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ESG DISCLOSURE: REGULATORY FRAMEWORK AND CHALLENGES FOR ITALIAN BANKS

by Tommaso Loizzo* and Federico Schimperna*

Abstract

In line with developments at the global level, the attention of financial regulators on ESG factors, particularly on environmental and climate-related risks, has significantly increased over recent years. In this context, disclosure of relevant climate-related information plays a key role, for both financial and non-financial stakeholders. The EU regulatory framework on disclosure is rather advanced when compared with other jurisdictions and will be almost ready for implementation in the next few months. The Bank of Italy, in line with the ECB and other national supervisors, has started a number of initiatives aimed at actively contributing to major international projects, strengthening the dialogue with the national industry and assessing the progress made by supervised entities. The paper: i) summarises the main regulatory requirements for ESG disclosure; ii) investigates the areas of commonalities at the EU level between the Pillar 3 disclosure requirements and those envisaged by the standards under development by the EFRAG; iii) takes stock of the main supervisory initiatives undertaken so far and presents some preliminary thoughts on the major challenges ahead to be faced by Italian banks.

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Contents

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1. Introduction[1]

A proper integration of environmental, social and governance (ESG) factors in the business model of financial and non-financial entities is crucial for sustainable economic growth in the light of the existing environmental challenges. Among the ESG factors, climate-related and environmental issues play a special role. Following the Paris Agreement, in 2015 the international community committed to keep average global warming well below 2 degrees Celsius compared with pre-industrial levels, and to continue its efforts to limit the temperature increase to 1.5 degrees. At the European level, in 2019 the European Commission presented a "European Green Deal" to reduce greenhouse gas (GHG) emissions by at least 55% by 2030 (compared with 1990 levels) and achieve climate neutrality by 2050. In 2021, the European Climate Law incorporated the goals set out in the European Green Deal.

A key role, always in the hands of governments, is also played by the availability of high quality climate-related data and information. Indeed, from a macro-economic perspective the availability of such data is a precondition for monitoring financial stability risks and assessing vulnerabilities; from a more micro perspective, ESG reporting increases companies' awareness and could help them in setting targets, measuring impacts and governing change in their organization. Nevertheless, at this stage, non-financial disclosure by financial and non-financial institutions is a material challenge for most entities.

Central banks and supervisory authorities are highly committed to fostering the disclosure of ESG factors. The Bank of Italy, in line with the ECB and other national supervisors, has started a number of initiatives aimed at contributing to major international projects, strengthening the dialogue with the national industry and assessing the progress made by supervised entities. This paper: i) summarises the main regulatory requirements for ESG disclosure[2]; ii) investigates the areas of commonalities at the EU level between the Pillar 3 sustainability disclosure requirements and those envisaged by the standards under development by the European Financial Advisory Group (EFRAG)[3]; iii) takes stock of the main supervisory initiatives undertaken so far and discusses some preliminary thoughts on the major challenges ahead to be faced by Italian banks.

The text is organised as follows: Section 2 discusses the implications of ESG factors on financial risks; Sections 3.1, 3.2 and 3.3 summarise the main regulatory requirements in terms of ESG disclosure; Sections 3.4 and 3.5 investigate the areas of commonalities and differences between the Pillar 3 requirements and those envisaged by the standards under development by the EFRAG; Section 4 reports the main supervisory initiatives undertaken in the context of ESG disclosure; Section 5 discusses the major challenges faced by Italian banks. Section 6 concludes[4].

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[2] This paper does not address market disclosure (SFDR) to which banks are subject as managers / advisors and which, in part, presents issues (similar indicators, data findability, reliance on external providers) similar to those outlined in this paper.

[3] The EFRAG is a technical, non-political body that deals with accounting standards at the international level. Together with the Accounting Regulatory Committee, a political body, the EFRAG contributes to the endorsement process of accounting standards.

[4] For further details on the terminology used in the paper, see the glossary.

2. ESG factors, climate change and disclosure

The ESG factors are the three main pillars of sustainability. According to the European Banking Authority (EBA)[5], *"ESG factors are environmental, social or governance characteristics that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual".* They are characterised by one or more of the following features: i) they are traditionally considered as non-financial; ii) their impacts present uncertainty related to the time horizon (short, medium and/or long-term); iii) they usually represent negative economic externalities; iv) they are interconnected with the related impacts stemming from the value chain of a single entity (upstream and downstream); v) they may imply changes in public policies with the aim of mitigating climate change and other externalities.

Examples of environmental factors included in the most commonly used frameworks are: GHG emissions, local pollution, energy consumption, water usage, biodiversity, waste management and production; examples of social factors could be labour and workforce considerations, human rights, inequality, gender rights, discrimination; while governance factors refer to all the issues related to management and the board (e.g. rights and responsibilities of directors, remuneration, policies to contrast bribery and corruption, board diversity and structure, codes of conduct and business principles).

The main risk drivers of environmental and climate factors are physical[6] and transition risks[7], that are transmitted through a range of channels into the traditional categories of financial risks, as shown in the following Figure 1[8].

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[5] EBA (2021). EBA report on management and supervision of ESG risks for credit institutions and investment firms, p. 31.

[6] Communication from the Commission "Guidelines on non-financial reporting: Supplement on reporting climate-related information" (2019/C 209/01) states: *"Physical risks are risks to the company that arise from the physical effects of climate change. They include:*

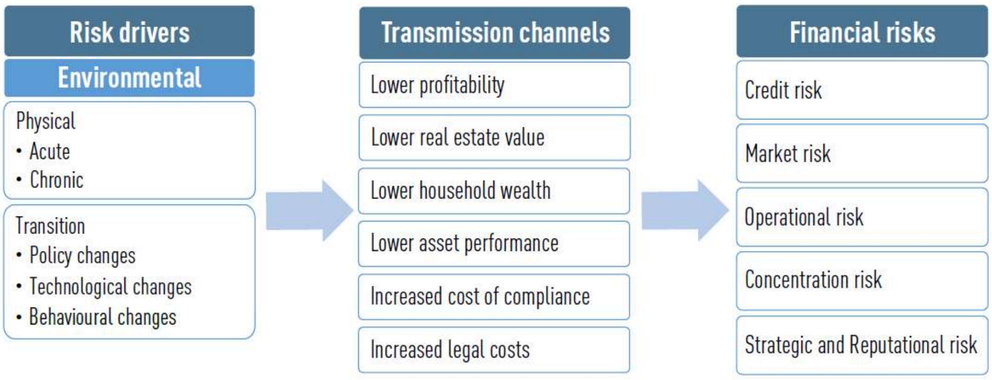
- *Acute physical risks, which arise from particular events, especially weather-related events such as storms, floods, fires or heatwaves, that may damage production facilities and disrupt value chains.*
- *Chronic physical risks, which arise from longer-term changes in the climate, such as temperature changes, rising sea levels, reduced water availability, biodiversity loss and changes in land and soil productivity".*

[7] Communication from the Commission "Guidelines on non-financial reporting: Supplement on reporting climate-related information" (2019/C 209/01) states: *"Transition risks are risks to the company that arise from the transition to a low-carbon and climate-resilient economy. They include:*

- *Policy risks, for example as a result of energy efficiency requirements, carbon-pricing mechanisms which increase the price of fossil fuels, or policies to encourage sustainable land use.*
- *Legal risks, for example the risk of litigation for failing to avoid or minimise adverse impacts on the climate, or failing to adapt to climate change.*
- *Technology risks, for example if a technology with a less damaging impact on the climate replaces a technology that is more damaging to the climate.*
- *Market risks, for example if the choices of consumers and business customers shift towards products and services that are less damaging to the climate.*
- *Reputational risks, for example the difficulty of attracting and retaining customers, employees, business partners and investors if a company has reputation for damaging the climate".*

[8] See i) Network for Greening the Financial System (2020). The macroeconomic and financial stability impacts of climate change: research priorities; ii) Basel Committee on Banking Supervision (2021). Climate-related risk drivers and their transmission channels; iii) EBA (2022a). Discussion paper on the role of environmental risks in the prudential framework.

Figure 1: How environmental risks may affect financial risks



Source: EBA (2022a). Discussion paper on the role of environmental risks in the prudential framework

The financial sector is exposed to new risks (and opportunities), as ESG factors could impact institutions' financial performance and solvency by affecting them directly or indirectly towards their counterparties. For this reason, in all major jurisdictions financial institutions are required to establish appropriate controls and develop adequate practices in order to identify, measure, monitor and manage these risks, while preserving the necessary access to credit. Additionally, this will boost the transition to a low-carbon economy and the tackling of climate change.

Non-financial disclosure represents a key source of information for different categories of stakeholders, such as[9]: investors and market participants, who want to redirect capital to more sustainable investments and need to understand the relevant risks, opportunities and impacts of their investment on people and on the environment; the undertakings which can consider the ESG disclosure as enabling tool for identifying and managing their ESG-related risks and opportunities; organisations, including non-governmental organisations and social partners, that keep companies accountable for their impact on people and the environment; policy-makers, public authorities and environmental agencies, in order to monitor environmental and social trends, contribute to environmental accounts, and support the decision making of public policy; individual citizens and customers. Additionally, as far as banks are concerned, *"disclosure of ESG factors is a vital tool for market discipline allowing stakeholders to assess banks' environmental risks and their sustainable finance strategy. Many stakeholders have a legitimate interest in the physical and transition risks that banks are exposed to from climate change. They also want to understand a bank's strategy in financing the transition to a zero carbon economy"*[10].

Despite these considerations, non-financial disclosure does not always provide all needed information on ESG risks and opportunities on companies[11]. This might depend on various factors, such as the difficulty or excessive cost of retrieving information, data quality, aversion to report negative climate-related performance to stakeholders, the absence of (the most relevant) required information in the business under analysis, or the absence of binding standards to apply in disclosing ESG information[12].

[9] European Commission (2021). Proposal for a Corporate Sustainability Reporting Directive, recitals 8 and 10.

[10] EBA (2022b). Environmental social and governance Pillar 3 disclosures.

[11] FSB (2017). Recommendations of the Task Force on Climate-related Financial Disclosures. ECB (2020). Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure.

[12] In the current scenario, the European Framework consists of NFRD and the non-binding Communications from the Commission "Guidelines on non-financial reporting (methodology for reporting non-financial information)" (2017/C

Thus, the need to improve the disclosure related to ESG factors and climate change (both for financial and non-financial companies) has clearly emerged over time. Notwithstanding the above, the forthcoming disclosure requirements, in UE, leave out most SMEs (which in Italy account for about two thirds of value added and about 80 percent of the workforce) while the concept of overall emissions is still uncertain due to considerable difficulties in the definition and measurement of scope 3 emissions (those connected to the entire production process)[13].

3. The regulatory framework

In April 2015, G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board (FSB) to convene public and private sector participants to review how the financial sector can address climate-related issues. As part of its review, the FSB identified the need for better information to support investment, lending, and insurance decisions and improve understanding and management of climate-related risks. To this end, it established an industry-led Task Force on Climate-related Financial Disclosures (TCFD) that in 2017 published a set of recommendations concerning the climate-related financial disclosures[14]. Works under the TCFD are ongoing, indeed the Task Force has continued to publish guidelines for the implementation of its recommendations[15] and to monitor the status of climate reporting in different jurisdictions[16], in line with the FSB Roadmap for Addressing Financial Risks from Climate Change[17].

At the European level, the Non-Financial Reporting Directive (Directive 2014/95/EU, NFRD) - which complements Directive 2013/34/EU (the Accounting Directive) - requires undertakings of significant size (i.e. listed non-financial companies and other listed financial institutions, as well as listed and unlisted banks and insurance undertakings)[18] to publish a non-financial statement on the impacts and how risks related to ESG matters are managed and measured. In 2017 and 2019, in order to provide companies with a useful methodology to effectively communicate non-financial information on ESG matters, the European Commission - as a supplement to the NFRD - published two non-binding guidelines aimed at supporting companies in communicating high-quality, relevant, useful, consistent and more comparable non-financial information on ESG issues, supplementing the European framework with the Recommendations of the TCFD.

The following Table 1 shows the main required supplementary information envisaged by the specific guidelines for banks in the different areas of disclosure:

215/01) and "Guidelines on non-financial reporting: Supplement on reporting climate-related information" (2019/C 209/01).

[13] Angelini (2022). "The financial risks posed by climate change: information gaps and transition plans".

[14] The core elements of recommended climate-related financial disclosures are Governance, Strategy, Risk Management, Metrics and Targets. Moreover, the TCFD envisages supplemental guidance for particular financial (i.e. banks, insurance undertakings, asset owners, asset managers) and non-financial industries (i.e. energy, transportation, materials and buildings, agriculture, food and forest products).

[15] TCFD (2021). Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures.

[16] TCFD (2022). Status Report.

[17] FSB (2021). FSB Roadmap for Addressing Financial Risks from Climate Change.

[18] Currently, the NFRD applies to "large public interest entities" (i.e. credit institutions, insurance undertakings and listed companies, the "PIEs") with more than 500 employees and which, at the balance sheet date, exceeded at least one of the following size limits: i) a balance sheet total of EUR 20,000,000; ii) a total net turnover from sales and services of EUR 40,000,000.

Table 1: Supplementary information required to banks

Area	Key message - Institutions are expected to:
Business model	Describe how climate-related risks and opportunities of the investment and lending portfolios might affect the financial institution's business model and how these climate-related factors are embedded in corporate strategies.
Policies and due diligence processes	Describe how the financial institution addresses climate-related risks and opportunities and any effort to increase the awareness of counterparties, and more generally of customers, of the relevance of climate-related issues as part of their lending and investment processes.
Outcomes	Describe the development trend of the amount of carbon-related assets in the different portfolios against any relevant target set and the related risks over time.
Risks and risk management	Describe whether risk management processes, including internal stress testing, consider climate-related risks. Additionally, they should describe the distribution of exposures and collaterals among sectors, geographical areas and counterparties subject to climate-related risk.
KPIs	Provide relevant KPIs, among which the amount or percentage of carbon-related assets in each portfolio; weighted average carbon intensity of each portfolio; credit risk exposures and volumes of collateral by geography/country of location of the activity or collateral, with an indication of those countries/geographies highly exposed to physical risk; volume of financial assets funding sustainable economic activities contributing substantially to climate mitigation and/or adaptation (as absolute figures and share of the total exposures) according to the EU taxonomy.

Source: our elaboration based on the Communication from the Commission "Guidelines on non-financial reporting: Supplement on reporting climate-related information" (2019/C 209/01)

The guidelines introduced the concept of "double materiality", envisaging that the reporting of climate and sustainability-related information should have a twofold perspective: i) social and environmental (i.e. how organisations impact on people or the environment); ii) financial (i.e. how climate change is likely to affect organisations, with a focus on the possible risks of negative financial impacts on the company, its performance and corporate positioning, with particular reference to physical and transition risks). However, these risks can be turned into opportunities through appropriate actions and the provision of products and services that contribute to climate change mitigation[19] and adaptation[20].

In 2020, in order to improve the disclosure of non-financial information, the European Commission conducted a public consultation on ESG disclosure[21] (Table 2):

[19] Article 10 of Taxonomy Regulation: *"An economic activity shall qualify as contributing substantially to climate change mitigation where that activity contributes substantially to the stabilisation of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system consistent with the long-term temperature goal of the Paris Agreement through the avoidance or reduction of greenhouse gas emissions or the increase of greenhouse gas removals, including through process innovations or product innovations* […]*"*.

[20] Article 11 of Taxonomy Regulation: *"An economic activity shall qualify as contributing substantially to climate change adaptation where that activity: (a) includes adaptation solutions that either substantially reduce the risk of the adverse impact of the current climate and the expected future climate on that economic activity or substantially reduce that adverse impact, without increasing the risk of an adverse impact on people, nature or assets; or (b) provides adaptation solutions that, in addition to satisfying the conditions set out in Article 16, contribute substantially to preventing or reducing the risk of the adverse impact of the current climate and the expected future climate on people, nature or assets, without increasing the risk of an adverse impact on other people, nature or assets.*[…]*"*.

[21] European Commission (2020). Summary Report of the Public Consultation on the Review of the Non-Financial Reporting Directive, 20 February 2020 - 11 June 2020.

Table 2: Critical issues on corporate sustainability reporting

Key evidence	Description of the evidence
Issues for users of non-financial information	The majority of respondents considered non-financial information reported by companies to be lacking in terms of comparability (71% of respondents), reliability (60%) and relevance (57%)[22].
Issues for preparers of non-financial information	64% of respondents who are or represent reporting companies, stated that additional requirements for non-financial information, e.g. from rating agencies, are a significant problem.
Strong support for an obligation for companies to use a common disclosure standard	82% of respondents believe that an obligation for companies to use a common standard would solve the abovementioned problems.
Strong support for simplified standards for SMEs	74% of respondents supported the development of simplified standards for SMEs. 46% answered that such standards should be mandatory for SMEs, while 39% answered that they should be voluntary.
Strong support for stricter audit requirements	67% of respondents believe that the EU should impose stricter audit requirements for non-financial information.

Source: our elaboration based on the Summary Report of the Public Consultation on the Review of the Non-Financial Reporting Directive[23]

In 2021, the European Commission published the Delegated Regulation 2021/2178 pursuant to Article 8 of the Taxonomy Regulation (see section 3.1) as well as the proposal for a Corporate Sustainability Reporting Directive (CSRD)[24] aimed at strengthening the disclosure framework set out in the NFRD and giving the mandate to the EFRAG for the development of European sustainability standards (see section 3.2). These sustainability standards are being developed via a constructive two-way cooperation with leading international initiatives[25], while taking into account European specificities.

At the beginning of 2022 the EBA published specific technical standards (ITS) on the prudential disclosure of ESG risks[26], in order to require credit institutions to provide qualitative information on how they are taking into consideration ESG factors in their governance, business model, strategy and risk management framework and quantitative information on climate-change-related transition and physical risks (see section 3.3).

[22] Considering only those respondents who identified themselves as users of non-financial information, these values rise to 84%, 74% and 70% respectively.

[23] European Commission (2020). Summary Report of the Public Consultation on the Review of the Non-Financial Reporting Directive, 20 February 2020 - 11 June 2020.

[24] See Proposal for a directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting - COM(2021) 189 final.

[25] For example, at the international level, the IFRS Foundation established a new standard-setting board – the International Sustainability Standards Board (ISSB) – to publish international sustainability standards based on the recommendations of the TCFD.

[26] See EBA (2022). Draft ITS on Pillar 3 disclosures on ESG risks.

3.1 Disclosure requirements under Commission Delegated Regulation 2021/2178 (EU)

Regulation (EU) 2020/852 (the Taxonomy Regulation) aims at defining environmentally sustainable activities on the basis of technical screening criteria set out in specific delegated acts. The first act was adopted on 4 June 2021[27] [28] and dealt with criteria for economic activities that make a substantial contribution to climate change mitigation and adaptation; the remaining delegated regulations concerning the criteria for the last four environmental objectives[29] will be adopted at a later stage.

With specific reference to the disclosure requirements, according to Article 8(1) of the Taxonomy Regulation, large companies which are required to publish non-financial information under the NFRD shall include in their non-financial statement further information on how and to what extent they are associated with environmentally sustainable economic activities. On this specific point, the European Commission adopted the delegated regulation 2021/2078[30], specifying the key performance indicators (KPIs) that financial and non-financial companies must publish to supplement the non-financial report. These rules allow companies to transform the technical screening criteria into quantitative indicators to demonstrate that the company's economic activity falls under the definition of environmentally sustainable activities. More in detail:

- from 1 January 2022 until 31 December 2022, non-financial undertakings shall disclose the proportion of taxonomy-eligible and taxonomy non-eligible economic activities[31] in their total turnover, capital and operational expenditure (Capex and Opex)[32], and related qualitative information[33];

[27] See Commission Delegated Regulation (EU) supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by laying down the technical screening criteria for determining under which conditions an economic activity may be considered to substantially contribute to climate change mitigation or adaptation, and whether the economic activity causes significant harm to any other environmental objective (C(2021)2800 final).

[28] As a complement to the first delegated act, in March 2022 the Commission adopted a specific delegated regulation on the gas and nuclear sectors, defining for these sectors specific technical screening criteria to fall under the definition of environmentally sustainable activities (C(2022)1214).

[29] According to Article 9 of the Taxonomy Regulation, the environmental objectives are: (a) climate change mitigation; (b) climate change adaptation; (c) the sustainable use and protection of water and marine resources; (d) the transition to a circular economy; (e) pollution prevention and control; (f) the protection and restoration of biodiversity and ecosystems.

[30] Commission Delegated Regulation (EU) of 6.7.2021 2021/2178, supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of the information that companies subject to Article 19(a) or Article 29(a) of Directive 2013/34/EU must report on environmentally sustainable economic activities and specifying the methodology for complying with this reporting obligation.

[31] The delegated act of the European Commission 2021/2178 of 6.7.2021 published pursuant to Article 8 of the Taxonomy Regulation defines "taxonomy-eligible" as an activity included in the delegated acts of the European Commission issued pursuant to Articles 10(3), 11(3), 12(2), 13(2), 14(2), and 15(2) of the Taxonomy Regulation, irrespective of whether that economic activity meets any or all of the technical screening criteria laid down in those delegated acts. For 2022, there is only the first delegated act of 4 June 2021, which defines the technical criteria for identifying economic activities that contribute to climate change mitigation and climate change adaptation, (Climate Delegated Act). Instead, an activity can be considered "taxonomy-aligned" when, in addition to being included in the delegated acts above, it complies with all the technical criteria set out in these delegated acts to be taxonomy-aligned.

[32] Capex means the share of capital expenditure and Opex is the share of operational expenditure towards taxonomy-aligned and taxonomy-eligible activities. These indicators should be calculated according to Paragraph 1.1 of Annex 1 of Delegated Regulation 2021/2178.

[33] This qualitative information is referred to in Section 1.2. of Annex I of the delegated regulation.

- from 1 January 2022 until 31 December 2023, financial undertakings shall disclose the proportion in their total assets of exposures to i) taxonomy-eligible and non-eligible activities; ii) central governments, central banks, supranational issuers, and derivatives; iii) undertakings that are not obliged to publish non-financial information pursuant to Article 19(a) or 29(a) of Directive 2013/34/EU; iv) the related qualitative information. Credit institutions shall also disclose the proportion of their trading portfolio and on-demand inter-bank loans in their total assets;
- from 1 January 2023, non-financial undertakings shall disclose KPIs related to turnover, Capex, and Opex in relation to taxonomy-aligned and taxonomy-eligible activities[34];
- from 1 January 2024, credit institutions shall disclose the Green Asset Ratio (GAR)[35] and the percentage of financial guarantees supporting debt instruments financing taxonomy-aligned economic activities as well as the proportion of assets under management (equity and debt instruments) from undertakings financing taxonomy-aligned economic activities, compared with total assets under management (equity and debt instruments)[36];
- from 1 January 2026, credit institutions shall disclose the proportion of fees and commission income from undertakings, derived from products or services other than lending, associated with taxonomy-aligned economic activities, and the GAR for the trading portfolio[37].

3.2 The Corporate Sustainability Reporting Directive (CSRD)

Following the feedback received during the public consultation and the EFRAG recommendations, in 2021 the Commission published a proposal for a CSRD aimed at amending the NFRD. In November 2022 the European Council approved the adoption of the CSRD, based on the following features: i) the extension of the scope of application of non-financial disclosure; ii) the list of requirements for additional detailed disclosure and the adoption of European sustainability standards; iii) a new role of the EFRAG; iv) the introduction of the obligation for the sustainability report to be audited by a third party; v) the publication of the report in accordance with the single electronic reporting format, as well as the obligation to include this report in the management report (Table 3).

Table 3: The main CSRD novelties

Novelties	Description
New scope of application and entry into force	All large companies (whether listed or unlisted) and all listed companies, with the exception of micro-listed companies. The change to the criteria means that approximately 49.000 companies in the EU will have to publish a sustainability report, compared with 11.600 companies under the current regime. The CSRD will be applicable for financial years starting on or after 2024.

[34] With particular reference to Capex, some companies, despite are outside sectors envisaged eligible for taxonomy, can be considered partly aligned, if some of their investments (Capex) are towards taxonomy-aligned activities. See Sustainable Finance Platform (March 2021). "Transition Finance report".

[35] The GAR shows the proportion of the credit institution's assets financing and invested in taxonomy-aligned economic activities as a proportion of total covered assets in accordance with point 1.1.2 and 1.2 of Annex V of Delegated Regulation 2021/2178.

[36] For further details, see points 1.2.2.1 and 1.2.2.2 of Annex V of delegated act 2021/2178.

[37] For further details, see points 1.2.3 and 1.2.4 of Annex V of delegated act 2021/2178.

More detailed information to be disclosed	The CSRD proposal aims to require companies to provide more information on their business model, their strategy, their targets, the role of the board of directors, management and supervisory/control bodies with regard to sustainability. Additionally, new Article 19(a) requires – among others – a description of i) the main risks and negative impacts related to the companies themselves and their respective value chains[38]; ii) intangibles; and iii) how the reported information was identified. The information to be reported must be understandable, relevant, verifiable, comparable and faithfully represented according to new Article 29(b). It is also worth highlighting the significant importance given to climate change-related information (in addition to social and governance-related information), as can be seen from a careful reading of the new Article 29(b). Examples of relevant information refer to climate change mitigation and adaptation, the use of water and natural resources, circular economy, and pollution. The CSRD clarifies that this information must be reported in a way that captures both the impact of environmental issues on the undertaking and the undertaking's impact on people and the environment (principle of double materiality). Additionally, companies are required to report qualitative and quantitative information, forward-looking and retrospective information and information covering short, medium and long-term time horizons as appropriate. This information should be reported in line with the standards that the Commission will adopt for large undertakings and, separately, with the proportionate standards for SMEs.
New role of the EFRAG	The European Commission will adopt the standards for the non-financial report prepared by the EFRAG. This led to a change in EFRAG's governance to ensure that standards are set according to appropriate due processes and stakeholders' consultation[39]. Indeed, in January 2022[40], the EFRAG finalised the establishment of the new sustainability pillar (which complements the existing pillar already responsible for providing technical advice to the Commission on international financial standards). With regard to the European sustainability reporting standards (ESRS), the CSRD aims to achieve a high level of alignment and integration between these and the remaining European sustainability framework (i.e. Pillar 3, Regulation (EU) 2019/2088 on Sustainability Reporting in the Financial Services Sector (SFDR), as well as with other international initiatives (i.e. the Recommendations of the TCFD and the sustainability standards of the newly established International Sustainability Standards Board (ISSB) of the IFRS Foundation). Additionally, the Commission will have to consult the Member State Expert Group on Sustainable Finance and the Accounting Regulatory Committee (ARC) at least once a year on the EFRAG work programme as regards the development of sustainability reporting standards. Moreover, the Commission shall request the opinion of the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) on the technical advice provided by EFRAG, in particular with regard to its consistency with Regulation (EU) 2019/2088 and its delegated acts. The ESMA, the EBA and the EIOPA shall provide their opinions within two months from the date of receipt of the request from the Commission.
Introduction of the audit of the new non-financial report	The CSRD requires a mandatory review of sustainability reports. The review on the sustainability reporting should be based on a limited assurance engagement. The CSRD foresees moving to reasonable assurance after assessing whether reasonable assurance is feasible for both statutory auditors and undertakings. Member States may apply national assurance standards, procedures or requirements as long as the Commission has not adopted an assurance standard covering the same subject matter. The Commission shall be empowered to adopt, by means of delegated acts, limited assurance standards before 1 October 2026. By 1 October 2028, the Commission shall adopt assurance standards for reasonable assurance, following an assessment to determine if it is feasible for the auditors and for the undertakings. The Commission should then specify when reasonable assurance would be required.

[38] For the first three years of the application of this Directive, in the event that not all the necessary information regarding the value chain is available, the undertaking shall explain the efforts made to obtain the information about its value chain, the reasons why this information could not be obtained, and the plans of the undertaking to obtain such information in the future.

[39] On this point, the EFRAG published in March 2021: i) a list of recommendations on the scope and structure of any future non-financial European standards; ii) a proposal for the internal reorganisation of the EFRAG to create a new pillar to be responsible for the preparation of any future non-financial European standards.

[40] See EFRAG welcomes thirteen new member organisations in sustainability reporting.

The single electronic reporting format	The CSRD requires financial statements and management reports to be prepared in the single electronic reporting format, in order to improve access and efficiency of corporate reporting.

Source: our elaboration based on the Corporate Sustainability Reporting Directive

The new framework will become applicable according to the following timetable. For financial years starting on or after:

- 1 January 2024 for those entities already within the scope of the NFRD[41];
- 1 January 2025 for large undertakings currently not subject to the NFRD; and;
- 1 January 2026 for listed small and medium-sized undertakings[42] and small and non-complex credit institutions that are also large undertakings[43] [44].

3.3 EBA regulation on Pillar 3 ESG disclosure

In January 2022 the EBA published technical standards on the prudential disclosure of ESG risks, with the aim to enrich the current Pillar 3 framework, i.e. requiring institutions to report qualitative and quantitative information on ESG risks, with a specific focus on climate risk, as well as quantitative information on key performance indicators (KPIs) on climate change mitigating measures, including the GAR and the Banking Book Taxonomy Alignment Ratio (BTAR)[45].

The EBA ITS includes three tables in which to provide qualitative disclosure on environmental, social and governance risks (one for each type of risk), divided into the following three sections: i) business strategy and processes, ii) governance and iii) risk management[46]. Focusing on quantitative information, the disclosure requirements are reported in Table 4.

[41] Currently, the NFRD applies to "large public interest entities" (i.e. credit institutions, insurance undertakings and listed companies, the "PIEs") with more than 500 employees and which, at the balance sheet date, exceeded at least one of the following size limits: i) a balance sheet total of EUR 20,000,000; ii) a total net turnover from sales and services of EUR 40,000,000.

[42] For financial years starting before 1 January 2028, listed SMEs may decide not to publish the corporate sustainability report.

[43] Large undertakings are undertakings which on their balance sheet dates exceed at least two of the three following criteria: (a) balance sheet total: EUR 20,000,000; (b) net turnover: EUR 40,000,000; (c) average number of employees during the financial year: 250. Medium-sized undertakings are undertakings which are not micro-undertakings or small undertakings and on their balance sheet dates do not exceed two of the three following criteria: (a) balance sheet total: EUR 20,000,000; (b) net turnover: EUR 40,000,000; (c) average number of employees during the financial year: 250. Small undertakings are undertakings which are not micro-undertakings and on their balance sheet dates do not exceed at least two of the three following criteria: (a) balance sheet total: EUR 4,000,000; (b) net turnover: EUR 8,000,000; (c) average number of employees during the financial year: 50.

[44] See Capital Requirements Regulation (CRR), Article 4, par. 145.

[45] The GAR shows the proportion of the credit institution's assets financing and invested in taxonomy-aligned economic activities as a proportion of total covered assets in accordance with point 1.1.2 and 1.2 of Annex V of Delegated Regulation 2021/2178. The BTAR differs from the GAR, because the numerator also includes taxonomy-aligned exposures to non-financial corporates that do not fall within the scope of the CSRD (i.e. SMEs).

[46] It should be noted that in the third table (Qualitative information on Governance risk) the section on business strategy and processes is absent.

Table 4: Draft EBA ITS templates

Templates	Description
Template 1	Information on those assets more exposed to the risks that institutions may face from the transition to a low-carbon and climate-resilient economy. In particular, institutions shall disclose information on their exposures towards non-financial corporates that operate in sectors that highly contribute to climate change, specifying, by sector, the value of i) exposures towards companies excluded from EU Paris-aligned Benchmarks in accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Regulation (EU) 2020/1818; ii) environmentally sustainable (climate change mitigation - CCM) exposures; iii) stage 2 exposures; iv) non-performing exposures; v) accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions; vi) financed GHG emissions; vii) the residual maturity of the exposures considered.
Template 2	Information on loans collateralised by immovable property, by energy consumption and by the energy performance certificate (EPC) of the collateral.
Template 3	Information on alignment metrics defined by the International Energy Agency (IEA) for different sectors.
Template 4	Information on institutions' exposures towards the top 20 carbon-intensive companies in the world.
Template 5	Institutions shall include in this template information on exposures in the banking book, including loans and advances, debt securities and equity instruments not held-for-trading and not held-for-sale, towards non-financial corporates, on loans collateralized with immovable property and on repossessed real estate collaterals, exposed to chronic and acute climate-related hazards.
Template 6	An overview of the KPIs calculated on the basis of templates 7 and 8.
Template 7	Institutions shall disclose in this template information on gross carrying amount of institutions' loans and advances, debt securities and equity instruments on their banking book, with a breakdown of the information by type of counterparty, including financial corporations, non-financial corporations, households, local governments as well as real estate lending towards households, and the taxonomy eligibility and taxonomy alignment of the exposures with regard to the environmental objectives of climate change mitigation and climate change adaptation. Moreover, this template allows the GAR. The GAR indicates the institution's environmentally sustainable activities, according to the European Taxonomy. This indicator is calculated as the ratio of the credit institution's assets that finance economic activities aligned with the Taxonomy or are invested in such activities to the total assets covered. The following assets are to be excluded from the numerator of the GAR: - financial assets held for trading (also excluded in the denominator); - exposures to sovereigns and central banks (also excluded in the denominator); - on-demand interbank loans, derivatives, cash and cash-related assets, other assets (e.g. goodwill, commodities, etc.); - exposures to undertakings that are not obliged to publish non-financial information pursuant to Article 19a or 29a of Directive 2013/34/EU (i.e. SMEs and non-EU non-financial corporations).
Template 8	Information for the GAR calculation in percentage terms (stock and flows)[47].
Template 9	Information for the calculation of the BTAR (also in percentage terms) and summary of the final values. The BTAR differs from the GAR, because the numerator also includes taxonomy-aligned exposures to non-financial corporates that do not fall within the scope of the CSRD (i.e. SMEs and non-EU non-financial corporations). Please note that this template should be disclosed on a voluntary basis.
Template 10	Information on other actions put in place by institutions to mitigate climate-change related risks (not covered in the European Taxonomy).

Source: our elaboration based on EBA ITS on Pillar 3 disclosures of ESG risks

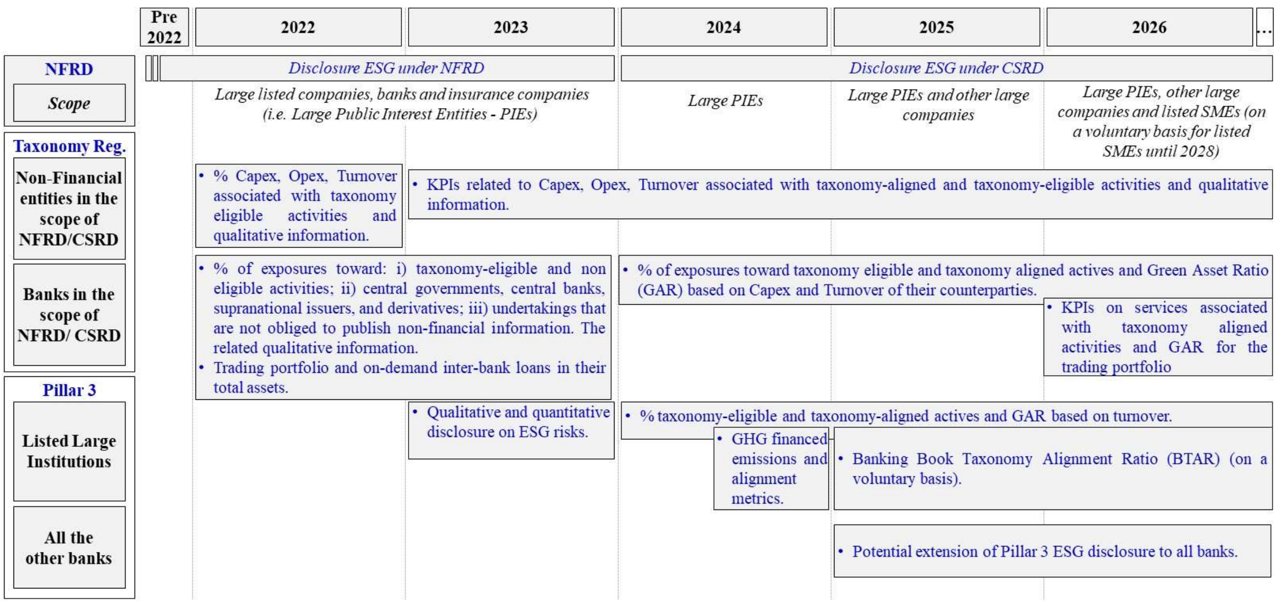
[47] The percentage of the flows refers to the proportion of new assets (within the current disclosure period) funding taxonomy relevant sectors.

Considering the large amount of information required and the potential challenges in retrieving it, the EBA ITS provides for a phase-in period, according to which:

- in template 1, information on environmentally sustainable (climate change mitigation - CCM) exposures shall be provided starting from 2024 with reference date December 2023 (referring to exposures included in the numerator of the GAR). Institutions may start disclosing that information in 2025, with first disclosure reference date as of 31 December 2024, for those exposures included in the numerator of the BTAR but not in the numerator of the GAR;
- the disclosure of the GAR shall be provided starting from 2024, with a reference date of December 2023;
- the disclosure of GHG financed emissions[48] and the alignment metrics envisaged by Template 3 will start with a reference date of the end of June 2024.

The approach for the entry into force of the ITS is consistent with the one envisaged by the Delegated Regulation issued pursuant to Article 8 of the Taxonomy Regulation and CSRD. Indeed, as shown by the following figure (Figure 2), the CSRD, the Delegated Regulation 2021/2178 pursuant to Article 8 of the Taxonomy Regulation, and the EBA ITS envisaged a gradual entry into force with a progressive enlargement of the scope of application and a phase-in for the more complex KPIs.

Figure 2: Entry into force of ESG disclosure requirements



Source: our own elaboration

[48] Institutions shall disclose the estimates of their scope 3 GHG emissions, composed of their counterparties' scope 1, 2 and 3 emissions associated with institutions' lending and investment activities. According to the TCFD (2017),

- *"Scope 1 refers to all direct GHG emissions.*
- *Scope 2 refers to indirect GHG emissions from consumption of purchased electricity, heat, or steam.*
- *Scope 3 refers to other indirect emissions not covered in Scope 2 that occur in the value chain of the reporting company, including both upstream and downstream emissions. Scope 3 emissions could include: the extraction and production of purchased materials and fuels, transport-related activities in vehicles not owned or controlled by the reporting entity, electricity-related activities (e.g., transmission and distribution losses), outsourced activities, and waste disposal".*

3.4 A comparison between EBA and EFRAG requirements

The CSRD envisages the adoption of EU Sustainability Reporting Standards (ESRS). In this context, the EFRAG was requested to provide technical advice to the European Commission in the form of draft standards. In April 2022 the EFRAG released for public consultation (expired in August) the Exposure Drafts (EDs) of a set of ESRS "core standards" composed of "cross-cutting" standards and "topical standards"[49]. The new EFRAG standards will enter into force as follows: June 2023 ("core standards" for large undertakings); June 2024 ("complementary standards" to the "core standards" and "sector specific standards" as well as standards for listed SMEs and small and non-complex institutions[50]).

Based on the draft of the first ESRS published in April 2022, this section aims at identifying the commonalities and the differences between the sustainability disclosure requirements under Pillar 3 ITS on ESG risks and those under the draft ESRS[51] developed by the EFRAG under the CSRD. Such a comparison considers only the "cross-cutting" draft ESRS (i.e. draft ESRS 1 and draft ESRS 2) and the topical ESRS focused on climate (i.e. draft ESRS E1), since the draft of "sector specific" standards will be published by the EFRAG at a later stage. Moreover, it is important to highlight that the two frameworks present significant differences in terms of methodological design: Pillar 3 disclosure focuses only on ESG risks, whereas in the draft ESRS consideration is given also to ESG opportunities; since Pillar 3 disclosure has been developed for the financial sector, it does not address some of the environment-related factors covered by the draft ESRS (e.g. water, marine resources, etc.); some quantitative and sector-specific metrics for measuring ESG performance are already defined in the EBA framework, while in the EFRAG framework such metrics will be developed later on.

As regards their time horizon, both frameworks require information to be provided on the short, medium and long term and comparative information regarding the previous reporting period; they both allow the use of proxies in cases of uncertainty or lack of data; they require information on business strategy, governance and metrics, and how climate risks are identified; finally, they ask for information related to GHG emissions, as well as exposure to physical risks.

The major differences are the following:

- the definition of materiality, since the EBA's concept of materiality differs from the EFRAG's one. Particularly, Pillar 3 states that *"When building the uniform disclosure formats, this Regulation has taken into account the complete materiality of the information required. Institutions' disclosures need to cover (i) the financial impact of ESG factors on institutions'*

[49] The cross-cutting standards cover the general provisions applying to i) sustainability reporting under the CSRD, including principles to be followed by the topical standards (sector-agnostic and sector-specific) when prescribing disclosure requirements related to policies, targets, actions and action plans, resources across all sustainability subject matters, in order to ensure consistency on these aspects throughout all ESRS (ESRS 1); and ii) the sustainability disclosure requirements (ESRS 2) that relate to how the undertaking complies with ESRS, to the way sustainability is embedded in the undertaking's "company-wide" business strategy and business model(s), its governance and to how the undertaking identifies and manages its principal sustainability impacts, risks and opportunities. Topical standards cover a specific sustainability topic or sub-topic, setting - from a sector agnostic perspective - disclosure requirements relating to the sustainability impacts, risks and opportunities that are deemed to be material for all undertakings, regardless of the sectors they operate in.

[50] Non-listed SMEs can also choose to use these proportionate standards on a voluntary basis.

[51] Based on the results of the public consultation, the draft standards are now under review and will be adopted by the European Commission by 30 June 2023.

economic and financial activities (outside-in perspective), and (ii) the ESG factors that may be triggered by institutions' own activities which in turn become financially material when these factors affect institutions' activities (inside-out perspective). As a result, the templates and tables used for those disclosures should convey sufficiently comprehensive and comparable information on ESG risks, thus enabling users of that information to assess the risk profile of institutions". Conversely, the EFRAG refers to the concept of double materiality, including both the *impact materiality*[52] and the *financial materiality*[53]. Thus, the EBA has a prudential disclosure and considers the impact on people and environment only when it in turn becomes financially material for the institution, while the EFRAG seems to have a wider coverage for its impact materiality;

- Pillar 3 requires a deeper focus on risk management processes and methodologies, the impact on capital and liquidity, ICAAP and ILAAP, as well as risk tolerance thresholds and related escalation triggers, while the ESRS require more disclosure on how materiality thresholds are defined;
- the presence of specific metrics provided in Pillar 3 and not in the ESRS and vice versa.

Indeed, the EBA Pillar 3, unlike the draft ESRS published for consultation, requires disclosure of the following indicators:

- information on exposures towards sectors that highly contribute to climate change, specifying, by sector, the gross carrying amount of exposures towards companies excluded from EU Paris-aligned Benchmarks in accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Regulation (EU) 2020/1818; the gross carrying amount of environmentally sustainable (CCM) exposures; stage 2 and non-performing exposures, the accumulated impairment and the residual maturity of these exposures (in addition to GHG emissions). However, the draft ESRS E1 submitted to European Commission in November 2022 and not yet endorsed requires companies to disclose whether the undertaking is excluded from EU Paris-aligned Benchmarks;
- the energy efficiency and the EPC label for loans collateralised by immovable property. However, the draft ESRS E1 submitted to European Commission in November 2022 and not yet endorsed requires companies to disclose the breakdown of the carrying value of its real estate assets by energy-efficiency classes;
- information, by sector, on the alignment metrics to the targets defined by the International Energy Agency (IEA);

[52] Draft ESRS 1, Appendix A: *"A sustainability matter is material from an impact perspective if the undertaking is connected to actual or potential significant impacts related to the matter on people or the environment over the short-, medium- or long-term. This includes impacts directly caused or contributed to by the undertaking in its own operations, products or services and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain, not limited to direct contractual relationships".*

[53] Draft ESRS 1, Appendix A: *"A sustainability matter is material from a financial perspective if it triggers or may trigger financial effects on undertakings, i.e., it generates or may generate risks or opportunities that influence or are likely to influence the future cash flows and therefore the enterprise value of the undertaking in the short-, medium- or long-term, but it is not captured or not yet fully captured by financial reporting at the reporting date. The undertaking relies on the availability of economic, natural and social resources of an appropriate pricing and quality. Such dependencies are sources of financial risks or opportunities".*

- information on exposures to the top 20 carbon-intensive firms;
- the BTAR (on a voluntary basis).

On the other side, the ESRS, unlike Pillar 3, requires disclosure of the:

- Energy consumption and mix of the undertaking;
- Energy intensity per net turnover of the undertaking;
- Scope 1, Scope 2 and total GHG emissions of the undertaking;
- GHG intensity per net turnover;
- GHG removals, GHG mitigation projects financed through carbon credits and avoided GHG emissions;
- Potential financial effects from material physical risks, transition risks and climate-related opportunities.

In summary, considering the version of draft ESRS in public consultation, on the one hand there are some areas of overlap between the two frameworks, which banks may leverage in drafting the two reports; on the other hand, there are some gaps (e.g. definition of materiality, focus only on the risk side) stemming from the different nature and scope of the frameworks (EBA Pillar 3 has a prudential perspective while EFRAG used a double materiality approach), to which banks will have to pay close attention (see Annex 1 for more details on a comparison between the EBA Pillar 3 and the draft of sustainability standards in public consultation).

Notwithstanding the above, based on the feedback received during the public consultation[54] of the draft ESRS, and the need to reduce the *data-gap*, the updated version of the draft ESRS submitted to the European Commission in November 2022 are more aligned to relevant EU legislation and, consequently, to EBA Pillar 3 requirements. Indeed, paragraph two of the updated version of the draft ESRS E1 states *"The requirements of this [draft] Standard take into account the requirements of related EU legislation and regulation (i.e., EU Climate Law, Climate Benchmark Standards Regulation, Sustainable Finance Disclosure Regulation (SFDR), EU Taxonomy, and EBA Pillar 3 disclosure requirements)"*. Moreover, the EFRAG *"Explanatory note of how draft ESRS take account of the initiatives and legislation listed in Article 1 (8) of the CSRD* […]*"*[55] explains that *"In order to support the creation of the necessary data infrastructure for credit institutions and investment firms to meet the CRR obligations, draft ESRS incorporate a limited number of specific data-points required by the EBA implementing standards"*.

Indeed, among the others improvements, the following data-points have been included in ESRS E1:

- Undertakings excluded from Paris-aligned Benchmarks (E1-1 paragraph 15 (f));
- Disaggregation of monetary amounts of assets by acute and chronic physical risk specifying the location of the assets (E1-9 paragraph 63);

[54] The EBA answer to the public consultation (question five) of the draft ESRS states *"The EBA suggests considering, to the extent possible, the information that banks are required to disclose into their ESG Pillar 3 report. This could be very important for cross-sectors standards as well as for the next work on the sector-specific standards"*.

[55] EFRAG (November 2022) *"Explanatory note of how draft ESRS take account of the initiatives and legislation listed in Article 1 (8) of the CSRD adding article 29 (b) -6 to the Accounting Directive"*.

- The energy efficiency represented in terms of either the ranges of energy consumption in kWh/m² or the EPC (Energy Performance Certificate) (E1-9 paragraph 64).

Moreover, the updated version of the draft ESRS 1 submitted to the European Commission in November 2022 allows the incorporation, in the non-financial report, of information prescribed by a disclosure requirement of an ESRS by reference to public disclosures under regulation 575/2013 (Pillar 3 disclosures)[56].

3.5 Information in the non-financial report useful for Pillar 3 purposes

The purpose of this section is to show what ESG information required by Pillar 3 banks can and cannot retrieve through the non-financial disclosure of their financed counterparties[57].

From a qualitative point of view, Pillar 3 requires financial institutions to describe the processes for assessing how financed counterparties address ESG risks. Indeed, from a risk management perspective, the disclosure provided by financed counterparties on how ESG factors are managed will be useful for institutions in understanding possible ESG risks. Focusing on the quantitative disclosure, the information to be reported in the EBA's Pillar 3 templates is set out below, broken down into i) information on bank' counterparties already available to the bank, but not included in their non-financial report; ii) information not available to the bank, but retrievable in the non-financial report; and iii) information not available to the bank, to be requested on a bilateral basis to the financed counterparties or to be retrieved through service providers (Table 5).

Table 5: Sources of information needed to fulfil the ESG Pillar 3 disclosure requirements

Template	**Information already available to the bank and not included in the non-financial report**	**Information not available to the bank, but retrievable in the non-financial report**	**Information not available to the bank, to be requested on a bilateral basis or to be retrieved through service providers**
Templ. 1: Banking book- Indicators of potential climate change transition risk: Credit quality of exposures by sector, emissions	*Reference date:* from December 2022. Exposures towards sectors that highly contribute to climate change (all sectors represented in the rows) and exposures towards sectors other than those that highly contribute to climate change. To this end, the bank will need:	*Reference date:* from December 2023. - environmentally sustainable (CCM)[58] exposures towards companies in the scope of the NFRD (and at a later stage of CSRD). *Reference date:* from December 2024.	*Reference date:* from December 2022 to December 2023. - exposures towards companies excluded from EU Paris-aligned Benchmarks in accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Regulation (EU) 2020/1818.

[56] The undertaking may incorporate information by reference, provided that the disclosures incorporated by reference: (a) constitute a separate element of information clearly identified in such other document; (b) are published at the same time as the management report; (c) are subject to at least the same level of assurance as the sustainability statements; and (d) are available with the same technical digitalisation requirements as the sustainability statements.

[57] The analysis was only carried out on the basis of draft ESRS 1, draft ESRS 2, draft ESRS E1 and the disclosures envisaged by the Delegated Act 2021/2178 issued pursuant to Article 8 of the Taxonomy Regulation.

[58] CCM means "climate change mitigation".

and residual maturity	- gross carrying amount of exposures; - gross carrying amount of exposures classified in stage 2; - gross carrying amount of non-performing exposures; - accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions; - maturity of exposures.	- GHG financed emissions (Scope 1, 2 and 3); - GHG emissions derived from company-specific reporting. *Reference date:* from December 2024. - exposures towards companies excluded from EU Paris-aligned Benchmarks in accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Regulation (EU) 2020/1818.	**Moreover, if the counterparty is an entity not obliged to provide the non-financial report (not in the scope of the NFRD and at a later stage of CSRD) the above and the following information:** *Reference date:* from June 2024. - GHG financed emissions (Scope 1, 2 and 3). *Reference date:* from December 2024 - Environmentally sustainable (CCM) exposures included in the numerator of the BTAR but not in the numerator of the GAR (on voluntary basis).
Templ. 2: Banking book - Indicators of potential climate change transition risk: Loans collateralised by immovable property - Energy efficiency of the collateral	*Reference date:* from December 2022. Gross carrying amount of loans collateralised by immovable property, divided into: - type of collateral (e.g. residential property or commercial property); - geographical area (EU and non-EU area); - level of energy efficiency (if available).	*Reference date:* from December 2024. - Level of energy efficiency.	*Reference date:* from December 2022 to December 2023. - Level of energy efficiency. **Moreover, if the counterparty is an entity not obliged to provide the non-financial report (not in the scope of the NFRD and at a later stage of CSRD), the following information:** *Reference date:* from December 2022 - Level of energy efficiency.
Templ. 3: Banking book - Indicators of potential climate change transition risk: Alignment metrics	*Reference date:* from June 2024. - gross carrying amount of exposures towards sectors that highly contribute to climate change.	n.a.	*Reference date:* from June 2024. - Alignment metrics, reference year and distance to International Energy Agency (IEA) Net Zero Emission 2050 (NZE2050) targets.
Templ. 4: Banking book – Indicators of potential	*Reference date:* from December 2022.	*Reference date:* from December 2023.	*Reference date:* from December 2022.

climate change transition risk: Exposures to top 20 carbon-intensive firms	- the aggregate gross carrying amount towards the top 20 carbon-intensive firms in the world; - gross carrying amount towards the top 20 carbon-intensive firms in the world divided by the total gross carrying amount of the institutions' exposures in the banking book; - weighted average maturity; - number of top 20 polluting firms towards which the bank has exposures.	- environmentally sustainable (CCM) exposures.	- the top 20 carbon-intensive firms in the world.
Templ. 5: Banking book – Indicators of potential climate change physical risk: Exposures subject to physical risk	*Reference date:* from December 2022. Exposures towards geographical area subject to climate change physical risk, divided into sectors that highly contribute to climate change, loans collateralised by residential / commercial immovable property, repossessed assets and other relevant sectors. To this end, with reference to the individual exposure, the bank will need: - gross carrying amount; - maturity; - stage 2 / non-performing exposures; - accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions.	*Reference date:* from December 2024. Exposures: - sensitive only to impact from chronic climate change events; - sensitive only to impact from acute climate change events; - sensitive to impact both from chronic and acute climate change events. Location of the assets subject to climate change physical risk.	*Reference date:* from December 2022. - geographical area subject to climate change physical risk. *Reference date:* from December 2022 to December 2023. Exposures: - sensitive only to impact from chronic climate change events; - sensitive only to impact from acute climate change events; - sensitive to impact both from chronic and acute climate change events. Location of the assets subject to climate change physical risk. **Moreover, from December 2022, if the counterparty is an entity not obliged to provide the non-financial report (not in the scope of the NFRD and at a later stage of CSRD) the above information.**
Templ. 6: Summary of GAR KPIs	n.a.	*Reference date:* from December 2023:	n.a.

		- summary of GAR KPIs	
Templ. 7 - Mitigating actions: Assets for the calculation of GAR	*Reference date:* from December 2023. - gross carrying amount of exposures divided into: i) assets in both numerator and denominator for GAR calculation; ii) assets only in the denominator for GAR calculation; iii) assets excluded from both the numerator and denominator for GAR calculation; - specialised lending.	*Reference date:* from December 2023. For the assets in both numerator and denominator for GAR calculation the bank will need the exposures: - Taxonomy-eligible (CCM and CCA)[59]; - Taxonomy-aligned (CCM and CCA); - towards transitional/adaptation activities; - towards enabling activities (CCM and CCA).	n.a.
Templ. 8 - GAR (%)	*Reference date:* from December 2023. - Based on the information in Template 7, the proportion of CCM and CCA exposures (stock) and new exposures (flow).	*Reference date:* from December 2023. - Based on the information in Template 7, the proportion of CCM and CCA exposures (stock) and new exposures (flow).	n.a
Templ. 9.1 - Mitigating actions: Assets for the calculation of BTAR[60]	*Reference date:* from December 2024. - gross carrying amount of exposures (col. a), divided into: i) assets excluded from the numerator for GAR calculation (covered in the denominator), but included in the numerator and denominator of the BTAR; ii) assets excluded from the numerator of BTAR, but covered in the denominator; iii) assets excluded from both the numerator and denominator of BTAR; - specialised lending.	n.a.	*Reference date:* from December 2024. For the assets excluded from the numerator for GAR calculation (covered in the denominator), but included in the numerator and denominator of the BTAR, the bank will need the exposures: - Taxonomy-eligible (CCM and CCA); - Taxonomy-aligned (CCM and CCA); - towards transitional/adaptation activities; - towards enabling activities (CCM and CCA).

59 CCM means "climate change mitigation", while CCA means "climate change adaptation".

60 Please note that this template should be disclosed on a voluntary basis.

Templ. 10 - Other climate change mitigating actions that are not covered in the EU Taxonomy	*Reference date:* from December 2022. Bonds and loans issued on the basis of sustainability standards other than European ones and broken down by type of counterparty. To this end, the bank will need: - gross carrying amount of exposures.	- n.a.	*Reference date:* from December 2022. Bonds and loans issued on the basis of sustainability standards other than European ones and broken down by type of counterparty. To this end, the bank will need: - type of risk mitigated; - qualitative information on the nature of the mitigating actions.

Source: our elaboration

Considering the disclosures envisaged by the Delegated Act 2021/2178 issued pursuant to Article 8 of the Taxonomy Regulation and the draft standards ESRS for large undertakings (in particular on ESRS 1, ESRS 2 and ESRS E1), a part of the required quantitative information is already available to banks or easily obtainable through the non-financial reports of the financed counterparties. In particular, the following is a list of the main information that banks are expected to be able to retrieve from the non-financial reports of their counterparties:

- GHG emissions (Scope 1, 2 and 3) [template 1];
- Exposures subject to acute/chronic physical risk [template 5];
- Taxonomy-eligible exposures [templates 7 and 8];
- Taxonomy-aligned exposures (through the turnover of financed counterparties) [templates 7 and 8];
- Exposures towards transitional activities [templates 7 and 8];
- Exposures towards enabling activities [templates 7 and 8];
- Exposures towards activities contributing to climate change mitigation and / or adaptation [templates 1, 4, 7, 8].

However, financial institutions may experience some difficulties in retrieving information that is not publically available, such as: the amount of exposures towards companies excluded from EU Paris-aligned Benchmarks in accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Regulation (EU) 2020/1818 [template 1 - from December 2022 to December 2023]; the alignment metrics, reference year and distance to IEA NZE2050 targets [template 3 - from June 2024]; the location of the assets subject to physical risk [template 5 - from December 2022 to December 2023]. Additionally, as shown in Table 5, retrieving ESG quantitative information could be even more complicated when referring to unlisted SMEs and listed micro-enterprises, for which there is currently no obligation in providing ESG disclosure.

4. Supervisory initiatives

4.1 ECB work on climate risk disclosure

In November 2020, the European Central Bank (ECB) published the *"Guide on climate-related and environmental risks - Supervisory expectations relating to risk management and disclosure"*[61]. The Guide set out supervisory expectations to be used in the ECB's supervisory dialogue with significant institutions directly supervised by the ECB. The document is based on the ECB's understanding of sound, effective and comprehensive management and disclosure of climate-related and environmental risks under the current prudential framework[62]. Thus, significant banks are expected to effectively consider climate-related and environmental risks in their strategy, organisational structure, policies, risk management, and disclosure.

Table 6: ECB expectations

Expectations number	Area	Key message - Institutions are expected to:
#1	Business environment	Make informed strategic and business decisions based on the understanding of the impact of climate-related and environmental risks on the business environment in which they operate.
#2	Business strategy	Integrate into the business strategy climate-related and environmental risks that impact on their business environment.
#3	Management body	Consider – through their management body (which also have to oversight) – climate-related and environmental risks when developing the institution's overall business strategy, business objectives and risk management framework.
#4	Risk appetite	Explicitly include climate-related and environmental risks in their risk appetite framework.
#5	Organisational structure	Assign responsibility for the management of climate-related and environmental risks in accordance with the three lines of defence model.
#6	Reporting	Enable the management body and relevant sub-committees to make informed decisions through aggregated risk data that reflect their exposures to climate-related and environmental risks.
#7 - #12	Risk management framework	Incorporate, manage, monitor and mitigate climate-related and environmental risks as drivers of all existing risk categories into their risk management framework.
#13	Disclosure policies and procedures	Publish meaningful information and key metrics on climate-related and environmental risks that they deem to be material.

Source: our elaboration based on ECB "Guide on climate-related and environmental risks - Supervisory expectations relating to risk management and disclosure"

Expectation #13 on climate and environmental risk disclosure comes downstream from the others, as it is closely informed by all the previous Expectations. The ECB aims at making available to market participants key information on how institutions manage environmental risks and how their strategy, risk management framework, risk exposures, and capital are affected by these risks or adapted to take into account such risks (Table 7).

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[61] ECB (2020). Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure.

[62] Articles 73, 74(1), 74(2), 76(1), 79, 83(1), 85, 91 CRD and 431(3), 432(1) of CRR.

Table 7: Expectation #13

Expectations number	Disclosure - Area	Key message - Institutions are expected to disclose:
#13.1	Materiality assessment	Policies key considerations that inform their assessment of the materiality of climate-related and environmental risks, as well as the frequency and means of disclosures.
#13.2		The results of the assessment based on climate-related risks deemed to be immaterial.
#13.3	Methodology	Methodology underpinning figures, metrics, and targets identified as material.
#13.4	Governance, Strategy, Risk Management, Metrics and Targets	Relevant climate risks, in line with the European Commission's Guidelines on non-financial reporting: Supplement on reporting climate-related information (see section 3) that integrates the recommendation of the FSB - Task Force on Climate-Related Financial Disclosure (TCFD).
#13.5	Financed emissions	Scope 3 GHG financed emissions, as well as the amount of carbon-related assets of the portfolio, the weighted average carbon intensity of each portfolio, the volume of exposures by sector of the counterparty, the credit risk exposures and volumes of collateral by geography/country.
#13.6 - #13.7	Performance	KPIs used for the purposes of their strategy-setting and risk management as well as any further environmental risk-related information needed to comprehensively convey their risk profile.

Source: our elaboration based on ECB "Guide on climate-related and environmental risks - Supervisory expectations relating to risk management and disclosure"

According to a first report published by the ECB in November 2020[63] none of the SSM involved significant institutions would appear to have met the minimum level of disclosures set out in the ECB Guide, in the European Commission's "Guidelines on non-financial reporting: Supplement on reporting climate-related information"[64] or in the Recommendation of the TCFD.

A second assessment was made in 2022[65] highlighting that, overall, institutions have made progress in several areas of disclosure compared with the previous report. However, major improvements are still needed in most cases since none of the Significant Institutions (SIs) reported information completely in line with ECB expectations. For instance, while 74% of banks in the sample declare that they disclose Scope 1, 2 and 3 GHG emissions, only 15% actually disclose (some of their) financed emissions. Moreover, only 12% of the banks disclose metrics on their portfolio alignment to the pathway for the transition to a low carbon and more sustainable economy. The ECB has therefore sent individual feedback letters to banks under its supervision highlighting key gaps in ESG disclosure and expecting banks to take decisive actions in the coming exercises to ensure that their environmental risk profile is properly described.

4.2 Bank of Italy action on climate-related risk disclosure

In recent years, the Bank of Italy has actively contributed to international initiatives on ESG disclosure. In 2021, in collaboration with the Minister of Economy and Finance, it participated in the FSB's activities for establishing a global minimum standard for disclosures on climate-related

[63] ECB (2020a). ECB report on institutions' climate-related and environmental risk disclosures.

[64] https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf

[65] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ECB_Report_on_climate_and_environmental_disclosures_202203~4ae33f2a70.en.pdf

financial risks[66]. This was part of a general effort of the Bank of Italy of putting sustainable finance at the center of the global agenda, also re-establishing the Sustainable Finance Study Group within the G20 Finance Track and upgrading it to a working group[67]. At the European level, it closely cooperated with the EBA, as part of the development of the ITS on Pillar 3 disclosure, and with the ECB projects. Analyses were also conducted with reference to the innovations introduced by the European Commission's CSRD proposal, as well as on the EFRAG draft standards.

At the national level, in 2022 the Bank of Italy published a first set of Supervisory Expectations on climate risks for both Less Significant Institutions and other non-banking financial institutions under its direct supervision[68]. Such expectations are not binding and aim at providing guidance on how the Bank of Italy expects banking and financial firms to address climate and environmental risks in their risk management framework. Each institution is required to carry out its own assessment, applying the solutions that are most consistent with their exposure to climate risk, depending on the type, size and complexity of their business. The document is divided into five areas: 1) governance; 2) business model and strategy; 3) organizational system and operational processes; 4) risk management system; 5) disclosure to the market (Table 8).

Table 8: Bank of Italy climate-related expectations

Disclosure - Area	Key messages
Governance	The governing body plays a central role in integrating climate and environmental risks within the governance process, including the approval of a detailed plan of initiatives explaining when and how expectations will be adopted. Particular attention should be paid to the acquisition of relevant expertise, the assignment of roles and responsibilities and the establishment of a reporting system suitable for the full sharing of information.
Business model and strategy	Institutions define the business strategy, taking into account the potential impacts of climate and environmental factors on the business environment, in order to ensure the resilience of the business model and promote its development.
Organisational system and operational processes	Any interventions on the organizational and operational processes are made by the institutions in a manner consistent with and proportional to the assessments made regarding the materiality of climate and environmental risks to their business.
Risk management system	Institutions should map events that could occur as a result of climate and environmental factors in order to identify potential risks. Then, they should equip themselves with appropriate safeguards, taking into account operational specificities. The availability of an adequate, complete and integrated database is also essential to carry out the necessary analyses of the phenomena in question. Specific expectations are, finally, defined with reference to credit, market, operational and liquidity risks.
Market disclosure	Institutions shall dispose of the infrastructure, databases and processes to disclose information regarding the integration of environmental sustainability drivers.

Source: our elaboration based on the Bank of Italy "Supervisory expectations on climate and environmental risks"

Regarding market disclosure, the Bank of Italy – in line with other supervisors – expects that the reporting of sufficiently detailed, comprehensive, and comparable information on exposure to climate and environmental risks enables the most virtuous intermediaries to increase the overall quality of

[66] https://www.fsb.org/2021/07/fsb-roadmap-for-addressing-climate-related-financial-risks/

[67] Visco (2021), "The G20 Presidency programme on Sustainable Finance", Remarks by Ignazio Visco Governor of the Bank of Italy, OMFIF-Sustainable Policy Institute symposium, 30 September 2021.

[68] Bank of Italy (2022). Supervisory expectations on climate and environmental risks.
https://www.bancaditalia.it/focus/finanza-sostenibile/vigilanza-bancaria/Aspettative_di_vigilanza_BI_su_ESG.pdf

disclosure to the market, informing all stakeholders about their positioning in the process of transition to a more sustainable economy.

5. Main challenges ahead for Italian banks

As part of a broader action aimed at facilitating the financial sector in the process towards sustainable finance, the Bank of Italy is promoting a technical dialogue with the Italian financial industry, in order to monitor and assess the degree of readiness of the system for the forthcoming regulatory requirements on ESG disclosure and, more broadly, the degree of alignment to the supervisory expectations published in April 2022. With specific regard to the banking system, the sector of the Italian Less Significant Institutions (LSIs) has started to strengthen its efforts to properly implement the new disclosure requirements, even though the degree of variability across banks is still very high. Moreover, the thematic review conducted by the Bank of Italy on a sample of LSIs shows a low degree of alignment with supervisory expectations, with, at the same time, a widespread and growing awareness of the importance of the issue for the prospective sustainability of the business models. The major critical issue, as expected, concerns the availability of data and information systems capable of handling them appropriately. The main findings highlighted that quantitative approaches in the measurement of climate risks are still limited; risk management processes are poorly structured; targets expressed in terms of quantitative risk indicators (KRIs) and performance indicators (KPIs) are not widely used[69]. The major challenges ahead are: 1) reducing data gaps and increasing the quality of ESG information; 2) increasing the resilience of the banking book; 3) assessing the accounting impact of ESG factors.

1. Reducing data gaps and increasing the quality of ESG information

The gaps in terms of availability and quality of the required information are still material, also due to the fact that the cost of collecting the data needed to meet ESG disclosure requirements is still rather high[70]. This is particularly true in Italy, where the economy is largely based on SMEs, on which reliable ESG information is not easily available.

As previously discussed, work on this is under way but it is also important that banks supplement the information set to the best of their abilities. Only a limited proportion of financial institutions has initiated analyses of the impact of climate risk (physical and transitional) on their loan portfolios, although a large percentage of them is planning to do so in the near future. Indeed, a growing number of intermediaries is showing higher awareness on climate-related risks, even though dissemination of good practices for their proper integration into business strategies is still insufficient[71].

Information from external providers represents a complementary route to fill the data-gap, especially in the first application of the disclosure requirements, but excessive reliance on them might not be fully appropriate, because these operators mainly rely on estimates to produce environmental data on

[69] Bank of Italy (November 2022). "Climate and environmental risks. Main evidence from a thematic survey conducted by the Bank of Italy on a sample of less significant banks".

[70] For an overview on the map of the existing and available data in Italy, see Lavecchia et al. (2022).

[71] Angelico et al. (2022). Il rischio climatico per le banche italiane: un aggiornamento sulla base di un'indagine campionaria. Note di stabilità finanziaria, n. 29, June 2022.

firms not subjected to non-financial reporting requirements. Banks will have to adjust such data to the specificities of their portfolio. To this end, it is crucial for institutions to understand the methodologies used by data providers, in order to avoid a 'black-box' effect.

Therefore, at the current stage it remains important to retrieve ESG information also by strengthening the dialogue between banks and non-financial companies' trade associations, as an example by developing a standardised template to collect relevant information. This would enable banks to obtain higher-quality data, while fostering more sustainable development with positive impacts on the economic system and the riskiness of the credit portfolio.

2. Increasing the ESG resilience of the banking book

Through lending and investments banks are in a very good position to facilitate the transition of their financed counterparties to a sustainable economy. To do this, it is important for them to receive from non-financial companies appropriate metrics regarding ESG-related risks and opportunities (especially climate-related factors) to which companies are exposed, together with credible transition plans.

The current EU taxonomy and the sectoral dimension represent two important elements that banks have to consider in such process. Nevertheless, both of them have to be taken into account with some caution in this phase. The current taxonomy leaves a wide variety of economic activities as non-classified. This might be interpreted as a negative signal, triggering fears that finance would dry up for activities that fall outside the current taxonomy. However, the current design of the taxonomy does not intend to convey a negative signal over all these other non-aligned or not-included activities, but so far it is limited to key sectors, providing clarity on green classifications. Further extensions of the taxonomy activities are currently under consideration by the Sustainable Finance Platform in order to enhance transparency and clarity for investors[72]. The same holds for sectors. As highlighted by Angelini[73], subsectors with extremely heterogeneous environmental footprints can coexist within a sector, as well as individual companies within the same sectors and subsectors may have very different environmental policies and carbon footprints, depending on the production processes adopted (e.g. reliance on renewables, more advanced machineries). Even companies that currently present the same high-emission levels may have developed very different transition plans. Indeed, a company seeking funding to carry out an ambitious and credible decarbonisation plan should be assessed by lenders differently from one that carries on with ordinary production strategies and policies.

In this context, banks can play a key role by advising and supporting non-financial companies in increasing their resilience to climate risk, regardless of their economic sector and the inclusion within the current taxonomy framework. This, in turn will have positive effects on achieving banks' transition plan goals and increasing the resilience of the banking portfolio. The transition plans of financial intermediaries clearly depend on the transition plans of their counterparties. It is therefore important that non-financial companies adopt ambitious and robust plans. To this end, the implementation of ESG disclosure is a valuable tool for the top management – of financial and non-

[72] Sustainable Finance Platform (March 2022). The Extended Environmental Taxonomy: Final Report on Taxonomy extension options supporting a sustainable transition.

[73] Angelini (2022), "The financial risks posed by climate change: information gaps and transition plans".

financial undertakings – to define strategy and goals as well as monitoring the impacts of ESG risks and opportunities on the business. Non-financial disclosure is therefore an opportunity that can add value to the company in terms of increasing resilience and adaptability.

Thus, banks, together with trade associations of non-financial companies as well as certified public accountants, auditors and national and international energy authorities, should support non-financial undertakings in increasing their know-how related to ESG factors management by: emphasising the importance of ESG disclosure as a "value-added tool" that can enable the company to systematically gather detailed information on the risks, opportunities, costs, and revenues, that ESG factors may bring to the company in the short, medium and long term; raising the awareness of non-financial companies about the importance of establishing or improving effective policies and disclosing ESG risks and opportunities related to their business.

3. Assessing the accounting impact of ESG factors

Accounting rules do not explicitly refer to climate-related matters. However, "*companies must consider climate-related matters in applying IFRS Standards when the effect of those matters is material in the context of the financial statements taken as a whole*"[74]. This has been reiterated by the ESMA[75], according to which credit institutions are expected *"to disclose whether material climate-related and environmental risks are taken into account in credit risk management, including information about the related significant judgments and estimation uncertainties".* Thus, it is key for financial institutions to properly assess the accounting implications stemming from ESG factors and climate-related matters, with reference, inter alia, to:

- the implications in terms of classification and measurement of financial assets, especially in the case of instruments with ESG features[76]. This aspect has been also raised by the industry during the Post-Implementation Review of IFRS 9 "Classification and Measurement" and it is currently under scrutiny by the IASB;
- the assessment of significant increase in credit risk (SICR), investigating, in particular how and to what extent climate risks (both physical and transitional) could affect the creditworthiness of banks' counterparties;
- the incorporation of climate risk factors in the development of the IFRS 9 macro-economic scenarios[77];

[74] IFRS Foundation (2020). Educational material. "Effects of climate-related matters on financial statements".

[75] ESMA (2021). "European common enforcement priorities for 2021 annual financial reports". In the ESMA (2022) "European common enforcement priorities for 2022 annual financial reports", climate-related matters remain relevant.

[76] Because, for instance, instruments include terms linking contractual cash flows to the achievement of climate-related targets.

[77] Entities should calculate their loan loss provisions in a way that reflects: i) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; ii) the time value of money; and iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. With regard to sub i) and iii), climate-related factors could affect the creditworthiness of banks' counterparties. For this reason, climate risks – if material – shall also be considered in the measurement of the ECL (to the extent to which reasonable and reliable information can be obtained without undue cost and effort).

- the measurement of the fair value of financial instruments since climate-related matters may also affect the fair value measurement of assets and liabilities in financial statements[78].

In the light of this, going forward it will be important for institutions to properly monitor the accounting implications stemming from ESG factors, amending, where necessary, their processes, accounting policies and valuation models in order to appropriately reflect these new sources of risks and, in particular, the climate-related implications, given their potential impact in terms of the measurement of financial instruments and estimation of fair value and expected credit losses.

6. Concluding remarks

Disclosure of ESG factors is becoming an essential ingredient of the broad process to drive the global economy towards a sustainable path. The regulatory framework on disclosure is rapidly evolving; at the European level, the disclosure requirements are mostly finalised and involve both financial and non-financial undertakings (Pillar 3 and non-financial disclosure under the CSRD).

The regulation is not fully complete yet. EFRAG work is under way; the BCBS is starting now to develop possible disclosure standards at a global level; the EU taxonomy is still under finalization. Nevertheless, the current state of the art already provides both financial and non-financial stakeholders a sound framework to assess ESG risks. In addition, regulators are working to enhance as much as possible the consistency between the Pillar 3 prudential perspective and the disclosure to be provided according to the EFRAG standards. Proportionality, i.e. a key principle in regulation, especially for Europe, will be declined in the forthcoming standards, considering the specificities of both banks (LSIs) and non-financial firms (SMEs).

In the light of this, banks are facing material challenges related to data gaps and data quality, especially with reference to information on counterparties outside the scope of the CSRD. This is particularly important also from a supervisory perspective, since ESG data are not only essential for disclosure but are even more crucial to manage effectively such new risks and finance the transition to a sustainable economy. Additionally, over-reliance on service providers could lead to insufficient consideration of the risks to be addressed. In this scenario, as highlighted by Bank of Italy's first set of Supervisory Expectations on climate risks, the need for an improvement of ESG-related risk management processes is emerging quite clearly. Therefore, in the coming years it will be crucial for financial and non-financial entities to proactively implement the new ESG disclosure and enhance the quality and availability of ESG information.

In line with similar initiatives undertaken by the ECB and other national supervisors, the Bank of Italy is promoting a constructive and open dialogue with the Italian financial industry in order to detect emerging issues in a timely manner and promote a constructive dialogue among all interested stakeholders.

[78] Particularly, for financial instruments categorised within Level 3 of the fair value hierarchy for which inputs unobservable on an active market are considered for their measurement.

Annex 1 – Commonalities and gaps between Pillar 3 and EFRAG draft standards issued in public consultation until 8 August 2022 / CSRD

Table 1 - Commonalities between Pillar 3 and EFRAG draft standards / CSRD (general requirements)

Area	Qualitative disclosure - Commonalities between Pillar 3 and EFRAG draft standards / CSRD
General requirements	- **Time horizon**: both frameworks require **short, medium** and **long-term forward-looking information** (however, the EFRAG draft standards require the reporting entity to adopt specific time intervals for the short (1 year), medium (2-5 years) and long term (> 5 years)). - **Presenting comparative information**: both frameworks require explanations of changes from previous disclosure periods. However, the **EFRAG** draft standards require **comparative information from the previous period for all metrics** reported in the current period. - **Estimating under conditions of uncertainty**: both frameworks allow the use of proxies.

Source: our own elaboration

Table 2: Gaps between Pillar 3 and EFRAG draft standards / CSRD (general requirements)

Area	Qualitative disclosure - Gaps between Pillar 3 and EFRAG draft standards / CSRD
General requirements	- **Reporting rules:** the EFRAG sets out general reporting principles that in most cases are not required by Pillar 3. These principles are typical of financial reporting. In particular, the rules concern: *updating disclosures about events after the end of the reporting period*; *changes in preparing or presenting sustainability information*; *reporting errors in prior periods*. - **Stakeholders:** for the **EFRAG** the stakeholders of reporting are: i) the **affected stakeholders;** and ii) the **users of sustainability reporting. Pillar 3**, on the other hand, does not define affected stakeholders and lists consumers and investors as stakeholders. Additionally, the EFRAG requires reporting the views, interests, and expectations of stakeholders, whereas this disclosure is not required by Pillar 3. - **Materiality**: the EBA's concept of materiality differs from the EFRAG's one. Particularly, Pillar 3 states that *"When building the uniform disclosure formats, this Regulation* ***has taken into account the complete materiality*** *of the information required. Institutions' disclosures need to cover (i)* ***the financial impact of ESG factors on institutions' economic and financial activities*** *(outside-in perspective), and (ii) the* ***ESG factors that may be triggered by institutions' own activities which in turn become financially material*** *when these factors affect institutions' activities (inside-out perspective). As a result, the templates and tables used for those disclosures should convey sufficiently comprehensive and comparable information on ESG risks, thus enabling users of that information to*

	assess the risk profile of institutions". Conversely, the EFRAG refers to the concept of **double materiality**, including both the *impact materiality*[79] and the *financial materiality*[80]. - **Consolidated reporting:** there may be differences between the accounting consolidation envisaged by the EFRAG framework and the prudential consolidation envisaged by the CRR.

Source: our own elaboration

Table 3: Commonalities and gaps between Pillar 3 and EFRAG draft standards / CSRD (strategy, governance and risk management)

Area / Topic	Qualitative disclosure: commonalities between EFRAG draft standards and Pillar 3	Qualitative disclosure: gaps between EFRAG draft standards and Pillar 3
Business strategy and processes	- Both frameworks require the disclosure of changes to the **business strategy** to integrate ESG factors, a description of **related objectives** and short, medium and long-term **targets**, and **processes** to identify, **measure and monitor activities and exposures subject to ESG risks and opportunities.**	- Pillar 3 requires a description of policies and procedures relating to direct and indirect **engagement with new or existing counterparties on their strategies to mitigate** and reduce environmental risks.
Governance	- Both frameworks require the disclosure of **responsibilities** of the management body for setting the **ESG risk management framework** within the company's strategy, policies and objectives.	- Pillar 3 requires a **more detailed disclosure** on the **involvement of governance** on the oversight of ESG risks, also requiring a description of what **processes** are in place for **assessing how counterparties assess and manage ESG risks**. - The EFRAG draft standards require reporting on sustainability matters addressed by administrative, management and supervisory bodies.
Risk management	- Both frameworks require information on **how ESG risks are identified and assessed.**	- **Pillar 3** requires a deeper focus on **risk management processes and methodologies**, the **impact on capital, liquidity, ICAAP and**

[79] Draft ESRS 1, Appendix A: *"A sustainability matter is material from an impact perspective if the undertaking is connected to actual or potential significant impacts related to the matter on people or the environment over the short-, medium- or long-term. This includes impacts directly caused or contributed to by the undertaking in its own operations, products or services and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain, not limited to direct contractual relationships"*.

[80] Draft ESRS 1, Appendix A: *"A sustainability matter is material from a financial perspective if it triggers or may trigger financial effects on undertakings, i.e., it generates or may generate risks or opportunities that influence or are likely to influence the future cash flows and therefore the enterprise value of the undertaking in the short-, medium- or long-term, but it is not captured or not yet fully captured by financial reporting at the reporting date. The undertaking relies on the availability of economic, natural and social resources of an appropriate pricing and quality. Such dependencies are sources of financial risks or opportunities"*.

		ILAAP requirements, as well as risk tolerance thresholds and related escalation triggers. - the **EFRAG** draft standards require **more disclosure on how materiality thresholds are defined**.

Source: our own elaboration

Table 4: Commonalities between Pillar 3 and EFRAG draft standards / CSRD

Quantitative disclosure - Commonalities between Pillar 3 and EFRAG draft standards / CSRD
Both frameworks require institutions to disclose: - **Scope 3 emissions** of the financed counterparties. However, it should be clarified that Pillar 3 requires such Scope 3 emissions to be split into Scope 1, 2 and 3 of the financed counterparties; - the exposure to acute and chronic physical risks. However, it should be clarified that Pillar 3 requires a detailed breakdown by geographical area; - the **GAR**.

Source: our own elaboration

Table 5: Gaps between Pillar 3 and EFRAG draft standards / CSRD

Quantitative disclosure - Gaps between Pillar 3 and EFRAG standards / CSRD
Pillar 3, unlike the EFRAG draft standards, requires to disclose: - information on exposures towards **sectors that highly contribute to climate change**, specifying, by **sector**, the gross carrying amount of exposures towards companies excluded from EU Paris-aligned Benchmarks in accordance with points (d) to (g) of Article 12.1 and in accordance with Article 12.2 of Regulation (EU) 2020/1818; the gross carrying amount of **environmentally sustainable (CCM) exposures**; **stage 2 and non-performing exposures**, the accumulated impairment and the residual maturity of these exposures (in addition to GHG emissions) [*Template 1 (banking book and climate change transition risk)*]; - information on loans collateralised by immovable property. The gross carrying amount of these loans, the level of energy efficiency and the EPC label of the collateral must be reported [*Template 2 (banking book and climate change transition risk)*]; - information, by sector, on the alignment metrics to the targets defined by the IEA [*Template 3 (banking book and climate change transition risk)*]; - information on exposures to top 20 carbon-intensive firms [*Template 4 (banking book and climate change transition risk)*]; - the BTAR [*Template 9 (BTAR)*]. The **EFRAG draft standards**, unlike Pillar 3, requires to disclose: - Energy consumption and mix of institution (DR E1-5); - Energy intensity per net turnover of institution (DR E1-6); - Scope 1, Scope 2 and total GHG emissions of institution (DR E1-7-8-10); - GHG intensity per net turnover (DR E1-11);

- GHG removals, GHG mitigation projects financed through carbon credits and avoided GHG emissions (DR E1-12-13);
- Potential financial effects from material physical risks, transition risks and climate-related opportunities (DR E1-15-16-17).

Furthermore, due to the Taxonomy Regulation, in addition to the GAR, the non-financial report (and not Pillar 3) will also have to report:

- the share of financial guarantees supporting debt instruments financing taxonomy-aligned economic activities (from 2024 as for the GAR);
- the share of revenues from products and services other than lending associated with taxonomy-aligned economic activities; and the GAR for the trading portfolio (from 2026).

Source: our own elaboration

Glossary

Banking Book Taxonomy Aligned Ratio (BTAR): the BTAR is the proportion of the of credit institution's assets financing and invested in taxonomy-aligned economic activities and the total covered assets. It differs from the GAR, because the numerator also includes taxonomy-aligned exposures to non-financial corporates that do not fall within the scope of the NFRD (i.e. SMEs and non-EU non-financial corporations).

Capex: Capex means the share of capital expenditure.

Climate change mitigation (CCM): Article 10 of Taxonomy Regulation: *"An economic activity shall qualify as contributing substantially to climate change mitigation where that activity contributes substantially to the stabilisation of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system consistent with the long-term temperature goal of the Paris Agreement through the avoidance or reduction of greenhouse gas emissions or the increase of greenhouse gas removals, including through process innovations or product innovations* […]*"*.

Climate change adaptation (CCA): Article 11 of Taxonomy Regulation: *"An economic activity shall qualify as contributing substantially to climate change adaptation where that activity: (a) includes adaptation solutions that either substantially reduce the risk of the adverse impact of the current climate and the expected future climate on that economic activity or substantially reduce that adverse impact, without increasing the risk of an adverse impact on people, nature or assets; or (b) provides adaptation solutions that, in addition to satisfying the conditions set out in Article 16, contribute substantially to preventing or reducing the risk of the adverse impact of the current climate and the expected future climate on people, nature or assets, without increasing the risk of an adverse impact on other people, nature or assets.*[…]*"*.

CSRD: proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting.

Double Materiality: double materiality is a concept that provides criteria for the determination of whether a sustainability matter has to be included in the undertaking's sustainability report. Double materiality is the union (in mathematical terms, i.e., union of two sets, not intersection) of impact materiality and financial materiality. A sustainability matter meets therefore the criteria of double materiality if it is material from either the impact perspective or the financial perspective or both perspectives. (EFRAG – draft ESRS 1)

EFRAG: it is a private association established in 2001 with the encouragement of the European Commission to serve the public interest. EFRAG's mission is to serve the European public interest in both financial reporting and sustainability reporting by developing and promoting European views in the field of corporate reporting and by developing draft EU Sustainability Reporting Standards.

ESRS: European sustainability reporting standards, published by the EFRAG.

Financial materiality: financial materiality in the context of sustainability reporting is a characteristic of a sustainability matter or information in relation to the undertaking. For the purposes of preparing sustainability reporting, a sustainability matter is material from a financial perspective if it triggers or may trigger significant financial effects on undertakings, i.e., it generates or may generate significant risks or opportunities that influence or are likely to influence the future cash flows and therefore the enterprise value of the undertaking in the short-, medium- or long-term, but it is not captured or not yet fully captured by financial reporting at the reporting date (EFRAG – draft ESRS 1).

Green Asset Ratio (GAR): the GAR shows the proportion of the credit institution's assets financing and invested in taxonomy-aligned economic activities as a proportion of total covered assets in accordance with point 1.1.2 and 1.2 of Annex V of Delegated Regulation 2021/2178.

Greenhouse gas (GHG): a gas that contributes to the greenhouse effect by absorbing infrared radiation. Carbon dioxide and chlorofluorocarbons are examples of greenhouse gases. To help delineate direct and indirect emission sources, improve transparency, and provide utility for different types of organizations and different types of climate policies and business goals, three "scopes" (Scope 1, Scope 2, and Scope 3) are defined for GHG accounting and reporting purposes.

IFRS Foundation: the IFRS Foundation is a not-for-profit, public interest organisation established to develop high-quality, understandable, enforceable and globally accepted accounting and sustainability disclosure standards. The standards are developed by our two standard-setting boards, the International Accounting Standards Board (IASB) and International Sustainability Standards Board (ISSB).

Impact materiality: impact materiality is a characteristic of a sustainability matter or information in relation to an undertaking. A sustainability matter is material from an impact perspective if it is connected to actual or potential significant impacts by the undertaking on people or the environment over the short-, medium- or long-term. This includes impacts directly caused or contributed to by the undertaking in its own operations, products or services and impacts that are otherwise directly linked to the undertaking's upstream and downstream value chain, and not limited to contractual relationships (EFRAG – draft ESRS 1).

NFRD: Non financial Reporting Directive (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).

Opex: Operational expenditure.

Scope 1 - Direct GHG emission: direct GHG emissions occur from sources that are owned or controlled by the company, for example, emissions from combustion in owned or controlled boilers, furnaces, vehicles, etc.; emissions from chemical production in owned or controlled process equipment.

Scope 2 - Electricity indirect GHG emissions: Scope 2 accounts for GHG emissions from the generation of purchased electricity consumed by the company. Purchased electricity is defined as electricity that is purchased or otherwise brought into the organizational boundary of the company. Scope 2 emissions physically occur at the facility where electricity is generated.

Scope 3 - GHG emission: Scope 3 is a reporting category that allows for the treatment of all other indirect emissions. Scope 3 emissions are a consequence of the activities of the company, but occur from sources not owned or controlled by the company. Some examples of Scope 3 activities are extraction and production of purchased materials; transportation of purchased fuels; and use of sold products and services.

Taxonomy-aligned: an activity can be considered "taxonomy-aligned" when, in addition to being included in the delegated acts of the European Commission issued pursuant to Articles 10(3), 11(3), 12(2), 13(2), 14(2), and 15(2) of the Taxonomy Regulation, it complies with all the technical criteria set out in these delegated acts to be Taxonomy aligned.

Taxonomy-eligible: the delegated act of the European Commission 2021/2178 of 6.7.2021 published pursuant to Art. 8 of the Taxonomy Regulation defines "taxonomy-eligible" an activity included in the delegated acts of the European Commission issued pursuant to Articles 10(3), 11(3), 12(2), 13(2), 14(2), and 15(2) of the Taxonomy Regulation, irrespective of whether that economic activity meets any or all of the technical screening criteria laid down in those delegated acts.

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