CENTRAL BANK OF MONTENEGRO

Working paper no. 35

EUROPEAN UNION REQUIREMENTS FOR SUSTAINABILITY REPORTING

Milica Kilibarda

Podgorica, 2024

PUBLISHED BY: *Central Bank of Montenegro*
Bulevar Svetog Petra Cetinjskog 6
81000 Podgorica
Telephone: +382 20 664 997, 664 269
Fax: +382 20 664 576

WEBSITE: *http://www.cbcg.me*

PREPARED BY: *Milica Kilibarda, Advisor to Vice-Governor,*
Centre for Macroeconomic and Financial Research and Forecasting

TRANSLATED BY: *Department for Financial Stability, Research and Statistics*

DESIGNED BY: *Nikola Nikolić*

Abbreviations

BoA	Bank of Albania
BoS	Bank of Slovenia
CBCG	Central Bank of Montenegro
CMA	Capital Market Authority
DNSH	"do no significant harm"
EBA	European Banking Authority
EBF	European Banking Federation
EC	European Commission
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESRS	European Sustainability Reporting Standards
EU	European Union
FBA	Banking Agency of the Federation of Bosnia and Herzegovina
GAR	Green asset ratio
GHG	greenhouse gas
HLEG	High-Level Expert Group on Sustainable Finance
HNB	Croatian National Bank
IFRS	International Financial Standard Reporting
IMF	International Monetary Fund
KPI	Key Performance Indicators
NBRNM	National Bank of North Macedonia
NBS	National Bank of Serbia
NGFS	Network for Greening the Financial System
SBFN	Sustainable Banking and Finance Network
TCFD	Task Force on Climate-related Financial Disclosures
UNEP FI	United Nations Environment Programs Finance Initiative

CONTENTS

Summary

Climate changes pose long-term financial risk stability and economic growth. In that sense, companies must conduct assessments, mitigate, and adapt their business to climate change. Their basic goal on both and macro level is sustainable development. A significant role in its realisation lies in the financial sector that supports process transitions and companies' transition to green, sustainable, ecologically acceptable activity through green and sustainable finances.

When financial institutions allocate financial funds, they mainly rely on statistics i.e. the disclosure of accurate, reliable, high-quality, comparable sustainability data. Comparability is possible by establishing standards and precise disclosure requests for data and information related to climate and sustainability, including information about social and ecological aspects of the project. Transparency of information about company's impact on the environment and society and how the information is managed is becoming increasingly important and acquires mandatory status.

Introduction

The global goal is to achieve ecologically sustainable economics. Sustainability means making economic prosperity long-lasting, more socially inclusive and less dependent on the exploitation of finite resources and the natural environment. (HLEG, 2018). Activities are carried out on implementing sustainable development goals to achieve sustainability.

This study will be based on activities which contribute to implementing Goal 13 - Climate action, reducing the negative influence of climate change on the environment (natural capital), economy (produced and financial capital) and people, that is, social development (human capital), as fundamental pillars of sustainable development.

The European Union's activities in the climate change area are defined in the European Green Deal (EC, 2019a) which aims to transform the EU into a fair and prosperous society with a modern, resource-efficient and competitive economy guaranteeing that:

- there will be no net emissions of greenhouse gases in 2050;
- economic growth is decoupled from resource use;
- none of the persons and regions are neglected.

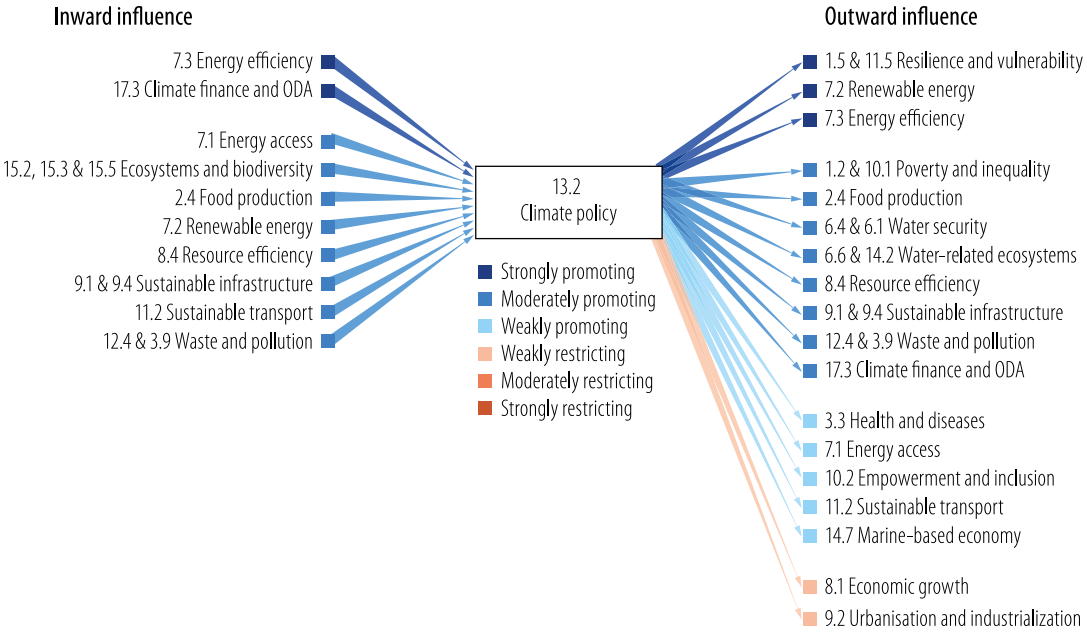
The European Council has set building a climate-neutral, green, fair, and social Europe as one of the four main priorities of the 2019-2024 strategic agenda (*European Council*, 2019). The aforesaid will influence many economic sectors and industries, while climatic change affects the real sector and indirectly affects the financial system.

In 2019, the European Parliament adopted a resolution declaring a climate and environmental emergency (*European Parliament*, 2019). The resolution calls on all subjects (citizens and all sectors of society and the economy, including industry) to take urgent, science-based action to limit global warming and halt biodiversity loss, while the European Commission is urged to fully assess the climate and environmental impact of all relevant legislative and budgetary proposals.

The EU's goal to become a climate-neutral area is incorporated into legislation by adopting the European Climate Law (EC, 2021a). This regulation goal has set the achieving the Union's climate-neutrality objective by 2050 as binding as well as a binding Union target of a net domestic reduction in greenhouse gas emissions for 2030.

The previous practice of producing necessary guidelines and recommendations and determining principles and frameworks for integrating activities to reduce climate risk in non-financial and financial companies points to collective dedication to climate actions. Commitment is primarily the result of the fact that climate changes globally affect all economic sectors. Sustainable development goals have strong synergic interconnection, while implementing the Impact 13.2 *Integrate climate change measures into national policies, strategies, and planning* has the most significant influence on other goals (Figure 1). Progress in implementing this goal leads to progress in achieving other goals (Dzebo and Shawoo, 2023).

Figure 1 – Impact Target 13.2 – Climate politics on other (sub) goals sustainable development



Source: Dzebo A, Shawoo Z. 2023. Sustainable Development Goal interactions through a climate lens: a global analysis. SEI Report. Stockholm Environment Institute, p. 15

The financial sector plays a significant role in sustainable development through sustainable finance.

Sustainable finance refers to the process of taking environmental and social considerations into account when making investment decisions. Environmental considerations refer to the environment and its related risks, that is, climate change mitigation and adaptation, while social aspects may relate to issues of inequality, inclusion, labour relations and investment in human capital and communities (EC, 2018b).

The European Banking Authority (EBA) defines sustainable financing as financing that contributes to the achievement of strong, sustainable, balanced and inclusive growth, supporting the framework of sustainable development goals (EBA, 2019) directly and indirectly. In its recommendations for facilitating the financing of the transition to a sustainable economy, the European Commission defines sustainable financing as both financing what is already environment-friendly and what is transitioning to such performance levels over time (EC, 2023c).

Although it has no primary responsibility nor a direct channel of influence, the financial sector is essential in mitigating climate change and biodiversity loss. Their role is primarily reflected in their contribution to managing climate risks and directing financial investments in environmentally sustainable activities.

With the Action Plan for Financing Sustainable Growth (EC, 2018b), the European Commission set the following goals:

1. reorient capital flows towards sustainable investment,
2. manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
3. foster transparency and long-termism in financial and economic activity.

These goals highlight the financial sector's role in sustainability.

Stemming from the increasingly strong impact of climate change on the environment, economy, and people, companies have had to disclose non-financial information about their operations in addition to financial indicators. It gives a better picture of the company's operations, the impacts it is exposed to, and its effects on the environment. Financial institutions/investors need this information to assess the viability of the investment.

After the European Commission established three sustainability indicators for non-financial companies, the EBA proposed relevant indicators for the banking sector.

Central banks monitor the development of standards in this area and carry out significant activities contributing to the sustainable development of their operations, the operations of the institutions they supervise, and the financial system greening.

Although there were disagreements about the role of central banks and other supervisors of financial institutions in activities related to climate risks, it was concluded that their role is to draw attention to these risks, monitor them and assess the resilience of institutions to them within their mandates and while preserving their independence.

This study highlights the importance and necessity of disclosing non-financial and sustainability information following EU regulations and standards. After the voluntary reporting period by

companies, the disclosure of non-financial information and its audit has become mandatory since 2024. Sustainability reporting will be mandatory for companies and banks under the regulation and reporting standards of the European Union.

The study is divided into four parts:

The first part presents the obligation of compiling non-financial reports for companies and sustainability reports. It presents the EU taxonomy, the classification of economic activities according to sustainability from the environmental protection aspect, created to facilitate assessing the degree of sustainability of investments in certain activities. Including the sustainability concept in company policies makes recognising and managing risks easier. A unified presentation of sustainability information is made possible by publishing sustainability reporting standards.

The second part pays special attention to the obligation of disclosing information on sustainability for the banking sector. The banking sector has a significant role in financing the transition to a green and sustainable economy in accordance with the European Plan. The transition of non-financial institutions also requires changes in the banking sector that should strategically approach the concept of sustainable development. Starting in 2024, EU banks are obliged to prepare sustainability reports.

The third part illustrates the experience of selected central banks in solving the challenges posed by climate change and sustainability issues for the banking sector and their operations.

The fourth part concludes the study.

1. Request for disclosure of non-financial information

Sustainability risk is "a sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment", while sustainable investment is 'sustainable investment' means an investment in an economic activity that contributes to an environmental objective,... or an investment in an economic activity that contributes to a social objective ... or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices..." (EC, 2019).

Like any other risk, assessing sustainability risk requires quality, comprehensive and comparable data.

Encouraging companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle is a sub-goal of Sustainable Development Goal 12 - Ensure sustainable consumption and production patterns. The indicator for monitoring this sub-goal is the number of companies publishing sustainability reports.

With the main task of adopting a comprehensive European Union strategy on sustainable finance, the High-Level Expert Group on Sustainable Finance (HLEG), established by the European Commission in 2016, set as one of its priorities:

1. establishing EU sustainability taxonomy, and
2. improving data disclosure.

The improvement of data disclosure meant implementing the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). TCFD is considered the founder of climate reporting principles.

The core elements of recommended climate-related financial disclosures include:

- the organization's *governance* around climate-related risks and opportunities,
- *strategy measures* the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning,

- *risk management*, which includes the processes used by the organisation to identify, assess, and manage climate-related risks, and
- *metrics and targets* used to assess and manage relevant climate-related risks and opportunities.

In addition, it is defined that disclosures should represent relevant information and be specific and complete, clear, balanced and understandable, consistent over time, comparable, reliable, verifiable and objective and provided on a timely basis (TCFD, 2017).

The above represents seven basic principles for effective disclosures of climate-related information.

Box 1 – ESG concept

The concept that answers how a company impacts the environment and social environment and how it is managed is known as ESG (Environment, Social, Governance).

The "E" component recognises ways of influencing the environment (climate change, carbon dioxide emissions, resource conservation, pollution and waste, protection of biodiversity), the "S" component recognises the way of influencing the social environment (human resources, working conditions, diversity and inclusion, health and safety at work, data protection and privacy), while the "G" component includes the company's governance, policies and practices of (structure of governing bodies, control and risk management, code of ethics, corruption, conflict of interest, and issues of transparency and reporting).

Companies facilitate risk recognition and management by including ESG components in their business strategy. On the other hand, investors need essential information about whether the company considers sustainability risks and bases its policies and measures on sustainable development goals.

The European Parliament has recognised the importance of publishing sustainability information by companies, primarily including information on environmental and social issues, to identify sustainability risks. In this regard, after the European Commission (EC) had adopted the directive that defines the content and obligation of preparing financial statements by undertakings, the so-called accounting directive (EC, 2013), it expanded it in 2014 with provisions defining the obligation to prepare non-financial statements and consolidated non-financial statements (EC, 2014, art. 19a and 29a).

It foresees that large undertakings (the criterion of the average number of 500 employees), which are public-interest entities, include a non-financial report in their reports. Non-financial reports

should contain information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters...". As stated in Article 19a of this decision, this implies a brief description of the undertaking's business model and of the policies pursued by the undertaking, the outcome of those policies, the principal related risks and key performance indicators. It increases the transparency of environmental and social aspects of the company's operations.

In the following period, Guidelines on non-financial reporting were prepared, which were recognised as "an essential element to enable sustainable finance" (EC, 2017). Risks to which the company may be exposed include, in addition to supply chain risks, the risks associated with violating human rights, employee rights, environmental protection... Complying with the guidelines, i.e. disclosing key and other policies and measures, and accurate and comparable information ensures the company's access to financial institutions. On the other hand, financial institutions find risk assessment by the company essential to assess, measure, and manage the risks to which it could be exposed by entering into that business relationship.

By expanding the provisions of this regulation and defining additional provisions, the European Commission established a framework to facilitate sustainable investment in 2020 (EC, 2020). The new regulation, known as the **taxonomy**, determines the criteria for defining whether an economic activity is considered sustainable from the environmental protection aspect, further determining the sustainability of financial investments in these activities. In other words, taxonomy represents a classification system, a list of ecologically sustainable economic activities (for more about taxonomy, see section 1.1 *Taxonomy* of this paper).

The Proposal of the Directive on Due Diligence (EC, 2022b), which applies to credit institutions, has been recognised as a "milestone in the historical transformation that will redefine undertakings' responsibilities and obligations to respect human rights and environment". This proposal lays down rules on obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts (with respect to their own operations, the operations of their subsidiaries, and the value chain operations) and the obligation to ensure that companies integrate due diligence into all their corporate policies and have in place a due diligence policy. In part related to combating climate change, companies must adopt a plan that identifies the extent to which climate change poses a risk for the company's operations and possible emission reduction objectives.

The proposal of the Directives also applies to large companies formed in accordance with the legislation of a third country and fulfil one of the following conditions:

(a) generated a net turnover of more than 150 million euros in the Union or (b) generated a net turnover of more than 40 million euros but not more than EUR 150 million in the Union, provided that at least 50% of its net worldwide turnover was generated in one or more of the sectors listed in the Directive.

At Glasgow's 2021 United Nations Climate Change Conference, the Foundation for International Financial Reporting Standards (IFRS) announced issuing standards for disclosing companies' sustainability.

In June 2023, an international financial standard of sustainability reporting (IFRS S1) was published. IFRS S1 refers to general requirements for disclosing sustainability-related financial information, and it applies from 1 January 2024. In addition, the related IFRS S2 related to climate-related disclosures was also published. These reporting standards follow the ESG criteria.

At the same time, the European Commission adopted the European Sustainability Reporting Standards (ESRS) on 31 July 2023 (EC, 2023a). For companies subject to nonfinancial directive reporting from 2013, reporting following these standards is mandatory for the financial year 2024.

There are twelve standards grouped into four areas:

1) General requirements and information: ESRS 1 - General requirements, ESRS 2 - General disclosures,
2) Environmental information: ESRS E1 - Climate change, ESRS E2 – Pollution, ESRS E3 – Water and marine resources, ESRS E4 - Biodiversity and ecosystems, ESRS E5 - Resource use and circular economy,
3) Social information: ESRS S1 - Own workforce, ESRS S2 - Workers in the value chain, ESRS S3 - Affected communities, ESRS S4 - Consumers and end-users, and
4) Governance information: ESRS G1 - Governance (Business conduct).

Standards are based on the so-called double materiality concept, which means that companies are, on the one hand, obliged to report on how ESG factors affect their economic and financial activities during the whole chain value (financial materiality, outside-in) and, on the other hand, to report on the method to which their business affects the environment and people (ecological and social materiality, inside-out).

Since 2021, the Montenegrin Law on Accounting has been fully harmonised with the European Commission's accounting directive from 2013. Additional harmonisation with the relevant EU regulation amending and/or supplementing the accounting directive is planned. According to the Law, legal entities must compile reports according to International Accounting Standards and IFRS.

Concerning companies from Montenegro or other non-EU Member State, ESRS standards are mandatory for companies which:

- have at least one related legal entity on EU territory that has already reported in accordance with the EU directive from 2014 (EC, 2014), including large undertakings with over 500 employees and which are quoted on the EU-regulated market, and reporting obligation refers to 2025 for the financial year 2024,
- have at least one related undertaking on EU territory that is, according to the EU directive from 2022 (EC, 2022), considered large, has at least 250 employees, a balance sheet exceeding 20 million euros, and a net turnover exceeding 40 million euros, and reporting obligation refers to 2026 for the financial year 2025,
- have related undertakings categorised as small and medium undertakings which are quoted on the EU regulated market, and obligation reporting refers to 2027 for the financial year 2026,
- have headquarters outside the EU, recorded turnover exceeding 150 million euros on the EU market in the last two financial years, and have at least one listed related party on the EU-regulated market or have a branch that has a turnover in the EU exceeding 40 million euros, and reporting obligation refers to 2029 for the financial year 2028.

Box 2 – Sustainability report and economic entities in Montenegro

In Q3 2023, Montenegro's Chamber of Economy, the Institute of Certified Accountants of Montenegro, The Faculty of Economics Podgorica and "Eco Fund" LTD implemented the survey on the Report of economic entities' sustainability in Montenegro. The survey included all economic entities to get an overview of their awareness of the Sustainability Report (Filipović, 2024).

The research showed that only 14% of the surveyed economic entities were aware of the (accounting) Directive 2014/95/EU, 29% partially, and 57% were unaware of the Directive.

Only 11% of surveyed economic entities voluntarily compiled a sustainability report, 60% did not compile, and 29% were unfamiliar with this reporting.

As a problem in preparing sustainability reports, 39% of economic entities saw insufficient knowledge of non-financial reporting issues, and some 52% saw complex or unclear non-financial reports' forms as a problem.

Only 8% of economic companies were aware of the Directive from 2022 (Directive 2022/2464), 27% were partially aware, and 65% were not familiar with this one Directive.

When asked whether they were aware of the preliminary version of international accounting standards for sustainability, 58% of economic entities answered negatively, 35% said they were partially aware, and only 7% responded affirmatively.

1.1. Taxonomy of the European Union

Two of the six recommendations of the NGFS to central banks and other supervisors of financial sector institutions are:

1. Achieving robust and internationally consistent climate and environment-related disclosure, and
2. Supporting the development of a taxonomy of economic activities.

The second recommendation specifies, "*It is necessary* ***to develop a taxonomy of economic activities*** *that contribute to the transition to a green and low-carbon economy and of activities more exposed to climate and environment-related risks. The taxonomy should be made publicly available. This way, financial institutions would easily identify, assess and manage these risks, and mobilise capital for green and low-carbon investments*. (NGFS, 2019).

As stated in the previous chapter, the European Commission established the framework to facilitate sustainable investment known as taxonomy (EC, 2020) in 2020. As the system for classifying sustainable economic activities, the taxonomy determines the criteria for assessing whether the economic activity is considered sustainable from the environmental protection aspect, further determining the sustainability of financial investments in these activities.

Article 3 of the regulation considers an activity ecologically sustainable if it:

A. contributes substantially to one or more of the environmental objectives:
   a. *climate change mitigation,*
   b. *climate change adaptation,*
   c. *sustainable use and protection of water and marine resources,*
   d. *transition to a circular economy,*
   e. *pollution prevention and control,*
   f. *protection and restoration of biodiversity and ecosystems,*

B. does not significantly harm any of the environmental objectives;

C. is carried out in compliance with the minimum safeguards[1] (human rights, social responsibility, worker rights, anti-corruption procedures);

D. complies with technical screening criteria that have been established by the Commission in accordance with the Decision[2].

[1] *Pursuant to Article 18 of the Regulation, "the minimum safeguards . . . are procedures implemented by an undertaking that is carrying out an economic activity to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights".*

[2] *Pursuant to Article 10(3), Article 11(3), Article 12(2), Article 13(2), Article 14(2), or Article 15(2).*

Article 8 of the Taxonomy Regulation establishes that any undertaking which is subject to an obligation to publish non-financial information pursuant to the directive of disclosure of non-financial information shall include information on how and to what extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under the EU taxonomy. Also, it defined that non-financial companies disclose data on the proportion of:

- turnover,
- capital expenditure (CapEx) and
- operating expenditure (OpEx)

associated with economic activities that comply with EU taxonomy. The required data represent sustainability indicators for non-financial companies. Key performance indicators for financial companies are defined in the EC Regulation from 2021 (for more information about key indicators for banking sector see Section 2. *Disclosure requirements for non-financial information in banks* above), with simultaneous presentation of information that all companies need to disclose and the methodology of disclosing these information (EC, 2021b).

After listed classification of activities according to sustainability and determining indicator sustainability, the EC additionally supplemented the decision on taxonomy (EC, 2021c) in 2021 by determining:

- technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change **mitigation** or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives

Technical screening criteria have been established for the following activities (and sub-activities): forestry, environmental protection and restoration activities, manufacturing, energy, water supply, sewerage, waste management and remediation, transport, construction and real estate activities, information and communication, and professional, scientific and technical activities. It also contains generic criteria of do no significant harm to climate change adaptation, sustainable use and protection of water and marine resources, pollution prevention and control regarding use and presence of chemicals, protection and restoration of biodiversity and ecosystems with technical specifications for water appliances.

Activities that **contribute to climate change mitigation** can be:

1) low-carbon activities (already they have low carbon dioxide emissions),
2) transitional activities (contribute to transitions to economy with net-zero emissions by 2050),
3) enabling activities (other activities which help to reducing emissions).

- Technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change **adaptation** and for determining whether the economic activity causes no significant harm to any of the other environmental objectives. Technical screening criteria have been established for the following activities (and sub-activities): forestry, environmental protection and restoration activities, manufacturing, energy, water supply, removal waste water, management waste and rehabilitation environment, transport, construction and real estate, information and communication, professional, scientific and technical activities, financial and insurance activities, education, human health and social work activities, arts, entertainment and recreation.

It includes classification of dangers which they bring climate changes, and the generic criteria of do no significant harm to sustainable use and protection of water and marine resources, pollution prevention and control regarding use and presence of chemicals, and protection and restoration of biodiversity and ecosystems with technical specifications for water appliances.

Activities which contribute **adaptation on climate changes** can be:

1. adapted activities (adapted to all material physical climate risks identified for economic activity) and
2. enabling activities (which reduce material physical climate risks in other economic activities and/or address systemic barriers to adaptation and which are -adapted on physical climate risks).

Box 3 – Compliance of company's activities with EU taxonomy

To establish whether the activity complies with the EU taxonomy, a company should undergo the following four steps:

1. **identifying "qualified activities" (answers whether the activity is qualified),**

If the activity is not qualified, it is rejected as Unqualified.

For Qualified activity continue with:

2. **an assessment whether the activities comply with the technical criteria (whether they cover a significant proportion and do no significant harm ,**
3. **verifying compliance with the minimum safeguards (Article 18.1 of the regulation on taxonomy),**
4. **applying relevant reporting rules.**

If the answers to the second and third questions are negative, the activity is graded as Uncomplied qualified activity.

In the next period, the relevance of the expression "non-financial information" was questioned, and it was decided that it needed change because it brings on conclusion that such information did not have financial importance. Separate directive established to use the expression "sustainability information" (EC, 2022). In addition, this directive expanded the scope of credit institution as entities for sustainability reporting (see more on this change in part 2. *Disclosure requirements of non-financial information for banks* in this paper).

Box 4 – Reporting requirements of the EU directive on corporate governance sustainability reporting

By highlighting some requirements for corporate governance sustainability reporting in this box, attention is drown to the scope and type of non-financial information required from non-financial and financial companies. In general, attention is drawn to the importance of defining the business model, strategy, policy, goals, measures, due diligence analysis, all for the purposes of sustainability analysis and determining the company's main risks related to sustainability issues.

The EC Directive as regards corporate sustainability reporting (EC, 2022) has expanded the scope of reporting entities. While are first these were large undertakings with over 500 employees on average during the year, it now includes small and medium-sized undertakings, that is, all companies which they have over 10 and less than 250 employees (microenterprises (up to 10 employees, according to this criterion) are exempt from obligation).

At the same time, the reporting scope was expanded. The management report must include the following information:

1. **a brief description of the undertaking's business model and strategy, including**
   - **the resilience of the undertaking's business model and strategy in relation to risks related to sustainability matters;**
   - **the opportunities for the undertaking related to sustainability matters;**
   - **the plans of the undertaking, including implementing actions … to ensure that its business model and strategy are compatible with the transition to a sustainable economy and … the objective of achieving climate neutrality by 2050;**
   - **how the undertaking's business model and strategy take account of the interests of the undertaking's stakeholders and of the impacts of the undertaking on sustainability matters;**
   - **how the undertaking's strategy has been implemented with regard to sustainability matters;**
2. **a description (of the time-bound) targets related to sustainability matters …, a description of the progress the undertaking has made towards achieving those targets, and a statement of whether the undertaking's targets related to environmental factors are based on conclusive scientific evidence;**

3. a description of the role of the administrative, management and supervisory bodies with regard to sustainability matters, and of their expertise and skills;
4. a description of the undertaking's policies in relation to sustainability matters;
5. Information about existence program incentives for members administrative, management and supervisory bodies connected with questions sustainability offered;
6. a description of:
   - the due diligence process implemented by the undertaking with regard to sustainability matters;
   - the principal actual or potential adverse impacts connected with the undertaking's own operations and with its value chain, including its products and services, its business relationships and its supply chain, actions taken to identify and monitor those impacts, and other adverse impacts which the undertaking is required to identify pursuant to other Union requirements on undertakings to conduct a due diligence process;
   - any actions taken by the undertaking to prevent, mitigate, remediate or bring an end to actual or potential adverse impacts, and the result of such actions;
7. a description of the principal risks to the undertaking related to sustainability matters, including a description of the undertaking's principal dependencies on those matters, and how the undertaking manages those risks;
8. indicators relevant to the disclosures referred to in points above.

Undertakings shall report the process carried out to identify the information that they have included in the management report.

Reporting in accordance with this directive is mandatory for undertakings which are subject to previous reporting directive starting from fiscal year 2024.

Other large undertakings have to start reporting from fiscal year 2025, small and medium public-interest entities from the fiscal year 2026, and companies without registered office in the EU, and have significant activities on the EU market should start reporting from fiscal year 2028.

In June 2023, the EC published the EU Taxonomy User Guide (EC, 2023b), intended for large undertakings, or institutions which were or will to be reporting entities for EU requirements for sustainable reporting.

Box 5 – Economic activity that does significant harm to environmental goals

Pursuant to Article 17 of the taxonomy regulation (EC, 2020), economic activity **significantly harms** (ecological objectives):

- *climate change mitigation*, where that activity leads to significant greenhouse gas emissions mitigating climate change;
- *climate change adaptation*, where that activity leads to an increased adverse impact of the current climate and the expected future climate, on the activity itself or on people, nature or assets;
- *the sustainable use and protection of water and marine resources*, where that activity is detrimental: to the good status or the good ecological potential of bodies of water, including surface water and groundwater; or to the good environmental status of marine waters;
- *circular economy*, including waste prevention and recycling, where: that activity leads to significant inefficiencies in the use of materials or in the direct or indirect use of natural resources, that activity leads to a significant increase in the generation, incineration or disposal of waste, or the long-term disposal of waste may cause significant and long-term harm to the environment;
- *pollution prevention and control*, where that activity leads to a significant increase in the emissions of pollutants into air, water or land, as compared with the situation before the activity started; or
- *the protection and restoration of biodiversity and ecosystems*, where that activity is: significantly detrimental to the good condition and resilience of ecosystems; or detrimental to the conservation status of habitats and species, including those of EU interest.

From the document of the Government of Montenegro (2022), we may conclude that the mentioned large undertakings are aware of the EU requirements related to taxonomy.

An example is Mine coal AD Pljevlja that aims to diversify the coal exploitation activities, resulting from adjustments to abandoning coal in producing electricity in 2035 and the energy transition process. In that direction, suggestions for investments were given stating that their implementations will follow the "do no significant harm" (DNSH) principle defined in Regulation 2020/852 (Regulation on Taxonomy). In addition, it lists the following EU directives whose monitoring is significant for proposed investments: Directive on the energy performance of buildings (2010/31/EU), Directive on energy efficiency (2012/27/EU), Commission Implementing Decision 2013/163/EU establishing the best available techniques (BAT) conclusions under Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions for the production of cement, lime and magnesium oxide, Directive 2009/33/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of clean and energy-efficient road transport vehicles.

Moreover, the Institute for Physical Medicine, Rehabilitation and Rheumatology „Dr Simo Milosevic" JSC Igalo states that it will be guided by the DNSH principle when assessing the planned investments.

It is crucial, but not simple, to follow the Regulation on EU taxonomy and classify activities according to the impact on achieving environmental goals. Its application is paramount for companies directed to financial institutions to provide funds for adaptation and climate change mitigation. Indeed, it is essential for financial institutions entering into a sustainable financing arrangement based on the company's assessment.

Montenegro implements activities aimed at achieving the sustainable development goals. It also harmonizes the Regulation with the EU regulation through Montenegro's accession to the EU.

The taxonomy regulation is only one of the regulatory requirements related to sustainable finance (Box 6).

Specifically, the 2013 Non-Financial Reporting Regulation (Accounting Directive) was transposed into the 2021 Law on Accounting. As stated above, alignment with the EC directive from 2014 (EC, 2014) and 2022 (EC, 2022) is planned.

Concerning the directives/regulations related to the financial sector, according to the available review, the institution primarily responsible for its transposition into domestic legislation is the Capital Market Authority (CMA) for the Regulation on Taxonomy and the Regulation on sustainability-related disclosure in the financial services sector.

Box 6 - EU regulation - sustainable finances (statement)

1. **Directive 2013/34/EU on the annual financial statements, consolidated financial statements... - Accounting Directive**
2. **Directive 2014/95/EU amending Directive 2013/34/EU (Accounting Directive) as regards disclosure of non-financial and diversity information …**
3. **Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector**
4. **Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation)**
5. **Regulation (EU) 2021/1119 establishing the framework for achieving climate neutrality ("European Climate Law")**

6. **Regulation 2021/2178 supplementing Taxonomy Regulation by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation**
7. **Regulation 2021/2139 supplementing Taxonomy Regulation by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives**
8. **Directive 2022/2464 amending … Directive 2004/109/EC (accounting Directive) as regards corporate sustainability reporting**
9. **Regulation 2022/1288 supplementing Regulation (EU) 2019/2088 with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports**
10. **Regulation 2023/363 amending and correcting the regulatory technical standards laid down in Delegated Regulation (EU) 2022/1288 as regards the content and presentation of information in relation to disclosures in pre-contractual documents and periodic reports for financial products investing in environmentally sustainable economic activities**
11. **Regulation 2023/2772 supplementing Directive 2013/34/EU (Accounting Directive) as regards sustainability reporting standards**

The stated EU regulations are fully binding and directly applicable in member states.

Two EU members states, Croatia and Slovenia, brought are law implementing the EU Disclosure Regulation with sustainability in the financial services sector.

Since February 2023, **Slovenia** has been applying the regulation on the implementing EU regulation on sustainability-related disclosures in the financial services sector[3], adopted by the Slovenian Government (Government of the Republic of Slovenia, 2023). According to the regulation, competent bodies for implementing the EU regulation EU and this Decree of the Government of Slovenia are Marketing Agency paper from values and Supervisory Agency insurance.

The Securities Market Agency is responsible for implementing regulations applied to:

[3] *Transposition of the EU regulation on taxonomy and regulation on sustainability-related disclosures in the financial services sector.*

- investment companies and credit institutions governing portfolios or providing investment advice;
- management companies and investment funds they manage;
- investment funds managed by managers of alternative investment funds.

The Insurance Supervision Agency is responsible for implementing regulations in the part that refers to:

- insurance and reinsurance companies, and
- management of pension funds formed as cover and cover groups, which are pension companies or insurance companies.

As of July 2021, **Croatia** has been applying the law implementing the EU regulation on sustainability-related disclosures in the financial services sector and the regulation on taxonomy (Croatian Parliament, 2021). According to this law, the competent authority for law enforcement is the Croatian Financial Services Supervision Agency.

Box 7 – Legal solutions for implementing EU regulations in Croatia

- **Act on the Implementation of EU Regulations Governing Payment Systems**
- **Act on the Implementation of the Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector and Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088**
- **Act on the Implementation of the Regulation (EU) 2020/1503 on European crowdfunding service providers for business**
- **Act on the Implementation of the Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014**
- **Act on the Implementation of the Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation**

Laws on transposing EU regulations (without citing amendments) are available on HNB website https://www.hnb.hr/regulativa-propisi

2. Non-financial disclosure requirements for banks

The EC regulation from 2019 (EC, 2019) emphasises the role of financial institutions supervisors and the preamble (30) gives the proposal for their actions. It states that the European supervisory bodies (EBA, EIOPA, ESMA) should be mandated to develop draft regulatory technical standards to further specify the content, methodologies and presentation of information in relation to sustainability indicators with regard to climate and other environment-related adverse impacts, to social and employee matters, to respect for human rights, and to anti-corruption and anti-bribery matters, as well as to specify the presentation and content of the information with regard to the promotion of environmental or social characteristics and sustainable investment objectives to be disclosed in pre-contractual documents, annual reports and on websites of financial market participants.

At the same time, financial market participants should, transparently, determine in their policies how they would monitor sustainability risks that might have a negative impact on the financial return of an investment.

When defining financial advisers as financial market participants, the same decision recognised credit institutions, but as institutions which provide investment advice.

In September 2020, the EC called supervisory bodies financial EU markets to declare what indicators would be adequate for banks, insurance companies societies and others financial market participants in, in the context of EU taxonomy.

Specifically, related to banking sector, the EBA received three questions:

- What information should banks and investment firms subject to the NFRD disclose on how their financial or broader commercial activities align with economic activities identified as environmentally sustainable in the EU taxonomy…? Which financial or commercial activities should be included/excluded?
- If turnover, OpEx and CapEx were not considered appropriate, what alternative indicators would achieve the same purpose? What should constitute the numerator and the denominator for a specific KPI for banks and investment firms?
- Could the green asset ratio be adapted to include taxonomy-related disclosures?

In its response (EBA, 2021) EBA explained why three indicators defined for non-financial institutions were not adequate for institutions under its jurisdiction:

- a KPI in terms of turnover is not relevant given the variety of counterparties and economic activities financed by banks, the different sources of income they rely upon and the structure of their profit and loss accounts;.
- the main sources of credit institutions' greenhouse gas emissions (GHG) are scope 3 emissions coming from their counterparties, and not scope 1 direct GHG emissions or indirectly scope 2 GHG emissions linked to their own consumption of purchased electricity, heat, or steam.

As he established indicators for non-financial institutions are not adequate for banks, EBA recommended to the Commission to apply green asset ratio as an alternative.

Green asset ratio (GAR) is the KPI to monitor financial institutions' ecological sustainability. Through this one indicator, banks should disclose the extent to which the banks in their banking book (including loans and advances, debt securities and equity instruments in the banking book) are associated with economic activities aligned with the EU Taxonomy. Compliance with EU taxonomy implies compliance with sustainable development goals.

The GAR should cover all bank's exposures in the banking book to all sectors (financial and non-financial corporates including SMEs, households and local governments/municipalities), including loans and advances, debt securities, equity instruments and repossessed real estate collaterals. Exposure to central government and central banks is not included in this phase[4].

EBA's recommendation is to lend EU institutions disclosed GAR for exposures according to EU clients, as well as and additional GAR that will to cover credit and ownership exposure according to clients (from sector included taxonomy) outside the EU, with use the best available data on these exposures.

The GAR computation excludes held for trading portfolio (assets in the held for trading) due to the different purpose of this portfolio. EBA advised that banks should separately disclose information on the overall sustainability, composition, trends and limits, and investment policy of their trading book.

Also, the EBA recommended that credit institutions disclosed:

[4] *By 30 June 2024, the European Commission shall review the application of this Article of Regulation in the part concerning central governments and central banks (EC, 2020b).*

- proportion of taxonomy-aligned financial guarantees,
- proportion of taxonomy-aligned assets under management, for guarantee and investee companies subject to NFRD disclosure obligations and linked to economic activities aligned with the Taxonomy,
- proportion of their fee and commission income, generated by services other than lending and asset management, related to NFCs subject to the NFRD, and linked to economic activities aligned with the Taxonomy.

At the same time, the EBA proposed a transition period until December 2022 is proposed for the GAR on the stock of loans when the counterparty is subject to the NFRD, and until June 2024 for the others clients.

Box 8 – EBA Recommendations regarding governance and ESG risk supervision

In the Report on management and supervision of ESG risks for credit institutions and investment firms (EBA, 2021a), the EBA made recommendations in several areas:

Recommendation 1

Incorporate ESG factors and considerations into business model analysis and the assessment of the viability and sustainability of the business model.

Incorporate ESG risks into institutions' business strategies and processes to provide the resilience of their business models in short-, medium- and long-term. In this context, the EBA proposes expanding the time horizon for strategic planning to at least 10 years (conducting qualitative analyses in the absence of quantitative forecasts for more than 5 years). The planning process should include a number of different environmental and social scenarios.

Recommendation 2

Incorporate ESG risks into own risk management frameworks:

- **Identify shortcomings concerning data and methodologies and undertake corrective measures,**
- **Collect necessary information and data related to ESG risks associated with counterparties at the loan origination phase, and review and update this information throughout the lifecycle of the transaction;**
- **Manage ESG risks as drivers of financial risks within their current risk management frameworks, in consistency with risk appetite;**

Recommendation 3

Incorporate ESG risks into your own internal governance arrangements through:

- **Establish clear work procedure and allocating the tasks and roles related to ESG risks to provide incorporating ESG risks into the business strategy, business processes and risk management,**
- **Establish the internal audit function to able to include ESG risks in its review of the effectiveness and adequacy of the internal governance arrangements,**
- **Enhance awareness, training and expertise of staff to identify, assess and manage ESG risks at all levels of the institution, as well as**
- **Encourage staff behaviour that is consistent with the ESG approach.**

The EBA also sees a need to gradually develop methodologies and approaches to test the resilience of institutions to the long-term negative impacts of environmental, social and governance factors. The initial objective of this testing should be to assess the long-term resilience of institutions' business models and support the setting of ESG-risk-related strategic objectives and/or limits.

After having received the supervisory authorities' response, the decision from 2021 (EC, 2021b) supplemented the Article 8 of the Taxonomy Decision by determining key performance indicators for financial undertakings. Article 4 of the new Regulation specifies (in Annexes) the information that credit institutions are obliged to publish, including the tabular templates for disclosing the information.

Annex V of the regulation, lays down that banks publish the aggregate GAR, as well as the GAR for the balance of loans, debt securities and equity holdings, as well as the flow of new lending, depending on the environmental goal and counterparty (non-financial institutions, financial institutions, retail, public institutions).

In addition to GAR, financial institutions publish KPIs for:

- off-balance sheet exposures on the level of association with Taxonomy-aligned economic activities, namely: 1) financial guarantees backing loans and advances and other debt instruments towards undertakings and 2) assets under management,
- fees and commissions,
- the trading portfolio.

The GAR numerator covers the loans and advances, debt securities, equities and repossessed collaterals, financing Taxonomy-aligned economic activities based on turnover KPI and CapEx KPI of underlying assets, while it excludes financial assets held for trading, on-demand interbank

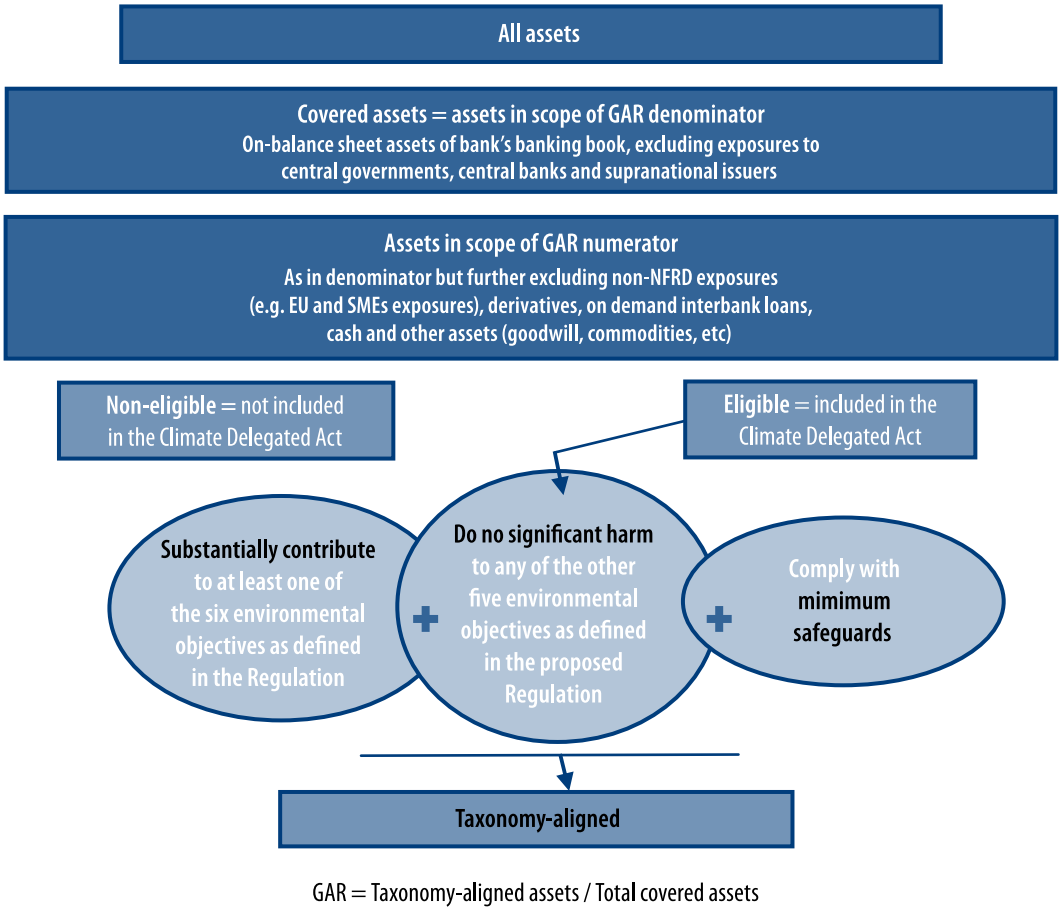
loans, exposures to undertakings that are not obliged to publish non-financial information in accordance with the Accounting Directive.

The GAR denominator includes total loans and advances, total debt securities, total equities and total repossessed collaterals and all other covered on-balance sheet assets (except exposures to central governments, central banks and supranational issuers.

Banks must publish all KPIs key performance indicators, including all accompanying information, from 1 January 2024.

Annex VI of the 2021 EC Directive (EC, 2021b) contains the *Template for the KPIs of credit institutions*, with a detailed presentation of credit institutions' reporting obligations.

Figure 2 – The process of calculating the GAR indicator



Source: UNEPFI. 2022. Practical Approaches to Applying the EU Taxonomy to Bank Lending p. 46

The EBA additionally emphasised the importance of having a common EU definition of green loans, highly noting that the definition of green loans based solely on the EU Taxonomy would exclude a large volume of such loans that credit institutions identify as green on their balance sheets (EBA, 2023).

In early 2024, the EBA expressed the view that the GAR cannot and should not be considered an indicator of progress on meeting institutions' sustainability commitments. Although it is a step towards improving transparency, it does not meet the primary objective of presenting banks' contribution to environmental and climate objectives. This is because the exposures towards SMEs or an enterprises outside the EU count towards the denominator and the numerator of the GAR, lowering the GAR value. To remind, not all enterprises are subject to CSRD reporting (99% of SMEs in Europe), and thus are excluded from the numerator of the GAR even if they comply with the EU Taxonomy. The GAR does not include all the banks' activities in financing the transition, and the European Commission is expected to reassess the composition of the GAR in June 2024. (EBF, 2024).

In the following period, the so-called Accounting Directive was partially amended through the directive on corporate sustainability from 2022 (EC, 2022). This directive noted that credit institutions and insurance companies that are not obliged to act in accordance with the so-called Accounting Directive should be subject to sustainability reporting requirements if they meet certain size criteria.

In addition, this directive applied the definition for credit institutions in accordance with the Regulation on prudential requirements for credit institutions and investment firms pursuant to which "credit institution" means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account. This has expanded the coverage of credit institutions as reporting entities.

2.1. Disclosure of indicators for banks

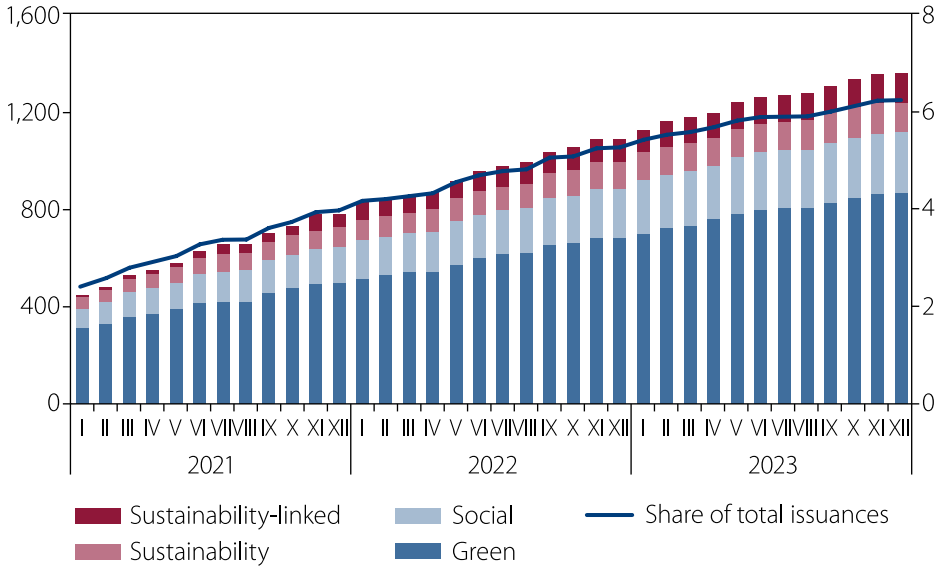
ECB

In early 2023, the ECB published the first series of climate-related statistical indicators, covering three areas:

1) *Experimental indicators on sustainable financing* - give an overview of issuances and holdings of sustainable debt securities in the euro area, labelled as "green", "social", "sustainable" or "sustainability-related".

The obtained data showed that the number of sustainable and green bonds, issued and those kept on the balance sheets (graphs 1 and 2), have more than doubled in the last two years.

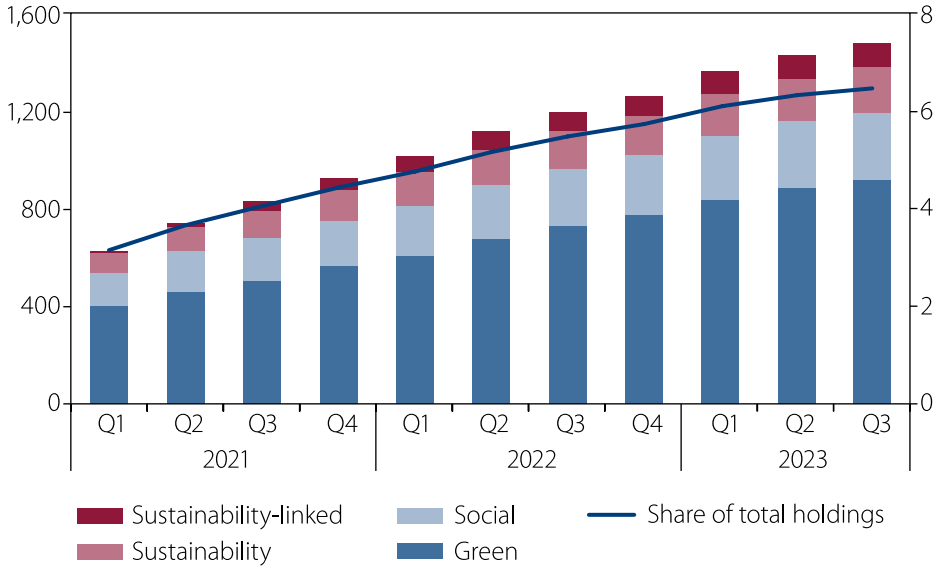
Graph 1 – Euro area issuances of sustainable debt securities
(Left-hand scale: outstanding amount, nominal value, in billion euros Right scale: %)



Source: ECB, available at https://www.ecb.europa.eu/stats/ecb_statistics/sustainability-indicators/data/html/ecb.climate_indicators_sustainable_finance.hr.html#_Data_access

If the volume of green debt securities issuances is observed by euro area countries, Germany leads followed by France and the Netherlands. France is in the top when looking at the volume of holdings of green debt securities, followed by Germany, Luxembourg and the Netherlands.

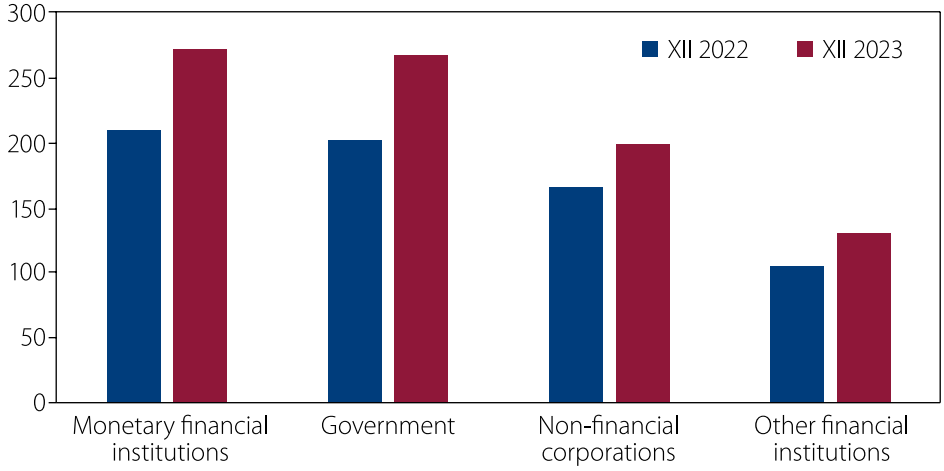
Graph 2 – Euro area holdings of sustainable debt securities
(Left scale: outstanding amount, nominal value, in billions of euros Right scale: %)



Source: ECB, available at https://www.ecb.europa.eu/stats/ecb_statistics/sustainability-indicators/data/html/ecb.climate_indicators_sustainable_finance.hr.html#_Data_access

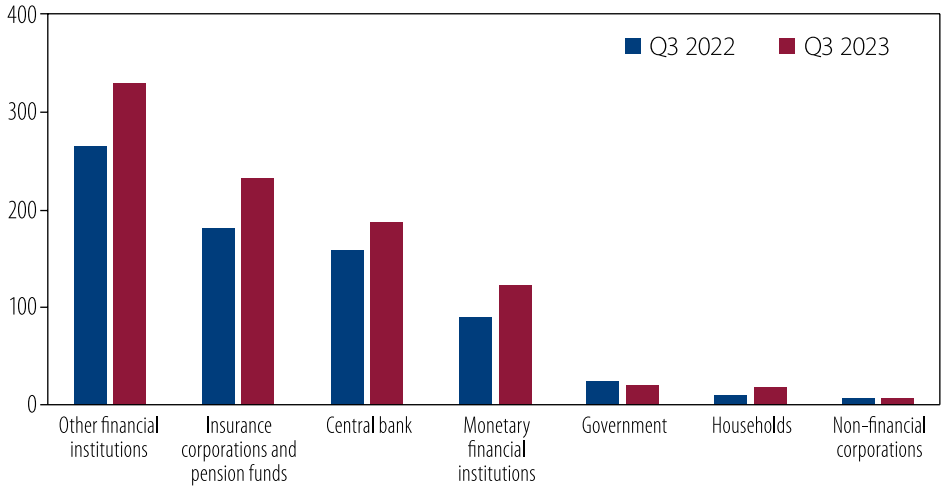
Sectoral division shows that the sector of monetary financial institutions accounted for the largest share in issuing green debt securities (graph 3), while graph 4 shows that the participation of banks in holding green debt securities is rising.

Graph 3 – Euro area issuances of green debt securities – by sectors
(outstanding amount, nominal value, in billions of euros)



Source: ECB, available at https://www.ecb.europa.eu/stats/ecb_statistics/sustainability-indicators/data/html/ecb.climate_indicators_sustainable_finance.hr.html#_Data_access

Graph 4 – Euro area holdings of green debt securities – by sectors (outstanding amount, nominal value, in billions of euros)



Source: ECB, available at https://www.ecb.europa.eu/stats/ecb_statistics/sustainability-indicators/data/html/ecb.climate_indicators_sustainable_finance.hr.html#_Data_access

2) *Analytical indicators on carbon emissions financed by financial institutions* – provide information on the intensity of carbon emissions in portfolios of securities and loan portfolios of financial institutions, and the financial sector's exposure to other contracting parties whose business models produce large carbon emissions.

The obtained data showed that the majority of emissions in the euro area are financed by equity securities or bonds of investment funds. In addition, the data showed that the activities with the highest carbon emissions are related to the banking sector's financing.

3) *Analytical indicators on physical climate-related risks* – are used to analyse the natural hazards' impact on the results of loans portfolio, bonds and equity securities.

In general, the indicators will facilitate the assessment of the climate risks' impact on the financial sector and monitor the development of sustainable and green financing. As assessed, this methodology should be further improved.

National Bank of the Republic of North Macedonia

National Bank of the Republic of North Macedonia (hereinafter text: NBRNM) published annual data for 2019 and 2020. From 30 September 2022, it publishes quarterly data on the share of green loans in total loans by sector (households, non-financial institutions) and bank size (small, medium and large). In addition, it publishes data on the "green" indebtedness of banks.

At the same time, it used the World Bank's definition of green loans, according to which, as stated, a "green" loan a form of financing that enables borrowers to use the proceeds to exclusively fund projects that make a substantial contribution to an environmental objective, including climate-related projects.

Table 1 – Share of "green" loans in total loans

Date	Large banks	Medium banks	Small banks	Banking system
2019	1.3%	5.5%	0.9%	2.2%
2020	1.4%	6.6%	0.8%	2.5%
IX 2021	1.4%	8.6%	0.7%	2.5%
XII 2021	1.7%	8.7%	0.7%	2.7%
III 2022	1.6%	9.1%	0.7%	2.7%
VI 2022	1.7%	8.6%	0.5%	2.7%
IX 2022	2.2%	8.9%	0.5%	3.1%
XII 2022	2.8%	11.9%	0.3%	3.6%
III 2023	2.9%	11.9%	0.6%	3.6%
VI 2023	3.3%	12.3%	0.7%	4.1%
IX 2023	3.5%	12.5%	0.8%	4.4%
XII 2023	3.6%	13.2%	0.9%	4.5%

Source: NBRNM

Table 2 – Share of "green" debts in total banks' borrowings

Date	Large banks	Medium banks	Small banks	Banking system
2019	17.0%	3.1%	0.0%	8.8%
2020	17.4%	4.7%	0.0%	9.4%
IX 2021	15.1%	0.8%	0.0%	7.7%
XII 2021	17.7%	1.2%	0.0%	8.7%
III 2022	15.4%	1.3%	0.0%	8.4%
VI 2022	13.5%	1.1%	0.0%	7.5%
IX 2022	17.3%	2.1%	29.1%	9.2%
XII 2022	18.8%	2.2%	15.9%	10.6%
III 2023	20.8%	2.4%	23.8%	11.8%
VI 2023	20.9%	2.4%	30.1%	12.1%
IX 2023	21.8%	2.4%	25.2%	12.5%
XII 2023	34.4%	2.1%	27.8%	17.7%

Source: NBRNM

Table 3 - Share of "green" loans in total loans, by sectors

Date	Large banks		Medium banks		Small banks		Banking system	
	Households	Non-financial companies	Households	Non-financial companies	Households	Non-financial companies	Households	Non-financial companies
2019	0.7%	1.9%	0.6%	9.4%	0.1%	1.9%	0.7%	3.7%
2020	0.7%	2.3%	1.2%	10.9%	0.1%	2.1%	0.8%	4.4%
IX 2021	0.9%	2.0%	1.7%	13.5%	0.1%	2.1%	1.0%	4.3%
XII 2021	0.5%	3.0%	1.8%	13.7%	0.0%	2.0%	0.7%	5.0%
III 2022	0.5%	2.9%	1.9%	14.4%	0.04%	2.0%	0.7%	5.0%
VI 2022	0.5%	3.0%	1.9%	13.6%	0.04%	1.5%	0.7%	4.9%
IX 2022	0.5%	4.1%	2.0%	14.1%	0.04%	1.4%	0.7%	5.8%
XII 2022	0.4%	5.4%	3.5%	16.5%	0.01%	0.9%	0.6%	6.9%
III 2023	0.3%	5.7%	3.6%	16.6%	0.02%	1.8%	0.6%	6.9%
VI 2023	0.3%	6.5%	3.5%	17.4%	0.01%	2.2%	0.5%	7.9%
IX 2023	0.3%	7.1%	3.4%	18.0%	0.01%	2.7%	0.5%	8.6%
XII 2023	0.3%	7.3%	3.8%	18.9%	0.01%	3.0%	0.5%	8.8%

Source: NBRNM

The National Bank of the Republic of North Macedonia also publishes the *Green Dashboard*, which, in addition to the aforementioned green finance indicators, also contains indicators related to the environment and energy, and climate risk indicators: for the financial sector (banks' exposure to physical risk (loans to individuals and companies, by region, by real estate collateral by region) and transition risk (banks' exposure to companies in relevant sectors (fossil fuels, communal services, energy sector, construction, transport, agriculture)), and other climate risk indicators.

3. A brief overview of the activities of selected central banks in the field of climate risks and sustainability

All central banks/agencies, which will be observed in this paper from the aspect of implemented climatic change activities (ECB, Bank of Albania (BoA), Banking Agency of the Federation of Bosnia and Herzegovina, CBCG, HNB, NBRNM, National Bank of Serbia (NBS), Bank of Slovenia (BoS) are members of the Network for Greening the Financial System (NGFS), two central banks are members of the Sustainable Banking and Finance Network (SBFN), and most participated in the work of the working group of the Vienna Climate Change Initiative.

The **NGFS** consists of central banks and financial market supervisors aimed at financial system greening and climate risk management.

As of 27 December 2023, NGFS has 134 members and 21 observers. In addition to the CBCG, members from the neighbouring countries are Bank of Albania, Bank of Slovenia, Croatian National Bank, National Bank of North Macedonia and National Bank of Serbia. In addition to the ECB, the central banks of the following EU member states are also members, in addition to the aforementioned central banks of Croatia and Slovenia: Italy, Spain, Portugal, Greece, Luxembourg, Estonia, Lithuania, Latvia, Cyprus, Hungary, Malta, Monaco, Denmark, the Netherlands, Germany, Finland, Slovakia, Romania, Belgium, and Austria. Among other countries, we single out the central banks of Switzerland, England, Canada, Russia, Norway, China, Japan and the Federal Reserve. Among the 21 observers of the NGFS are the IMF, the World Bank, the Bank for International Settlements, the European Bank for Reconstruction and Development, the European Investment Bank, Financial Stability Board and Organisation for Economic Cooperation and Development.

NGFS recommendations to central banks and other financial sector supervisors represent an analytical framework for assessing climate-related risks (NGFS, 2019).

Of the six recommendations, the first four are for central banks and other supervisors and can be seen as recommendations for financial institutions:

1) *Integrating climate-related risks into financial stability monitoring and micro-supervision,*
2) *Integrating sustainability factors into own-portfolio management,*
3) *Bridging the data gaps,*
4) *Building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing.*

The last two recommendations are addressed to policy makers and are intended to facilitate the work of central banks and supervisors:

1) *Achieving robust and internationally consistent climate and environment-related disclosure*, and
2) *Supporting the development of a taxonomy of economic activities*.

In 2021, the NGFS published the Glasgow Declaration, which emphasizes the NGFS's readiness to contribute to global activities carried out on reducing the climate change impact. The contribution of NGFS and its members will be reflected in the financial system greening, increasing the financial system's resistance to climate and environmental risks, and stimulating financial flows that would help the transition to a sustainable economy. As the declaration announce, many NGFS members published their declarations, strategies or policies related to the combating climate change during the 2021 United Nations Conference on Climate Change (COP26).

Box 9 - Glasgow declaration - extract

... In the coming years, the NGFS will then:

- **further enhance and enrich its climate scenarios, thus providing on a regular basis an important public good for a broad range of stakeholders, both public and private;**
- **deepen its analysis on integrating climate change considerations into monetary policy strategies and frameworks, in the context of the mandates of its members;**
- **intensify the work to bridge the data gaps that currently hinder the identification, management and mitigation of climate-related risks;**
- **supplement the set of NGFS practical guides with guidelines on TCFD-aligned reporting for central banks;**
- **facilitate uplift in supervisory capabilities and the global consistency of supervisory practices;**
- **step up its efforts on capacity building, with a particular focus on members from emerging and developing economies, to support members' progress in addressing climate-related and environmental risks and in implementing the NGFS recommendations;**
- **keep exploring emerging topics such as the impact of the loss of biodiversity or the risks associated with climate-related litigation, and work towards addressing them, in the context of the mandates of its members;**
- **continue to cooperate with standard-setters, other policy makers, the financial sector, academia and other relevant stakeholders to keep on distilling best practices, identifying challenges and solutions and avoiding duplication of work.**

SBFN includes financial sector regulators and financial associations from emerging markets committed to advancing sustainable finance.

The main goals of the members of this platform for sharing knowledge and capacity building on sustainable finance are improved management of environmental, social, and governance (ESG) risks – including climate risks – across the financial sector and increased capital flows to activities with positive environmental and social impact, including climate change mitigation and adaptation.

SFBN has 93 members from 71 countries. In addition to the CBCG, the BoA is a member from the neighbouring countries, as well as the associations of banks of Montenegro, Serbia and North Macedonia.

In October 2020, **Vienna Initiative** held its annual forum. During the Forum, the issue of climate change within the Initiative was brought up to date and proposed the establishment of a new working group for climate change and financial stability. The goal of forming the new group was to improve cross-border cooperation in identifying and assessing climate risks in the financial sector and coordinating policies to reduce these risks.

Most of the central banks discussed below in this paper participated in the work of the working group of the Vienna Initiative for Climate Change and Financial Stability.

The **European Central Bank** (ECB) set three objectives linked to climate change:

1. Managing climate-related risks, reducing those risks and assessing their impact on the economy;
2. enhancing sustainable financing to support the transition to a low-carbon economy;
3. enhancing knowledge in order to change behaviour more widely.

The ECB has included climate risks in the risk map of the single supervisory mechanism since 2019. In 2020, it published a Guide on climate-related and environmental risks (ECB, 2020) which contains expectations when it comes to risk management and disclosures (Annex I).

In 2021, the ECB invited institutions to perform a self-review of practice in relation to the aforementioned ECB Guide, and to prepare an action plan to improve the management of climate and environmental risks.

After reviewing the institutions' strategies related to climate and environmental risks, their risk management and governance frameworks and processes, the ECB also published the review of good practices for climate-related and environmental risk management (ECB, 2022a). As assessed, this review "is a key supervisory publication" which shares observations and good prac-

tices illustrating the different ways that significant institutions can align their practices with the supervisory expectations set out in the ECB Guide.

Good practices are discussed in the areas of: a) materiality (Identification of risk drivers and identification of exposures), b) business strategy (strategic approaches and strategic steering tools), c) governance (management body, remuneration, organisational structure) and risk management (risk appetite, reporting), d) risk management (risk classification, collateral valuations, environmental risks, capital adequacy...). The review should not be understood as an instruction, but as a direction in which direction to develop activities, and the practice will, of course, for each institution depend on its specificity, as well as the specificity of the economic and natural environment in which it operates.

In July 2022, the ECB published an action plan for the implementation of activities related to climate change (ECB, 2022) that will contribute to the achievement of its three set goals. It has identified six areas in which the necessary activities will be implemented:

1) Assess the macroeconomic impact of climate change and mitigation policies on inflation and the real economy,
2) Improve the availability and quality of climate data to better identify and manage climate-related risks and opportunities,
3) Enhance climate change-related financial risk assessment,
4) Consider options for monetary policy operations and assess the impact of climate change on monetary policy,
5) Analyse and contribute to policy discussions to scale up green finance,
6) Increase transparency and promote best practices to reduce the environmental impact.

The ECB conducted survey on the fulfilment of the supervisory expectations contained in its Guide on climate-related and environmental risks. It published the survey results in November 2022. The survey concluded that banks are still far from adequately managing climate and environmental risks, and thus the ECB set deadlines for banks to gradually meet all supervisory expectations until the end of 2024.

The ECB's action plan to include climate change considerations in its monetary policy strategy from 2021 foresees developing new statistical collections related to climate change during 2021 and 2022, which will be improved or developed in 2023 and 2024.

In early 2023, the ECB published the first series of climate-related statistical indicators (see more in section *2.1 Disclosure of indicators for banks - ECB* of this paper).

The **Bank of Albania** (BoA) has been a member of NGFS Since December 2020 and of SFBN since 2024 and participates in the work of the Working group for climate changes of the Vienna initiative.

In August 2012, it surveyed banks on climate and ecological risks (BoA, 2023). In May 2023, the BoA cooperated with World Bank and prepared medium-term green strategy with the action plan (BoA, 2023).

The section that relates to risk assessment and measurement foresees the preparation of a survey for corporations and the preparation of Green Dashboard that during 2023, which will to be important for the achieving financial stability goals and implementing monetary politics. Its preparation requires quality indicators. In addition, it is planned to prepare methodology for the assessment of transition risks that will encompass current stress testing methodology in place, as well as international best practice in this area in the first half of 2024. It will be followed up a first top-down assessment of transition risks in the second half of 2024. After that, it will apply the same approach for physical and transition risks in the first half of 2025, and then the first physical stress test of physical risks in the banking sector.

As for the supervisory activities, first activities are planned for 2024 and 2025. We highlight the preparation of guide of supervisory expectations related to climate risks, and the preparation of the reporting form. After adopting the guide, banks will implement self-assessment in this area.

The document, it is also discussed taxonomy and stated that there is still no uniform taxonomy for business activities and the BoA should develop and implement the national green taxonomy based on the EU taxonomy.

The **Banking Agency of the Federation of Bosnia and Herzegovina** (FBA) participates in the work of the Vienna initiative's working groups for climate changes and it conducted and planned significant activities on climate and environmental risks in the banking sector.

In 2022, it conducted a research on climate and environmental risks in which four banks participated. The research has shown that the banks were in their early phase of managing these risks. Foreign-owned banks used the experience of their own groups in this area. Most banks were not ready to start including climate risks in their credit risk management frame and did not progress in integrating climate risks into liquidity risks, while they achieved progress in integrating climate risks into operational risk management framework. In addition, they not had established procedures for collecting client data to assess their carbon footprint. Green products that banks offered referred to improving energy efficiency building.

FBA recognised the need to adopt guidelines, expectations and regulations in this area.

In January 2023, it determined supervisory expectations regarding banking actions in that year. In the part relating to risk development and supervisory expectations from banks, it stated that banks estimated the importance of risks arising from climate change as sub-categories of credit and operational risks with due attention (FBA, 2023d). Banks should also include climate and environment risks in business strategies and frameworks for internal governance and management risks.

In February 2023, FBA determined the strategic priorities on the Management and Supervision of Climate-Related Risks and Environmental Risks in the Banking Sector for the 2023-2025 Period. (FBA, 2023c).

Concerning regulatory measures, it planned to draft regulations for the climate and environmental risk management in 2023, and to adopt regulations for the management of these risks for other banking system entities in 2024, to draft other potential regulations in 2025.

Moreover, it foresees performing *Top-down* exercise/ Preparation of the "bottom-up" stress test methodology in 2024. As stated in the document, banks were supposed to perform their self-assessment of the compliance with the regulations for climate and environmental risk management in 2023, to update supervisory methodologies in 2024 and to define reporting forms for on-site examinations in 2025.

To guide banks' activities required for determination, measurement, management and control climate and ecological risks and publish data and information related with these team risks, the FBA determined Guidelines for managing risks related to climate changes and ecological risks for banks (FBA, 2023 and 2023a) in July 2023. The Guidelines contain expectations from banks regarding climate and ecological risks in: banks' business models and strategies, banks' internal management systems and risk appetites, then risk management framework, and policies, procedures and the content of risk disclosures related to climate changes and environment risks. Guidelines contain instruction to banks for applying the Guidelines, alignment plan with the Guidelines and self-assessment forms for banks.

In the above documents, the FBA discussed the taxonomy issue.

The first document concluded that, in the absence of common framework, banks should use own definitions of sustainable/green activities, avoiding risk from manipulative green marketing. They can evaluate own portfolio's sustainability. It estimated that defining taxonomies is not under FBA's competence, since state agency classification of economic activities sustainability will not only affect supervisory institutions, but many others economic subjects, including non-financial organisations and public sector entities (FBA, 2023c).

The second document states that, as there is no applicable taxonomy in Bosnia and Herzegovina, banks will internally develop and definitions, when necessary apply them on products offered to

their clients and may use definitions from other international practice. It stated that, following the proportionality principle, applicable taxonomy should be adequate to bank's nature, extent, size and business model.

In October 2023, FBA passed the Decision on measures to strengthen financial inclusion and sustainable business of banks (Banking Agency Federation of Bosnia and Herzegovina, 2023b). The Decision defines green products, social responsible financing, ESG criteria, and sustainable operations.

The **Central Bank of Bosnia and Herzegovina** invested part of its foreign exchange reserves portfolio in green bonds.

The **Central Bank of Montenegro** (CBCG) has been a member of NGFS since October 2022, SFBN since 2024 and has participated in the work of the Vienna Initiative's working group on climate changes. As a NGFS member, it also accepted and published Glasgow declaration on its website.

In 2021, the CBCG conducted the first survey on the impact of climate and environment risks on banking operations (Kilibarda, 2021). Research has shown all banks saw opportunities in offering green financial products and services through financing renewable energy sources and energy efficiency projects, in lending to clean technologies, and agricultural production. Besides that, fewer banks offered some green product and these were improvement loans energy efficiency. There were several banks that did not take into account climate risks in the loan approval process. Furthermore, the survey showed that few banks assessed their exposure to environment and social risks, only few had climate change related strategy within in its business strategy, while only few banks assessed the portfolio's exposure to climate risks.

In March 2022, the CBCG adopted the Central Bank of Montenegro Policy Related to Climate Change Challenges (CBCG, 2022), and then the Action Plan for implementing the Central Bank of Montenegro Policy Related to Climate Change Challenge in the 2023–2025 period. The Action Plan contains overview of planned activities on strengthening credit institutions' resistance on climate changes and on strengthening the CBCG's resilience to climate changes. After the relevant analysis, it has planned to include climate and environment risks into supervisory expectations, define reporting form for collecting data and indicators for monitoring credit institutions' exposure to climate and ecological risks, implement supervisory and macroprudential climate stress tests of credit institutions, improve model for macro stress testing of credit institutions, integrate sustainability and climatic and ecological risks in monitoring financial stability and prudential regulation. In addition, it planned integrating sustainable investments criterion from the aspect of climate risk in managing CBCG's portfolio and integrating sustainability and climate and environmental risk management in the CBCG's operational risk management, as assessing CBCG's carbon footprint, setting standards for its reduction, transitioning to the use of renewable source energy and reducing harmful influence on the environment.

In 2023, it conducted the second survey of banks on climate changes with evident by improvement of their commitment to climatic change. Thus, six out of 11 banks followed European recommendations and practices in this area, four banks had an organisational unit or person responsible to monitor climate and environmental risk, six banks had products promoting green financing. On the other hand, only two banks had the practice of approving loans based on clients' answers questionnaire of climate and ecological risks, and one bank invested in green bonds. Four banks analysed their portfolio's exposure to climatic and ecological changes.

CBCG invests a part of its portfolio into green bonds. On the occasion of 20 September, the Ecological State of Montenegro Day, the CBCG established annual Green Award for the best paper on the climate change effects on financial system in 2023.

The **Croatian National Bank** (HNB) has been a member of NGFS since June 2021. As its member, it also adopted and published Glasgow Declaration and Climate Pledge (HNB, 2021) on its website. In its declaration, the HNB recognised credit institutions' exposure to climate change risks, the importance of the financial sector's role in financing sustainable projects, and its role of "catalytic role in fostering climate transition in Croatia". HNB participated in the Vienna Initiative's working group on climate changes.

At the end of 2021, it published Supervisory expectations regarding the identification and management of ESG risks (HNB, 2021a). They recommended that these institutions follow the ECB's Guide on climate-related and environmental risks, which specified 13 supervisory expectations relating to the management of climate-related and environmental risks. As stated, less significant supervised entities are expected - when formulating their overall business strategy and making strategic and business decisions to take into account how environmental risks affect their business environment in the short, medium and long term; when formulating their risk management framework to include environmental risks in the risk appetite framework and within their organisational structure clearly assign responsibilities for the management of environmental risks at all levels (three lines of defence model); to include environmental risks in their risk management framework as drivers of existing categories of risk (e.g. credit, reputational, market. liquidity risk) and identify and quantify these risks within their overall process of ensuring capital adequacy; and expectations relating to disclosure.

Less significant credit institutions are first invited to complete the HNB's questionnaire for self-assessment of harmonisation with the listed expectations. They conducted two self-assessments. The results showed that their highest exposure to physical climate risks is towards companies in tourism, and then, in a significantly smaller percentage, in the energy sector, while the highest exposure to transitional climate risks is towards construction companies. At that time, only one institution was publishing relevant information and key benchmarks of significant ecological risk, only one the institution included environmental risk within the framework management, while two included these risks within the risk estimates framework etc.

In accordance with commitments from declarations, the HNB is at the beginning December 2023 adopted the Climate Strategy of the Croatian National Bank for 2024-2026 (HNB, 2023).

The strategy defines HNB's mission and vision in the context of climates and environment, and sets its goals. For the purposes, it set: 1) Understanding of climate-related risks for price stability and financial stability (as estimated, these activities require developing system for collecting relevant data), 2) Understanding of climate-related risks for price stability and financial stability, 3) Support to the transition to a low-carbon economy (anticipated preparing the climate strategy and setting up a climate risk management system, preparing a comprehensive climate report on the investment of HNB financial assets and the continuation of reporting on the ESG investment of financial assets), 4) Reducing own carbon footprint, and 5) Providing support to climate change-related activities. The action plan for the indicated period follows each the above-mentioned goals.

HNB invests a portion of its portfolio in securities with sustainability characteristics.

National Bank of the Republic of North Macedonia (NBRNM) has been a member of NGFS since March 2021 and participated in the Vienna Initiative's working group on climate changes. As a NGFS member, it also accepted and published Glasgow Declaration and its commitment to climate goals on its website, (NBRNM, 2021).

Since January 2021, NBRNM has been collecting data from banks on green finance. In February 2022, it conducted the Survey of banks on Climate Risks (NBRNM, 2022). The survey showed that banks saw the lack of standards and tools, the absence of guidelines from the regulator and lack of adequate data as main obstacles to climate-related risk management. The survey results showed that only three institutions considered climate change in their development plan at that time.

In June 2021, the NBRNM adopted the Strategic Plan of the National Bank for the period 2022-2024, which set increasing awareness of climate change and contribution to a green sustainable economy (NBRNM, 2021a) as an objective. The plan recognised the need to integrate climate change risks into financial stability risk assessment.

After adopting *Medium-Term Plan of the National Bank activities in the area of climate risk management for the period 2023 – 2025* in early 2023, the NBRNM published Guidelines on managing climate-related risks in October 2023 (NBRNM, 2023). The guidelines also introduce banks to the NBRNM's expectations regarding the risk management related to climate change. Thus, banks are expected to: 1) to adjust their business strategy in order to adequately include the potential changes in their business environment as a result of climate changeand their impact on operations in the long term. Banks are recommended to determine climate strategic goals and establish appropriate transition plans to monitor the fulfilling these goals and provide adequate financial and human resources; 2) to include the material climate-related risks in the risk management process. This requires appropriate adjustment and modification of the established risk management framework; 3) to establish an appropriate organizational structure for efficient management

of climate-related risks. At the same time, the guidelines pointed out that in the coming period, the NBRNM will also assess the need for appropriate changes and improvements to the existing banking regulation for risk management.

Furthermore, the NBRNM implements changes to the regulatory framework governing this area – it adopted the new Decision on disclosure of reports and data by banks, which, in the part related to banks' exposure to risks, also contains a part on climate risks. According to the decision, "The bank shall disclose data and information on climate risk exposure which include data and information on the way the bank has taken into account the effects of these risks on other risks management, the share of green loans in the total loan portfolio of the bank, as well as data and information on the risk of loss to the bank which may occur as a result of the current or future effects of the environmental, social and governance factors on its customers and investments." (NBRNM, 2023a)

It also adopted the Decision on the methodology for credit risk management, which includes the concepts of green finance and ESG. The adopted Decision on Reserve Requirement (NBRNM, 2023c) reduced the basis for calculation of the reserve requirement by the amount of newly approved loans to legal entities intended for financing projects for the domestic production of electricity from renewable sources. The NBRNM announced changes to the foreign exchange reserve investment policy, and increasing the term of investment in ESG bonds from 10 to 15 years.

Bank of Slovenia (BoS) has been a member of NGFS since 2020. As a NGFS member, it accepted the Glasgow Declaration and published its declaration, i.e. the Commitment of Banka Slovenije to participate in the global response to climate change on its *website*, (BoS, 2021). It participated in the Vienna Initiative's working group on climate changes.

It implemented significant measures in the area of climate transitions (BoS, 2023).

In the field of supervision, the BoS conducted the first supervisory climate stress tests for smaller Slovenian banks in 2022. They showed that banks included climate risks in their operations, risk management frameworks and data disclosure.

Within the monetary policy and. monetary policy instruments, the BoS adopted four measures. Concerning the monetary policy portfolio, the BoS initiated the process of decarbonising the corporate bond holdings in its monetary policy portfolio in October 2022, i.e. tilting the portfolio towards issuers with better climate performance. The BoS published the first financial disclosures of the climate-related portfolio in March 2023 (BoS, 2023a). Then, BoS planned restrictions concerning the collateral. By the end of 2024, BoS will limit the share of marketable assets issued by non-financial corporations with a high carbon footprint that other counterparties can pledge as collateral. From 2026, BoS will only accept collateral from companies that publish annual ESG reports. Then, by the end of 2024, in cooperation with rating agencies, it will develop minimum

standards for including climate change risks in the internal credit assessment systems of national central banks.

The BoS plans to increase investments in green, social and sustainable bonds to approximately 10% of its own financial assets by end-2025. It also planned to expand the minimum disclosure expectations set by the Eurosystem, the BoS established a methodology for monitoring and reporting our own greenhouse gas emissions and in 2023 (BoS, 2023).

National Bank of Serbia (NBS) has become member of NGFS on 2 July 2021 and participated in the Vienna initiative's working group on climate changes.

The NBS has been investing a portion of its foreign exchange reserves in green bonds.

It has conducted survey of banks related to climate risks. The survey shown that the majority banks recognised climate risks, more than half banks expected significant influence of climate risks on risk profile in the future and integrated that risk concept in internal acts. In addition, half of the banks has neither included these risks to banks' management body competencies, nor in the risk reporting system and had not defined any restriction regarding climate risks. Those who did it did it for the list of activities not supported or by defining exposure limit in the form of targeted maximum values required to be reached by some date.

The NBS has already been implementing advanced macroprudential stress tests of solvency and liquidity in the banking sector. Additionally, to include different macro scenarios of the influence of climate risks in existing frameworks, the NBS cooperates with central banks of the ESCB within the new regional Instrument for Pre-Accession Assistance (IPA project).

Conclusion

Risks connected with climatic changes are too important to be ignored.

The setting up and implementing goals related to climate and sustainability requires quality and comparable non-financial data and information of companies, primarily on the activity's ecology sustainability.

The need for this data and information and regulation which accompanying these needs have quickly changed and become more complicated in the past ten years. A set of new rules and EU strategies was adopted to facilitate transformation and adapting business companies and institutions to factors caused by climatic changes and other sustainability challenges.

The reporting status has changed, moving from non-financial reporting to sustainability reporting, from voluntary to mandatory involvement in financial reports, expanding the reporting entities coverage from large companies of public interest from the non-financial sector with over 500 employees to including all (except micro) companies. The coverage of financial companies as reporting entities has been expanded to include credit institutions that provide investment advice services to all credit institutions.

Starting from voluntary preparations non-financial report, the need for this data and information resulted in the introduction of international, or European standards sustainability reporting, which is mandatory applications expands and beyond the EU borders by introducing obligations preparations deep-sea analyses companies in question sustainability.

All listed changes have been implemented to increase transparency of non-financial and financial companies on the impact of their business on sustainability and managing climate and environmental risks.

This paper presented three EC regulations that serve as the basis of requirements for ESG reporting, and which support strategy on EU's sustainable funding (EC, 2019; EC, 2020; EC, 2022).

The 2019 EC Regulation (EC, 2019) binds financial markets participants to reveal ESG risks to prevention eco-manipulation and increase transparency on European markets capital.

The overall needs developments has recognised the importance of establishing a classification system and criteria to estimate whether economic activity is ecologically sustainable and, furthermore, whether investment in such activity is financial sustainable. A regulation on EU taxonomy was adopted and amended several times for more precise provisions for activities' contribution to achieving defined ecological goals.

This decreases climate risk, and thus financial risk. We may conclude that the existence of reporting obligations on sustainability, in accordance with EU taxonomy, facilitates financial institutions to implement their role – they provide funds for activities on reducing and adapting climatic changes avoiding eco-manipulation.

The need for unifying requests and methodology in this areas, and comparability of activities and companies in the process of financing, resulted in the producing sustainable financing standards and proposing EU regulation on the transparency and integrity of environmental, social and management rating activities.

All economic subjects they should commit to achieving the ESG concept business.

Following the EU regulation in this area and achieving ESG criteria is important for businesses wanting to become a part of big EU market companies supply chain. A Montenegrin company can become part of the chain if it applies ESG criteria, which an EU company evaluates by implementing in-depth analysis. Expectations for financial sector do not differ, as EU institution will approve credit or give a guarantee to Montenegrin banks if it meets ESG criteria rated through in-depth analysis.

In this direction, companies and institutions should have clear mission to mitigate or adapt their business to climate changes, environment protection, resources conservation, respect social aspect – protect human rights, health, conditions work, and to apply good management.

This implies the existence of clearly defined goal, aligned with sustainable development goals and relevant international and European policies governing this area. The mission and goal should be clearly involved in the organisations' policies, strategies, plans and activities. Institutions should have a clear vision of financing the set goal to achieve mitigation or adaptations on climate changes. Organisational structure should support activities in this field.

Institution's mission, goal, vision, policies, strategies, and relevant frameworks for monitoring climate and ecological risks, should be based on and refer to the EU's agenda and plan for achieving climate neutrality and other relevant international and European documents and policies. This would mean that institution's governance structure and all employees are aware of and act towards implementing the ESG criteria. Such acting is no longer an option, but a must.

At the same time, financial institutions have the same obligation, which should be subject of monitoring, regulation and routing by the financial system's supervisor.

It is necessary to disclose willingness to support ecologically sustainable activities that contribute to mitigating or adapting climate changes. It is evident that interested consumers, potential clients of financial institutions often they lack information on green financial products. Therefore, it is necessary to consider their more active engagement in raising awareness of green products, risks and possibilities they carry. Supervisors of these institutions should also support financial institutions in this field and prepare adequate guidelines and detailed instructions with clear expectations.

The CBCG and analysed central banks countries from the neighbouring countries started activities in this one field, but more active action are required considering the importance of questions and growing requirements to institutions and supervisors in this sector.

In particular, the CBCG should round up process of determining concept their ESG strategies based on brought policies and action plan in its actions, and acting of relevant financial institution in the climatic change area. After the CBCG initiated finding solutions form transposing regulations on EU taxonomy in Montenegrin regulations, these activities should continue in the near future cooperation with others Montenegrin financial system supervisors.

The institution primarily competent for transposing the regulation on taxonomy and the Regulation on disclosures related to sustainability in the financial services sector into domestic regulation is the CMA. Financial Stability Council should discuss joint action in this field, with the ultimate goal of the stability of financial institutions and the entire system. All three financial system supervisors should prepare internal plans for preparing the transposing of the provisions of the regulations that refer to them, provide a data collection system, create relevant indicators and cooperate with the institutions subject to their supervision.

We remind you that one from recommendation of the NGFS to central banks and other supervisors of financial sector institutions is supporting the development of a taxonomy of economic activities. As the decision was made at the EU level, the Montenegrin financial system supervisors should make this taxonomy publicly available, to "facilitate financial institutions' identification, assessment and management of climate and environment-related risks and mobilise capital for green and low-carbon investments" (NGFS, 2019).

Furthermore, in accordance with the relevant EC directive, as well as and ECB manuals, guidelines and principles, the CBCG should develop the system of reporting banks sustainability indicators to the CBCG, as and other supervisory expectations. The aforesaid would be important for banks and the CBCG for easier and comparable monitoring of risks and sustainability assessments of both banks' clients, and the banks themselves.

The assessment of the current exposures of banks and other financial institution under its supervision it is important for the CBCG primarily to facilitate the process of preparing relevant policies, guidelines, and strategies. In the near future, in cooperation with banks, the CBCG should develop common reporting system of companies (banks' clients) on sustainability indicators to banks. It is clear that banks are challenged to assess their clients' reports to be able to prepare their report on exposure and sustainability. Data accessibility is crucial for starting the process. One way is that the supervisor define single questionnaire for financial institutions, which would be sent to non-financial and to others financial institutions through competent structural boards and institutions. In this part, cooperation with the Association of Montenegrin Banks is important related to the CBCG's competence.

On the other hand, Montenegro's Chamber of Economy and the Institute of Certified Auditors should continue strengthening the awareness of non-financial institution with EU sustainability requirements. The businesses will face the challenge of assessing and documenting their compliance with the taxonomy criteria. Having in mind that the Law on Accounting will be adapted to the EU directive from 2014 on non-financial reports and the 2022 directive on corporate sustainability reporting. This is supported by research how much economic society in Montenegro is aware of the sustainability reporting obligation (Filipović, 2024).

Moreover, non-financial and financial institutions should be aware of published sustainability reporting standards, and of the possibility of creating ESG ratings.

Banks in Montenegro, especially banks with parent banks in the EU, have or prepare ESG strategies and policies, prepare an ESG report, and two banks have the assigned ESG rating within their groups. Pursuant to the Law on Accounting, report to management is part of banks' annual financial reports.

As stated above, this paper aims to highlight the importance of ESG criteria and reporting on sustainability, for both non- financial and financial institutions. This is primarily due to the importance and obligations of this reporting, rapid change on the EU market and applying the double materiality concept in reporting. Thus, the report includes how ESG factors affect business companies during whole chain values, and how their business affects environment and people. Fulfilling these requirements, non-financial and financial institutions significantly increase their competitive advantage.

References

1. **Banking Agency of the Federation of Bosnia and Herzegovina**. 2023. *Smjernice za upravljanje rizicima povezanim s klimatskim promjenama i okolišnim rizicima*. "Službene novine Federacije BiH", br. 57/23. Sarajevo. Jul
   Available at: *https://www.fba.ba/upload/docs/14smjernica_za_upr_riz_klimat_promjen_ozs_18_07_23_bos_1docx_qGe.pdf*
2. **Banking Agency of the Federation of Bosnia and Herzegovina**. 2023a. *Ispravka Smjernice za upravljanje rizicima povezanim s klimatskim promjenama i okolišnim rizicima*. „Službene novine Federacije BiH, br. 69/23. Sarajevo. Jul
   Available at: *https://www.fba.ba/upload/docs/ispravke_smjernica_o_klim_promjenama_za_sl_n_06_09_23_bos_a4J.pdf*
3. **Banking Agency of the Federation of Bosnia and Herzegovina**. 2023b. *Odluka o mjerama za jačanje finansijske inkluzije i održivog poslovanja banke*. Službene novine Federacije BiH. br. 85/23. Sarajevo. Oktobar.
   Available at: *https://www.fba.ba/upload/docs/2_odluka_o_mjerama_za_jacanje_fin_inkl_i_odr_poslovanja_za_uo_bos_27_10_23_6t3.pdf*
4. **Banking Agency of the Federation of Bosnia and Herzegovina**. 2023c. *Strateški prioriteti o upravljanju i nadzoru rizika povezanih sa klimatskim promjenama i ekološkim rizicima u bankarskom sektoru za period 2023.-2025. godina*. Sarajevo. Februar.
   Available at: *https://www.fba.ba/upload/docs/strateski_prioriteti_o_upravljanju_u_nadzoru_rizika_povezanih_sa_klimatskm_promjenama_i_okolisnim_rizicima_tIk.pdf*
5. **Banking Agency of the Federation of Bosnia and Herzegovina**. 2023d. *Supervizorska očekivanja u vezi sa postupanjem banaka u 2023. godini*. Sarajevo. Januar.
   Available at: *https://www.fba.ba/upload/docs/supervizorska_ocekivanja_u_vezi_sa_postupanjem_banaka_u_2023_godini_HSm.pdf*
6. **BoS**. 2021. *Commitment of Banka Slovenije to participate in the global response to climate change*.
   Available at: *https://www.bsi.si/en/about-us/cop26-climate-pledge*
7. **BoS**. 2023. *Tine Žumer, a keynote speech at the Green Finance Conference*. Ljubljana. Slovenia. June
   Available at: *https://www.bsi.si/govori-in-intervjuji/2076/nagovor-tine-zumer-na-konferenci-na-temo-zelenih-financ*
8. **BoS**. 2023a. *Climate-related disclosure of Banka Slovenije's own financial assets*. Ljubljna. March.

Available at: https://bankaslovenije.blob.core.windows.net/publication-files/climate-related-disclosure-of-banka-slovenije-own-financial-assets_march-2023.pdf

9. **CBCG**. 2022. *Politika Centralne banke Crne Gore u vezi sa izazovima klimatskih promjena*. Podgorica. Mart.
Available at: https://www.cbcg.me/slike_i_fajlovi/fajlovi/fajlovi_o_nama/cbcg_i_klimatske_promjene/politika_cbcg_u_vezi_sa_izazovima_klimatskih_promjena.pdf
10. **Croatian Parliament**. 2021. *Zakon o provedbi Uredbe (EU) 2019/2088 o objavama povezanim s održivosti u sektoru financijskih usluga i Uredbe (EU) 2020/852 o uspostavi okvira za olakšavanje održivih ulaganja i izmjeni Uredbe (EU) 2019/2088*. Narodne novine 70/21. Zagreb.
Available at: https://narodne-novine.nn.hr/clanci/sluzbeni/2021_06_70_1334.html
11. **Dzebo A, Shawoo Z**. 2023. *Sustainable Development Goal interactions through a climate lens: a global analysis*. SEI Report. Stockholm Environment Institute.
12. **EBA**. 2021. *Opinion of the European Banking Authority on the disclosure requirement on environmentally sustainable activities in accordance with Article 8 of the Taxonomy Regulation*. EBA/Op/2021/03. February.
Available at: https://www.eba.europa.eu/sites/default/files/document_library/About%20Us/Missions%20and%20tasks/Call%20for%20Advice/2021/CfA%20on%20KPIs%20and%20methodology%20for%20disclosures%20under%20Article%208%20of%20the%20Taxonomy%20Regulation/963619/EBA%20Opinion%20-%20Advice%20to%20EC%20on%20Disclosures%20under%20Article%208%20Taxonomy%20Regulation.pdf
13. **EBA**. 2021a. *EBA Report on management and supervision of ESG risks for credit institutions and investment firms*. EBA/Rep/2021/18. Paris. February.
14. **EBA**. 2023. *EBA Report in Response to the call for Advice from the European Commission on Green Loans and Mortgages*. EBA/REP/2023/38. December.
15. **EBF**. **European Banking Federation**. *2024. Green Asset Ratio cannot be to sustainability what CET1 is to capital*. Staff paper. January.
16. **EC**. 2013. *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance*. OJEU L 182/19. Brussels. June.
17. **EC**. 2014. *Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance*. OJEU L 330/1. Brussels. November.
18. **EC**. 2017. *Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information)*. OJEU C 215/1. Brussels. July.
19. **EC**. 2018b. *Communication from the Commission to the European Parliament, The European Council, The Council, The European Central Bank, The European Economic and*

Social Committee and the Committee of the regions. Action Plan: Financing Sustainable Growth. Brussels. March.

20. **EC**. 2019. *Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Text with EEA relevance)*. OJEU L 317/1. Brussels. December.

21. **EC**. 2019a. *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal*. COM (2019) 640 final. Brussels.

22. **EC**. 2020. *REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088. Official Journal of the European Union*. L 198/13. Brussels. June.

23. **EC**. 2021a. *REGULATION (EU) 2021/1119 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')*. OJEU L 243/1. Brussels. July.

24. **EC**. 2021b. *Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation (Text with EEA relevance)*. OJEU L 443/9. Brussels. December.

25. **EC**. 2021c. *Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives (Text with EEA relevance)*. OJEU L 442/1. Brussels. December.

26. **EC**. 2022. *Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (Text with EEA relevance)*. OJEU L 322/15. Brussels. December.

27. **EC**. 2022a. *Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sus-*

tainable investment objectives in pre-contractual documents, on websites and in periodic reports (Text with EEA relevance). OJEU L 196/1. Brussels. July.

28. EC. 2022b. *Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU)* 2019/1937. 2022/0051. Brussels. July.

29. EC. 2023. *Commission Delegated Regulation (EU) 2023/363 of 31 October 2022 amending and correcting the regulatory technical standards laid down in Delegated Regulation (EU) 2022/1288 as regards the content and presentation of information in relation to disclosures in pre-contractual documents and periodic reports for financial products investing in environmentally sustainable economic activities (Text with EEA relevance)*. OJEU L 50/3. Brussels. February.

30. EC. 2023a. *Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards. OJEU L 2772*. Brussels. December.

31. EC. 2023b. *The EU Taxonomy User Guide*. Brussels. June.

32. EC. 2023c. *Commission Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy. OJEU L 174/19. Brussels. July.*

33. ECB. 2020. *Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure. Frankfurt am Main*. Germany. November.

34. ECB. 2022. *ECB climate agenda 2022. Frankfurt am Main*. Germany. July.

35. ECB. 2022a. *Good practices for climate related and environmental risk management, Observations from the 2022. Thematic review. Frankfurt am Main. Germany*. November.

36. European Council. 2019. *A New Strategic Agenda 2019 – 2024*. Brussel.

37. **European Parliament**. 2019. *European Parliament resolution of 28 November 2019 on the climate and environment emergency (2019/2930(RSP))*. P9 TA (2019)0078. Strasbourg. November.

38. FBA. 2023. -
nancial sector, for the years 2023-2025. Tirana. May.
Available at: *file:///D:/Users/milica/Downloads/Strategjia_GREEN_anglisht_final_with_cover_25494.pdf*

39. Filipović. L. A. 2024. *Izvještaj o održivom poslovanju kroz prizmu Direktive 22/2464 EU*. Prezentacija. Stručni seminar, webinar. 25-26.04.2024.

40. Government of Montenegro. 2022. *Platforma ekonomskog oporavka 2022–2026. godine*. Podgorica

41. Government of the Republic of Slovenia. 2023. *Uredba o izvajanju Uredbe (EU) o razkritjih, povezanih s trajnostnostjo, v sektorju finančnih storitev*. Uradni list RS, št. 17/23. Ljubljana. Februar.
Available at: http://www.pisrs.si/Pis.web/pregledPredpisa?id=URED8454

42. **HLEG**. 2018. *Financing a European Economy. Final Report 2018 by the High-Level Expert Group on Sustainable Finance*. European Commission.
43. **HNB**. 2021. *Klimatska deklaracija*. Zagreb. Novembar.
Available at: *https://www.hnb.hr/o-nama/funkcije-i-struktura/hnb-i-klimatske-promjene/klimatska-deklaracija*
44. **HNB**. 2021a. *Supervizorska očekivanja za identifikaciju i upravljanje okolišnim rizicima*. Zagreb. Decembar.
Available at: *https://www.hnb.hr/o-nama/funkcije-i-struktura/hnb-i-klimatske-promjene/supervizorske-aktivnosti*
45. **HNB**. 2023. *Klimatska strategija za period 2024. do 2026*. Zagreb. Decembar.
Available at: *https://www.hnb.hr/o-nama/funkcije-i-struktura/hnb-i-klimatske-promjene/klimatska-strategija*
46. **Kilibarda. M**. 2021. *Klimatske promjene i finansijski sektor - poseban osvrt na bankarski sector.* CBCG. Radna studija br. 30. Podgorica. Novembar.
47. **NBRNM**. 2021. *Declaration - The National Bank, as a member of the international Network for Greening the Financial System, supported the international declaration adopted at the UN Climate Change Conference*. Skopje. November.
Available at: *https://www.NBRNM.mk/ns-newsarticle-soopstenie-03112021-en.nspx*
48. **NBRNM**. 2021a. *Strategic Plan 2022-2024*. Skopje. June.
Available at: *https://www.NBRNM.mk/content/Strategic-Plan-NB-2022-2024.pdf*
49. **NBRNM**. 2022. *Climate Risks – Results from the Survey conducted in banks and savings houses in the Republic of North Macedonia*. Februar.
50. **NBRNM**. 2023. *Guidelines on managing climate-related risks*. Skopje. October.
Available at: *https://www.NBRNM.mk/ns-newsarticle-Guidelines-on-managing-climate-related-risks.nspx*
51. **NBRNM**. 2023a. *Decision on reports and data disclosure by banks*. Skopje. October.
Available at: *https://www.NBRNM.mk/ns-newsarticle-decision_data_disclosure.nspx*
52. **NBRNM**. 2023b. *Decision on the methodology for credit risk management*. Skopje. October.
Available at: *https://www.NBRNM.mk/ns-newsarticle-decision_credit_risk_2013.nspx*
53. **NBRNM**. 2023c. *Decision on reserve requirement*. Skopje. January.
Available at: *https://www.NBRNM.mk/content/%D0%94%D0%A4%D0%9F/ENG%20%D0%B2%D0%B5%D1%80%D0%B7%D0%B8%D1%98%D0%B0/ENG%20Decision%20on%20reserve%20requirement_16012023.pdf*
54. **NGFS**. 2019. *First comprehensive report: A call for action: Climate change as a source of financial risk*. April.
55. **NGFS**. 2021. *Glasgow Declaration, Committed to Action*. Glasgow. November.
56. **TCFD**. 2017. *Final report Recommendations of the Task Force on Climate-related Financial Disclosures*, June.

Annex

Supervisory expectations of the ECB (ECB, 2020):

1. Institutions are expected to **understand** the impact of climate-related and environmental risks on the business environment in which they operate (macroeconomic variables, the competitive landscape, policy and regulation, technology, societal/demographic developments, and geopolitical trends), in the short, medium and long term, in order to be able to make informed strategic and business decisions.
2. **When determining and implementing their business strategy, institutions are expected to integrate climate-related and environmental** risks that materially impact their business environment in the short, medium or long term.
3. The management body is expected to consider climate-related and environmental risks when developing the institution's overall business strategy, business objectives and risk management framework, and to exercise effective oversight of climate-related and environmental risks. Considering the aforesaid, management bodies are expected to consider assigning the responsibility for climate-related and environmental risks to a member of an established committee or to set up a dedicated committee.
4. Institutions are expected to explicitly include climate-related and environmental risks in their risk appetite framework. This increases institutions' resilience to such risks and improves their ability to manage those risks, for example, "by setting limits on lending to sectors and geographies that are highly exposed to climate-related or environmental risks". Institutions should prepare a list of risks in accordance with the internal taxonomy of risks. Risk management strategy and risk appetite should consider all material risks to which they are exposed and specify risk limits, tolerances and thresholds. It means that institutions need to assign quantitative metrics to climate-related and environmental risks.
5. Institutions are expected to assign responsibility for the management of climate-related and environmental risks within the organisational structure in accordance with the three lines of defence model.
6. For the purposes of internal reporting, institutions are expected to report aggregated risk data that reflect their exposures to climate-related and environmental risks with a view to enabling the management body and relevant sub-committees to make informed decisions. Data on climate and ecological risks must be included in the reporting framework.

7. Institutions are expected to incorporate climate-related and environmental risks into their existing risk management framework, with a view to managing and monitoring these over a sufficiently long-term horizon, and to review their arrangements on a regular basis. Institutions are expected to identify and quantify these risks within their overall process of ensuring capital adequacy. In that sense, institutions may set limits on financing certain sensitive economic (sub-)sectors, sovereigns, or businesses.
8. In their credit risk management, institutions are expected to consider climate-related and environmental risks at all stages of the credit-granting process and to monitor the risks in their portfolios. Specifically, institutions are expected to form an opinion on how climate-related and environmental risks affect the borrower's default risk. These risks should also be considered in their collateral valuations.
9. Institutions are expected to consider how climate-related events could have an adverse impact on business continuity and the extent to which the nature of institutions' activities could increase reputational and/or liability risks. Institutions are also expected to adopt all necessary measures to safeguard business continuity. As part of business continuity management, institutions are expected to assess the impact of physical risks on their operations in general, including the ability to recover quickly. When assessing its critical or important functions, institutions are expected to consider the impacts of climate change on the provision of these services.
10. Institutions are encouraged to monitor, on an ongoing basis, the effect of climate-related and environmental factors on their current market risk positions and future investments, and to develop stress-testing scenarios that incorporate climate-related and environmental risks.
11. Institutions with material climate-related and environmental risks are expected to evaluate the appropriateness of their stress testing with a view to incorporating them into their baseline and adverse scenarios.
12. Institutions are expected to assess whether material climate-related and environmental risks could cause net cash outflows or depletion of liquidity buffers and, if so, incorporate these factors into their liquidity risk management and liquidity buffer calibration.
13. For the purposes of their regulatory disclosures, institutions are expected, to publish meaningful information and key metrics on climate-related and environmental risks that they deem to be material in line with the European Commission's Guidelines on non-financial reporting: Supplement on reporting climate-related information.