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Presentation of the Bank of Italy's Responsible Investment Charter

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The Bank of Italy today presents its Responsible Investment Charter, with the aim of reaffirming its commitment to contribute to a balanced and sustainable economic development in the management of its investments.

The available analyses suggest that, to avoid the most negative climate scenarios (connected to a rise in global temperatures of over 3 degrees by the end of the century), global greenhouse gas emissions must be halved by 2030 and carbon neutrality must be achieved by mid-century. These conditions, which have been translated into binding targets by the European Union,[1] require a major overhaul of how we produce and consume energy.

Policies to induce/achieve the reduction of emissions and to improve adaptation to climate change are foremost in the sphere of action and responsibility of governments, which can employ several tools, such as the introduction of incentives for green investments, the establishment of carbon pricing systems, and regulatory initiatives to limit activities with greater environmental impact.

However, the risks associated with climate change also have implications for central banks and their main functions: supervising banking and financial intermediaries; protecting financial stability; and monetary policy. According to the International Energy Agency, to reach the target of halving emissions by 2030, investments in clean energy will have to triple, reaching $4,000 billion a year globally. Financial operators are key to achieving a swift transformation, as they allow the necessary resources to be allocated to climate transition projects, in particular those aimed at technological innovation and infrastructures. Furthermore, climate risks and policies aimed at tackling those risks have important implications for economic activity: they can shape a successful framework for some companies but an adverse one for others. There is a clear link with the traditional risks of financial intermediaries - credit risk for banks, natural catastrophe risks for

1 The Climate Law was approved by the European Parliament and the Council at the end of June and introduces a collective target to reduce net greenhouse gas emissions by at least 55 per cent by 2030 compared with 1990 levels and the target of EU climate neutrality by 2050.

insurance companies. The achievement of the climate objectives therefore requires adequate policies for regulating and supervising markets and financial intermediaries.

As a supervisory authority and under the Single Supervisory Mechanism (SSM), the Bank of Italy has helped to define a set of non-binding recommendations for directly supervised banking groups for the adoption of management practices and information disclosure on climate risks,[2] and it is evaluating how to extend these indications to the other Italian intermediaries under its direct responsibility. This effort is part of the initiatives for promoting transparency criteria for the information disclosed by companies and financial intermediaries, to which the Financial Stability Board (FSB) made a pivotal contribution with the Task Force on Climate-related Financial Disclosure (TCFD). The European legislator is intervening in this issue with the Directive for non-financial reporting, which is currently being reviewed.[3]

One area where central banks are making a significant contribution is the measurement of climate and environmental risks. This is a fundamental task – given that the correct measurement of risks is the pre-requisite for their effective management – and is not easy, as the data available for this purpose are still lacking in quality and completeness. Standard accounting and prudential reporting are not adequate to perform this task, and so work is underway to fill these gaps.

As part of the in-depth analysis for the strategy review of the Eurosystem's monetary policy, in which the Bank of Italy participates/is taking part, technical analyses are underway on how to integrate environmental risks into the macroeconomic models used for the analysis and on which is the best implementation of monetary policy in the presence of such risks, also considering their possible future developments.

In line with its commitment to environmental risks, the Bank carries out and disseminates research on the possible macroeconomic and financial effects of climate change and on the opportunities offered by sustainable finance, also with the aim of raising awareness of climate risks among financial intermediaries, investors and savers.

The Responsible Investment Charter does not refer to the afore-mentioned central banks' specific functions; it focuses on the role of the Bank of Italy as a financial investor. It takes its cue from, among other things, the Eurosystem's common stance, agreed last February, for applying sustainable and responsible investment principles to non-monetary policy portfolios.[4] Similar documents have already been published by some Eurosystem central banks that manage financial portfolios.

The Charter defines the principles that inspire the Bank in the sustainable management of its financial investments and sets out the commitments through which it

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2 See the Guide on climate-related and environmental risks.

3 The Bank has also been participating since 2019 in the work of the Network for Greening the Financial System, the global network of central banks and supervisors that coordinates analyses, based on common objectives and guidelines, to strengthen the role of the financial system in managing climate risks and fostering sustainable investments.

4 https://www.bancaditalia.it/media/notizia/eurosystem-agrees-on-common-stance-for-climate-change-related-sustainable-investments-in-non-monetary-policy-portfolios/

intends to give substance to its action aimed at systematically integrating sustainability assessments with financial ones. The more general ambition is to stimulate awareness in the financial community of these issues and the risks that may arise, and to encourage companies to manage in a way that is attentive to the environment and society, and compliant with the best corporate governance practices.

The publication of the Charter is consistent with the choice made by the Bank of Italy in 2019 to integrate environmental, social and corporate governance (ESG) aspects into the management of its equity portfolio.[5] All other things being equal, priority is given to companies that use natural resources carefully and are mindful of their impact on ecosystems, that maintain adequate conditions of safety, health, justice, equality and inclusion, that generate income and work in compliance with ethical principles and are structured according to the best corporate governance practices.

The choice to place the emphasis not only on climatic aspects, but also on social and corporate governance ones stems from the belief that these three aspects, each of which is important in itself, cannot be separated if successful action is to be achieved on the sustainability front. Achieving the ambitious targets for reducing global carbon emissions also involves awareness and assumption of responsibility on the part of corporate governance bodies and more generally of citizenship.

The Charter applies to assets managed under the Bank's own responsibility, namely investments in its financial portfolio and foreign exchange reserves. This covers a considerable amount: at the end of 2020, it consisted of assets for approximately €190 billion (€148 and €44 billion respectively, for the financial portfolio and foreign exchange reserves). However, it does not apply to monetary policy portfolios, the management of which is the responsibility of the Eurosystem. In-depth studies are underway on this issue as part of the strategy review, which focus in particular on the measurement of risks and any actions for their mitigation with a view to protecting the Eurosystem's balance sheet.

The Bank takes on three commitments in the Charter:

a) to promote ESG sustainability, with initiatives to encourage the disclosure of sustainability information by issuers, intermediaries and other operators in the financial system;

b) to continue to integrate ESG principles into the management of investments and financial risks and to favour investments with the best ESG profile, applying exclusions based on fundamental conventions on labour and international treaties on controversial weapons, and lastly excluding tobacco producers;

c) to publish information and analyses on sustainable finance; to periodically report the results achieved for their investments and the effects on society and the environment; and to contribute to the dissemination of the culture of sustainable finance in the financial system and among citizens.

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5 https://www.bancaditalia.it/media/approfondimenti/2019/informativa-esg/index.html?com.dotmarketing.htmlpage.language=1

As early as next year, we will start publishing an annual report on sustainable investments. This report will initially be based on TCFD recommendations and will subsequently take into account the European Directive for non-financial reporting. Furthermore, by 2023, we will complete/finalize a methodology to measure exposure to climate risks using the scenario analysis to be applied to the Bank's financial portfolio. A description of this task will be included in the Sustainable Investment Report.

The publication of the Charter takes place in a significant year for Italy: it holds the Presidency of the G20, whose work focuses on three pillars: People, Planet and Prosperity; and in partnership with the United Kingdom, it is also hosting the 26th Conference of the Parties of the UN Convention on Climate Change (COP26), to be held in Glasgow in the autumn.

The Italian Presidency of the G20 has organized a Conference on Climate Change, to be held in Venice on 11 July, aimed at identifying possible initiatives to be taken to improve the quality, comparability and consistency of data on sustainability and to involve private finance and development banks to support the transition to carbon neutrality. The Bank of Italy is actively contributing to the initiatives of the Italian Presidency of the G20 and has worked on setting up the Sustainable Finance Working Group.[6]

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[6] The Group is co- chaired by China and the United States (together responsible for more than 40 per cent of global greenhouse gas emissions), with the secretariat of the United Nations Development Programme.

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