middle, high, very high).

¹⁴ For example, some banks use ratings developed by the Morgan Stanley Capital Index (MSCI), which provide a summary of the issuer's exposure to ESG risks based on its sector, adjusted for its ability to manage and mitigate such risks.

¹⁵ The SFDR defines two types of 'sustainable financial products':

	Number of green products in total products sold
Other	GHG emissions (Scope 1) per employee

3.3.2. Optimizing the risk-return profile of the portfolio to take transition and physical risk into account

Good practice: integration of credit policies to consider transition risk - NEW

With a view to an overall optimization of the risk-return profile of the portfolio, the integration of credit standards for individual counterparties with elements that also take transition risk into account. The following, among other things, have been considered:

- carbon intensity indicators of the portfolio as a proxy for transition risk (such as the Weighted average carbon intensity - WACI - expressed as a weighted average of the ratio of carbon emissions¹⁶ to the turnover of borrowers);¹⁷
- indications by the European Banking Authority (EBA) regarding the most polluting sectors for the purposes of pillar 3;¹⁸
- long-term objectives integrated with intermediate objectives, leveraging on the short-, medium- and long-term investment plans (transition plans) of entrusted firms and reflected, in addition to credit policies, in the RAF, in strategic plans and in remuneration policies through specific KRIs and KPIs;
- cross-sector allocation guidelines, accompanied by the offer of financing dedicated to the energy transition, with the insertion of contractual clauses to monitor the achievement of the purposes of the investment and/or to incentivize virtuous behaviour in the financed companies;
- portfolio composition simulations for achieving the objectives in multiple reference scenarios (e.g. Paris Agreement, scenarios provided by the NGFS or the International Energy Agency) and over different time horizons (e.g. 2030 and 2050).

Good practice: integration of credit policies to consider physical risk - NEW

Observed practices generally include the following steps:

- mapping of the exposure of debtors and real estate collateral to physical risk, generally using information produced by specialized providers or to internal analyses using institutional risk maps (e.g. maps for hydrogeological risk, seismic classification, volcanic risk zones, subsidence or coastal erosion areas);
- an assessment of the risk level (ability to repay debt and/or value of real estate collateral), taking into account any mitigation measures that may be implemented by customers (e.g. specific insurance, business continuity plans, adaptation of buildings);

-
- products that promote, among other things, environmental or social characteristics, or a combination thereof, provided that the companies in which the investments are made follow good governance practices ('Article 8 products');
 - products that aim at sustainable investments with an explanation of how the investment objective has been achieved ('Article 9 products').

Operators who want to classify their products in one or the other category are therefore required to clarify how the products respect sustainability characteristics, or how they achieve sustainable investment objectives.

¹⁶ If the non-financial report of the undertaking is not available, estimates provided by external companies shall be used.

¹⁷
$$WACI = \sum \left(\frac{\text{Exposure}_i}{\text{Portfolio value}_s} \times \frac{\text{Company GHG Scope 1 \& 2 emission}_i}{\text{Revenue}_i} \right)$$

¹⁸ Banking book - Indicators of potential climate change transition risk: Alignment metrics.

- identification of possible areas of concentrated physical risk (e.g. high exposures in geographical areas at high seismic or hydrogeological risk), against which maximum exposure limits may be set, reflected in allocative credit policies (e.g. limits on reliance on certain geographical areas, economic sectors or types of collateral);
- providing financing products (e.g. green loans) or specific services (e.g. advice to SMEs) to support customers in investing in measures that reduce their vulnerability to physical risk (e.g. seismic adjustment, water efficiency), which may be accompanied by contractual clauses aimed at monitoring the purposes of the investment and/or incentivizing virtuous behaviour;
- insurance policy offers to cover catastrophe risks.

3.3.3. Conducting materiality analysis using internal and external information sources

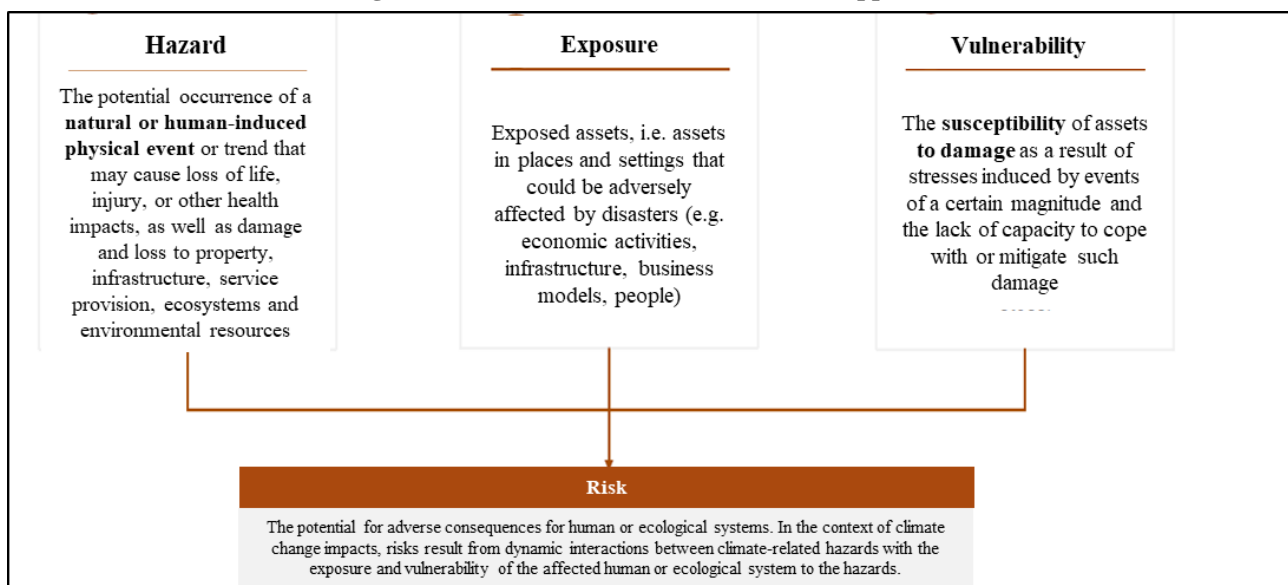
Good practice: documented and structured approaches

Drawing up of structured and documented approaches that make early assessments of C&E risk exposure possible.

One example is the approach adopted by the IPCC, aimed at mapping factors that could affect traditional risks, including through the assessment of transmission channels.

The materiality of the various physical and transition risk events is assessed on the basis of three drivers: hazard, exposure and vulnerability (Figure 10).

Figure 10 - Drivers considered in the IPCC approach

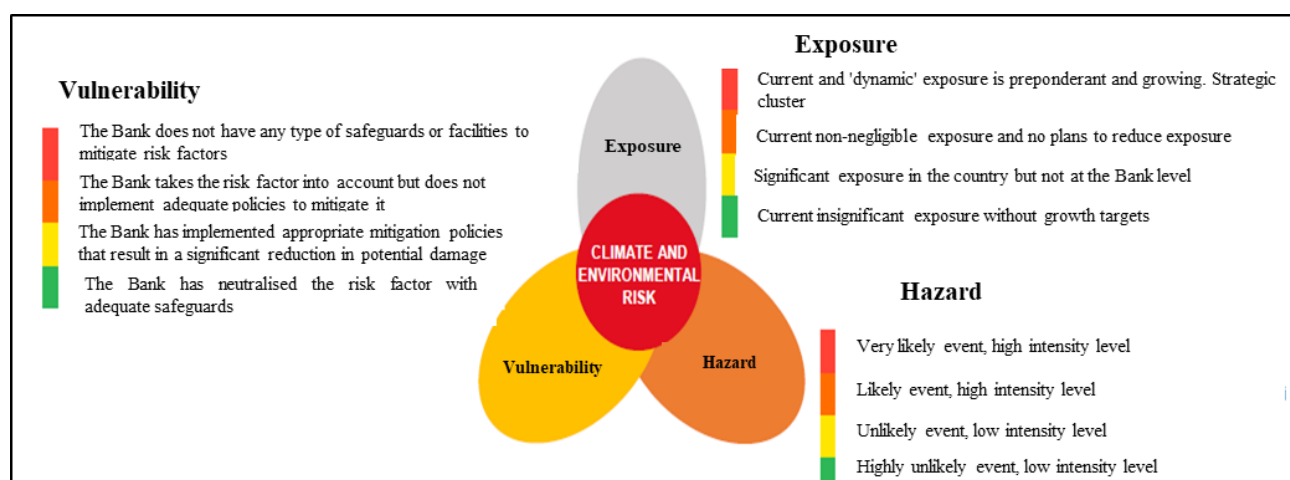


The ‘hazard’ driver for each factor is estimated by using public statistics and reports, such as those of the Italian Institute for Environmental Protection and Research (Istituto Superiore per la Protezione e la Ricerca Ambientale, ISPRA) and the World Economic Forum. As for the ‘exposure’ driver, the impact of physical risks is assessed by taking into account the type of bank and the lending in areas with a high hydrogeological risk; for transition risks, the counterparties in sectors deemed particularly exposed to transition policies were first mapped on the basis of a number of public studies. The ‘vulnerability’ driver is assessed by analysing corporate policies in order to understand the level of protection against C&E risks.

For each traditional risk type, a qualitative score can be assigned by combining the three drivers; each type of risk can be directly or indirectly affected (e.g. credit risk is indirectly affected if an extreme

weather event has an impact on the value of real estate collateral; operational risk is always directly affected as extreme climate events have an impact on business continuity).

Figure 11 – Vulnerability, hazard and exposure assessment methods



The results of the analyses are represented in a heatmap highlighting the most critical C&E risk areas; the output of the matrix makes it possible to focus quantitative analyses on the most significant risk areas.

Research in collaboration with academia is another good practice, specifically the funding of research grants to study models that can estimate the capacity of micro and small enterprises to transition to a circular and decarbonized economy. The purpose of this research is to provide banks with knowledge of their loan portfolio, as well as advice and support in dealing with small local businesses.

Good practice: assessment of the materiality of physical risk in credit risk¹⁹

An analysis of the materiality of physical risk organized according to territory, counterparty type and type of investment financed, using a wide range of information derived from various institutional sources, such as the Istituto Nazionale di Statistica (Istat), the Istituto Nazionale di Geofisica e Vulcanologia (INGV), ISPRA and the Ministry of Culture.

Environmental risk exposure assessment with a synthetic indicator based on the hydrogeological and seismic risk indices, built: (i) the first, on the basis of indicators of flood risk and landslide risk, determined for each Italian municipality based on data extracted from the ISPRA Report; and (ii) the second, on the basis of the map of seismic hazard drawn up by the National Institute of geophysics and Vulcanology (INGV) ('Higher value for the maximum soil acceleration of the values of the grid points within the municipal territory').²⁰

Good practice: materiality assessment of physical risk relating to operational risk - NEW

In order to develop suitable methodologies for the physical risk materiality analysis, sufficiently granular information is used relating to the incidence of risk factors in micro territories, combined with the effective location of the headquarters of banks, proprietary data centres and the main IT providers.

In detail, for each of the properties included, on the basis of the geographical location, a score is determined for each threat of 'acute' and 'chronic' physical risk, which is then synthesized in an overall

¹⁹ For the materiality assessments of transition risk, please refer to the practices described in Sections 3.2.1 and 3.3.2.

²⁰ Other data to which intermediaries could refer are those provided by the Euro-Mediterranean Centre on Climate Change (CMCC), available at the following link: [Climate Data - CMCC](#).

score. Finally, a ‘materiality index’ is determined as a percentage of the impact of the number of properties assigned an overall score in the highest range of the total properties valued.

Good practice: materiality assessment of C&E factors in legal and reputational risk

Several examples of good practices have been observed for the assessment of the importance of ESG factors as causes of operational, legal and reputational risks.

- measuring a bank’s own CO₂ emissions with the methodological support of external providers, by applying the Greenhouse Gas Protocol international standards and the guidelines of the Italian Banking Association (ABILab). The measurement scope, the methods and the results of the assessment are disclosed to the stakeholders in the NFD;
- measuring a bank’s own environmental and sustainability profile using international third-party tools (e.g. tools developed by B Lab and by the United Nations Global Compact);
- using indicators developed by third-party companies to gauge their brand reputation, with a focus on sustainability issues; more specifically, synthetic scores for brand reputation are created, also based on press articles in which the bank is associated with negative commentary and bad reviews on social networks;
- using a ‘risk thermometer’ to monitor, ex ante and ex post, all the risks (including climate-related and environmental ones) that may have an impact on a bank’s media exposure and reputation; in this case too, in some of the practices studied, a score is assigned for actions taken to mitigate a high risk;
- reviewing ESG litigation files and complaints.

Some of these indicators have been included in a number of RAF documents.

Good practice: materiality analysis on liquidity risk - NEW

Geographical mapping of depositors and use of public databases to determine the share of funding localized in the areas most exposed to C&E factors.

For example, based on the relative probabilities of occurrence, some public databases provide the level of exposure per province on a global scale to a range of physical risk threats (e.g. floods, landslides, extreme heat, water scarcity).²¹ For each Italian province in which the institutions present data collection reports, an overall score has been determined, calculated as the average of the individual physical risk factors provided in the database; subsequently, a ‘materiality index’ has been calculated, determined by the ratio between the collection volumes relating to the provinces with the worst overall score and the data collection as a whole.

However, as described in the section entitled ‘Databases and IT systems’ in Chapter 2, banks should step up their efforts to obtain analytical information from individual counterparties.

²¹ The data sources mentioned in this report are those currently most frequently used by the LSI system, but they do not cover the range of databases that banks can use. In order to build a high-quality database (see Expectation no. 5), banks are expected to rely initially on databases attributable to qualified Italian or international institutional entities (e.g. Ministries, Research institutes, European Commission).

3.3.4. Data governance

Expectation 5

Intermediaries take action to create a comprehensive, high-quality database for climate-related and environmental risk profiles integrated into an information system suitable to support the development of metrics for assessing climate-related and environmental risks.

Good practice: safeguards to ensure the accuracy of data provided by external providers

Formulation of an ESG data governance and data quality policy to ensure the robustness and integrity of data obtained from third-party providers.

Policies define automated processes and identify figures for professional data quality monitoring, such as a single manager for the whole company structure or a contact point for each business area (credit, investment services); data quality checks are also carried out via comparisons with customer evidence already held by banks or obtained through specific qualitative questionnaires, and they can determine the correction of the rating determined by the external provider.

In some cases, the Risk Management Function is involved in data validity and plausibility checks; the Internal Audit conducts verification audits of compliance with the data governance policy.

Another safeguard was the involvement of bank representatives in training initiatives organized by suppliers, during which the methodologies used were presented, or at meetings requested from the supplier to deal with the first extractions made and the rationale of the methodological choices.

3.3.5. Information Systems

Good practice: adaptation of IT systems

Active involvement of IT suppliers to ensure the feasibility, from the information systems point of view, of the different initiatives contained in the action plan and the identification of possible evolutionary interventions by IT services. In some cases, several banks have coordinated with each other in order to promote, among the common IT service providers, interventions aimed at accelerating certain developments that can make action plans initiatives possible.

The most important IT activities include the integration of ESG factors – derived from third-party sources and/or questionnaires administered by banks – into data lakes and business processes such as commercial, credit, risk management, planning and balance sheet processes.

With specific regard to credit, the IT solutions that recur most frequently, including those relating to compliance with the EBA guidelines on lending and loan monitoring, include: making ESG scores available online, integrating qualitative questionnaires and the Climate Risk Score calculated by data providers into credit files, and retrieving energy certifications and information on the physical risk of real estate pledged as collateral.

In this regard, one good practice is the definition of a proprietary scoring tool that considers all ESG factors, which is already integrated into IT systems and used for the climate/environmental risk assessment of new credit applications.

As shown in Chapter 2, the ‘risk management’ section, it is essential that the information received from external suppliers be properly assessed in terms of robustness and significance.

3.3.6. Internal Capital Adequacy Assessment Process (ICAAP)

Expectation 6

Based on suitable materiality analyses, intermediaries incorporate climate-related and environmental risks into their internal capital and liquidity adequacy assessment processes by integrating the risk limits system. The intermediaries not required to assess internal capital must supplement the limits system to take into account the impacts of climate-related and environmental risks on the value of their portfolios under management and/or operating volumes.

Good practice: ICAAP - stressed internal capital on credit risk - UPDATE

Introduction of C&E factors into ICAAP reports, quantifying internal capital against credit risk in the adverse scenario. Operationally speaking, the estimation exercise took place, for example through:

- the assessment of the impact on PD and LGD (and the fair value of financial assets) parameters of a deterioration in fossil-source energy supply conditions for borrowers (e.g. a significant oil price increase);
- the use of structured methodologies based on ISPRA data, aimed at identifying the physical risk associated with loans with counterparties resident in certain geographical areas;
- for the purpose of quantifying LGDs, the estimated depreciation of commercial and residential real estate – placed as collateral for credit exposures – due to low energy efficiency or non-compliance with regulatory environmental standards;
- the introduction of an increase in the lifetime PD of corporate counterparties based on the scenarios developed by the NGFS.

In other cases, the credit risk stress test followed the ECB's approach adopted for significant banks, identifying the sectors most exposed to the alternative, orderly and disorderly transition scenarios (i.e. scenarios in which no regulation or policy is introduced aimed at limiting climate change, with a reduction in transition risk and an expansion in the physical risk linked to natural disasters).

Finally, other examples observed were:

- for transition risk, a simulation of the impact relating to the introduction of a carbon tax on emissions, by worsening the balance sheet data and ESG ratings of debtors (the latter acquired by external suppliers);
- for physical risk, a simulation of the default for counterparties operating in the agricultural sector with 'fragile' ratings, assuming that they are unable to reconvert/move production plants as a result of permanent climate change (2-degree temperature rise), leading to a potential loss in productivity/biodiversity.

Good practice: ICAAP - Reputational and Strategic Risk Internal Capital - NEW

The inclusion of the hypothesis of a loss of customers due to greenwashing events and/or inadequate attention to ESG issues in the model for estimating internal capital on reputational risk; specifically, reduced revenues relating to lower usage and indirect funding relating to customer loss are factored in.

3.3.7. Credit risk

Expectation 8

Intermediaries integrate climate-related and environmental risks into all phases of the credit process, adapting their lending policies and procedures in line with the EBA GLs on loan origination and monitoring (EBA/GL/2020/06).

Good practice: lending policies

Introduction into credit policies of a definition of ‘sustainable lending’ from an ESG perspective and of criteria for assessing the sustainability of customers.

Definition of exclusion lists and/or concentration limits for specific sectors and/or counterparties that may be considerably exposed to ESG factors (e.g. high physical risk or with a significant delay in implementing transition plans compared with similar entities by sector and production); for potentially riskier counterparties, activation of an enhanced investigation and/or decision-making process to ensure an adequate level of oversight of ESG issues depending on the importance of the transaction/client.

Good practice: calculation of the expected loss - NEW

Application of corrective measures to the calculation parameters for the expected loss, subject to periodic ex post analyses to assess their robustness and verify their adherence with the actual risk of the counterparty.

Specifically, they are experimentally applied and evidence-based remedies produced by external suppliers, including: (i) an increase in PD that grows as the ESG rating worsens and differentiated between Stage 1 and Stage 2; and (ii) an increase in the LGD for mortgage loans defined by the level of physical risk and/or energy efficiency of collateralized properties.

Good practice: assessment of collateral

Adoption of a collateral assessment framework that takes account of physical and transition risks. Projects considered as good practices include:

- integration of information on secured real estate with the catastrophic events covered by insurance policies and the corresponding deductibles and ceilings;
- tightening of appraisal selection and monitoring processes, by including ESG factors in appraisal standards, as well as in the triggers for adjusting property values and for updating estimates;²²
- sensitivity analysis of the value of the properties pledged as collateral, taking C&E risks into account.

Another example was the inclusion of the ESG assessment for collateral in the loan approval and monitoring phase, establishing energy efficiency, emissions and flood risk KPIs. If the pledged property exceeds the KPI threshold, the assessment is escalated to the sustainability unit, which carries out further checks and provides a final technical opinion.

Finally, backtesting analyses of property values to collateralize customer loans were conducted using the values obtained by the Automated Valuation Model (AVM),²³ and Real Estate Market Observatory quotes published by the Revenue Agency as a reference.

²² For example, experts are asked to consider whether the property is in a seismic or hydrogeologically hazardous area (e.g. proximity to waterways or coastlines subject to erosion or potentially rising sea levels) or exposed to other environmental risks (e.g. land lowering, proximity to potentially polluting industrial sites, exposure to extreme weather events). Assessments of real estate should therefore take account of historically recorded adverse events in the area (e.g. earthquakes, landslides and floods) and the presence and efficacy of any defence (embankments, retaining walls, drainage systems).

²³ AVMs are able to measure - with varying degrees of reliability - the real estate value using the comparative method. The reliability rating is given in the first instance by the quality - and quantity - of available comparatives (be they market data, trading acts, trend supply and demand statistics). Similarly, the wide-ranging information available from individual comparatives allows AVMs to identify, during evaluations, those that are closer to the property being assessed, on the basis of:

- Demographic information on the property (location, address);
- Technical characteristics (area, conditions, year of construction, local number, number of rooms, etc.);
- performance (energy class).

Through statistical-mathematical models, AVMs identify the most suitable comparatives to use for assessment and, based on their economic-financial information, find the value of the property.

3.3.8. Market risk

Expectation 9

Intermediaries take account of the possible impact of climate-related and environmental risks on the pricing of investments in financial instruments, both their own and those managed on behalf of third parties, including on a forward-looking basis, in order to minimize the risk of losses.

Good practice: own portfolio risk management

Integration of ESG criteria into own portfolio management processes, by defining a list of issuers, business areas and countries less sensitive to ESG issues:²⁴ any decision to invest in assets relating to entities on this list is subject to an enhanced process involving the relevant structures to verify potential reputational profile impacts.

Good practice: managing risks relating to the client investment portfolio - NEW

Integrating ESG criteria into customer portfolio management processes, such as:

- updating the internal framework by providing consistency assessments between the customer portfolio and the sustainability preferences indicated in the MIFID questionnaires;
- advice and provision of investments in managed funds in line with the criteria laid down in Articles 8 and 9 of the SFDR;
- drafting of a ‘sustainable core list’ and of a ‘sustainable portfolio model’ in the evolved consultancy service.

3.3.9. Operational risk

Expectation 10

Intermediaries consider the possible impact of climate-related and environmental risks on business continuity as well as on reputational and legal risk levels.

Good practice: business continuity plans

Updating of business continuity plans, defining exposure to different physical risk factors (e.g. earthquakes, floods, landslides, hailstorms, tornadoes) by means of a georeferencing system for the banks’ premises, each of which is associated with a risk level based on data from public sources. The assessments were extended to the most important suppliers, typically IT companies, which were requested to update their business continuity plans with physical risk factors.

The business continuity plans include a series of countermeasures against such risks, such as: the activation of alternative websites or the development of cloud solutions, to mitigate the impacts of possible extreme events on IT services; the possibility for employees to work remotely and for customers to use home banking and ATMs in the event of damage to offices and commercial premises.

Good practice: updating the operational loss database - NEW

²⁴ Specific restrictions on investment in companies subject to a breach of the OECD Transfer Pricing Guidelines or in countries subject to UN sanctioning regimes.

Inclusion of loss events caused by climatic and environmental events in the database for operational losses, important for both management purposes and the calculation of the internal risk capital.²⁵

Good practice: reputational risk - stakeholder engagement

Conducting a survey of stakeholders' ESG expectations and perceptions of sustainability awareness, with the aim of incorporating them when drawing up corporate strategy.

These surveys usually involve questionnaires sent to stakeholders such as shareholders, customers, institutions, suppliers and representatives of the communities in which banks do most of their business. Table 5 shows some examples of topics used in the questionnaires.

Table 5 – Examples of topics covered in stakeholder expectations surveys

<i>Environment</i>	<i>Social</i>	<i>Governance</i>
Climate change	Local socio-economic development	Ethics and integrity in corporate conduct
Direct environmental impacts	Social cohesion	Transparency and communication with stakeholders
Sustainable infrastructure	Training, development and enhancement of human capital	Responsible supply chain management
	Health and safety at work	Measures to channel public resources
	Diversity, inclusion and equal opportunities	Identity mission and brand and reputation management
	Innovation, research and digitalization	Corporate risk management
	Customer satisfaction and quality of service	
	IT security	
	Customer data protection	
	Demographic changes and ageing population	
	Epidemics and their socio-economic consequences	
	Geopolitical tensions and impacts	

Good practice: reputational risk - green procurement policies

²⁵ For operational risk, see also the practices in the 'materiality analysis' section. The Basel IV framework states that the historical series of losses will continue to be relevant only for medium to large banks, i.e. those with a Business Indicator Component (BIC) of more than €1 billion; the BIC is an indicator linked to the total revenues of the intermediary.

Specific sustainability due diligence processes have been put in place for suppliers focusing on analysing organizational and documentary aspects (policies, procedures, assignment of responsibilities and internal control and reporting systems; use of materials with a reduced environmental impact) and aim to assess - also through ad hoc questionnaires - the commitment of counterparties to sustainability issues and compliance with the main regulatory frameworks.

As a result of these findings, green procurement policies have been defined to supplement supplier selection criteria with assessments of their sensitivity to ESG issues; furthermore, controls and reporting on suppliers' activities have been extended to ESG areas.

3.3.10. Internal Liquidity Adequacy Assessment Process (ILAAP)

Expectation 11

Intermediaries integrate climate-related and environmental risks into the measurement and management of liquidity risk, estimating potential deteriorations in the liquidity position due to cash outflows and/or decreases in the amount of reserves and/or changes in the liquidity of financial instruments which are either directly owned or included in managed portfolios.

Good practice: inclusion of ESG factors in the ILAAP report - NEW

The practices observed in the ILAAP reports include the following:

- outflow estimates, with an impact on the LCR as well, for counterparties belonging to sectors identified as particularly vulnerable to C&E risks, with a progressively higher incidence over a three-year period; in some cases the expected outflows were quantified based on the scenarios indicated in the NGFS Climate Scenarios for Central Banks and Supervisors;
- analysis of the composition of the direct funding to evaluate the exposure of depositors to physical risk (floods and landslides) by means of a link between the geographical location of customers and the data produced by ISPRA. Once the riskiest areas are identified, indicators for periodic monitoring are developed and sensitivity analyses are carried out;
- with a view to backtesting, conducting an analysis on extinct deposits to explore the existence of a positive correlation between liquidity risk and ESG risks; these analyses are also used to fine-tune the behavioural models of clients.

3.4. Reporting

Expectation 12

Intermediaries shall have the necessary infrastructure, data and processes to communicate how they integrate environmental risk drivers into their business strategy, internal organization and risk management mechanisms, including the metrics used to assess climate risks and sustainability objectives.

3.4.1. Sustainability Information Reporting

Good practice: voluntary reporting - NEW

Publication, on a voluntary basis, prior to the entry into force of the CSRD, of a sustainability statement incorporated in the management report or in a separate document.

Planned future reporting on investment-related issues in the ownership portfolio (e.g. shares, bonds, fund management, etc.), and establishing collaboration with a data provider for this purpose.

Good practice: adopt reporting standards - NEW

Draft compilation of a specific disclosure aligned with the framework of the Task Force on Climate Related Financial Disclosure (TFCD).