ESG EXCERPT: Group Credit Policy

1. Foreword

Credit quality is one of the founding and distinctive principles of the Credem Group (hereinafter the Group) which, by ensuring capital stability, is part of the strategic process of value creation.

The "**Group Credit Policy**" (henceforth the "Policy") is designed to provide the Group with a shared credit culture rationale which is essential to ensure that the ambitious goals that have historically characterised the quality of Credem assets within the banking landscape can be achieved.

The Policy is approved by resolution of the Parent Company's **Board of Directors** and concerns all the Companies belonging to the Credem Financial Conglomerate that directly take on credit / counterparty / market / settlement risks and are required to adopt the Policy, with a specific resolution of their own Board of Directors, and to ensure compliance therewith, taking into account the specific nature of their business, their own organisational structure and industry regulations. The companies in the scope are required to report to the Parent Company any contents of the Policy that conflict with specific industry regulations.
This excerpt will be updated in line with the changes made to the Group Credit Policy and the ESG Credit Strategy Guidelines approved by the Parent Company's Board of Directors.

2. Fundamental principles

The fundamental principles on which the disbursement of credit by the Group is based are the following:

- consistency with its standing as a domestic commercial bank when assessing the customer’s business activity, its size and its geographic location with respect to the Credem network;
- the technique adopted for risk assessment, which provides an objective and coherent basis for granting credit, in line with the purpose and the financial needs of customers, with their capital and financial structures and their historic and potential repayment capacities;
- the quality, verifiability and adequacy of information, in accordance with the data governance principles defined by the Parent Company, which are to be considered a fundamental pre-requisite for the objective valuation of a risk profile, which is briefly summarised by an internal rating;
- the fractioning of credit risk pursued by diversifying the customer portfolio with a selective approach consistent with the capital and risk/return objectives;
- the consolidated assessment of counterparties at Group level, in order to obtain a coherent and non-fragmented perception of the risk profile of each single or group counterparty;
- the attention paid to formal correctness, before credit is disbursed, also through the support of specialist departments of the Parent Company, which provide any necessary technical or other advice;
- the careful handling of customer relationships by front and central offices and the checks conducted by dedicated functions guarantee the correct application of credit lines, the continuous updating of customer information, the prompt and precautionary identification of potential non-performing loans and the adoption of the measures needed to mitigate the risk and recover the relative exposures;
- the adoption of rigorous policies to classify and hedge non-performing loans, preferring, where possible, policies aimed at settlements designed to reach out-of-court agreements with counterparties, therefore containing recovery costs;
- paying attention to ESG factors, with a special focus on the degree of exposure to the impacts generated by climate and environmental factors on credit portfolios, on the sustainability of counterparties and on the value of collateral;
- abstaining from granting loans to companies directly linked to controversial sectors as defined by the Parent Company's Board of Directors, specifically those related to the production and marketing of unconventional weapons and the use of speculative derivatives on food commodities.

3. Credit governance

The development of the procedures for the governance, management and monitoring of credit risk takes place in a manner consistent with the structure of the Group and by means of a delegation process involving the functions of the Parent Company. The tasks and responsibilities related to the governance, management and control of credit risk lie with the **Corporate bodies**.

To implement the principles defined above, the credit governance model relies on:

- the separation of the strategic guidance and monitoring functions from those concerned with management and decision making;
- the prevailing centralisation of credit autonomies within the central structures;
- the separation of central decision-making functions from the peripheral functions that forward proposals;
- the sharing and dissemination of principles and methodologies throughout the Group.

A fundamental pillar of credit governance is also represented by the assignment of "ad personam" delegated powers, having first assessed the fundamental competencies of the decision-making individual, such as expertise, results achieved in credit management and disbursement and training undertaken.

The main governance instruments are three committees, the **Group Credit Strategy Committee**, the **Group Credit Committee** and the **Non-Performing Loans Committee**, which meet at least once every six months and are composed of members of the Parent Company's BoD, of Central Management and Top Management figures of the Parent Company and the Companies in the scope.

One of the main objectives of the **Group Credit Strategy Committee (CCS)** is to support the Parent Company's BoD in defining the Group's risk appetite and credit policy guidelines, monitor the level of exposure to ESG factors that may affect the Group's credit policies, and, consistent with the RAF, define and monitor the Group's risk limits and credit strategy guidelines.

One of the main objectives of the **Group Credit Committee (CCG)** is to support the Parent Company's BoD in monitoring and controlling the credit risk that the Credem Group takes on towards a counterparty or a group of connected customers, and guarantee compliance with current regulations on risk concentration.

One of the main objectives of the **Non-Performing Loans Committee (CCN)** is to support the BoD in defining the strategic guidelines for the management of anomalous and non-performing loans and the related operational plan and monitor the implementation of the strategic guidelines in the NPL sector by analysing and reporting any deviations from what is defined in the operational plan, and establishing the guidelines for loan write-downs.

4. Counterparty evaluation and selectivity

For **loans to companies**, of primary importance are:

- the current **and future** cash flow analysis;
- the results of the assessment of balance sheet fundamentals from a predictive perspective that can be obtained using the Credem Method, which includes the assessment of the counterparty's sustainability performance, with a particular focus on its environmental performance;
- the results of specific balance sheet indicators, such as the **Debt Service Coverage Ratio**.

Selectivity in granting of credit also provides for:

- caution in positions that report a risk-weighting of loans that is significantly higher than the standard risk-weighting;

- the focus on calibrating the size of the loan with the Share of Wallet (SoW) target for the segment and the reference rating;
- careful discretion towards counterparties who:
    - have incurred in negative reports;
    - have found performance anomalies and/or predictive evidence from Early Warnings models;
    - belong to sectors with strong speculative connotations, with problematic trends and consistent with the defined sector ranking strategy;
- the consistent use of the results of the scoring/acceptance and early warning systems, as well as the constant monitoring of their consistency and performance with regard to policy and strategy indications;
- for corporate counterparties an in-depth assessment of ESG risk characteristics and C&E information with particular reference to physical risk and transition risk;
- attention is paid to the emission levels of individual counterparties and the relative consistency with the de-carbonisation targets defined by the Group of the most relevant sectors in the Credem portfolio that have been identified as being the most carbon-intensive;
- the exclusion of companies with direct links to:
    - production of unconventional weapons (weapons that have indiscriminate effects, cause undue damage and are incapable of distinguishing between civil and military targets. Several categories of controversial weapons are regulated by international conventions aimed at limiting their proliferation. Unconventional weapons include, among others: anti-personnel mines, depleted uranium, biological and chemical weapons, nuclear weapons, cluster munitions and submunitions, blinding lasers, white phosphorus, undetectable fragments, incendiary weapons and weapons of mass destruction. It is intended to exclude only first-tier weapon manufacturers and not to extend to companies in the production chain (armaments). These production companies may neither be clients nor be financed by the Group, and their financial instruments may not be included in the Group's portfolios or offered to clients. It is also specified that the evaluation and decision-making process envisages the possibility of involving the Sales Functions as defined in the "CPC - Manual of first level controls in the second instance on credit" in order to delve deeper, with special reference to the weapons/armaments sector and the available lists of "companies that produce anti-personnel mines and cluster munitions and submunitions" pursuant to Law 220/2021);
    - use of speculative derivatives on food commodities (financial instruments of this nature, as they are functional to financial speculation that influence the price of food and food commodities, generating direct negative impacts for millions of people in developing countries. This does not include the use of food commodity derivatives for hedging purposes related to the sector's core business. This being the case, these products may not be included in the Group's portfolios or offered to clients);
- a strong limitation of transactions falling within the scope of Leveraged Transactions;
- special attention, with reference to the previous point, is paid to construction, real estate and financial companies, which are considered structurally risky counterparties and should therefore be treated accordingly:
    - by giving priority to small-scale construction projects with financing directly related to the sale of the building units;
    - by limiting financing to real estate companies to cases where the necessary repayment capacity is ensured by the presence of income-producing real estate;
    - by granting loans exclusively to financial companies belonging to or that can be traced back to leading credit or insurance groups;
- by focusing credit risk in the Financial Institution segment towards banks, insurance companies and other commercially significant Financial Institutions, generally ruling out investment banks and financial holding companies with the exception of financial holding companies of Global Systematically Important Institutions (G-SIIs) or Other Systematically Important Institutions (OSIIs) in Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Luxembourg, Netherlands, New Zealand, Norway, Spain,

Sweden, Switzerland, United Kingdom, USA, adopting a proportionality criterion that takes into account the activities carried out by the counterparties.

5. Metrics for assessing ESG factors

ESG factors represent the environmental, social and governance elements that need to be taken into account owing to their potential impact, either positive or negative, on financial performance, the solvency of a counterparty, and the calculation and relative retention of value of real estate collateral.
The ESG risk assessment system takes into account the so-called dual materiality, thus considering not only the negative impacts that the Bank may be subject to, but also the negative impacts that the economic activities financed by the Bank may have on ESG factors.

5.1 Evaluation of corporate counterparties

The identification of ESG factors concerns:

- risks related to climate change, i.e. CO2 emissions, energy efficiency, water use, waste/scrap generation, biodiversity and environmental hazards (the **"E" component**);
- the counterparty's relationship with the community, its employees, its customers, respect for human rights including impacts on poverty and famine, gender and remuneration differences (the **"S" component**);
- corporate integrity, considerations regarding the strategy and risk management of the counterparty, inclusiveness and transparency of the counterparty and the presence of the Code of Ethics (the **"G" component**).

Risks related to climate and environmental factors are analysed to a greater extent also due to the greater tangibility of their effects. Furthermore, in line with current and prospective expectations, as well as ongoing regulatory developments, "social" and "governance" elements that can help to investigate whether a company can meet standards now considered necessary for sustainable and ethical development are also identified.

Climate change and environmental degradation give rise to structural changes that affect economic activities and, consequently, the financial system.
Credem, therefore, pays attention to the exposure of its portfolios to physical and transitional risk factors. The main variables considered are:

- **physical risk** understood as the financial impact generated by climate change that includes, inter alia, climate change, environmental degradation or air pollution. This risk is classified as **acute** if caused by extreme events (droughts, floods and storms) or as **chronic** if caused by progressive changes such as rising temperatures or rising sea levels;
- **transition risk** understood as the financial loss suffered by a counterparty, either directly or indirectly, as a result of the adjustment to a low-carbon and more sustainable economy. Transition risk analyses must include forward-looking assessment elements in view of the potential forward-looking economic, financial and capital impacts on the individual counterparties;
- **Greenhouse Gas (GHG) emissions** to be understood as greenhouse gas emissions produced by business activities. These emissions, which are the main cause of the increase in global average temperature, are measured, in accordance with regulatory requirements, in relation to:
    - **Scope 1:** which includes emissions directly produced by the corporate counterparty in connection with its own activity;
    - **Scope 2:** which includes emissions related to the energy purchased by the company in order to operate its business;
    - **Scope 3:** which includes emissions by the production chain to which the counterparty belongs.

Analyses referring to emissions, relative to the counterparty's turnover adjusted for inflationary effects, make it possible to determine the so-called **"GHG Intensity" which mainly focuses on Scope 1 and Scope 2**. Of particular importance is the analysis and monitoring of the "portfolio average GHG intensities weighted for the agreed level", defined as **"WACI - Weighted Average Carbon Intensity"**, especially with reference to the most carbon-intensive sectors.

5.1.1 Evaluation metrics

In this context, for Corporate customers, the credit granting and monitoring process is supplemented by a scope of assessment aimed at analysing and monitoring the positioning of applicant companies with respect to climatic and environmental factors in addition to physical and transitional factors.
More specifically, a set of summary performance indicators/metrics was defined that are representative of the level of exposure to these factors of applicant counterparties.
The indicators are instrumental in evaluating the attractiveness and the loan resolution process for the individual counterparty.
Below are the summary performance indicators and their descriptions.

ESG Score: a summary score certifying the soundness of the counterparty in terms of environmental, social and governance factors.
Environmental Score: a summary score summarising the counterparty's situation with regard to the management of environmental issues (emissions, energy efficiency, water use, waste/scrap generation, biodiversity, environmental hazards).
Transition Risk Score: a summary score expressing a qualitative assessment of the expected impact in economic-financial terms (impact on turnover, impact on investments, impact on EBITDA) of the transition to a low-carbon economy. This indicator should be taken into account in particular when evaluating medium- to long-term investments
Physical Risk Score: a summary score expressing the company's degree of exposure to physical risks, taking into account all analysed natural phenomena, both **chronic** (temperature change, heat stress, wind change, rainfall change, permafrost thaw, sea level rise, water stress, soil and shoreline erosion, soil degradation) and **acute** (heat waves, cold/freezing snaps, fires, storms, droughts, heavy rainfall, floods, landslides). The score is a function of the geographical hazard (probability of a natural event occurring) and the expected damage to the company, estimated on the basis of the company's local units and sector of operations.
GHG Intensity: a summary metric defined as the ratio between GHG emissions (Scope I and II generated by the counterparty and the counterparty's turnover)

GHG Scope I + Scope 2 (tonnes CO_2 eq) Revenues (€ mln)

This metric indicates the level of emissions produced per million euro generated.
This metric enables the production of a relative emission-related parameter by which one can assess the counterparty's position relative to comparable peers.
Fossil Fuel Sectors: flag certifying that the counterparty belongs to the fossil fuel sector cluster. A greater level of attention is paid to counterparties belonging to this cluster.

In addition, attention is paid to "social" and "governance" aspects, also in light of the evolution of the relevant regulations and the progress in these areas resulting from market evidence.
Below are the summary performance indicators and their descriptions.

Social Score: a summary score summarising the counterparty's situation with regard to the management of social issues (impact on the community to which the counterparty belongs, relationship with employees, relationship with customers, commitment to respect human rights, commitment to poverty/famine reduction, gender equality, gender pay gap).

Governance Score: a summary score summarising the counterparty's situation with regard to the management of governance issues (ethical integrity of the counterparty, strategy and risk management, inclusiveness, corporate transparency, presence of code of ethics).

5.2. Evaluation of real estate collateral

When evaluating and monitoring collateral, particular attention is paid to the physical location and energy efficiency of real estate, as well as climate and environmental risks (C&E risk factors).
To this end, two specific documents are to be collected that are crucial for the evaluation phase of the granting proposals and necessary to guide the disbursement choices, namely:

- the **E**nergy **P**erformance **C**ertificate (**APE**), to assess the transition risk of the collateral property. This document, also known as an "energy certificate", is an official document that certifies the performance and energy category of a building unit. Through this document, it is possible to find out the building's energy consumption, energy quality, carbon dioxide emissions and use of renewable energy sources, which directly influence the building's running costs and environmental impact. The main relevant indicators contained in the APE are the Energy Class (which summarises the energy quality of the building and thus makes it possible to know the energy required for heating, hot water production, lighting), electricity consumption, Net Zero Energy Building classification (an NZEB building is characterised by low summer and winter energy requirements, mostly provided by systems using renewable sources), carbon emissions, coal consumption, NREN Energy Performance Index;
- the **Advanced Physical Risk Report**, provided by an external info provider, in order to assess the exposure of individual guarantees to physical risks, in particular by providing a focus on the main natural hazards (flood, landslide, extreme wind, earthquake) in terms of direct damage. The tool provides several evaluation metrics, including the level of territorial hazard of the site where the property is located and a monetary estimate of the expected annual losses that may occur as a result of the natural phenomena analysed. Specifically, the main relevant indicators are the RCP 4.5 Territorial Hazard (indicating the territorial hazard of the site where the property is located and the monetary estimate of the expected annual losses that may occur as a result of the natural phenomena analysed according to the RCP 4.5 transition scenario), the Hazard Climate Change Score (summary score of the territory's exposure to the physical risks considered (flood, extreme wind, landslide), the likelihood that the property reconstruction value may drop).

6. ESG Credit Strategy guidelines

6.1 Corporate counterparties

- Fully integrate ESG scores into the overall assessment of corporate counterparties, favouring/rewarding improvement of C&E performance, even though the gradual development of special green products and services.
- Thoroughly assess corporate counterparties with an E=5 (Very High) score focusing mainly on individual EBA factors that show an inadequacy rating, by investigating various adaptation and mitigation projects and strategies with the client.
- Valuing counterparties with official de-carbonisation/transition plans or documented company commitments to GHG emission reduction, in line with European emission reduction targets (Fit for 55, Green Deal) and, in general, an improved emissions profile compared to the sector they belong to.
- Pay attention to the GHG emission levels of corporate counterparties with a focus on the IEA "Oil & Gas" and "Power" sectors, and their consistency with the de-carbonisation targets set by the Group in line with its Net Zero commitments.
- Refrain from granting loans to counterparties belonging to blacklisted sectors (coal, anthracite and lignite mining) and monitor and supervise the incidence of loans to counterparties in IEA sectors.
- Enhance the supervision of counterparties with non-primary ratings that present a high physical risk and/or transition risk.

6.2 Real estate collateral

- Inclusion of physical risk factors (Advanced Physical Risk Report) and transitional risk factors (APE) in the current and prospective assessment of property value
- Exercise particular caution during the loan acceptance stage (and in LTV levels) when granting loans with collateral with High or Very High physical risk, investigating the individual hazards to which it is exposed (flood, landslide, extreme wind) or elements that might indicate other environmental risks; also monitor the incidence of loans secured by collateral that are subject to High or Very High environmental risks related to water stress and/or soil degradation.
- Avoid increasing the overall incidence in the portfolio of loans secured by collateral with Energy Class F and G, by monitoring any new disbursements and promoting Green loan aspects.