ESG disclosure analysis of a sample of Italian and European banks

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1. Introduction and main conclusions[1]

The European framework for Environmental, Social, Governance (ESG) factors, particularly climate and environmental ones, has changed rapidly and profoundly in recent years, based on the European Commission's Action Plan for Sustainable Finance.[2] The authorities' heightened awareness of the impacts of the climate transition on EU society and the economy led to the introduction of a comprehensive set of legislative measures, primarily aimed at facilitating the sharing of data and information on these risks, so as to make it easier to measure and manage them.

In this context, banking and financial supervisory authorities have also progressively stepped up their efforts to assess the integration of ESG risks into the business processes of supervised intermediaries. At the national level, Banca d'Italia – in addition to defining specific action plans with reference to individual intermediaries, both banking and non-banking – carried out specific analyses on the first disclosures published by banks on the impacts of ESG risks. In December 2023, the main findings of the analysis of ESG risk accounting impacts and disclosures were published for a sample of Italian and European banks.[3] This document updates these analyses with 2024 data from the same sample

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of banks: 12 Italian and 11 European significant banks, with reference to ESG Third Pillar disclosures, and 29 Italian banks with reference to non-financial reports.[4]

The main findings are outlined below:

<u>Climate change-related transition risk for loans secured by real estate assets</u>

- In general, the data confirm the difficulty that most banks, both Italian and European, encounter in obtaining ESG information on their counterparties, in many cases due to difficulties in accessing public databases containing data on the energy consumption of companies and households.

- However, Italian banks show a gradual improvement in retrieving and processing quality data and information, reflecting a greater ability to measure the transition risk tied to real estate collateral than in the previous year: the average share of commercial and residential properties lacking any data (real or estimated) on energy consumption has decreased from 25 to about 16 per cent, reaching levels comparable to those of the main European banks.

<u>Climate change-related transition risk for the banking book</u>

- The share of exposures of all European and Italian banks to non-financial companies operating in sectors defined as 'highly contributing to climate change' remained high, in line with the previous year's figures. However, the evidence available on the riskiness of credit exposures to these sectors remains weak. While a higher incidence of exposures classified in stage 2 and non-performing has been observed for these sectors, it cannot be ruled out that this finding is driven by idiosyncratic factors – such as the higher risk profile of counterparties operating in these sectors – rather than by the incorporation of climate risks in determining expected losses and IFRS 9 staging. For example, sectors classified as 'highly contributing to climate change' include manufacturing, construction, real estate, agriculture and accommodation and food services, which in recent years have been considered particularly sensitive to risks relating to the macroeconomic scenario characterized by rising inflation and high interest rates in the 2022-2023 period. Conversely, the sectors excluded from this group are primarily service industries, which are known to have performed better than other sectors.

<u>Banking book physical risk</u>

- Exposures subject to physical risk (chronic and acute) are a non-negligible percentage of the loan portfolio for both Italian (16.6 per cent) and European banks (18.1 per cent). However, we found no significant evidence with regard to the impact of physical risk on the determination of expected losses. Among the sectors most exposed to physical risk are agriculture, construction and manufacturing for

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[4]   Compared with the previous year's analysis, one Less Significant Institution (LSI) was removed from the sample, as it was no longer obliged to provide the non-financial report because it had become part of a banking group. The sample of 29 Italian banks for the non-financial report also includes the 12 significant Italian banks.

Italian banks, and agriculture, mining and quarrying, and electricity, gas, steam and air conditioning supply for European banks. Similarly to transition risks, no significant evidence emerged on the impact of physical risk on the calculation of expected losses.

Initial evidence on the Green Asset Ratio (GAR)

- The information published in 2024 (referring to 31.12.2023) also provides evidence on the Green Asset Ratio (GAR) for the first time, an indicator introduced by the EU Taxonomy and later incorporated into the EBA framework on Pillar 3 disclosure. The objective of the indicator is to provide a summary metric for the ratio between the assets financing taxonomy-aligned activities and total balance sheet assets.

- The initial findings indicate that there is room for improvement in the construction of the GAR. The calculation methodology, together with the incompleteness of the Taxonomy framework, generate values that are extremely low, for both Italian banks (1.68 per cent) and European banks (2.61 per cent).[5] This, together with more conceptual issues, casts doubt on the real informative value of the indicator.

- In this context, as well as in the context of the broader ongoing debate at the European level on the possible streamlining of the ESG framework, discussions are under way to introduce improvements to these metrics. The necessary improvement of the information value of the GAR could for instance be achieved by working on extending the Taxonomy framework also to those economic sectors currently excluded from it, as well as by revising how the indicator is calculated, making the information provided more effective with regard to banks' support for the climate transition. The consideration of other metrics, such as those already provided for on a voluntary basis (e.g. the Banking Book Taxonomy Alignment Ratio – BTAR), could also help in the same vein.

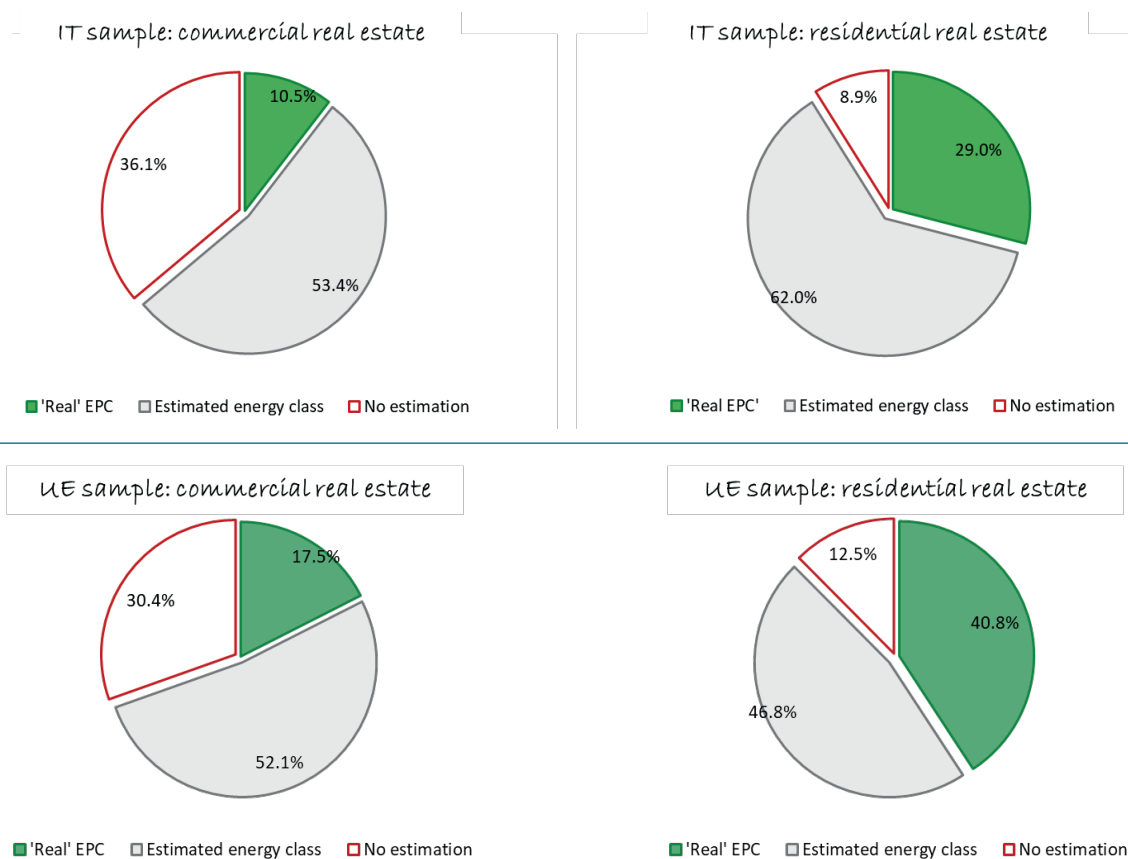## 2. Climate change-related transition risk for loans secured by real estate assets

Our analysis of Third Pillar data confirms the difficulty that most banks encounter in obtaining high-quality ESG information on their counterparties, an issue already highlighted in our analysis of the ESG disclosures as at December 31, 2022. Nonetheless, compared with the 2022 data, Italian banks are showing a gradual improvement – both in the commercial and residential segments – in the measurement of the transition risk tied to real estate collateral: the average share of commercial and residential properties lacking any data on energy consumption has decreased from 25 to about 16 per cent, reaching levels comparable to those of the main European banks.

The data gap continues to reflect the difficulties in accessing public databases (e.g. SIAPE, ARERA and ENEA) containing information on the energy consumption

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[5] It should be noted that these values only refer to significant banks and are provided in the turnover-based version (see Section 5).

of companies and households. Among the main challenges are issues relating to compliance with privacy regulations and confidentiality constraints.[6] [7] Comparing the sample of Italian banks with that of European banks, in line with last year's data, Italian banks recorded a lower percentage of real estate collateral for which the energy consumption data are certified by Energy Performance Certificates (EPCs), in both the commercial sector (10.5 per cent IT vs 17.5 per cent EU) and the residential sector (29.0 per cent IT vs 40.8 per cent EU) (Figure 1). Analysing the aggregate data shows that the percentages of residential and commercial real estate collateral for which EPCs are available are 24.4 per cent for the sample of Italian banks and 36.4 per cent for the EU sample.[8]

Figure 1: Distribution of energy efficiency for commercial and residential properties – Italian SIs and EU SIs sample

IT sample: commercial real estate
- 10.5% 'Real' EPC
- 53.4% Estimated energy class
- 36.1% No estimation

IT sample: residential real estate
- 29.0% 'Real' EPC
- 62.0% Estimated energy class
- 8.9% No estimation

UE sample: commercial real estate
- 17.5% 'Real' EPC
- 52.1% Estimated energy class
- 30.4% No estimation

UE sample: residential real estate
- 40.8% 'Real' EPC
- 46.8% Estimated energy class
- 12.5% No estimation

Source: Third Pillar data for the banks in the Italian and European sample.

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[6] See P. Angelini (2023), 'SMEs and the climate and environmental transition' and P. Angelini (2022), 'The financial risks posed by climate change: information gaps and transition plans'.

[7] On this point, the 'Improving Access to Climate and Environmental Risk Data Working Group', operating under the Sustainable Finance Roundtable promoted by the Ministry of Economy and Finance (MEF), is currently engaged in initiatives aimed at creating the conditions for more efficient and widespread access to public databases. See also MEF, *Sustainable Finance Platform – Annual Report on Activities – 2023* (only in Italian).

[8] In the previous year, the share of collateralized properties for which an EPC was available stood at 17 per cent for the Italian sample and 32 per cent for the EU sample, respectively.

At the same time, Italian banks rely on estimated values more frequently than European banks do, with the largest gap in the residential sector, where 62 per cent of Italian residential properties feature estimated data, compared with 46.8 per cent in the EU (Figure 1).[9] At the aggregate level, the percentage of properties with an estimated energy class is 59.9 per cent for Italian banks versus 47.8 per cent for the EU sample.[10] Moreover, in Italy, the share of properties lacking any data on energy consumption is highest in the commercial segment (36.1 per cent IT vs 30.4 per cent EU), whereas in the residential segment, the EU sample shows a higher percentage (8.9 per cent IT vs 12.5 per cent EU).

3. Climate change-related transition risk for the banking book

Italian Significant Institutions (SIs) and the sample of European SIs show 83.6 and 62.7 per cent respectively of their exposures to non-financial corporates operating in sectors defined as 'highly contributing to climate change',[11] i.e. those industries that contribute most significantly to climate change and thus require more investment to achieve the climate transition. These figures are broadly consistent with those found in previous analyses, confirming the central role of Italian banks in financing the climate transition of the client companies in these sectors.

Sectors that contribute significantly to climate change show, both at national and European level, a higher share of exposures classified as stage 2 and non-performing compared with the rest of the economic sectors.[12] However, it cannot be ruled out that this finding stems from idiosyncratic factors – such as the higher risk profile of counterparties operating in these industrial sectors – rather than from the incorporation of climate risks for the purposes of determining expected losses and IFRS 9 staging. For example, sectors classified as 'highly contributing to climate change' include economic sectors such as construction, real estate, agriculture, and accommodation and food services, which in recent years have been considered particularly sensitive to risks linked to the macroeconomic scenario characterized by rising inflation and high interest rates in the 2022-2023 period.

Moreover, analysis of coverage levels does not reveal a clear pattern: the coverage ratio for 'highly contributing to climate change' sectors – both in Italy and in the EU – is higher than that for the remaining economic sectors in the case of non-performing

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[9] In the commercial sector, 53.4 per cent of Italian properties feature estimated data, compared with 52.1 per cent in the EU.

[10] In the previous year, the share of collateralized properties for which the energy class was estimated amounted to 58 per cent for the Italian sample and 52 per cent for the EU sample, respectively.

[11] The sectors are: A - Agriculture, forestry and fishing; B - Mining and quarrying; C - Manufacturing; D - Electricity, gas, steam and air conditioning supply; E - Water supply; sewerage, waste management and remediation activities; F - Construction; G - Wholesale and retail trade; repair of motor vehicles and motorcycles; H - Transportation and storage; and L - Real estate activities. In addition to these, the EBA ITS for the Third Pillar ESG risk disclosure requires the inclusion of sector I - Accommodation and food service activities.

[12] For Italian banks, those sectors that contribute most to climate change show average stage 2 and non-performing exposures (14.9 and 4 per cent, respectively) higher than exposures to other economic sectors (14.6 and 2.9 per cent). At the European level, this trend is confirmed, as the percentage of stage 2 loans stands at 12.3 vs 10.2 per cent, while non-performing loans stand at 3.5 vs 3.1 per cent.

exposures,[13] whereas for stage 2 positions, coverage levels are only higher for the Italian banks.[14]

4. Banking book: physical risk

For Italian banks, exposures subject to chronic physical risk[15] account for 3.7 per cent of total exposures, subject to acute physical risk[16] account for 10.4 per cent and subject to both risks account for 2.5 per cent; the average figures for European banks are 7.8, 6.7 and 3.6 per cent, respectively. On an aggregate level (chronic and acute), exposures subject to physical risk are a non-negligible percentage of the loan portfolio, amounting to 16.6 and 18.1 per cent for Italian and European banks respectively. Among the sectors most exposed to physical risk are agriculture, construction and manufacturing for Italian banks, and agriculture, mining and quarrying, and electricity, gas, steam and air conditioning supply for European banks.

With regard to the impact of physical risk on stage classification, no specific indications emerged. For Italian banks, exposures subject to this risk have a percentage of positions classified as stage 2 and that for non-performing loans only slightly higher than that of total exposures; at the European level, there is only a higher impact on the non-performing classification. However, the physical risk in no way seems to significantly impact the level of coverage. Therefore, for physical risk and the related accounting impacts too, the findings are substantially in line with those resulting from the analysis of the data as at December 31, 2022.

5. Initial evidence on the GAR and possible improvements

The Green Asset Ratio (GAR) measures, compared with total assets,[17] the percentage of exposures included in the banking book that comply with two requirements: i) they are granted to large companies or to listed small and medium-sized companies that publish a non-financial report under the Corporate Sustainability Reporting Directive

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[13] For Italian banks, those sectors that highly contribute to climate change show a coverage of non-performing exposures of 56.2 per cent, compared with 50.5 per cent for exposures to other economic sectors. At the European level, the coverage of non-performing exposures in sectors highly contributing to climate change is 41.6 per cent, compared with 39.8 per cent for exposures to other economic sectors.

[14] For Italian banks, those sectors highly contributing to climate change show a coverage of stage 2 exposures of 5.2 per cent, compared with 3.5 per cent for exposures to other economic sectors. At the European level, the coverage of stage 2 exposures in sectors highly contributing to climate change is 3.1 per cent, compared with 3.7 per cent for exposures to other economic sectors.

[15] The European Commission's 'Guidelines on non-financial reporting: Supplement on reporting climate-related information' (2019/C 209/01) define chronic physical risks as risks 'which arise from longer-term changes in the climate, such as temperature changes, rising sea levels, reduced water availability, biodiversity loss and changes in land and soil productivity', Communication from the Commission, 2019.

[16] The European Commission's 'Guidelines on non-financial reporting: Supplement on reporting climate-related information' (2019/C 209/01) define chronic physical risks as risks 'which arise from particular events, especially weather-related events such as storms, floods, fires or heatwaves, that may damage production facilities and disrupt value chains', Communication from the Commission, 2019.

[17] Excluding exposures to sovereigns, central banks and the trading book.

(CSRD),[18] or to households and local authorities, and ii) they finance 'aligned' activities according to the Taxonomy Regulation.[19]

Based on data as at 31 December 2023, the value of the indicator is very low for both significant Italian and European banks (1.68 and 2.61 per cent respectively);[20] even lower values are found for the sample of Italian Less Significant Institutions (LSIs) included in the non-financial reports analysis: 0.84 per cent (Figure 2). This primarily reflects the way the GAR is calculated, particularly the exclusion of companies not subject to ESG disclosure obligations from the numerator (i.e. SMEs and micro-enterprises), the inconsistency between numerator and denominator, and the incompleteness of the Taxonomy framework.

Figure 2: GAR comparison between Italian LSIs and SIs
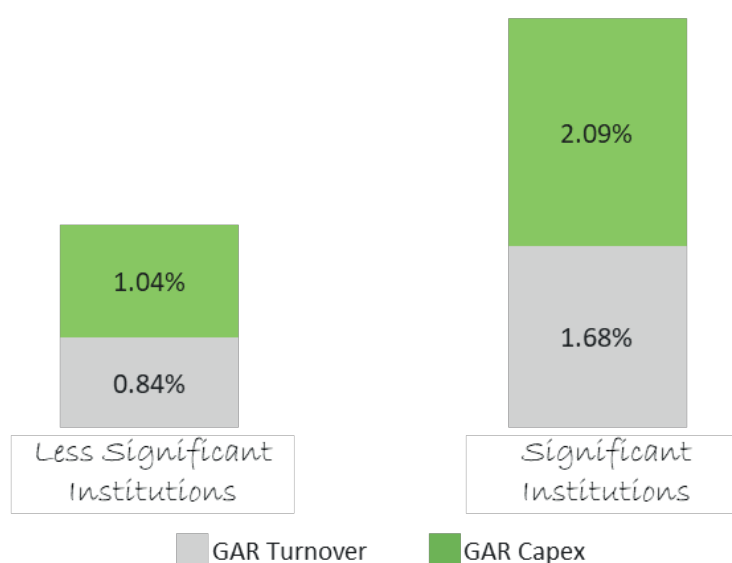
Source: Third Pillar and non-financial reports data for the banks in the Italian sample.

With specific reference to the Taxonomy, it is actually worth noting that, to date, it only covers a part of the economic sectors in which non-financial companies operate, while some sectors are not included at all. Moreover, even for those economic sectors currently included in the Taxonomy framework, there are not always the technical criteria available for every sub-activity that would enable companies to fully assess the degree of alignment of their business model. This implies that, as shown in Figure 3,

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[18] The CSRD is applicable to i) all 'large companies', i.e. companies that exceed two out of the following three criteria: a balance sheet total of €25 million, a net turnover of €50 million and an average number of employees totalling 250 during the financial year; and ii) listed SMEs.

[19] An activity is 'aligned' according to the Taxonomy Regulation if: i) it substantially contributes to at least one of the six environmental objectives defined in the Regulation; ii) it does not cause significant harm to any of the other environmental objectives (Do No Significant Harm, DNSH); iii) it respects the minimum safeguards (human and labour rights as set out in the Guiding Principles and UN International Conventions); and iv) it complies with the technical screening criteria (TSC) published by the European Commission for each objective.

[20] Values calculated with reference to the turnover-based version. Please note that the GAR calculated on capital expenditure (capex based) must also be included in the non-financial report.

the degree of alignment to the Taxonomy is almost zero or, at best, very low for many economic sectors (for both the European and the Italian sample).

Figure 3: Alignment of individual economic sectors to the Taxonomy Regulation: ITA SIs vs EU Sis
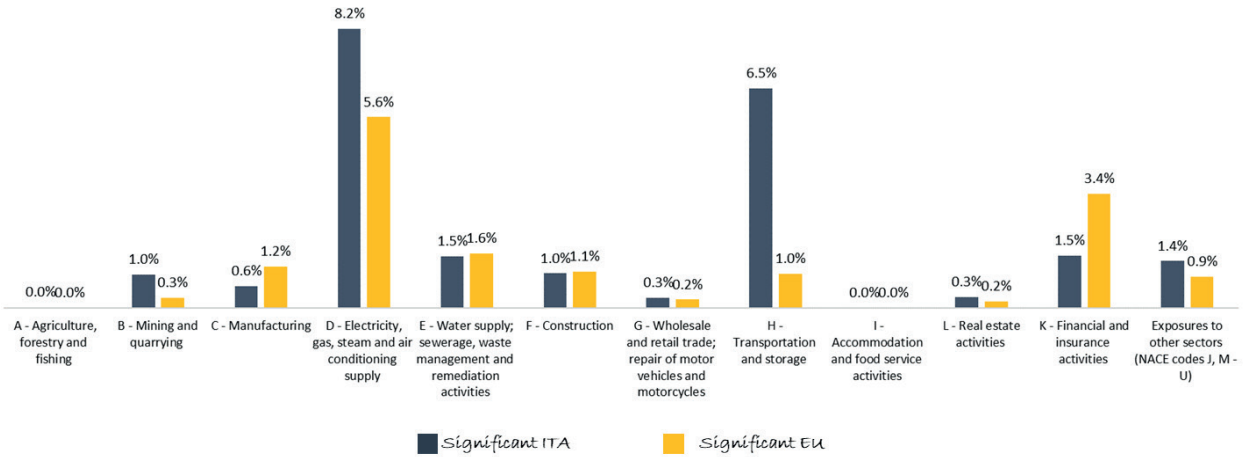
Source: Third Pillar data of the banks in the Italian and European sample.

In light of the above, at the European level – starting from the work on the development of an 'Omnibus' framework[21] on climate risks – discussions are under way on the opportunity and feasibility of adding other metrics to the GAR that could better reflect the effective alignment of banking portfolios with sustainability objectives.

One first possibility would be to provide an 'adjusted' GAR, with a denominator that is more consistent with its current numerator. This version would exclude all exposures to counterparties not included in the numerator (i.e. lending to SMEs, government bonds, derivatives, tangible and intangible assets).[22] Such a metric would make it possible to gauge the contribution banks make more immediately and comprehensively in terms of financing the climate transition, both to listed and large companies subject to disclosure requirements and to households.

A second possibility is provided by the Banking Book Taxonomy Alignment Ratio (BTAR), provided on a voluntary basis under the EBA Pillar 3 disclosure framework. Unlike the GAR, it includes taxonomy-aligned exposure to companies not subject to disclosure requirements in the numerator (i.e. SMEs and micro-enterprises) that, based on internal estimates, represent more than 80 per cent of the banking portfolio for

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[21] On February 26, 2025, the European Commission published an initial Omnibus regulatory proposal regarding the disciplines of the Corporate Sustainability Reporting Directive (CSRD), Taxonomy Regulation and Corporate Sustainability Due Diligence Directive (CSDDD), with the aim of reducing the regulatory burden on operators, thereby simplifying the regulatory framework.

[22] Among the items in the Omnibus proposal there is the amendment – published for public consultation – of Delegated Regulation 2021/2178 to exclude from the GAR denominator the exposures to entities not required to provide a non-financial report under the CSRD. This proposed amendment to the GAR would make its numerator more consistent with the denominator.

Italian banks.[23] Moreover, the EBA framework allows the use of proxies and information collected bilaterally from counterparties.

Furthermore, to ensure these metrics have effective informational value, it is essential to complete the Taxonomy framework promptly by incorporating the economic activities currently excluded. The present exclusion of certain activities leads those that may actually be sustainable or that do not negatively impact environmental issues being labelled as 'non-aligned'. Consequently, the existing Taxonomy framework does not enable an accurate assessment of the genuine contribution made to environmental protection and the climate transition.

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[23]   Estimates based on data provided by the Central Risk Office on the composition of the corporate banking portfolio.