Assessment of Sustainable Finance in Western Balkans: Prospects for Sustainable Finance Taxonomy

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Trg Bosne i Hercegovine 1/V,
71000 Sarajevo Bosnia and Herzegovina
Tel: +387 33 561 700
Email: rcc@rcc.int

Consultant: Center for economic, technological and environmental development (CETEOR)
Topal Osman Paše 32 B
71000 Sarajevo, Bosnia and Herzegovina
Tel: +387 33 563 580
Fax: +387 33 205 725
E-mail: info@ceteor.ba

Authors: Vedad Suljić, Lead Author
Nejra Biber, Associate

Design: Damir Bilalović

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* This designation is without prejudice to positions on status and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence

LIST OF ABBREVIATIONS

FSAA	Financial Supervisory Authority of Albania
BARS	Banking Agency of Republika Srpska
BoA	Bank of Albania
CB	Central Bank
CBBH	Central Bank of Bosnia and Herzegovina
CBK	Central Bank of Kosovo*
CBM	Central Bank of Montenegro
CRM	Common Regional Market
CSDDD	Corporate Sustainability Due Diligence Directive
CSRD	Corporate Sustainability Reporting Directive
EBRD	European Bank for Reconstruction and Development
EE	Energy Efficiency
EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
ESG	Environmental, Social and Governance
ESRS	European Sustainability Reporting Standards
EU	European Union
FBA	Banking Agency of the Federation of Bosnia and Herzegovina
FDI	Foreign Direct Investment
FI	Financing Institution
GAWB	Green Agenda for the Western Balkans
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISO	International Organization for Standardization
MEL	Monitoring, Evaluation and Learning
MFI	Microfinance Institution
MoF	Ministry of Finance
CBS	Central Bank of Serbia
NDC	National Determined Contributions
CBNM	Central Bank of North Macedonia
NGFS	Networks for Greening the Financial System
NPAA	National Programme for Adoption of the Acquis Communautaire
PRI	Principles for Responsible Investment
RCB	Regional Coordination Body
RCC	Regional Cooperation Council
RES	Renewable Energy Sources

SBFN	Sustainable Finance and Banking Network
SDG	Sustainable Development Goal
SFDR	Sustainable Finance Disclosure Regulation
SLA	Savings and Loan Associations
SMEs	Small and Medium-sized Enterprises
TCFD	Task Force on Climate-related Financial Disclosures
UN	United Nations
UNDP	United Nations Development Programme
WB	Western Balkans
WBG	World Bank Group

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CONTEXT AND LIMITATIONS

Note on terminology

Understanding the differences between green finance and sustainable finance is important for comprehending the scope and implications of the initiatives discussed in this report. Green finance specifically refers to financial activities focused on environmental benefits, such as investments in renewable energy, energy efficiency and pollution reduction projects. Sustainable finance, on the other hand, encompasses a broader spectrum, integrating environmental, social and governance (ESG) criteria into financial decision-making to promote overall sustainable development.

In this report, the terms "taxonomy" and "green taxonomy" are used interchangeably. The rationale behind this choice is to avoid providing a rigid definition, recognizing that the concept of a taxonomy in sustainable finance is complex and multifaceted. There are various types of taxonomies, including green, sustainable finance and social taxonomies, each serving different but complementary purposes. This allows for a broader discussion that encompasses environmental, social and overall sustainability aspects, thus ensuring flexibility and inclusivity.

Limitations

The research for this report primarily focused on Ministries responsible for finance, Central Banks and Financial Institutions in the Western Balkans. The research did not extensively cover other stakeholders such as the private sector, investors, asset managers, insurance companies and others. While this focus provides valuable insights into the perspectives and challenges faced by MoFs, CBs and FIs in adopting sustainable finance practices, it may not fully capture the views and experiences of all stakeholders involved in the financial ecosystem. Future research should aim to include these additional stakeholders to provide a more comprehensive understanding.

Additionally, the survey conducted as part of this research was sent to all 134 financial institutions in WB. Despite significant effort, including repeated follow-ups, only 27 institutions responded. This response rate, representing approximately 20% of the targeted institutions, provides a snapshot of current practices and opinions but may not reflect the entire financial sector's stance on sustainable finance. Therefore, the results of the survey should be interpreted with caution.

EXECUTIVE SUMMARY

The project Technical Assistance to Assess the Financial Landscape in the Western Balkans in Relation to Sustainable Finance Taxonomy Prospects was initiated and supported by the RCC under the framework of Common Regional Market (CRM) Action Plan 2021–2024. Its primary objective is to provide a comprehensive assessment of the sustainable finance landscape in the WB and develop recommendations for a sustainable finance taxonomy framework in alignment with EU regulations and international standards. Developing a regional sustainable finance taxonomy framework is crucial for preventing market fragmentation, reducing information asymmetry and enabling the flow of capital towards environmentally sustainable projects.

The assessment involved a thorough review of existing regulatory frameworks, central bank regulations and available literature. This included reports and analyses related to sustainable finance taxonomy in WB economies. A total of 20 interviews were conducted with MoFs, CBs and FIs from the WB. These interviews provided insights into current frameworks and methods used to categorise green and sustainable activities. The data were analysed to assess the consistency of banks' approaches in classifying sustainable activities and their adherence to EU taxonomy.

The financial sectors in WB are predominantly composed of banks, accounting for 80-90% of total financial assets in most economies. Foreign ownership of these banks has facilitated the adoption of modern business models and advanced ICT systems but also led to excessive leveraging prior to the global financial crisis. Currently, commercial banks in WB maintain healthy capitalisation and liquidity ratios, primarily supported by their deposit bases. Despite these advancements, banking sector penetration remains relatively low, with financial sector assets averaging below 100% of GDP, lower than the eurozone average of 280% of GDP in 2021.

The alignment of the WB with the EU Taxonomy and international standards for sustainable finance is an important step in fostering sustainable finance across the region. The EU Taxonomy for sustainable activities defines environmentally sustainable economic activities, helping investors and companies understand what qualifies as sustainable. Accompanying the EU Taxonomy are additional regulatory frameworks like the CSRD and the SFDR. Together, these frameworks aim to channel capital towards sustainable investments, facilitate cross-border/boundary investment flows and support climate goals.

A survey of financial institutions in WB revealed that 88% offer sustainable finance products, split evenly between multiple and few offerings. Nearly half use specific classification systems for green activities, while over a third use a general framework. EE and RES initiatives are top priorities for 64% and 60% of respondents, respectively. The importance of sustainable finance is recognised by 84% of institutions, which are actively preparing for its increased role. Major barriers include the lack of a regulatory framework (76%) and clear definitions (60%), along with high implementation costs, lack of expertise and low market demand. Financial incentives or subsidies (56%) and regulatory guidance (40%) are the most requested forms of support to overcome these barriers.

Despite the availability of funding from EU sources, bilateral donors and IFIs, the WB faces difficulties in accessing these resources due to insufficient administrative capacity and challenges in matching projects with available fund. A significant barrier is the general lack of awareness and understanding of sustainable finance principles among stakeholders, leading to underestimation of long-term benefits such as increased resilience to climate risks, enhanced reputation and access to new markets and funding opportunities. The lack of data is seen as one of the major barriers in understanding the nature of an investment to flag it appropriately. Additionally, there is a misunderstanding of the EU taxonomy, often seen narrowly as a decision-making tool for investment approval rather than a broader classification system for sustainable activities. This misunderstanding is compounded by the absence of an economy-level taxonomy, leading to inconsistencies and fragmented practices, such as reliance on varied and non-standardised classification systems including general green frameworks and specific internal guidelines from international partners. There is also a lack of strong commitment and push-back from key stakeholders, such as Ministries of Finance (MoFs) and Central Banks (CBs), due to the perceived regulatory burden and limited resources to manage new mandates. The lack of existing frameworks further hampers the development of standardised procedures for assessing and managing ESG risks, resulting in fragmented efforts. Limited technical capacity and expertise among stakeholders deepens these challenges, as many financial institutions lack the knowledge to integrate complex sustainable finance frameworks effectively.

Moreover, the relatively small market size in the WB limits the scale and impact of sustainable finance initiatives, making it challenging to attract international investors and achieve significant environmental and economic benefits. Finally, there is a critical need for greater collaboration and regional cooperation to advance sustainable finance effectively, avoiding fragmented regulatory landscapes and ensuring coordinated efforts.

To address the challenges identified, several strategic recommendations have been proposed:

1. **Capacity building** – Develop comprehensive educational programmes on sustainable finance principles, conduct workshops and training sessions, promote understanding of the EU Taxonomy, encourage knowledge sharing and invest in specialised skills development.
2. **Policy advocacy and development** – Develop long-term strategic plans, develop and implement taxonomies adapted to the EU Taxonomy, create clear regulatory frameworks, ensure strong regulatory support and expand the range of green financial products.
3. **Regional collaboration** – Utilise the CRM to streamline efforts, coordinate policy development at the regional level, promote regional harmonisation, align sustainable finance practices with regional and global benchmarks and utilise funding opportunities from EU funds and international financial institutions.

To further address these challenges and implement the recommendations effectively, a structured and coordinated approach is essential. This involves establishing robust mechanisms and frameworks that can guide and synchronise efforts across the WB economies, ensuring that sustainable finance initiatives are both impactful and aligned with EU and international standards. The following strategic steps are proposed to achieve this:

1. **Establishing a Regional Coordination Body (RCB)**. The RCB will synchronise sustainable finance initiatives across WB economies, develop common guidelines, provide training, track progress and promote the benefits of sustainable finance.
2. **Alignment with relevant sustainability goals**. Focus on NDC as a starting point, directing investments towards projects that directly contribute to NDC targets.
3. **Focus on sectors with the most impact on defined sustainability goals**. Define priority sectors like energy, transport, residential buildings, agriculture and waste management.
4. **Public consultation and publishing the framework**. Engage a broad spectrum of stakeholders through public consultations, gather feedback and publish the framework.

5. **Action plan for the taxonomy framework.** Develop a comprehensive action plan outlining specific actions, timelines, responsible parties and key milestones.
6. **Draft conceptual framework.** Emphasize principles such as interoperability, avoiding unnecessary reinvention, holistic thinking and simplicity. Adopt and adapt the EU taxonomy while starting with a whitelist approach (in the first phase), given the limited capacities among stakeholders.
7. **Engage with WB economies to draft their taxonomies.** Provide general recommendations such as defining a lead institution, creating a timeline, developing a stakeholder engagement plan, setting objectives, conducting research and benchmarking, drafting the taxonomy design, piloting, finalising the design, building capacities, developing a MEL framework and collecting and disclosing data.
8. **Monitor and update the taxonomy.** Establish mechanisms for regular reviews, engage stakeholders, adapt the taxonomy based on new data and feedback, and provide continuous training and technical assistance.

1. INTRODUCTION

The project Technical Assistance to Assess the Financial Landscape in the Western Balkans in Relation to Sustainable Finance Taxonomy Prospects is an initiative by the Regional Cooperation Council (RCC), under the Common Regional Market (CRM) Action Plan 2021–2024. This project seeks to provide a comprehensive assessment of the sustainable finance landscape in the Western Balkans (WB) and develop recommendations for a sustainable finance taxonomy framework that aligns with European Union (EU) regulations and international standards.

WB is facing challenges in aligning with sustainable development goals and green transition objectives outlined in the Green Agenda for the Western Balkans (GAWB). There is an urgent need to mobilise financial resources towards sustainable investments, which requires a clear understanding of what constitutes 'sustainable' finance. The absence of a common definition and classification system hinders greater uptake of sustainable finance across the region. Thus, developing a regional sustainable finance taxonomy framework is crucial for preventing market fragmentation, reducing information asymmetry and enabling the flow of capital towards environmentally sustainable projects.

This project aims to:

- Comprehensively assess the sustainable finance landscape in WB, with a particular focus on the prospects of sustainable finance taxonomy; and
- Propose viable options for developing a common guiding framework or standards on sustainable finance taxonomy and for promoting sustainable finance in general in WB.

The assessment involves a thorough review of the existing regulatory frameworks, central bank (CB) regulations and available literature. This includes reports and analyses related to sustainable finance taxonomy in WB economies. A total of 20 interviews were conducted with Ministries of Finance (MoF), CBs and financial institutions (FIs) in each economy (see Annex 2). These interviews provided insights into current frameworks and methods used to categorise green and sustainable activities. The data were analysed to assess the consistency of FIs' approaches in classifying sustainable activities. The document recommends options for developing a common guiding framework on sustainable finance taxonomy that promotes sustainable finance in the WB.

2. CURRENT UPTAKE OF SUSTAINABLE FINANCE IN THE WESTERN BALKANS AND ALIGNMENT WITH EU TAXONOMY

The financial sectors in WB are predominantly composed of banks, which account for 80-90% of the total financial assets in most economies, with Kosovo* being an exception at 68% in 2020 due to its notable and expanding private pension-fund sector. Other financial intermediaries, such as insurance companies, pension and investment funds and stock exchanges, play a relatively minor role in the region's financing landscape. A significant number of these banks are owned by foreign, primarily EU-based, parent banks. This foreign ownership has facilitated the adoption of modern business models and advanced information and communication technology (ICT) systems but also led to excessive leveraging prior to the global financial crisis, as evidenced by high loan-to-deposit ratios. The Vienna Initiative, launched in 2009 by the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), European Commission (EC), International Monetary Fund (IMF) and the World Bank Group (WBG), played a crucial role in preventing chaotic deleveraging by parent banks in WB, thereby maintaining financial stability post-crisis. Currently, commercial banks in WB maintain healthy capitalisation and liquidity ratios, primarily supported by their deposit bases. Despite these advancements, banking sector penetration remains relatively low. Financial sector depth, typically measured by total assets or private-sector credit relative to GDP, is usually positively correlated with economic development, though excessive levels can lead to crises. The WB banking sector assets average below 100% of GDP, lower than the eurozone average of 280% of GDP in 2021 (1).

For a detailed overview of the current financial landscape in the WB, please see Annex 1.

2.1. Overview of relevant international sustainable finance frameworks

Globally, sustainable finance is driven by a combination of regulatory initiatives, voluntary guidelines and market-driven standards. The United Nations' Principles for Responsible Investment (PRI) serve as a global benchmark, encouraging investors to incorporate Environmental, Social and Governance (ESG) considerations in investment decisions. The Task Force on Climate-related Financial Disclosures (TCFD) provides recommendations for companies on climate-related financial disclosures. Additionally, the Equator Principles offer guidelines for environmental and social risk management in project finance. Green bonds, adhering to the Green Bond Principles, have also gained prominence, reflecting a growing investor demand for sustainable finance solutions (50). Moreover, the United Nations (UN) Sustainable Development Goals (SDGs) further guide these efforts by setting broad environmental and social targets that companies and FIs aim to support through their activities.

Over the past few years, the EU has introduced a series of sustainability regulations affecting companies both within and outside the EU. Table 1 highlights how each regulation contributes to the overarching goal of enhancing sustainability and transparency within the EU and among international businesses operating in EU. The EU Taxonomy serves as a foundational element across these regulations, guiding companies in identifying and reporting on environmentally sustainable activities.

***Table 1.** CSDD, CSRD, SFDR and ESRS and their link with the EU taxonomy*

Act	Key elements	Timeline	Mandates	Link to EU Taxonomy
CSDDD (Corporate Sustainability Due Diligence Directive)	Establishes a framework requiring companies to manage their environmental and social impacts.	Endorsed in April 2024	Companies must conduct due diligence on environmental and human rights impacts, mitigate risks, report publicly and establish grievance mechanisms.	Aligns with the EU Taxonomy by requiring due diligence that considers environmental risks.
CSRD (Corporate Sustainability Reporting Directive)	Replaces earlier directives, expanding reporting on sustainability impacts from a double materiality perspective.	Rule starts applying between 2024 and 2028	Companies must disclose sustainability risks and their alignment with the 1.5°C target.	Requires reporting on operations aligned with EU Taxonomy-defined sustainable activities.
SFDR (Sustainable Finance Disclosure Regulation)	Mandates ESG risk disclosure by financial market participants.	Applicable since March 2021	Requires transparency on sustainability risk assessments and promotion of ESG features.	Links financial products to sustainable activities as defined by the EU Taxonomy.
ESRS (European Sustainability Reporting Standards)	Promotes interoperability with existing standards to ensure comprehensive sustainability reporting.	Starting between 2024 and 2026	Establishes guidelines on what topics and indicators companies should include in their sustainability reports.	Complements the EU Taxonomy by providing detailed reporting guidelines for aligning disclosures with Taxonomy criteria.

***Source:** CETEOR, 2024*

The EU Taxonomy for sustainable activities (EU taxonomy) defines environmentally sustainable economic activities, helping investors and companies understand what qualifies as sustainable. This classification system provides businesses and investors with a common language, ensuring investments contribute substantially to at least one of six environmental objectives: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and protection and restoration of biodiversity and ecosystems (51). Since January 2022, companies within the scope have been required to disclose the percentage of their turnover, capital and operational expenditures, as well as Assets Under Management (AUM) for asset managers or Green Asset Ratio for FIs that are eligible under the Taxonomy. As of January 2024, all FIs in the EU need to report on the Taxonomy alignment of their investments, applying only to investee companies that have already reported their own alignment.

Accompanying the EU Taxonomy are additional regulatory frameworks like the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR). The CSRD expands sustainability reporting requirements for companies, increasing transparency on ESG issues and ensuring better comparability of sustainability information across businesses. The SFDR, on the other hand, mandates financial market participants to disclose how they incorporate sustainability risks in their investment decisions and how sustainable objectives are achieved (51). As of April 2024, there are 47 sustainable finance taxonomies (from simple to more complex). Currently, three-quarters of advanced economies are now covered by an economy-level or regional sustainable finance taxonomy, and just over 10% of emerging markets and developing economies are covered (52).

Together, these frameworks aim to channel capital towards sustainable investments, facilitate cross-border/boundary investment flows and support the EU's climate goals. By creating a standardised approach to defining, measuring and reporting on sustainability-related activities, these frameworks enhance transparency and comparability across different markets and industries. This harmonisation of standards not only ensures investors have the information they need to make informed decisions but also fosters collaboration and consistency, thus accelerating the shift towards sustainable finance.

Table 2. *Few examples of sustainable finance regulations Worldwide (53)*

United Kingdom	• Sustainability Disclosure Requirements (SDR) and investment labels (effective from July 2024) • Sustainability Disclosure Standards (SDS)
United States	• Securities and Exchange Commission (SEC) Climate Disclosure Rules • California's Climate Disclosure Law
Canada	• Canadian Securities Administrators (CSA) Guidance on ESG Disclosure • Supplier ESG Disclosure for Large Federal Contractors
Latin America	• Brazil's Central Bank mandates banks to consider ESG risks • Chilean Financial Market Commission (CMF)
Asia	• China is developing an economy-level ESG rating system • Japan's Corporate Governance Code encourages ESG considerations • India has issued guidelines for responsible business conduct
Africa	• In Egypt the FRA introduced resolutions requiring listed companies and large non-banking FIs to submit annual ESG disclosure reports • In South Africa listed companies on the JSE must report on ESG risks and opportunities

At the COP28 summit, the International Organization for Standardization (ISO) highlighted the essential role of standards in promoting sustainable finance and achieving net-zero goals. The discussions focused on using standards to enhance transparency, align assurance and verification processes across financial sectors and develop new standards for future challenges. In partnership with the International Financial Reporting Standards (IFRS) Foundation, ISO aims to set a global benchmark for sustainability disclosures to aid better decision-making in finance. The ISO 14000 environmental management standards enhance the IFRS S1 and S2 climate disclosure standards, ensuring robust data management and reporting. These standards are crucial for providing reliable information that helps manage climate risks and evaluate sustainability impacts effectively (54).

Box 1. Carbon Boarder Adjusted Mechanism (CBAM)

The CBAM is a policy tool, put in place in October 2023, which sets a carbon price on some of the products imported to the EU to prevent carbon leakage, while at the same time pushing producers outside the EU to switch to greener practices. From the point of view of WB economies, CBAM touches on their market access and competitiveness in exporting goods towards the EU, as this policy ensures that those exports meet rigid environmental standards within the EU. The EU Taxonomy and CBAM serve different purposes within the EU's overarching strategy to combat climate change, yet they are interconnected in promoting sustainable economic practices. While it applies directly only to importers of certain carbon-intensive products listed in Annex 1 of the CBAM proposal, it indirectly helps to promote the objectives of the EU Taxonomy in relation to lower-carbon production methods. This complementary relationship ensures that both mechanisms drive the transition towards a low-carbon economy, albeit through different approaches.

2.2. Sustainable finance practices in the WB

The alignment of the WB with the EU Taxonomy and international standards for sustainable finance is an important step in fostering sustainable finance across the region. For WB, aligning with the EU Taxonomy is not merely a regulatory compliance exercise but a strategic imperative to attract international investments, integrate into the broader European financial market and meet the global sustainability commitments. Moreover, adherence to international standards, such as those set by the IFRS and PRI, enhances the credibility and attractiveness of the region's financial systems.

This chapter examines the current uptake of sustainable finance practices and the state of alignment with the EU Taxonomy and other relevant international standards across WB. The analysis draws on literature review and stakeholder consultations (see Annex 2), provides a comprehensive overview of the WB's sustainable finance landscape and its readiness to meet international benchmarks.

The overall situation in the WB reveals several common issues related to sustainable finance taxonomy. Despite progress in certain areas, all economies face significant challenges in establishing and implementing comprehensive sustainable finance frameworks. Key issues include a general lack of awareness and understanding of sustainable finance principles among stakeholders, limited technical capacity and expertise and the absence of standardised taxonomies. These challenges lead to inconsistencies and fragmented practices in classifying sustainable activities. Furthermore, the relatively small market size in each economy limits the scale and impact of sustainable finance initiatives, making it difficult to attract international investors. The need for greater collaboration and regional cooperation is critical to avoid fragmented regulatory landscapes and ensure coordinated efforts towards adopting sustainable finance taxonomies. Addressing these issues requires targeted capacity building, development of clear regulatory frameworks and enhanced regional cooperation to align with EU standards and global best practices.

Box 2. The Eu4Green Project

The EU4Green project aims to foster sustainable finance in the Western Balkans by introducing the EU Taxonomy through practical case studies. Each economy, in collaboration with its Ministry of Finance and IPA coordinators, will select a specific project to apply the EU Taxonomy criteria, aiming to empower local stakeholders to independently utilise these standards. Additionally, the project organises regional workshops to enhance understanding of sustainable finance, focusing on EU Taxonomy and global best practices, thereby creating a common language for mobilising financial resources. Deliverables for this specific task include:

- Inventory of available educational activities on the EU Taxonomy;
- Series of workshops on sustainable finance;
- Development of a sustainable finance literacy roadmap;
- Overview of the application of the EU Taxonomy by donors;
- Reports and materials from workshops, webinars and training sessions;
- Climate risk management training sessions.

Companies that are subsidiaries or part of supply chains of large European companies can expect requests in the coming years to report the percentage of their revenue and investments that align with the EU Taxonomy. Starting in 2024, large EU banks will need to disclose the proportion of their portfolios invested in EU Taxonomy-aligned activities, including exposures to entities outside the EU, such as those in WB. Consequently, banks can anticipate increased reporting requirements on the percentage of funds allocated to sustainable activities.

During the project, a survey was conducted (see results in Annex 3) providing valuable insights despite its limitations. Sent to all 134 financial institutions in the region, only 20% FIs responded after considerable effort, including multiple follow-ups. A significant portion of institutions (88%) currently offer sustainable finance products, with an equal split between those offering multiple products and those with a few offerings. Nearly half of the institutions have implemented specific classification systems for green and sustainable activities, while over a third use a general framework. Energy efficiency and renewable energy initiatives are the top priorities, highlighted by 64% and 60% of respondents, respectively. The importance of sustainable finance is widely recognised, with 84% of institutions actively preparing for their increased role in the next 2-3 years.

However, the survey also identifies substantial barriers. The lack of a regulatory framework and clear definitions and standards are the main challenges, cited by 76% and 60% of institutions, respectively. To overcome these barriers, the most requested forms of support are financial incentives or subsidies (56%) and regulatory guidance (40%). These findings underscore the proactive stance of many institutions towards sustainable finance while highlighting the need for targeted regulatory and financial support to foster a robust sustainable finance ecosystem in the WB region.

2.2.1. Albania

Status of sustainable finance

The UN Joint Programme Strategic Policy Options for SDG Financing aims to support SDG financing in Albania. Working in close collaboration with the Government of Albania, the Programme seeks to expand institutional capacities for developing feasible solutions and identifying fiscal space to progressively increase those SDG-related and integrate these in the budgetary framework (55).

Since July 2017, the Bank of Albania (BoA) has been part of the Global Sustainable Development Resolution, highlighting the importance of the financial sector in fulfilling the Principles of the UN SDGs and the projects of the Paris Agreement (COP21). In December 2020, the BoA joined the Central Banks and Supervisory Networks for Greening the Financial System (NGFS), emphasizing the "green" content (56). The Government of Albania plays a crucial role in leading environmental policies, while the private sector is seen as a vital partner in achieving sustainable finance goals. The BoA acknowledges that the government and public sector alone cannot meet the commitments of the Paris Agreement without active private sector involvement. The Government of Albania has implemented several incentives, particularly in agriculture and energy, to promote sustainable investments. The BoA is also exploring ways to involve the private sector more effectively through its green finance initiatives.

The BoA has established a high-level working group dedicated to sustainable finance, which includes representatives of all departments. This group contributed to the medium-term green finance strategy in collaboration with WBG (FinSAC). The strategy, which spans from 2023 to 2025, emphasizes managing climate risks within the banking sector. It outlines clear action plans, timelines, tasks and departmental responsibilities. The strategy also includes the development of a green dashboard to identify and bridge data gaps related to climate finance.

Data collection is a critical component of Albania's sustainable finance strategy. The BoA has upgraded its credit register to capture more detailed industry information, which now includes a four-digit classification of new loans. This enhanced data collection is aimed at integrating real economy data with climate data and financial sector data to assess sectors most exposed to climate risks. The BoA is also conducting surveys with the private sector to gather granular data. The BoA's collaboration with international organisations like the IMF, NGFS and the Sustainable Finance and Banking Network (SBFN) further supports this initiative.

The 2023-2027 Financial Supervisory Authority of Albania (FSAA) Strategy includes priority actions with green/sustainable financing aspects. The development of green financing and harmonisation with EU practices in green finance are considered substantial developments for a sustainable economy and financial system. The challenge of the FSAA's work is the integration of ESG factors for sustainable investments, thus enhancing literacy and awareness of the Albanian investor to orient respective decision-making towards green financial products. Pursuant to the action plan for sustainable finance, in line with EU practices (i.e. EU Green Bond Standard), FSAA aims to establish a standard for green bonds issuance (57). The BoA is also cooperating with international institutions, such as the WBG and IMF, to further integrate green/sustainable finance aspects in its regulatory framework (13).

Albania plans to incorporate sustainable considerations in its disclosure regime for both non-financial and financial companies in order to improve the availability of reliable data on banks' credit risk exposures and, therefore, fully implement the BoA's Medium-Term Strategy on the management and supervision of climate-related financial risks in the banking sector (13).

Association of Banks of Albania (AAB) organises conferences, forums, and training related to ESG and sustainability:

- AAB collaborated with Sparkassenstiftung from Germany in organising two workshops on Green Finance, which were attended by 56 bank representatives,
- Conference "Banks for sustainable development"

One of the main challenges identified is the lack of specific data and the need for more granular data collection. There is also a need for technical assistance in developing a taxonomy and providing training to stakeholders. Additionally, raising awareness about climate change and building capacity within FIs are essential steps towards effective sustainable finance implementation.

Status of development of a taxonomy

Tools and methodologies for climate risk measurement in Albania are still being developed, facing several analytical challenges. Currently, there is no uniform system for classifying business activities based on their environmental impact. Therefore, it is crucial to work with the government to develop a green taxonomy. Supervisors need capacity building on these new methods to make good policy decisions (56).

The lack of climate data from customers hampers the ability of both supervisors and FIs to assess climate risks accurately. The BoA aims to support FIs in developing the necessary data infrastructure for measuring these risks. FIs in Albania are in the early stages of classifying green and sustainable activities, primarily relying on the BoA's guidelines and the green dashboard for identifying and bridging data gaps (56).

Albanian FIs are just starting to classify green and sustainable activities. They rely on the BoA's guidelines, which include a green dashboard to identify and fill data gaps related to climate finance. This dashboard helps categorise activities based on their environmental impact. However, not all FIs are implementing these standards equally. Larger banks with EU-based parent companies are more advanced in integrating these principles, while smaller and local FIs are still catching up. Some FIs, especially those with EU headquarters, have developed their own guidelines to identify green activities.

The BoA uses a system based on Battiston et al. (2017) to classify economic activities that are relevant to climate policy. These activities could be affected by climate policy changes. One goal of the FSAA Strategy is to create a unified classification system following EU practices, involving the development of taxonomy regulations for green activities (56) (57).

Some of the identified challenges faced by stakeholders in Albania in adopting the EU Taxonomy include:

- General lack of awareness about the EU Taxonomy and its implications
- Lack of technical expertise and resources needed to implement the detailed requirements of the EU Taxonomy
- Limited data availability and granularity
- Insufficient technical expertise and resources
- Incomplete integration of sustainability principles across FIs

Despite these challenges, Albania is dedicated to aligning with the EU Taxonomy Regulation. The green finance strategy aims to incorporate EU sustainable finance directives, demonstrating willingness to implement the EU taxonomy. This includes adopting the EU taxonomy's classification criteria and integrating its principles into the governance and risk management frameworks of FIs.

Outlook

Looking ahead, the focus will be on building institutional capacities and raising awareness among stakeholders to facilitate the seamless integration of sustainability principles across all sectors. The BoA and FSAA are expected to continue their collaborative efforts with international organisations like the IMF and WBG to provide technical assistance and training. These efforts will be essential in addressing the current challenges related to data availability and technical expertise. As Albania progresses towards EU accession, the commitment to implementing the EU Taxonomy will drive further enhancements in governance and risk management frameworks.

To integrate climate change efforts effectively, the BoA plans to establish internal networks, hubs, domestic expert forums, or dedicated units within its organisational structure. The BoA will evaluate and compare existing sustainability governance practices in other central banks, exploring options like forming green/sustainability committees or setting up specialised green centres. Additionally, it plans to raise awareness of climate risks and build capacity both within the central bank and among FIs under its mandate through "in-house" training, conferences, roundtables and campaigns (56).

The BoA will implement sustainability indicators via the NGFS Green Dashboard to monitor financial stability, conduct regular corporate surveys on green practices, issue principle-based climate risk guidelines for supervisory discussions and hold frequent roundtables with licensed institutions to address green finance challenges and raise awareness (56).

2.2.2. Bosnia and Herzegovina

Status of sustainable finance

Sustainable finance in Bosnia and Herzegovina has gained momentum over the past decade, driven by the need to address climate change and align with international commitments like the Paris Climate Agreement and the UN SDGs. This has led to an increase in availability of green financial products offered by both domestic and international FIs, targeting sectors such as energy efficiency (EE), renewable energy sources (RES) and sustainable agriculture. However, despite high liquidity in Bosnia and Herzegovina's financial sector, green finance efforts are primarily directed at individuals and public institutions, with EE measures being the most common. The private sector's green finance offerings remain modest, with commercial banks often adopting ESG policies due to group-level mandates (those with headquarters in the EU), resulting in a negligible share of green financial products (less than 2% in 2021) for the private sector. International Financing Institutions (IFIs) play a crucial role by financing the public sector through partner institutions, with limited direct investments in private companies (58).

Efforts towards establishing a sustainable finance framework are fragmented and primarily driven by international organisations like the WBG through educational seminars and the PULSAR[1] programme which focuses on government obligations related to sustainability. Currently, there is limited coordination between the Ministry of Finance and Treasury (MFT) of Bosnia and Herzegovina and entity-level financial bodies regarding sustainable finance projects. The development and enforcement of a domestic taxonomy will require significant collaboration across various government levels and sectors. Additionally, a lack of data and administrative capacity to manage and report on sustainable financial activities remains a major challenge.

However, the uptake of sustainable finance has seen gradual progress, driven primarily by regulatory frameworks and initiatives aimed at integrating ESG criteria into the financial sector. The Central Bank of Bosnia and Herzegovina (CBBH) has outlined several strategic goals to enhance financial stability and inclusion, which align indirectly with the principles of sustainable finance. The CBBH's strategic plan highlights the importance of aligning with EU and international standards to enhance the quality and timeliness of official statistics related to financial stability and economic developments (59).

Bosnia and Herzegovina currently lacks a comprehensive regulatory framework specifically tailored to sustainable finance. The topic of sustainable finance and taxonomy is considered relatively new. Currently, Bosnia and Herzegovina does not have specific laws addressing ESG factors. The concept of ESG is gradually being introduced through educational initiatives and seminars organised by international organisations such as the WBG.

In the financial sector, some banks have developed specific guidelines for green lending and collaborate with entities like the EBRD on sustainable finance initiatives. These products primarily focus on EE and RES, with a strong emphasis on the social component, especially targeting small and medium-sized enterprise (SMEs) and women entrepreneurs. However, FIs are still developing the necessary tools and processes to support sustainable finance effectively. The maturity of the market is hindered by the lack of a coherent regulatory framework and standardised methodologies for reporting and compliance.

The MFT of Bosnia and Herzegovina, along with entity-level ministries of finance, plays an important role in shaping sustainable finance policies in Bosnia and Herzegovina. However, these institutions are still in the early stages of integrating sustainable finance into their regulatory frameworks. Collaboration with international organisations like the EC is crucial for capacity building and policy development.

Awareness and engagement among stakeholders, including banks, corporations and investors, vary significantly. While some FIs are proactive in developing sustainable finance products, there is a general lack of understanding and expertise in the broader market. Stakeholders generally perceive sustainable finance as beneficial, especially in terms of aligning with EU standards and enhancing competitiveness. However, they also highlight challenges such as regulatory uncertainty, lack of expertise and the need for significant investment in capacity building.

Bosnia and Herzegovina faces several challenges in aligning with EU sustainable finance regulations. These include:

- The absence of clear regulations and guidelines hampers the development and implementation of sustainable finance practices;

1 Public Sector Accounting and Reporting Programme

- There is no established taxonomy for sustainable finance, making alignment with the EU Taxonomy difficult;
- Access to high-quality ESG data from clients is limited, complicating the assessment and management of ESG risks;
- There is a significant knowledge gap among stakeholders regarding sustainable finance principles and practices;
- The relatively small market size limits the scale and impact of sustainable finance initiatives.

Policymakers and FIs are beginning to address these barriers through educational programmes, development of internal guidelines and collaboration with international organisations. There is a need for more robust regulatory frameworks and dedicated institutions to support the transition.

Status of development of a taxonomy

The Banking Agency of the Federation of Bosnia and Herzegovina (FBA) outlines strategic priorities for managing and overseeing climate-related and environmental risks in the banking sector in the entity of the Federation of Bosnia and Herzegovina for the period 2023-2025. A key focus is supporting the development of a green taxonomy. The EU Taxonomy, recognised as the global standard, serves as a primary reference point (60). A Decision by the FBA mandates banks to incorporate ESG criteria into their decision-making processes. This includes the introduction of green products specifically designed to finance environmentally friendly projects, such as EE improvements and investments in RES (61). The FBA officially states that defining a green taxonomy is beyond its authority and recommended that FIs individually develop their own taxonomies in alignment with international standards to enhance the efficiency and effectiveness of green financing (62).

The Banking Agency of Republika Srpska (BARS) has taken some steps to manage and supervise risks associated with climate change and environmental factors within the banking sector. The Agency emphasizes the importance of aligning with EU regulations and proactively addressing climate risks and sets the foundation for developing future regulatory and supervisory requirements for assessing, managing and controlling climate risks faced by banks in the entity of Republika Srpska (63). BARS's guidelines emphasize the importance of integrating climate and environmental risks into the banking sector's risk management frameworks. In terms of taxonomy, the document outlines the necessity of developing a classification system that identifies sustainable economic activities. The guidelines encourage banks to adopt international best practices and standards (64).

In practice, FIs classify green and sustainable activities using internally developed guidelines. These classifications primarily focus on EE, RES projects and some social components. Some FIs use specific criteria for green lending, including EE mortgages, green transportation and RES financing. The classification methods are often based on best practices of international partners and align with internal policies rather than a taxonomy.

The extent to which FIs in Bosnia and Herzegovina align with the EU Taxonomy Regulation varies significantly. Institutions with international affiliations strive to align closely with EU standards due to obligations at the group level. However, smaller local banks face challenges in alignment due to limited resources and expertise. Overall, there is an emerging trend towards adopting EU-aligned practices, but comprehensive alignment remains a work in progress. Moreover, divergences occur in sectors where local regulations or market conditions differ from EU standards, e.g. the application of green criteria in industries heavily dependent on local economic factors may not fully align with EU definitions of sustainability.

FIs in Bosnia and Herzegovina face several challenges in adopting the EU Taxonomy.

- General lack of awareness and understanding of the EU Taxonomy among local stakeholders.
- Limited technical capacity and expertise hinder effective implementation and compliance.
- The absence of a taxonomy creates inconsistencies in adoption.
- FIs fear that the taxonomy development will follow a "copy/paste" approach, with limited or without any adaptation to local conditions.

Raising awareness and building capacity are critical for successful adoption of EU Taxonomy. Many FIs struggle with understanding the detailed requirements and implications of the taxonomy. Additionally, the regulatory environment in Bosnia and Herzegovina is not yet conducive to full alignment, necessitating significant efforts in policy development and stakeholder education.

Compared to global best practices, FIs in Bosnia and Herzegovina are in the early stages of adopting comprehensive sustainable finance frameworks. Globally, leading FIs implement rigorous ESG criteria, robust reporting mechanisms and advanced data analytics to assess sustainability. In contrast, FIs in Bosnia and Herzegovina are still developing basic frameworks and tools, indicating a substantial gap in practices.

Outlook

The outlook for sustainable finance in Bosnia and Herzegovina is cautiously optimistic. Continued efforts to align with EU standards and international best practices are expected to drive significant progress. Key to this will be development and implementation of an economy-level taxonomy, which will require concerted collaboration among government bodies, FIs and international organisations. The increasing awareness and gradual adoption of ESG principles indicate a positive trend, but substantial challenges remain, including regulatory gaps, limited expertise and the need for comprehensive data management systems.

While there are initiatives in place, the comprehensive adoption and adaptation of the EU Taxonomy into domestic regulations are limited. Bosnia and Herzegovina faces several challenges in aligning with EU sustainable finance regulations. One of the primary obstacles is the lack of existing frameworks and capacity building of stakeholders to fully integrate ESG criteria and the EU Taxonomy. Moreover, there is a gap in awareness and understanding of sustainable finance principles. Regulatory differences and the need for harmonisation with EU standards also pose significant challenges.

Looking forward, initiatives such as the strategic goals outlined by the CBBH to enhance financial stability and inclusion will indirectly support the growth of sustainable finance. In 2024, the CBBH submitted an application for membership in the NGFS. Furthermore, partnerships with institutions like the WBG and EBRD are expected to play a crucial role in providing the necessary expertise and financial support. As the market matures and regulatory frameworks evolve, Bosnia and Herzegovina has the potential to significantly expand its sustainable finance sector, contributing to both economic development and environmental sustainability.

2.2.3. Kosovo*

Status of sustainable finance

Currently, Kosovo* lacks advanced sustainable finance products such as green bonds or dedicated ESG funds. However, there are mechanisms like the Kosovo* Credit Guarantee Fund, which supports businesses in EE and sustainable agriculture. The MoF is key in shaping sustainable finance policies in Kosovo*. It collaborates with other ministries, including the Ministry of Trade and Industry and the Ministry of Economy to develop and implement relevant laws and policies. International donors, mainly the European Commission and WBG, also play a significant role in providing financial and technical support. This support includes policy-based loans and technical assistance aimed at enhancing sustainable finance frameworks. However, Kosovo* needs to improve its coordination and cooperation with international bodies to fully leverage best practices and drive sustainable finance forward.

In the fall of 2023, Kosovo* Assembly approved the Law on Sustainable Investment, aimed at creating a comprehensive legal framework to protect, promote and encourage sustainable investments. This new law will replace and consolidate the existing laws on foreign and strategic investments. Its objectives include attracting investments, removing legal and administrative barriers and establishing screening mechanisms to ensure compliance with public interest, partially transposing the EU Regulation 2019/452. Priority sectors for investment under this law include manufacturing, agriculture, ICT, education, research, health, tourism, waste administration, transport, energy and mining. The law also establishes the Agency for Investment and Export (AIE) and the Agency for Support to Enterprises in Kosovo* (ASEK), terminating the previous investment promotion agency, KIESA. However, at the time this report was written the law's implementation is pending a decision from the Constitutional Court, following a request for a constitutional review by several parliament members.

WBG's FinSAC has been important in providing technical assistance, focusing on financial stability reforms, capacity building and aligning with international standards. A notable project in Kosovo* involves supporting the Central Bank of Kosovo* (CBK) efforts in green finance, bank resolution and risk-based supervision. Key activities included developing a Climate Risk Strategy, enhancing risk-based supervision methodologies and building capacity for climate-related risk management. Although bank resolution work was postponed due to structural changes at the CBK, FinSAC's efforts have significantly advanced Kosovo*'s regulatory and supervisory frameworks, with further assistance anticipated in 2024 (65).

The private sector, particularly FIs, is increasingly open to adopting sustainable finance practices. However, there is a recognised need for further capacity building and knowledge sharing to enhance understanding and implementation of sustainable finance initiatives across all sectors. Key barriers to the growth of sustainable finance in Kosovo* include:

- a lack awareness and expertise,
- inadequate data availability,
- limited market size.

To address these issues, policymakers and FIs are focusing on capacity building, improving regulatory frameworks and enhancing cooperation with international organisations. Efforts are also being made to increase awareness and engagement among stakeholders.

Kosovo* should conduct further work to incorporate sustainable considerations in both banking and non-banking strategic policies and objectives and implement a regulatory financial framework supporting private investments towards sustainable and green activities. As part of the Climate Promise project, the UN Development Programme (UNDP) in Kosovo* supported the Ministry of Economy and Ministry of Environment, Spatial Planning and Infrastructure (MESPI) in designing EE Policies and Measures, a Circular Economy Roadmap and developing thematic policy briefs in the climate sector. Additionally, UNDP in Kosovo* initiated partnerships with local CSOs to develop environmental misconduct reporting tools and conduct training, aimed at identifying environmental risk areas (66).

Kosovo* Banking Association (KBA) contributes to education on these topics through various training and seminars such as RES and EE financing, green economy and green finance and international reporting standards. Additionally, the topic of sustainable financing is addressed within the pages of The Kosovo* Banker journal.

Although Kosovo* is not a signatory to Agenda 2030 and the SDGs at the UN General Assembly it has chosen to participate in global efforts to embrace sustainable development and the SDGs. The implementation of Agenda 2030 and SDGs, though voluntary, is assured through the Kosovo* Assembly's adoption of a parliamentary resolution in January 2018 endorsing the SDGs (67).

Status of development of a taxonomy

FIs are progressively integrating green and sustainable activities into their frameworks. The CBK has been at the forefront, encouraging FIs to incorporate ESG factors into their planning and governance. Efforts have included surveying banks on their climate risk management practices and developing strategies to embed these risks within the supervisory framework. However, the classification methods for green and sustainable activities are not yet standardised across all FIs, leading to varying approaches. Compared to global best practices, Kosovo*'s FIs are in the early stages of developing sustainable finance frameworks.

While there is a strong intention to align with EU standards, the practical implementation is gradual and uneven. The CKB's efforts to align with the EU's Sustainable Finance Regulations have led to the development of preliminary strategies and roadmaps. Moreover, the document "Strategy for industrial development and business support 2030 – Industrial Policy" foresees the adoption of the EU taxonomy and lists Kosovo*'s Agency of Statistics as responsible institution. However, full compliance and integration remain in progress.

The CBK Strategic Plan 2024-2028 focuses on advancing the regulatory and supervisory framework for FIs, while supporting sustainable economic development in Kosovo*. Specific objectives include implementing ESG principles in the operations of the CBK, capacity building, digitalisation, modernising processes, establishing an advisory group of external experts and coordination and support for initiatives in the field of ESG (68). The Climate Change Strategy 2018-2027 sets out the policies for reducing greenhouse gas emissions and adaptation to climate change. It is in line with the strategic priorities of the Government of Kosovo* (69).

The Resilience and Sustainability Facility (RSF) programme supports the implementation of energy and climate reform agenda. RSF financing has expanded fiscal space to implement actions aimed at increasing the share of renewables and protecting vulnerable energy consumers (70).

Outlook

The recent approval of the Law on Sustainable Investment is an important step towards creating a legal framework to promote and protect sustainable investments. The CBK will continue to play an important role in advancing sustainable finance initiatives. Its Strategic Plan for 2024-2028 includes key goals like integrating ESG principles into financial operations, improving regulatory and supervisory frameworks and building institutional capacity. These efforts aim to align Kosovo*'s financial practices more closely with EU standards, encouraging more investment and participation in the green economy. Additionally, developing a comprehensive Climate Risk Strategy and adopting risk-based supervision methods will make the financial sector stronger and more sustainable.

The CBK, with help from the WBG, is creating a strategy to manage climate and environmental risks. This 2024-2026 Strategy will include:

- A "green table" to evaluate economic indicators of the green economy in Kosovo*;
- Standards for the banking sector to identify, manage, control and report climate risks;
- A framework for reporting banks' exposure to climate and environmental risks;
- Macroprudential stress tests for climate change risks;
- A methodology for assessing climate risks and fully integrating them into CBK's supervisory activities (71).

Private sector involvement is expected to grow as awareness increases and the financial benefits of sustainable investments become clearer. Kosovo*'s Banking Association (KBA) and other groups need to enhance their efforts to educate and train financial institutions on sustainable finance principles and practices. This will help the private sector to contribute to and benefit from developing sustainable finance ecosystem.

Developing microfinance, insurance and secondary markets, along with focusing on mixed financing and public-private partnerships, will help the government move from budget financing to diversified funding sources. This approach is essential for financing the goals of the National Development Strategy (NDS) and SDGs, ensuring that European integration becomes more than just a political success.

Building capacity and sharing knowledge are crucial for the widespread adoption of sustainable finance practices. Ongoing support from international organisations, including WBG and the EU, will be vital for providing the necessary technical assistance and funding to fill the gaps in expertise and infrastructure. Programmes like the Resilience and Sustainability Facility will continue to expand fiscal space, enabling Kosovo* to implement energy and climate reforms effectively (72).

2.2.4. Montenegro

Status of sustainable finance

Montenegro's commitment to sustainable and green finance is evident in its National Strategy for Sustainable Development by 2030, which emphasizes integration of environmental considerations into financial systems to support sustainable development. This approach aims to ensure that economic growth does not come at the expense of natural resources, promoting a balance between economic, social and environmental sustainability. By prioritising green finance, Montenegro seeks to enhance its ecological footprint management and foster sustainable economic practices that align with the global goals of the UN 2030 Agenda for Sustainable Development (73).

Montenegro has made strides towards integrating sustainable finance into its financial system, primarily driven by the Central Bank of Montenegro (CBM). While specific laws or guidelines related to ESG factors are still being developed, the green agenda and sustainability aspects are currently prioritised. The CBM has initiated the creation of a Sustainable Finance Roadmap, focusing on mapping and determining the extent of necessary work, which includes developing a taxonomy for sustainable activities.

A study on climate change related to the banking sector in Montenegro highlights that extreme weather events, driven by climate change, significantly affect macroeconomic variables in Montenegro, such as inflation, industrial production and unemployment rates. The research underscores the necessity of integrating robust climate risk assessments and sustainability measures into financial and economic planning to mitigate adverse effects on key sectors, including energy production and agriculture. The study recognised the importance of development of a taxonomy for economic activities. Institutions are expected to incorporate climate and environmental risks clearly into their risk appetite frameworks, thereby enhancing their resilience and risk management practices (74).

The CBM's 2022 Annual Report highlights progress in sustainable finance initiatives.[2] The report emphasizes the importance of integrating international standards and best practices into the local financial system to enhance its resilience and sustainability. The CBM has actively engaged in promoting ESG considerations within the banking sector, aligning with broader EU directives and international frameworks. In collaboration with international organisations like the IMF and WBG, Montenegro is working to build capacity and raise awareness among FIs regarding sustainable finance practices (33).

In March 2022, the CBM adopted a policy to reduce the adverse climate change impact on the financial system and on greening the financial system (75). In December 2022, according to the CBM Policy Related to the Climate Change Challenges, CBM adopted the Action Plan for their implementation in the period 2023 - 2025. Depending on the goals to be achieved in relation to climate change challenges, the Action Plan groups CBM activities in two segments, those being: a) activities aimed at strengthening the resilience of credit institutions and other financial service providers to climate change, and b) activities aimed at strengthening the resilience of CBM to climate change whilst achieving carbon neutrality.

The CBM aims to promote the green economy by integrating sustainability criteria into its policies and encouraging development of green financial products. It also emphasizes the importance of credit institutions identifying and managing climate risks. The CBM will join international organisations focused on green finance, develop analytical capacities to understand and monitor climate risks and support the transition to renewable energy sources (76). In October 2022, the CBM has become a member of the NGFS and in May 2024 it joined the IFC-facilitated SBFN.

Currently, the sustainable finance products and services available in Montenegro include primarily green loans. The Investment and Development Fund of Montenegro offers credit lines for green financing, supported by EIB and French Development Agency (AFD). These initiatives primarily target projects in RES and green economy sectors.

Montenegro faces several challenges in aligning with EU sustainable finance regulations, including:

- Need for capacity building and expertise in sustainable finance;
- Requirement for better coordination among institutions and international partners;
- Lack of a taxonomy.

Key institutions shaping sustainable finance policies in Montenegro are the CBM, Ministry of Economy and MoF. The CBM is spearheading the development of sustainable finance frameworks, including the taxonomy (in terms of advocacy), while the Ministry of Economy handles broader economic policies and initiatives. On the other hand, MoF does not consider development of a taxonomy as a short-term priority (next 1-2 years), but certainly in the medium to long run. Collaboration with international bodies, such as the IFC, EBRD and UNDP, is crucial for advancing these efforts.

2 At the moment of drafting this report (May 2024), the 2023 annual report was not published.

Stakeholders emphasize the need for broader education and mindset shifts to view sustainable finance as an opportunity for economic transformation. They recognise the potential benefits of sustainable finance, including economic transformation, improved environmental outcomes and alignment with international best practices. However, challenges such as inadequate data availability, lack of expertise and the complexity of integrating climate risks into decision-making processes pose significant barriers.

The introduction of sustainable finance practices in Montenegro is expected to positively impact the financial market and broader economy by promoting green investments and aligning with international standards. However, the current state of the market and the need for substantial capacity building present challenges that must be addressed to reap these benefits fully.

Status of development of a taxonomy

Although there is no taxonomy for defining sustainable financial activities yet, Montenegro is putting efforts to align with international standards. The CBM, in collaboration with other institutions, is working towards adopting the IFC methodology and toolkit for this purpose. It underscores the importance of clearly defining and effectively communicating the taxonomy, highlighting the need for external expertise and technical assistance from partners such as EBRD, GIZ and UNDP.

Currently, FIs classify green and sustainable activities primarily based on international guidelines and frameworks. These guidelines help in identifying and classifying projects related mostly to RES and EE. For example, projects financed through international credit lines often follow the sustainability criteria set by international organisations (e.g. EBRD, GGF), which are generally in line with EU standards.

The extent to which FIs in Montenegro align with the EU Taxonomy Regulation is currently limited. Stakeholders acknowledge the need to develop a taxonomy that aligns with the EU Taxonomy. However, this process is still in its initial stages, with the CBM focusing on creating a Sustainable Finance Roadmap that will eventually lead to development of a comprehensive taxonomy.

Outlook

As the CBM continues to align with international standards, including the EU Taxonomy Regulation, the establishment of a Sustainable Finance Roadmap will play a pivotal role in shaping Montenegro's sustainable finance landscape. Enhanced collaboration with IFC, EBRD and UNDP is expected to provide the necessary expertise and technical assistance to build relevant frameworks and policies.

Montenegro's future plans for promoting sustainable finance include:

- Finalising and implementing the Sustainable Finance Roadmap;
- Enhancing stakeholder engagement and capacity building;
- Strengthening regional collaboration and knowledge sharing;
- Developing and adopting a taxonomy for sustainable activities;

Montenegro's focus on integrating sustainability criteria into financial practices will likely foster a more resilient and environmentally conscious financial sector. The ongoing efforts to develop a taxonomy, coupled with increased stakeholder engagement and capacity building initiatives, are set to drive significant progress. The anticipated positive impacts on the financial market and broader economy, through green investments and improved alignment with global best practices, underscore the potential for Montenegro to emerge as a regional leader in sustainable finance. However, addressing challenges such as capacity constraints and regulatory alignment remains crucial to fully reaping these benefits.

2.2.5. North Macedonia

Status of sustainable finance

North Macedonia has made some steps in aligning with EU regulations and guidelines for sustainable finance. The MoF, Central Bank of North Macedonia (CBNM) and Stock Exchange of North Macedonia play important roles in shaping sustainable finance policies. These institutions are responsible for drafting and implementing regulations, providing guidelines and ensuring compliance with EU standards. The primary regulatory body, the CBNM, has issued guidelines for managing climate-related risks, which are based on standards of the European Central Bank, European Banking Authority and Basel Committee. These guidelines are currently voluntary, but there are plans to incorporate them into local laws in the future, following practices in the EU regarding risk management requirements. The new Corporate Governance Code of Stock Exchange of North Macedonia was developed together with the Securities and Exchange Commission of the North Macedonia. This new Code, besides other reporting requirements, requires the biggest and most liquid listed companies to report on environmental and social issues based on the principle of transparency and in accordance with relevant legal requirements and good international practices. Additionally, the Stock Exchange of North Macedonia has implemented ESG guidelines that listed companies must follow, although these are also not mandatory. The ESG Reporting Guide, in addition to general guidelines for listed companies on the subject matter, is also designed as a specific tool for listed companies that will aim to be fully compliant with the new Corporate Governance Code.

The CBNM has conducted:

- Preliminary assessment of banking sector exposure to transition risks (identification of climate policy sensitive sectors, approach, main challenges);
- Preliminary assessment of banking sector exposure to physical risks (including the assessment of impact of these risks on the value of the banks collateral);

The CBNM has adopted a new Regulation on disclosure, including regulatory requirement on ESG disclosure by banks, applicable from January 2026.

The CBNM has developed a comprehensive mid-term plan (2023-2025) aimed at embedding climate risks into financial analyses and improving the resilience of banking sector. The plan includes introduction of guidelines for climate risk management, stress testing and data collection on green financing. North Macedonia has also aligned itself with international initiatives like the Paris Agreement and the European Green Deal, highlighting a robust regulatory framework and international collaboration to support sustainable finance (77). As part of the CBNM's Strategy for the management of climate-related risks, North Macedonia adopted a Decision on the methodology for credit risk management in February 2023, according to which banks are expected to adequately incorporate the climate-related risks in their credit risk management from January 2025 (39).

In addition, the CBNM published a Green Dashboard that provides a structured framework for reviewing green indicators, covering three main groups: Environment and Energy, Climate Risks and Green Finance, to support informed decision-making to promote sustainable finance and green investments. A Methodological Guide with clarifications and definitions of the indicators was also developed and published, and it is available on CBNM's website.

A survey of FIs in North Macedonia reveals that approximately 90% of FIs recognise climate change as a significant risk to financial stability, yet 87% of banks have not established internal climate risk management policies. Less than half of FIs have introduced new green financial products, primarily through partnerships with the EBRD. Major challenges include the absence of regulatory guidelines, lack of standards and tools and inadequate data. The survey underscores the need for more detailed regulatory frameworks and capacity building to align with EU standards and effectively manage climate risks (78).

The MoF, in collaboration with other regulatory bodies, is reviewing and adapting various EU directives and regulations related to ESG factors. Despite recent elections causing some delays, there is a clear intention to align laws with EU directives, particularly those related to climate risk management and ESG reporting.

North Macedonia collaborates extensively with IFIs such as the EBRD and EIB, which provide technical assistance, funding and expertise to help align with EU regulations and implement best practices in sustainable finance. There is also a focus on learning through regional cooperation and knowledge sharing. North Macedonia's financial sector offers several sustainable finance products, including:

1. Green bonds – supported by the Development Bank of North Macedonia, which provides loans for EE and RES projects;
2. Green loans – offered in collaboration with IFIs like the EBRD, EIB and others.

Despite significant growth, the share of green loans is at a very low level. Over the period 2019-2023, it increased from 2.2% to 4.5%. As of 30 September 2023, the share of green loans in the total loans to non-financial entities in North Macedonia was very low. Green loans specifically to non-financial entities accounted for 8.8%, while green loans to households represented a much smaller share, at only 0.5% of their total loans. Although green lending increased by 2.1% compared to 31 December 2022, its overall presence in the banks' loan portfolios remains limited (79).

North Macedonia raised approximately EUR 10 million from a green bond auction (0.4% of total bonds issued in 2023), aimed at supporting projects through the Energy Efficiency Fund within the Development Bank of North Macedonia. The proceeds from these green bonds will be utilised to finance projects that improve EE and promote RES (80).

While there is a clear awareness among larger companies, especially those involved in exports to the EU, about the importance of sustainable finance, smaller companies still face challenges in adopting these practices. There is a consensus on the need for further capacity building and knowledge sharing to enhance market maturity. Generally, stakeholders recognise several benefits of sustainable finance such as access to favourable loan terms, enhanced reputation and compliance with international standards. However, challenges such as knowledge gaps, complexity of reporting and the need for a taxonomy are significant barriers. Addressing these challenges requires targeted training, capacity building and regulatory support.

Status of development of a taxonomy

Currently, North Macedonia does not have a green taxonomy, the absence of which is one of the main challenges in aligning with EU sustainable finance regulations. Developing such a taxonomy requires collaboration among various stakeholders, including the MoF, CBNM and Ministry of Economy.

Banks are encouraged to establish internal classifications, considering international classifications and principles, including the EU Taxonomy. The challenge lies in determining the level at which classification will be applied—whether based on the client's activity, client's characteristics or specific assets. FIs are expected to play a crucial role in achieving climate and sustainability goals. Banks are encouraged to develop transition plans aligned with their business strategies and to establish long-term key performance indicators for monitoring exposure to climate-related risks (81).

FIs classify green and sustainable activities based on a combination of international guidelines and local practices. The CBNM has published guidelines for climate risk management, which FIs use to assess and report on ESG factors. In this effort, FIs primarily rely on the EU Taxonomy and guidelines from EBRD and EIB. This results in a fragmented approach where FIs use different classification systems depending on the source of their funding or the regulatory requirements of specific projects.

Adopting the EU Taxonomy presents several challenges for FIs in North Macedonia:

- There is still a general lack of awareness among, especially, smaller FIs and companies about the EU Taxonomy and its implications;
- Many FIs lack the necessary expertise and resources to fully implement the detailed requirements of the EU Taxonomy;
- The absence of a taxonomy and clear regulatory guidance makes it difficult for FIs to uniformly apply the EU Taxonomy;
- Collecting the necessary data to comply with the EU Taxonomy's requirements is a significant hurdle for many institutions.

Outlook

North Macedonia is poised to enhance its regulatory frameworks to better align with EU sustainable finance directives. The planned incorporation of voluntary guidelines into binding laws will strengthen the management of climate-related risks. This shift will require robust monitoring and enforcement mechanisms to ensure compliance, fostering a more resilient financial sector. Initiatives such as the issuance of green bonds will likely expand, providing more financing options for EE and RES projects.

The creation of an economy-level green taxonomy aligned with the EU Taxonomy is essential. Supporting SMEs in their green transition will be a focus, as they will benefit from tailored financial products and technical support to adopt sustainable practices.

Regional collaboration will play an important role, i.e. learning from others that have successfully implemented sustainable finance practices will help North Macedonia overcome current challenges. This collaboration can include joint training programmes, shared regulatory frameworks and coordinated efforts to attract international green investment. Efforts to educate the financial sector, public administration, general public, businesses and investors about the benefits and opportunities of sustainable finance can foster a culture of sustainability and drive demand for green financial products.

2.2.6. Serbia

Status of sustainable finance

The document regarding Serbia's sustainable finance framework outlines the commitment of this economy to sustainable development, focusing on ESG policies. It details Serbia's strategies to achieve the UN SDGs, support global decarbonisation and promote social inclusion. The framework serves as a guide for issuing Green, Social and Sustainable Finance Instruments to raise funds from international capital markets (82).

The Green Bond Framework enables sustainable finance in Serbia by establishing a comprehensive structure for issuing green bonds, which align with international standards. This framework ensures that the funds raised are allocated to eligible green projects. It supports various sectors such as renewable energy, energy efficiency, sustainable water management and pollution prevention (83). In August 2021, the Government of Serbia adopted its first sovereign green bond framework, detailing the process for defining, selecting and reporting eligible green expenditures and envisioning a sustainable economy of Serbia. A month later, Serbia issued its first green bond in international markets, raising EUR 1 billion with a 1% annual coupon rate (84). The Central Bank of Serbia (CBS) is developing guidelines for issuers of green bond and there is ongoing collaboration with UNDP to develop frameworks for these financial instruments.

The Law on Accounting in Serbia (Official Gazette of Serbia, No 73/2019 and 44/2021) plays an important role in promoting sustainable finance by mandating comprehensive financial and non-financial reporting standards. It stipulates some legal entities (around 200) to adhere to stringent accounting and reporting practices. Additionally, the law requires the disclosure of non-financial information related to ESG factors, thereby encouraging companies to adopt sustainable practices. The CBS conducted a survey targeting around 200 companies to assess their compliance with EU standards on sustainability reporting. Some large enterprises, especially those with significant interactions with EU markets, demonstrated high compliance and advanced reporting practices (about 10%). A considerable number of companies were found to be struggling with compliance (about 30%), indicating a need for further support and training. The remaining part (about 60%) have significant difficulties understanding and implementing the requirements. The MoF is working with WBG and UNPD on providing additional guidance and training to help companies meet these standards effectively.

The integration of green financial products in Serbian banks' portfolios remains limited, with these products constituting approximately 5 to 10% of the total portfolio on average. Despite the growing emphasis on sustainability, green financing measures such as green loans and green bonds are still underrepresented.

The MoF and CBS are pivotal in shaping sustainable finance policies in Serbia. They collaborate with various international organisations to develop frameworks and guidelines for sustainable finance. Other relevant ministries, such as those responsible for energy and environmental protection, also play crucial roles.

Awareness and engagement among stakeholders, including FIs, corporations and investors, are growing. However, there is still a need for greater education and understanding of the benefits of sustainable finance. The MoF works with the WBG on studies and capacity building initiatives. These collaborations help Serbia incorporate international best practices and align its policies with global standards.

Key barriers to the growth of sustainable finance in Serbia include:

- lack of expertise among the wide spectrum of stakeholders (there is a small number of persons with deep knowledge and understanding);
- inadequate data availability (lack of comprehensive, high-quality and consistent ESG data) making it difficult to assess risks and ensure compliance with international standards;
- varying levels of readiness among companies to adopt sustainable practices; and
- market size and the current economic context pose challenges to the widespread adoption of these practices.

Policymakers and FIs are addressing these barriers through several initiatives. These include developing methodologies for green project selection, providing training and education on the benefits of sustainable finance and fostering interdepartmental cooperation. The MoF is also working on guidelines and frameworks tailored to the local context to ensure better implementation.

Status of development of a taxonomy

The CBS is an active member of the NGFS, a leading group of FIs focused on greening the global financial system. As part of its activities, CBS participates in discussions and workshops on the integration of climate change into business models, including the application of the EU taxonomy and data disclosure frameworks (47).

The Association of Serbian Banks has been enhancing sustainable finance and ESG practices within Serbia's banking sector since joining the SBFN in 2021. Collaborating with the IFC, it has developed educational programmes and technical guidance, including access to global and local e-learning platforms. Voluntary guidelines were created to integrate ESG factors into investment decisions, aligning with the EU's Green Deal and Sustainable Finance agenda. These guidelines encourage banks to adopt ESG strategies, incorporate climate risks into risk management and align portfolios with the Paris Agreement, using taxonomies like the EU Taxonomy to classify economic activities (85).

FIs in Serbia classify green and sustainable activities based on own methodologies and guidelines that are being developed. These classifications typically include renewable energy projects, energy efficiency improvements, waste management and other projects with clear environmental benefits. The development of these classifications involves input from various stakeholders, including the MoF and international organisations like the UNDP and WBG. Banks with headquarters in the EU have varying approaches to classifying green activities. Some institutions adopt simpler frameworks based on whitelists, while others implement more complex classification systems. This discrepancy highlights the need for a more standardised approach to sustainable finance classification.

While there are significant efforts to align with EU standards, full compliance is challenging due to the ambitious nature of the EU Taxonomy and the current state of Serbia's financial and regulatory environment. Stakeholders recognise divergences in the application of EU Taxonomy, particularly in sectors where local economic conditions differ significantly from those of the EU. For example, while renewable energy projects are widely accepted as green, the criteria for other sectors may vary, e.g. for green buildings, vehicles, etc. The Chamber of Commerce of Serbia drafted a comprehensive Guideline for non-financial reporting and EU taxonomy and provides a valuable material on the basics of EU taxonomy and how it fits into the bigger picture of Serbia's attempt towards decarbonisation.

There is a cautious approach among institutions in Serbia regarding leadership in developing a green taxonomy. The CBS has taken on the role of observer and analyst in the realm of green taxonomy. By monitoring market developments and conducting analyses, the CBS seeks to provide insights that inform policy and regulatory adjustments. While the MoF is actively involved in green finance initiatives, there is a reluctance to assume sole leadership in this area. Institutions are aware of the complexities and resource requirements involved, leading to a preference for a collaborative approach that includes multiple stakeholders to ensure the taxonomy is comprehensive and practical. There is general understanding that the EU taxonomy is needed but should not follow a "copy/paste" approach, rather be tailored to local circumstances.

Key challenges faced by FIs in Serbia when adopting the EU Taxonomy include the complexity of the taxonomy itself, the need for tailored approaches and capacity constraints. FIs often struggle with the lack of clear guidance and the need for detailed analyses to adapt EU standards to the local context. Additionally, regulatory differences and the initial state of sustainable finance practices pose significant hurdles. There is a lack of awareness and understanding of the benefits and requirements of the EU Taxonomy among stakeholders. Capacity constraints, such as limited expertise and resources, further complicate the adoption process. Regulatory differences between the EU and local laws also create barriers, requiring significant adaptations to ensure compliance.

Outlook

Serbia's commitment to sustainable development, outlined in the Serbia Sustainable Finance Framework, emphasizes achieving the UN SDGs, supporting global decarbonisation and promoting social inclusion. The MoF and CBS are key in these efforts, collaborating with international organisations.

In the coming years, Serbia aims to expand its issuance of green, social and sustainability bonds, leveraging its Green Bond Framework to attract international capital for environmentally beneficial projects. Efforts to enhance stakeholder awareness and capacity building will be critical to overcoming current barriers, such as a lack of expertise and data availability.

Regional cooperation is recognised as important for the advancement of sustainable finance in Serbia. Collaboration with neighbouring economies allows for sharing of best practices and development of cohesive strategies that can address common challenges across the region.

The MoF drafted Serbia's roadmap for implementing green budgeting, highlighting the significant steps towards aligning with the EU Taxonomy for sustainable finance. Serbia plans to develop its taxonomy to classify economic activities that contribute to a green and low-carbon economy, as well as those exposed to climate and environmental risks. This initiative, supported by the Development Agency of France and WBG, aims to integrate EU Taxonomy principles into Serbia's budgeting process by 2025. The roadmap includes steps to ensure transparency, capacity building and inter-ministerial collaboration to effectively manage and report green expenditures (86).

3. COMMON CHALLENGES AND BARRIERS

When it comes to financing climate related goals (to put it into a broader perspective), WB economies face significant challenges due to the substantial funds required and the complexity of transforming these into actionable projects. Despite the availability of considerable funding from EU-funds, bilateral donors and IFIs, the WB economies encounter difficulties in accessing these resources. Key issues identified include insufficient administrative capacity, matching them to potential projects and navigating the application process.

Moreover, the stakeholders in WB mainly lack awareness about sustainable finance, leading to a limited role in financing green projects. The analysis also highlights the need to assess public budgets concerning green economy initiatives, as projects not prioritised in public budgets are unlikely to be financed or implemented. Developing an action plan for greening the budget can help prioritise green projects and mobilise public funds. The SME sector, which constitutes a significant share of the economies in WB, requires focused attention. To understand the current state of sustainable finance and green taxonomy uptake, a SWOT analysis has been conducted. The subsequent chapters highlight some of the most pressing common challenges in this regard.

Table 3. *SWOT analysis of sustainable finance and green taxonomy uptake in WB*

Strengths	Weaknesses
• increasing recognition of the need to align with international sustainability commitments like the Paris Agreement and UN SDGs • most WB economies have adopted clear climate targets (e.g. NDCs) • some WB economies align with NFRD regulations • well established collaboration with IFIs such as EBRD, WBG and EIB • increasing availability of green financial products, such as green loans and green bonds • some Central Banks have outlined strategic goals that (in)directly support sustainable finance	• general lack of awareness and understanding of sustainable finance principles • absence of a taxonomy and strong regulatory frameworks • lack of specialised knowledge and skills • limited access to high-quality ESG data • insufficient administrative capacity to manage and report on sustainable financial activities
Opportunities	**Threats**
• initiatives like the CRM can foster collaboration • aligning with EU Taxonomy and global standards can attract international investments • developing training programmes and educational initiatives • project like the EU4Green aim to foster sustainable finance by introducing the EU Taxonomy through practical case studies and regional workshops • greater regional collaboration and cooperation can streamline efforts and reduce duplication • access to considerable funding from EU funds, bilateral donors and IFIs	• political instability and frequent changes in government • relatively small market size in WB limits the scale and impact of sustainable finance initiatives • lack of strong commitment and push-back from stakeholders to lead the development of a taxonomy • high current expenditures and limited fiscal space • inconsistent regulations and lack of clear policy direction • developing taxonomies and sustainable finance practices without regional coordination can lead to fragmented regulatory landscapes

Source: *CETEOR, 2024*

3.1. General lack of awareness and understanding of sustainable finance principles among stakeholders

A general lack of awareness and understanding of sustainable finance principles among stakeholders in the WB presents a significant barrier to the effective adoption and implementation of sustainable finance practices. Many stakeholders are not fully informed about the benefits and requirements of sustainable finance. Without a clear understanding of sustainable finance principles, stakeholders may underestimate the potential long-term economic and environmental benefits, such as increased resilience to climate risks, enhanced reputation and access to new markets and funding opportunities.

Furthermore, insufficient knowledge about sustainable finance can lead to ineffective implementation of related initiatives. For instance, FIs struggle to develop and manage green financial products, while corporations find it challenging to report on ESG factors accurately. Policymakers also face difficulties in creating and enforcing regulations that support sustainable finance without a solid understanding of its principles and practices.

3.2. Misunderstanding of the EU taxonomy

The absence of a taxonomy for sustainable finance in the WB presents a significant challenge for aligning with the EU Taxonomy. Without a taxonomy, FIs face inconsistencies in defining and reporting sustainable activities, leading to fragmented and often incompatible practices. This issue is further compounded by a general misunderstanding of the EU Taxonomy among local stakeholders, including FIs, corporations and regulatory bodies (ministries and central banks). Many, not all, perceive a green taxonomy only as a decision-making tool for investment approval—essentially a yes/no framework. While taxonomy indeed helps classify which activities are sustainable and which are not, this narrow view misses its broader purpose. For the purpose of this report, a dedicated text on demystifying sustainable finance taxonomies was drafted (see Annex 5).

3.3. Lack of strong commitment and push-back from stakeholders

The lack of strong commitment and push-back from MoFs and CBs in the WB poses a substantial obstacle to the advancement of sustainable finance. There is no clear leadership or coordination on who should lead the efforts to adopt sustainable finance taxonomies at the economy level. Without a designated authority to guide and unify efforts, progress is slow and disjointed.

Additionally, the complexity and novelty of the EU Taxonomy and other international sustainable finance standards make officials in MoFs and CBs hesitant. Many are still trying to understand these frameworks' implications and requirements. This uncertainty can lead to resistance, as stakeholders might be wary of committing to initiatives they do not fully understand or that could disrupt existing financial and regulatory systems.

There is also push-back because of the perceived burden of additional regulatory compliance and reporting requirements. MoFs and CBs are often focused on immediate economic stability and growth and may see the extensive requirements of sustainable finance frameworks as secondary or even conflicting with these priorities. This challenge is worsened by the limited resources and capacity within these institutions to manage and integrate new sustainable finance mandates effectively.

The lack of strong political will and clear policy direction from the highest levels of government leads to a lack of enthusiasm among financial regulators and policymakers. Without clear and strong support from political leaders, efforts to advance sustainable finance can seem unimportant and non-essential, further reducing the momentum needed for meaningful change.

3.4. The lack of existing frameworks

Currently, many FIs and regulatory bodies in the WB do not have established frameworks to guide sustainable finance activities. This absence of frameworks leads to several issues. First, it hampers the development of standardised procedures for assessing and managing ESG risks. Without clear regulations and methodologies, FIs and corporations struggle to identify, evaluate and report on sustainable activities consistently. This inconsistency can result in fragmented efforts, reducing the overall impact of sustainable finance initiatives.

Stakeholders have no clear benchmarks or reporting standards to follow, making it difficult to measure progress and ensure compliance with international sustainability standards. This limits the ability of policymakers to enforce sustainable finance practices effectively. This may discourage FIs and corporations from investing in sustainable finance initiatives due to fears of potential changes or inconsistencies in regulations.

3.5. Limited technical capacity and expertise among stakeholders

Limited technical capacity and expertise among stakeholders in the WB significantly hinder the effective implementation and compliance with sustainable finance principles. Many FIs lack the specialised knowledge and skills needed to understand and apply complex sustainable finance frameworks, such as the EU Taxonomy. This gap in expertise results in uncertainty and confusion about how to integrate ESG criteria into their operations and decision-making processes.

Training programmes and educational initiatives on sustainable finance are not yet widespread in the region, leading to a shortage of professionals who can guide FIs in adopting these principles. Without adequate training, staff at FIs may struggle with tasks such as evaluating green projects, reporting on sustainability metrics and understanding regulatory requirements.

Moreover, FIs often face difficulties accessing high-quality ESG data necessary for assessing and managing risks. In the absence of reliable data and standardised reporting mechanisms, it becomes challenging for FIs to make informed decisions and comply with international standards. This data gap further complicates the integration of sustainable finance practices.

3.6. Relatively small market size, limiting the scale and impact of sustainable finance initiatives

The relatively small market size in the WB limits the scale and impact of sustainable finance initiatives. In a smaller market, the potential for large-scale investments in green projects is reduced, making it challenging to achieve significant environmental and economic benefits. This limitation affects the ability of FIs to develop and offer a wide range of sustainable finance products, as there is often insufficient demand to justify the costs associated with creating and managing these products. Smaller markets also struggle to attract international investors who are crucial for the growth and development of sustainable finance. Investors typically seek opportunities in larger, more established markets where the potential for returns is higher. This lack of interest from international investors further restricts the availability of capital for sustainable projects, hindering their implementation and scalability.

The small market size also means fewer resources are available for capacity building and technical support. Local FIs and regulators may find it difficult to allocate the necessary funds and personnel to develop expertise in sustainable finance, leading to slower adoption and integration of sustainable practices. This scarcity of resources results in fragmented efforts and reduced overall impact.

3.7. Need for greater collaboration and regional cooperation

There is a strong need for more collaboration and regional cooperation to advance sustainable finance effectively.

Stakeholders understand that sharing knowledge and experiences is important for developing sustainable finance frameworks. By working together, economies can learn from each other's successes and challenges, avoiding mistakes that come from working alone. Joint workshops, seminars and training programmes can help FIs and policymakers understand and follow sustainable finance principles better. Coordinated policies can ensure that sustainable finance regulations are similar across the region, reducing differences that can cause confusion.

The CRM initiative shows the importance of a unified approach to economic development and regulatory alignment. If economies develop their own taxonomies without regional cooperation, it could lead to a fragmented regulatory landscape. This fragmentation would make it harder for FIs and businesses to operate across different economies. It would also create inconsistencies in how sustainable activities are classified and reported, reducing the effectiveness of sustainable finance initiatives. Without regional collaboration, there is also a risk of duplicating efforts and wasting valuable resources.

Additionally, developing taxonomies without working together could increase differences in sustainable finance practices and capabilities. Economies with more advanced frameworks might move ahead faster, leaving others behind. This uneven development could weaken regional unity and economic integration efforts, slowing down the overall transition to sustainable finance in the WB.

4. CONCLUSION AND MAIN RECOMMENDATIONS

Improving sustainable finance and aligning with the EU Taxonomy in the WB are important steps towards creating a strong financial system that supports environmental and social sustainability. While some progress has been made, there are still many challenges that prevent full adoption of sustainable finance practices in the region. This chapter presents a set of strategic recommendations designed to overcome these obstacles. These recommendations are based on extensive literature reviews, stakeholder consultations and surveys conducted during this project. Using a Logical Framework Approach (LFA), this chapter outlines targeted solutions to address common regional challenges and advance sustainable finance in the WB.

In this section, viable options for developing a common guiding framework on sustainable finance taxonomy in the WB are proposed. This framework aims to ensure full compliance with the EU taxonomy regulation and other relevant international frameworks, addressing the common challenges and barriers identified earlier. These recommendations aim to increase stakeholder awareness, establish comprehensive frameworks, encourage regional cooperation and attract international investments. The general recommendations in Table 4 provide a guide for policymakers, FIs and other stakeholders in the WB to build a stronger and more sustainable financial system.

Table 4. *General recommendations on sustainable finance taxonomy in WB*

Category	General recommendation
Capacity building	• Develop comprehensive educational programmes on sustainable finance principles • Conduct workshops, seminars and training sessions for stakeholders • Promote understanding of the EU Taxonomy and its implications • Encourage knowledge sharing and best practice exchange among WB economies • Invest in training programmes to develop specialised skills in sustainable finance • Provide technical support and resources to FIs • Facilitate access to high-quality ESG data and reporting tools • Establish partnerships with universities and research institutions • Develop online learning platforms for continuous education • Organise exchange programmes with leading institutions in sustainable finance
Policy advocacy and development	• Develop long-term strategic plans to maintain consistency in policies • Develop and implement taxonomies aligned with the EU Taxonomy • Align local practices with global standards to attract international investors • Create clear regulatory frameworks and guidelines for sustainable finance • Ensure strong regulatory support and enforcement mechanisms • Encourage FIs to expand their range of green financial products • Develop strategies to scale up sustainable finance initiatives in smaller markets
Regional collaboration	• Utilise initiatives like the CRM to streamline efforts • Establish a regional sustainable finance advisory council • Coordinate policy development and implementation at the regional level • Promote regional harmonisation by avoiding fragmented regulatory landscapes and standardising sustainable finance classifications and reporting across the region • Align sustainable finance practices with regional and global benchmarks • Utilise funding opportunities from EU funds, bilateral donors and IFIs • Promote regional projects that pool resources and expertise • Organise annual regional conferences on sustainable finance

Source: *CETEOR, 2024*

4.1. Developing a regional taxonomy framework

EC's Guidelines for the Implementation of the GAWB highlights that future financial assistance will need to integrate the EU taxonomy and adhere to the green oath to "do no harm" across broader sustainable economic development initiatives in the WB (88). That said, the EU taxonomy is becoming the main guide for WB economies to classify activities by sustainability. Setting up green taxonomies is important because it will affect not only FIs but also various other economic players, including non-financial institutions and public sector organisations. Developing a regional taxonomy framework in the WB is essential for fostering sustainable finance and facilitating the green transition in the region. Given the common economic, social and environmental contexts of the WB, a regional taxonomy could balance local relevance with international interoperability to ensure it meets global standards while addressing specific WB needs.

This framework does not aim to propose a regional taxonomy to substitute taxonomies (at economy level), but to provide a framework which aims to coordinate efforts and development of local green taxonomies, to align with one of the goals of the CRM – free movement of capital.

4.1.1. Establishing a regional coordination body

The establishment of a regional coordination body (RCB) is essential to harmonise efforts across the WB in developing and implementing an interoperable sustainable finance taxonomy. This body would ensure that all economies in the region align with the EU taxonomy regulations and international standards. The primary functions of the RCB may include:

- Synchronise sustainable finance initiatives across WB economies to avoid duplication and ensure cohesive efforts;
- Develop common guidelines, methodologies and standards for sustainable finance activities;
- Provide training and resources to enhance technical capabilities of stakeholders;
- Track the progress of sustainable finance implementation and assess the effectiveness of policies and initiatives;
- Promote the benefits of sustainable finance and advocate for supportive policies and regulations at the regional level.

The RCB may consist of representatives of key stakeholders across the WB economies, including representatives of MoF, other relevant ministries (e.g. economy and environment), CBs, Association representatives (e.g. banking associations), experts and academia. The body may be joined, on advisory level, by representatives of IFIs, UN organisations and NGOs.

The RCB may engage in a range of activities designed to foster collaboration, build capacity and drive the implementation of sustainable finance practices. These activities may include regular meetings, organising workshops and seminars, developing guidelines, establishing a M&E framework, launching awareness campaigns, advocating for supportive policies, etc. Establishing such a body could leverage collective strengths, share resources and harmonise efforts.

4.1.2. Alignment with relevant sustainability goals

The principal aim of a taxonomy (green or sustainable) is to contribute to a broader goal or set of goals in the field of sustainable development. In practice, around the world, approaches differ. While some taxonomies focus only on environmental goals, others focus also on social goals. For instance, the EU taxonomy is primarily focused on climate change mitigation and adaptation, but it also integrates other aspects (water, air, waste, etc.). However, the social part in the EU taxonomy is not yet fully regulated. On the other hand, Georgia's Sustainable Finance Taxonomy has two components, a green and a social taxonomy. In simple terms, each taxonomy should be tailored to local circumstances and contribute to the goals to which it is aligned. In the WB, there is a proven track record of studies and strategies related to climate change and all WB economies (except for Kosovo*) have developed and adopted **National Determined Contributions (NDCs)** in line with the Paris Agreement. For WB, it is highly recommended to focus initially on the NDCs, as they seem to be a logical starting point. By prioritising the NDCs, the WB can ensure that their taxonomy supports local sustainability agendas while aligning with global climate goals.

Table 5. National Determined Contributions *declared by the economies of WB (89)*

Economy	NDC (2030)
Albania	20.9% compared to BAU
Bosnia and Herzegovina	12.8% compared to 2014 (i.e. 33.2% compared to 1990) – unconditional scenario
Kosovo*	Not signatory under the UNFCCC
Montenegro	35% compared to 1990
North Macedonia	51% compared to 1990
Serbia	13.2% compared to 2010 level (i.e. 33.3% compared to 1990)

Concentrating on the NDCs will facilitate a cohesive approach among the WB, enhancing regional cooperation and enabling a unified response.

4.1.3. Focus on sectors with most impact on defined sustainability goals

The next step is to focus on sectors with the most significant impact on sustainability goals. Key sectors include energy, transport, residential buildings, agriculture, waste management and others. The energy sector should prioritise RES and EE measures, while the transport sector should promote public transport and electric vehicles. Improving EE in residential buildings through upgrades and sustainable materials is essential. Sustainable agricultural practices, efficient waste management and sustainable water management practices are also critical.

However, criteria from the EU taxonomy may not be directly applicable due to the unique WB context, as highlighted by stakeholder interviews. One notable example is the financing of electric vehicles, which is not yet realistic in the WB due to infrastructure and economic constraints. Additionally, the EU taxonomy sets very high standards for the energy performance of buildings, which are challenging for the WB to meet given the current state of building stock and financial resources. Adapting the criteria to better fit the regional realities of the WB will ensure that the taxonomy is both practical and achievable, allowing for a more effective transition to sustainable practices without imposing unrealistic expectations.

4.1.4. Action plan for the taxonomy framework

This action plan will serve as a roadmap, guiding the coordination, development, implementation and continuous improvement of the taxonomy framework. The plan should outline specific actions, timelines, responsible parties and key milestones to ensure systematic progress and accountability.

4.1.5. Draft conceptual framework

Given the unique economic and infrastructural context of WB, it is advisable to adapt the EU taxonomy rather than adopting it wholesale (or simply said, do not copy/paste). This Adapt and Adopt principle allows the framework to be tailored to the specific needs and capacities of the WB, ensuring it is both relevant and practical.

Given the strong emphasis on lack of capacities (reflected in lack of skill and data unavailability) for the WB, a gradual phase-in of sustainable finance taxonomies is recommended. In the first phase, WB should start with a whitelist approach, which involves identifying and listing specific economic activities considered sustainable. This method is simpler and less resource-intensive than developing comprehensive TSC criteria. As capacities among stakeholders improve, the WB can gradually incorporate more detailed criteria and align more closely with the EU's approach. In the second phase (e.g. after 2-3 years), the taxonomy could be more complex and fully aligned with the EU Taxonomy (based on the TSC and DNSH approaches). This phased implementation will help build the necessary expertise and infrastructure to support a fully-fledged sustainable finance taxonomy over time. This proposal was highly welcomed during interviews with stakeholders, as the regional taxonomy framework can help leverage this process by synchronising efforts in WB.

In developing a regional taxonomy framework, several principles must guide the conceptual design to ensure effectiveness, practicality and alignment with both local and international standards. These principles include interoperability, avoiding unnecessary reinvention, holistic thinking and simplicity.

I. To facilitate cross-border/boundary capital flows and **ensure international comparability**, the regional taxonomy must be interoperable with global standards like the EU taxonomy. This means using common methodologies, design principles and structures. Employing internationally recognised industrial classification systems, such as the ISIC, can help achieve this interoperability. This reduces the risk of market fragmentation and ensures that the taxonomy can be easily integrated with existing international financial frameworks.

II. **Leverage existing taxonomies** and guidelines rather than starting from scratch. Learning from other taxonomies saves time and resources. For instance, South Africa and Colombia have taxonomies aligned with the EU's, while Mongolia's taxonomy follows the approach of China. By adopting and adapting existing frameworks, the WB can develop a taxonomy that benefits from proven methodologies and best practices.

III. The taxonomy should not be developed in isolation but as part of a broader sustainable finance ecosystem, i.e. **considering existing and planned sustainable finance policies and regulations**, such as green bonds, green loans and corporate disclosure requirements. Ensuring that the taxonomy complements these initiatives will enhance its acceptance and implementation.

IV. To ensure broad adoption and usability, the taxonomy **should be clear, straightforward and easy to implement**. This includes having clear definitions and classifications of economic sectors and activities. The logic and rationale behind the criteria should be transparent and easily understandable. This simplicity will help users navigate the taxonomy without confusion and reduce the burden of compliance. It will also make the taxonomy more accessible to a wide range of stakeholders, including SMEs.

4.1.6. Public consultation and publishing the framework

Engaging a broad spectrum of stakeholders, including government agencies, FIs, industry representatives (including chambers of trade and economy), academia, civil society and the public, ensures that the taxonomy is comprehensive, practical and widely accepted. The consultation process should involve multiple stages, starting with initial drafts, allowing for iterative feedback and refinement. This participatory approach helps identify potential challenges, gather diverse perspectives and build consensus around the taxonomy's goals and methodologies. Public consultations can be conducted through workshops, seminars, online surveys and public forums.

Once the public consultation phase is complete and the feedback has been incorporated, the framework should be finalised and prepared for publication. Publishing the framework involves making it publicly available through official channels. Clear communication of the framework's objectives, benefits and application procedures will facilitate its adoption and use. Additionally, launching awareness campaigns and holding informational sessions can help promote the taxonomy and educate stakeholders on its significance and operational aspects. These will enhance transparency and trust and ensure that the taxonomy is effectively integrated into the region's sustainable finance practices.

4.1.7. Engage with WB economies to draft their taxonomies

Engaging with the WB economies to draft their taxonomies is a crucial step in establishing a coherent and effective regional taxonomy framework. This process should be guided by a set of general recommendations to ensure a structured and inclusive approach, leveraging the principles and best practices outlined in various international guidelines. General recommendations include:

Initiation	Identify and designate a lead institution to oversee the taxonomy development process. This institution could be a government ministry, such as the MoF or Ministry of Environment or the central bank. The lead institution will coordinate efforts, manage stakeholder engagement and ensure alignment with the regional framework. This is extremely important in WB, given the complex administrative setup in some economies and the political instability, coupled with a common understanding rooted in the region's paradigm that the decisive role is at higher levels.
	Develop a detailed timeline for the taxonomy development process. This timeline should include key milestones and deadlines for each phase, from initial research to final publication.
	Formulate a comprehensive stakeholder engagement plan. This plan should identify all relevant stakeholders, including government agencies, FIs, industry representatives, academia and civil society. Regular consultations, workshops and feedback sessions should be scheduled to ensure broad participation and buy-in.
Preparation	Clearly define the objectives of the taxonomy. These should align with both the sustainability goals and international standards, such as the Paris Agreement and the SDGs.
	Undertake extensive research and benchmarking against existing taxonomies (i.e. EU taxonomy and other relevant models). This research will provide valuable insights into best practices and help tailor the taxonomy to the specific context of each WB economy.
	Develop a draft design of the taxonomy. This design should include the classification of economic activities, criteria for sustainability and the methodologies for assessment. The draft should be detailed yet flexible enough to incorporate feedback from stakeholders.
	Implement a pilot phase to test the draft taxonomy. This phase involves selecting a few sectors or projects to apply the taxonomy and gather practical insights and identify potential issues and areas for improvement.

Implementation	Refine the draft taxonomy based on feedback from the pilot phase and public consultations. Once finalised, publish the taxonomy along with comprehensive guidance documents and explanatory materials to ensure clear understanding and application.
	Develop and deliver capacity building programmes for the organisations that will implement the taxonomy. This includes training sessions, workshops and the provision of resources and tools to enhance technical capabilities.
	Establish a MEL framework to track the implementation and effectiveness of the taxonomy. This framework should include KPIs, data collection methods and regular reporting schedules to ensure continuous improvement.
	Implement robust data collection and disclosure mechanisms. Organisations should be required to regularly report on their alignment with the taxonomy and this information should be made publicly available to enhance transparency and accountability.

4.1.8. Monitor and update the taxonomy

Monitoring and updating the taxonomy is essential to ensure it remains effective, relevant and aligned with evolving sustainability goals and market conditions. This involves setting up regular reviews, engaging with stakeholders and adapting the taxonomy based on new information and feedback.

First, it is important to establish a schedule for regular reviews, e.g. every year. During these reviews, the performance of the taxonomy should be evaluated to ensure it aligns with defined goals. KPIs should be developed to measure the impact of the taxonomy. These might include metrics like the amount of green investments made, the number of projects aligned with the taxonomy and reductions in greenhouse gas emissions. Collecting and analysing data is also crucial. Organisations and FIs should regularly report on how their activities and investments align with the taxonomy.

Engaging with stakeholders is another key part of the MEL process. Ongoing dialogue with government agencies, FIs, industry representatives and civil society should be maintained. Regular consultations and feedback mechanisms should be in place to gather insights and suggestions for improvements. Supporting stakeholders through continuous training and technical assistance is vital. Providing workshops, seminars and online resources will help ensure that everyone understands and can effectively apply the updated taxonomy. Offering technical assistance to organisations and FIs will help them adapt to changes and ensure compliance with new criteria. Additionally, ensuring transparency by publicly reporting the findings from reviews and updates is important. Regularly publishing reports that detail the taxonomy's performance, any changes made and the reasons behind those changes will help maintain trust and engagement.

Keeping the taxonomy updated with the latest scientific research and technological advancements and integrating new findings into it will keep it effective. Responding to market conditions and emerging sustainability challenges by updating criteria, expanding the scope to include new sectors or activities and refining the technical screening criteria is necessary.

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APPENDICES

Annex 1: Current financial landscape in the Western Balkans

Albania

The legislative body of the financial market is the Assembly of Albania, while specific regulations for the supervision are issued by the Bank of Albania (BoA) and the Financial Supervisory Authority in Albania (FSAA). The Law on the Bank of Albania regulates the operation of the central bank, which functions as an independent institution with the primary objective of maintaining price and financial stability, overseeing monetary policy, financial system supervision, foreign exchange reserves and issuing Albanian currency, the lek (2). FSAA, accountable to the Albanian Parliament, supervises and regulates the non-banking financial system, ensuring stability and transparency in insurance, securities and private pensions (3). The MoF manages public finances and economic policy, including budget preparation, fiscal policy development, economic trend monitoring and developing policies to support economic growth and stability (4). These institutions together play a crucial role in managing the economy, finances and development in Albania.

The financial sector of Albania is relatively stable and concentrated on the banking sector, which constitutes about 87.95% of the economy's total assets in relation to GDP (5). The banking system in Albania has a two-tier structure: the BoA at the first tier and commercial banks, branches of foreign banks and non-bank financial institutions (NBFI) licensed by the BoA at the second tier (6). The Albanian Association of Banks (AAB) serves as the unified voice of the banking industry in Albania, actively advocating for the interests of its member banks (7).

According to the lists of licensed institutions currently published by the BoA, the structure of the banking and financial system in Albania includes 11 banks, 27 non-bank financial institutions, 626 foreign exchange bureaus, 16 Savings and Loan Associations (SLA) and one union of SLAs (8). According to data reported by the Bank, the total assets of banks were 19.22 billion EUR (converted from ALL to EUR as at 29.12.2023) in December 2023, with foreign capital dominating the capital structure (9).

Albania is attracting foreign investments in sectors such as tourism, energy, infrastructure and industry, with foreign direct investment (FDI) reaching 1.49 billion EUR in 2022 (converted from USD to EUR as at 29.12.2022), marking a 16.2% increase relative to the previous year (10). In the first three quarters of 2023, FDI inflows totalled 1.08 billion EUR, a 10.6% increase compared to the same period in the previous year, as reported by the BoA (11). The main contributors to this were the Netherlands, Tukey and Italy, as per data from the Central Bank (12). Foreign investments are primarily focused on sectors like extractive industries, energy, banking, insurance, ICT and real estate.

Albania collaborates with international financial institutions such as the IMF, WBG, EBRD and EIB, which offer financial support and advisory services to facilitate economic reforms and advance the development of financial system, which is pivotal in aligning legislative frameworks and standards with those of the EU, a top priority for the economy's integration efforts (13).

Bosnia and Herzegovina

The financial sector of Bosnia and Herzegovina is a complex administrative set-up. Legislative bodies include the Parliamentary Assembly of Bosnia and Herzegovina, entity parliaments and relevant regulatory agencies, while regulations are issued by the Central Bank of Bosnia and Herzegovina (CBBH), Banking Agency of the Federation of Bosnia and Herzegovina (FBA) and Banking Agency of Republika Srpska (BARS).

The CBBH serves as the supreme monetary authority, with its operations defined by the Law on the Central Bank of Bosnia and Herzegovina. The CBBH maintains monetary stability, issues currency, manages foreign reserves and oversees the payment system. It also participates in international organisations to strengthen economic stability and represents Bosnia and Herzegovina on monetary policy issues (14). The Ministry of Finance and Treasury of Bosnia and Herzegovina manages the government budget, fiscal policy and public debt (15). At the entity level, the Ministries of Finance of the entity of the Federation of Bosnia and Herzegovina and entity of Republika Srpska have similar responsibilities.

The FBA and BARS regulate and supervise the banking, microfinance and leasing systems at the entity levels, with their work and primary tasks defined by the laws governing their operation (16) (17). The banking system is regulated at the entity level by the Law on Banks of the entity of the Federation of Bosnia and Herzegovina and the Law on Banks of the entity of Republika Srpska. The Banks Association of Bosnia and Herzegovina (BABIH) is established so as to create a representative, professional organisation that advocates for the interests of its members before authorities and institutions in Bosnia and Herzegovina (18).

According to the FBA, as of 31 December 2023, there are 13 commercial banks operating in the entity of the Federation of Bosnia and Herzegovina (19). Of these, 12 banks are predominantly privately owned, while one is predominantly publicly owned. Three banks are majority owned by domestic entities, while nine banks are majority owned by foreign entities. Additionally, there are 13 microfinance institutions (MFI) and four leasing companies in the entity of the Federation of Bosnia and Herzegovina. The total net assets of the banking sector in the entity of the Federation of Bosnia and Herzegovina amount to 14.83 billion EUR, with the total assets of microfinance sector being 423.04 million EUR and the leasing sector totalling 268.58 million EUR. The primary components of bank assets include net loans (57.1%), followed by cash reserves (29.6%) and securities (8.6%) (19).

According to the BARS, as of 31 December 2023, there are eight banks headquartered in the entity of Republika Srpska, all predominantly privately owned (20). Among them, four banks have most of domestic shareholder capital, while the remaining four have a majority of foreign shareholder capital. The gross balance sheet assets amount to 5.22 billion EUR, while the net balance sheet assets stand at 5.06 billion EUR. The finance sector in the entity of Republika Srpska includes also 15 MFIs, with a total asset value of 311.29 million EUR. Currently, there are no leasing companies in the entity of Republika Srpska (ibid).

Analysis of indicators of the banking system and the economic landscape in Bosnia and Herzegovina reveals significant challenges primarily linked to macroeconomic factors. Cooperation and coordination in economic policymaking within Bosnia and Herzegovina have deteriorated due to political stalemates and a short-term focus, hindering essential reforms for economic growth. Additionally, decentralised banking supervision and limited oversight by the central bank pose significant challenges to financial stability (21).

Bosnia and Herzegovina's financial and capital markets have limited integration with the EU, despite a significant portion of the banking sector being owned by European banks. Approximately two thirds of the economy's FDI comes from EU members, with annual inflows following a similar trend (21). Foreign investments in Bosnia and Herzegovina are relatively low compared to other economies in the region, mainly due to political instability and complex regulatory environments.

The inflow of foreign direct investments in Bosnia and Herzegovina in 2022 amounted to 0.74 billion EUR (converted from BAM to EUR), which is the highest amount recorded so far, according to data from the CBBH (22). They are mostly concentrated in sectors like energy, tourism and manufacturing. Bosnia and Herzegovina heavily relies on longer-term financing from IFIs like the IMF, EIB and the WBG, with the gross external debt ratio standing at around 58% of GDP as of 2022 (21).

Kosovo*

The Assembly of Kosovo* is the main legislative body for the financial sector, responsible for enacting laws, while regulations and directives are issued by the Central Bank of Kosovo* (CBK) and relevant regulatory bodies. The CBK is an independent public institution with its operations defined by the Law on the Central Bank of Kosovo*. Its primary objective is to promote and maintain a stable financial system and efficient payment system. CBK oversees the banking sector, manages foreign reserves, implements monetary policy and is exclusively responsible for licensing, regulating and supervising FIs and other entities engaging in financial activities as defined by Kosovo*'s legislation (23). The MoF is responsible for policy preparation, financial legislation enforcement, macroeconomic stability assurance, fiscal policy oversight, debt management, procurement, internal controls, payroll, social benefits and international agreement coordination (24). Key legislative document is the Law on Banks, MFIs and non-banking FIs.

The Kosovo* Banking Association (KBA) supports development of banking sector by acting as the representative voice of the industry in Kosovo* and assists member banks in achieving their objectives through advocacy, capacity building and public relations (25).

The financial sector of Kosovo*, predominantly characterised by foreign ownership, maintains a strong capitalisation and stability, with banking dominating the sector, holding 68.4% of financial assets (26). Total assets of banks in December 2023 amounted to 7.54 billion EUR (27). Following closely are pension funds, MFIs and insurance companies, contributing 24.5%, 4.1% and 2.7% to the financial system, respectively (26). There are twelve banks operating nowadays in the banking system in Kosovo*, nine of which are foreign owned (27). Their products and services include banking accounts, loans, domestic and international payments, banking cards, banking guarantees, letter of credit and e-banking. Microfinance has gained momentum in recent years, but shortcomings in the legal framework regulating microfinance institutions hinder the industry's long-term growth and sustainability (26).

According to the data published by the Bank, in December 2023, financial system assets reached a value of 11.1 billion EUR, representing an annual increase of 12.4%. Excluding the banking sector, which marked a slowdown of increase in assets, all other sectors were characterised by an accelerated annual growth rate (28).

Kosovo* uses euro as its currency even though Kosovo* is not a member of the European Central Bank (ECB) and has no independent monetary policy of its own (26). This decision mitigates currency volatility risks and bolsters attractiveness to foreign investors.

Foreign direct investments reached a value of 844.3 million EUR in 2023, marking an annual increase of 15.3% compared to 2022 (28). EU Member States are the primary investors in Kosovo*, with a notable surge of 88.0% in net FDI inflows in 2022 (26). The increase of FDI was primarily driven by significant diaspora investments in real estate, alongside financial and insurance activities. A slight increase in FDI was observed in the electricity supply and mining sectors, including quarrying. Kosovo* faces challenges in attracting foreign investment due to political instability and a perception of high risk. The EU has implemented various measures concerning Kosovo*, which also affect financial support. These measures are temporary and fully reversible.

In the absence of a sovereign credit rating and very limited access to international bond markets, foreign financing has been provided by international donors. Foreign debt rose by 11.2% in 2022.

This includes loans from the WBG (60.1 million EUR), EIB (23.8 million EUR), EBRD (14.5 million EUR) and Council of Europe Bank (10.8 million EUR) (26). Although the institutional framework for managing EU funds has not yet been established, efforts are being made to improve the investment environment through legislative reforms and promotion of sectors such as energy, agriculture and information technology.

Montenegro

The regulatory framework for the financial market is segmented and divided among three regulators: the Central bank of Montenegro, Insurance Supervision Agency and Capital Market Authority. The Central Bank of Montenegro (CBM): regulates the operations of credit institutions, issues licenses and grants authorisations to credit institutions and supervises the credit institutions; regulates and supervises MFIs and institutions engaged in leasing, factoring, receivables purchasing and credit guarantee operations; regulates and carries out the payment system operations; grants authorisations to payment institutions to provide payment services and supervises payment institutions; grants authorisations to electronic money institutions to issue electronic money and to provide payment services and supervises electronic money institutions; and performs other functions in accordance with the Law on CBM.

The Insurance Supervision Agency supervises and controls insurance companies and other legal and individual persons providing activities within insurance industry, while the Capital Market Authority supervises the operations of persons and companies that professionally trade in securities.

In accordance with the Law on the Central Bank of Montenegro, until Montenegro's accession to the European Union, the objectives of CBM remain fostering and maintaining of stability of the financial system, including fostering and maintaining a sound banking system and safe and efficient payment system. The CBM contributes to achieving and maintaining price stability. Without prejudice to pursuing its objectives, the CBM supports the implementation of economic policy by the Government of Montenegro. After Montenegro's EU accession, the main objective of CBM will be to maintain price stability. The CBM will support the general economic policies of the EU (30).

The MoF is responsible for preparing and monitoring Montenegro's economic policy, planning and executing the government budget, processing payments for spending units, maintaining the main treasury ledger, managing the government revenue accounting system and exercising financial control (31).

Association of Montenegrin Banks (AMB), representing all licensed banks, aims to enhance banking operations, foster domestic and international partnerships, advocate for member interests and promote EU-aligned standards and ethical conduct (32).

The total net assets of the financial sector in Montenegro amounted to 7.22 billion EUR at the end of 2023 (29). The financial sector of Montenegro is stable, with a strong emphasis on the banking sector, with banks making up 93.2% of the system's total assets and handling the majority of financial intermediation. Banks' primary operations include deposit-taking, loan issuance and various payment services, while investment banking and significant investment in financial instruments are minimal. Insurance companies, which make up 4.3% of total assets, are the next most important, mainly dealing with non-life insurance. The rest of the financial sector comprises MFIs (1.2%), leasing companies (0.6%), investment funds (0.5%), factoring companies (0.1%) and receivables purchasing companies (0.1%) (ibid).

In 2023 (preliminary data), the net inflow of FDI amounted to 428.67 million euros, which is 45.23% less compared to 2022. The total inflow of FDI amounted to 856.99 million euros (a decrease of 25.59%), which is the result of a decrease in investments based on intercompany debt and investments in companies and banks, as well as on the basis of the withdrawal of investments from abroad. (71)

Montenegro collaborates with key IFSs, including the IMF, EBRD, EIB and WBG. The CBM represents the economy in the IMF and acts as a depositary for the WBG, focusing on assessing Montenegro's economic system. As Montenegro advances towards EU accession, the CBM cooperates closely with EU institutions like the EC and ECB, highlighting its role in economic development and international financial integration (35), (34).

North Macedonia

The Central Bank of North Macedonia (CBNM), as the economy's central bank, aims primarily to achieve and maintain price stability. Subordinate to this goal, it also strives to maintain a stable, competitive and market-based financial system while supporting general economic policies and adhering to the principles of an open market economy and free competition without compromising its primary objective (36). Under the Law on the Central Bank of North Macedonia and the Banking Law, CBNM is the sole authority for licensing and supervising banks and savings houses in North Macedonia.

The MoF oversees various areas, including budget management, treasury operations, debt administration, macroeconomic policy, tax policy, customs, financial regulation, foreign currency transactions, accounting, international relations, EU collaboration, financial oversight, fiscal decentralisation and regulatory supervision (37). Law on Financial Stability outlines the objectives, status, tasks and operations of the Financial Stability Committee, as well as the instruments and implementation of North Macedonia's macroprudential policy.

The Banking Association of North Macedonia (MBA), formed by all banks and savings houses, operates independently under the Banking Law and Central Bank regulations and aims to enhance its members' activities, represent their interests, develop regulatory frameworks, protect common interests, boost productivity and ensure fair market conditions while maintaining autonomy and competition (38).

Financial diversification in North Macedonia is progressing slowly, with banks still accounting for 79.1% of financial sector assets (39). As of 31 March 2023, there are thirteen banks in North Macedonia, nine of which are predominantly in foreign ownership, with five being subsidiaries of foreign banks. Total assets of banks amounted to 12.142 billion EUR (converted from DEN to EUR as at 31.12.2023) in 2023 (40). The share of banks with foreign ownership in total loans to non-financial sector amounts to 81.8%. (41). The banking system owns high-quality capital positions, which provide it with satisfactory resilience to potential stressful scenarios. Total green loans to the non-financial sector comprise 4.5% of total loans, with two out of twelve analysed banks having no green loans in their portfolios (ibid).

Net FDI in North Macedonia amounts to 5.2% of GDP, with EU member states continuing to be the largest investors, contributing approximately 50% of total FDI inflows in 2022 (39). International financial relations involve working with international and bilateral FIs. This includes managing EU Funds and keeping track of the progress of measures and activities outlined in the National Programme for Adoption of the Acquis Communautaire (NPAA), a responsibility handled by MoF (42).

Serbia

The position, organisation, powers and functions of the Central Bank of Serbia (CBS), as well as its relations with the authorities in Serbia and international organisations, are regulated by Serbia's Constitution and the Law on the Central Bank of Serbia. The Bank operates independently and is accountable to the Parliament. Its main goal is achieving and maintaining price stability while contributing to the stability of the financial system. The Bank directs monetary policy, sets interest rates, issues securities, manages foreign exchange reserves, ensures bank liquidity, enacts regulations and oversees internal audits, all aimed at preserving financial and price stability (43).

The MoF's responsibilities, as outlined in the Law on Ministries, encompass managing the public budget, overseeing tax policies, public debt and assets, conducting public procurement, combating money laundering and coordinating financial management in the public sector, among other key duties specified in the legislation (44). The Securities Commission of Serbia regulates the capital market, while the Deposit Insurance Agency manages deposit protection in banks. These primary stakeholders in the financial sector play key roles in maintaining economic stability, regulating financial market and managing public finances.

All banks operating in Serbia are members of the Association of Serbian Banks (ASB). The aim of the Association is to position and strengthen the reputation of the banking sector. It represents, protects and promotes its members' activities, coordinating banking practices through implementing professional standards and good business practices (45).

According to the information currently available on the website of CBS, there are 20 banks: 16 majority owned by foreign shareholders, two with majority private domestic capital and two are majority owned by Serbia (46). Banking models are oriented towards traditional credit-deposit activities (47).

The total assets of banks amounted to 50.55 billion EUR in December 2023 (converted from RSD to EUR as at 30.12.2022), with foreign-owned banks holding 82.4% of the total assets (48). Among banks owned by foreign shareholders, those with shareholders from Italy, Austria and Hungary have the largest share of total activity.

Non-banking FIs remain largely inactive, with no reforms made to the legal framework for the leasing sector and no advancement in establishing regulations for microfinance institutions (49). The insurance sector's share of the total balance sheet of the financial sector was 5.6%, with 20 re-insurance companies operating. In the voluntary pension fund market, four companies managed the assets of seven voluntary pension funds, while 15 financial leasing providers were licensed to conduct financial leasing activities (47).

Net FDI constituted 7.2% of GDP. The EU continues to be Serbia's primary trading and investment ally, representing 58.7% of its overall trade and 32.9% of FDI in 2022. In recent years, there has been a significant increase in FDI inflows from China, accounting for roughly one quarter of the total FDI (49). During 2022, there was significant cooperation with IFIs, particularly the IMF, WBG, EBRD, EIB and Bank for International settlements (BIS), as well as with the EU (47). The programme aimed to support economic recovery, maintain macroeconomic and financial stability and implement structural reforms to encourage sustainable growth. The most significant activity of the CBS in the European integration process in 2022 was preparing the new National Programme for Adoption of the Acquis for 2022-2025 (ibid).

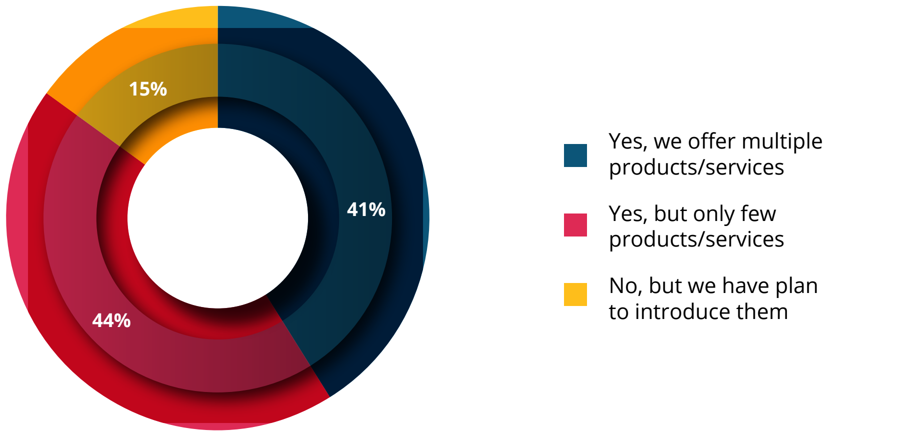
Annex 2: List of interviewed stakeholders

No	Date	Stakeholder	Type	Economy
1	08.05.	Ministry of Finance of Kosovo*	Ministry	Kosovo*
2	09.05.	Raiffeisen BANK dd BH	Commercial bank	Bosnia and Herzegovina
3	09.05.	Central Bank of Montenegro	Central bank	Montenegro
4	16.05.	Komercijalna banka AD Skopje	Commercial bank	North Macedonia
5	17.05.	Central Bank of Kosovo*	Central bank	Kosovo*
6	17.05.	Central Bank of Serbia	Central bank	Serbia
7	17.05.	OTP Bank	Commercial bank	Serbia
8	17.05.	Ministry of Finance of Montenegro	Ministry	Montenegro
9	20.05.	Ministry of Finance of North Macedonia	Ministry	North Macedonia
10	27.05.	Bank of Albania	Central bank	Albania
11	27.05.	Ministry of Finance of Serbia	Ministry	Serbia
12	28.05.	Association of Serbian Banks	Association	Serbia
13	28.05.	Ministry of Finance and Treasury of Bosnia and Herzegovina	Ministry	Bosnia and Herzegovina
14	29.05.	Banca Intesa	Commercial bank	Serbia
15	04.06.	NLB Bank North Macedonia	Commercial bank	North Macedonia
16	12.06.	Sparkasse Bank AD Skopje	Commercial bank	North Macedonia
17	12.06.	ProCredit Bank Kosovo*	Commercial bank	Kosovo*
18	14.06.	Central Bank of North Macedonia	Central bank	North Macedonia
19	17.06.	NLB Bank Montenegro	Commercial bank	Montenegro
20	20.06.	Raiffeisen Bank Kosovo*	Commercial bank	Kosovo*

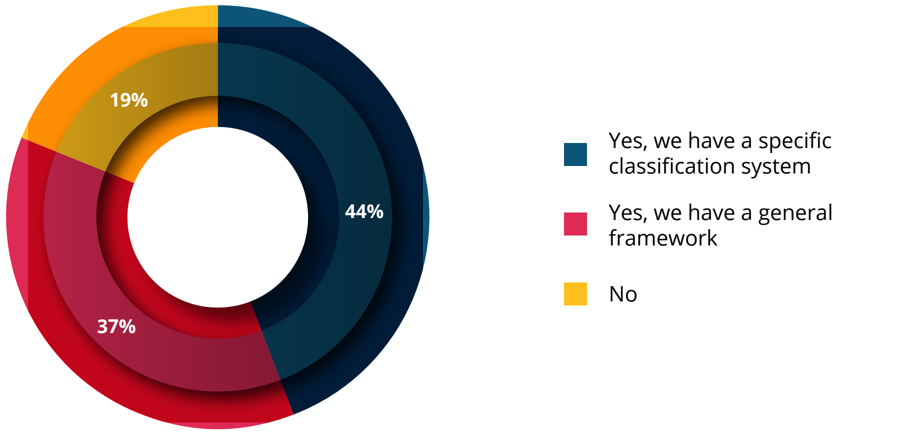
Note: *The Central Bank of Bosnia and Herzegovina stated that they do not relate to this issue and their efforts in this regard are published in their reports.*

Annex 3: Western Balkans Sustainable Finance Survey (CETEOR, 2024)

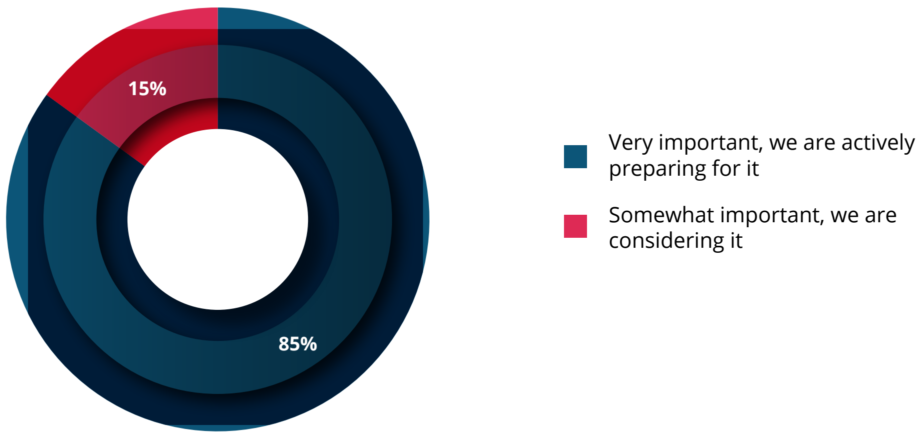
Does your institution currently offer any products or services related to sustainable finance?



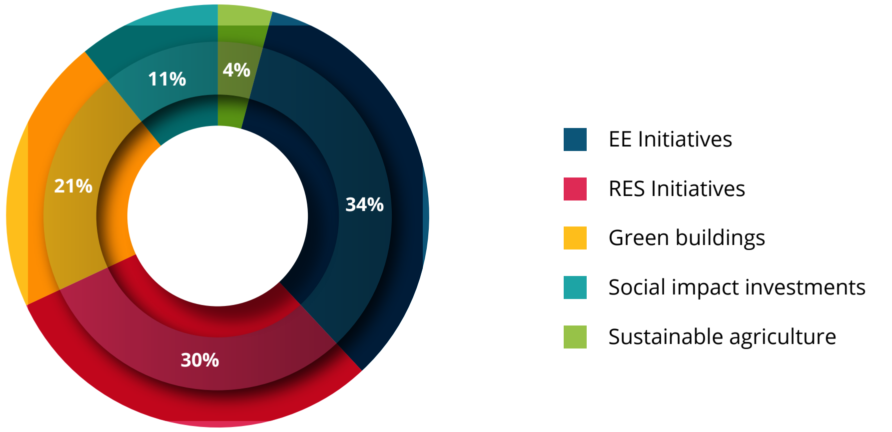
Does your institution have a method for categorising green and sustainable activities?



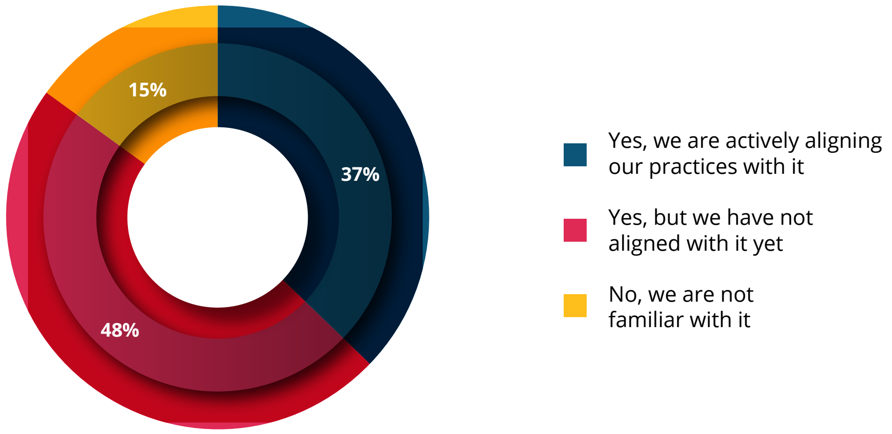
How does your institution perceive the importance of sustainable finance in the next 2 to 3 years?



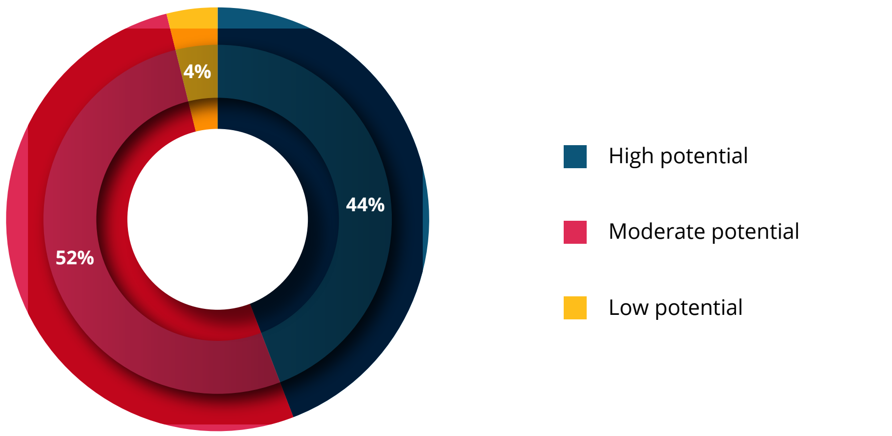
Which of the following areas does your institution prioritise when it comes to sustainable finance? (Select up to two)



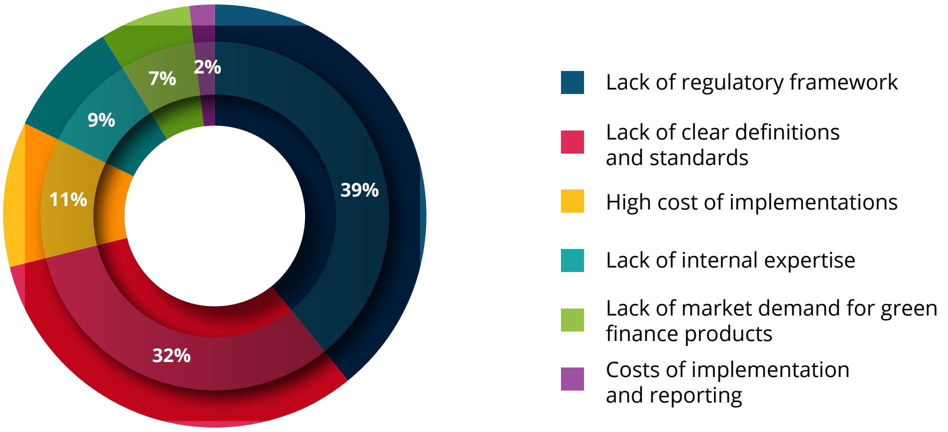
Is your institution aware of the EU Taxonomy for sustainable finance activities?



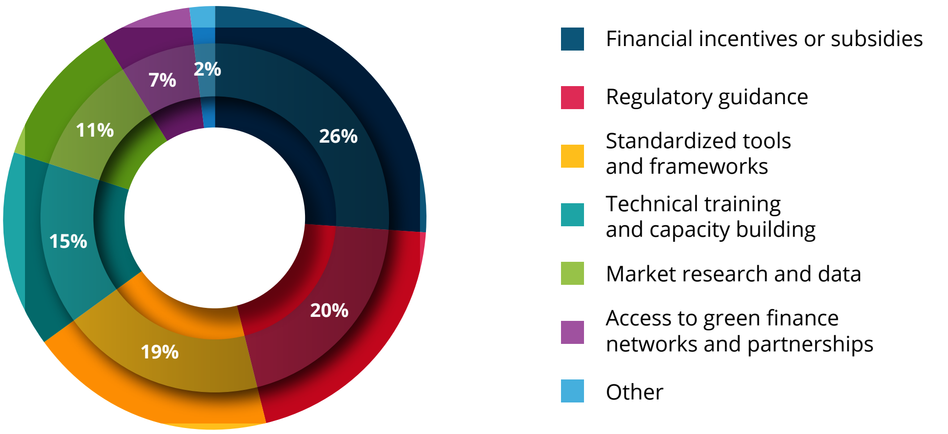
How does your institution assess the potential for growth in the sustainable finance sector in your economy?



What do you see as the main barrier for your institution in adopting sustainable finance practices?



What type of support would be most beneficial for your institution to develop sustainable finance products and services?



Annex 4: List of relevant networks and platforms on sustainable finance

Coalition of Finance Ministers for Climate Action

Economy
Montenegro
North Macedonia
Serbia

United Nations Environment Programme Finance Initiative

Economy	Institutions
Montenegro	Hipotekarna Banka AD Podgorica – banking
North Macedonia	SPARKASSE BANK MAKEDONIJA AD SKOPJE - banking
Serbia	Dunav RE (Insurance)
Serbia	Eurobank Direktna a.d. (subsidiary member) – banking
Serbia	OTP banka Srbija – banking

Network for Greening the Financial System (NGFS)

Economy	Institutions
Albania	Bank of Albania
Montenegro	Central Bank of Montenegro
North Macedonia	Central Bank of North Macedonia
Serbia	Central Bank of Serbia

Sustainable Banking and Finance Network (SBN)

Economy	Institutions
Albania	Bank of Albania
Kosovo*	Central Bank of Kosovo*
Kosovo*	Kosovo* Banking Association
Montenegro	Association of Montenegrin Banks
Montenegro	Central Bank of Montenegro
North Macedonia	Macedonian Banking Association
Serbia	Association of Serbian Banks

Principles for Responsible Investment

None.

Sustainable Stock Exchanges Initiative

Economy	Institutions
Bosnia and Herzegovina	Banja Luka Stock Exchange (BLSE)
North Macedonia	Macedonian Stock Exchange
Serbia	Belgrade Stock Exchange

International Platform on Sustainable Finance

None.

Annex 5: Demystifying sustainable finance taxonomy

The purpose of this annex is to clarify and demystify the concept of sustainable finance taxonomies. Despite growing awareness about taxonomies among stakeholders in WB, a gap in understanding their full purpose still remains. This annex aims to provide a comprehensive overview of what sustainable finance taxonomies are, why they matter and how they function.

According to the International Capital Market Association (ICMA), a sustainable finance taxonomy is “a classification system identifying activities, assets and/or project categories that deliver on key climate, green [environmental], social or sustainable objectives with reference to identified thresholds and/or targets.”

Sustainable finance taxonomies can be categorised into several types based on their focus and scope. **Green taxonomies** specifically target environmental objectives, such as climate change mitigation, renewable energy and biodiversity conservation. **Sustainable taxonomies** encompass a broader range, integrating environmental, social and governance (ESG) criteria to promote overall sustainable development. **Social taxonomies** concentrate on social goals, including healthcare, education and financial inclusion. By addressing various aspects of sustainability, these different taxonomies provide tailored frameworks to guide investments and policy decisions in specific areas of sustainable finance.

Global landscape of sustainable finance taxonomies

As at February 2024, 47 sustainable finance taxonomies or lists of eligible activities have been published globally since 2012. Among these, 31 are taxonomies from 20 economies, all addressing climate change. Most (27) target multiple “green” objectives like climate mitigation, adaptation, pollution prevention, circular economy, water protection and biodiversity conservation. Eleven focus solely on climate change, while more are beginning to support social objectives (e.g. healthcare, food security, financial inclusion, education), blue economy and SDGs. These taxonomies range from principles-based approaches and simple lists to detailed catalogues with strict criteria and safeguards. They are evolving to meet changing goals and implementation challenges, particularly in emerging markets, which emphasize inclusivity by incorporating criteria for MSMEs, women-owned businesses and vulnerable groups. As more economies issue taxonomies, there is an increasing need for governance to ensure their effectiveness, updates and expansion to match evolving sustainability objectives (52).

Sustainable finance taxonomies offer a structured framework to guide investments towards environmentally and socially beneficial activities. Their primary goals are to promote transparency, consistency and comparability in classifying sustainable investments. By defining which activities qualify as sustainable, taxonomies help investors make informed decisions, reduce greenwashing and ensure capital flows to projects that genuinely contribute to sustainability goals. They also support regulatory compliance by providing benchmarks for financial institutions and companies, fostering a more accountable and transparent financial system.

To determine whether activities are aligned with a sustainable finance taxonomy, they must be examined in detail and compared against specific criteria or performance thresholds. There are three common approaches to this assessment: technical screening criteria, a whitelist and principles.

- **Technical Screening Criteria (TSC)** – TSC set the conditions under which an economic activity qualifies as taxonomy-aligned and can also determine when an activity does no significant harm to other objectives (DNSH principle). These criteria can be both qualitative and quantitative, ideally based on a science-driven approach. TSC provides clarity and transparency, helping investors understand sustainability standards. This approach is widely used in taxonomies globally, including those in the EU, Colombia, South Korea and South Africa.

- **Whitelist Approach** – This approach lists eligible economic activities under various sectors and subsectors with detailed descriptions. An activity is considered taxonomy-aligned if it matches these descriptions. While this method simplifies alignment for businesses, its lack of detailed criteria can lead to interpretative flexibility, potentially undermining credibility. Economies like Georgia use this approach and it can be combined with TSC, as seen in China which uses detailed descriptions and TSC for specific activities.
- **Principles-Based Approach** – Unlike the whitelist and TSC approaches, principles-based taxonomies use a set of principles to assess and categorise economic activities. They do not cover specific sectors or activities nor do they set quantifiable thresholds. Instead, they provide assessment criteria and questions, allowing for classification based on the taxonomy's principles. This approach focuses on broader evaluation rather than specific standards. An example of such taxonomy can be found in Malaysia and Philippines.
- **Traffic light taxonomies** are unique frameworks that classify economic activities based on their sustainability performance using a colour spectrum of green, amber and red. These taxonomies assess a broader range of activities compared to traditional green or social taxonomies by including varying degrees of sustainability performance and alignment with sustainability objectives. An example of such taxonomy can be found in Indonesia, ASEAN, Brazil and Thailand.

Traffic Light Taxonomies	
Green	These activities are fully aligned with the sustainability objectives of the taxonomy, contributing significantly to environmental goals without causing harm.
Yellow (Amber)	These activities currently do not meet the sustainability objectives but have the potential to do so over time if their sustainability performance improves. Amber activities are often provided with performance criteria and transition pathways to help them move towards green status.
Red	These activities are not aligned with the sustainability objectives and are considered harmful. They require urgent transition plans to reduce their negative impact and improve their sustainability performance.

One common misconception is that taxonomies are merely decision-making tools for approving or rejecting investments. Taxonomies are comprehensive frameworks designed to classify and guide sustainable economic activities. They provide detailed criteria and standards to ensure investments align with ESG goals. By offering a structured approach to sustainability, taxonomies help streamline regulatory compliance, enhance transparency and foster consistent reporting across different sectors. Another prevalent misconception is that taxonomies are overly complex and difficult to use. While it is true that developing and implementing a taxonomy involves detailed criteria, efforts are being made globally to make them more user-friendly. Simplified guidelines, clear documentation and user training programmes are being developed to assist stakeholders in understanding and applying taxonomies effectively.

The selected case studies of the EU Taxonomy for sustainable activities, Sustainable Finance Taxonomy for Georgia and Indonesia's Sustainable Finance Taxonomy provide diverse approaches to sustainable finance, addressing the unique challenges and barriers faced by WB. The EU Taxonomy exemplifies a rigorous and comprehensive framework with detailed TSC, offering a high standard of sustainability alignment that can guide WB economies towards robust regulatory frameworks. Georgia's approach combines environmental and social objectives with a whitelist method, illustrating how developing economies can create inclusive taxonomies that address both environmental and social challenges. Indonesia's Traffic Light Taxonomy introduces a flexible categorisation system tailored to local contexts, demonstrating how economies with complex administrative setups and political instability can effectively prioritise and transition towards sustainable practices.

Global case studies and examples		
EU Taxonomy (2020) – endorsed by the EU Commission	Georgia (2022) – endorsed by the Bank of Georgia	Indonesia (2024) – endorsed by the Financial Services Authority of Indonesia
The taxonomy recognizes as ‘environmentally sustainable’ those economic activities that make a substantial contribution to at least one of the EU’s climate and environmental objectives, while not significantly harming any of these objectives and meeting minimum social safeguards complying with **Technical Screening Criteria.** **Environmental objectives:** (1) Climate change mitigation; (2) Climate change adaptation; (3) Sustainable and protection of water and marine resources; (4) Transition to a circular economy; (5) Pollution prevention and control; (6) Protection and restoration of biodiversity and ecosystems. **Categories of economic activities:** (1) Agriculture, forestry and fishing; (2) Manufacturing; (3) Electricity, gas, steam and air conditioning supply; (4) Water, sewerage, waste and the related remediation; (5) Transportation and storage; (6) ICT; (7) Buildings (construction and real estate activities)	**Whitelist** – detailed list of eligible activities with corresponding technical screening criteria [pass list] **Environmental Objectives:** (1) Climate change adaptation and mitigation; (2) Biodiversity conservation; (3) Natural resource conservation; (4) Pollution prevention and control; (5) Sustainable use and protection of water and marine resources; (6) Transition to a circular economy; (7) Waste prevention and recycling **Social Objectives:** (1) Poverty reduction; (2) Food security, (3) Education; (4) Healthcare; (5) Financial inclusion **Categories of economic activities** ***11 sectors under the Green Taxonomy:*** Renewable Energy, Energy Efficiency, Waste Management, Sustainable Water Management, Pollution Prevention Control, Green Transport, Sustainability Agriculture, Farming Aquaculture, Biodiversity Conservation, Sustainable Buildings Construction, Sustainable Production Trade, Green Services ***5 sectors under the Social Taxonomy:*** Affordable Basic Infrastructure, Healthcare and Related Social Services, Financing and Financial Services, Food Security, Education, Technology, Culture, Fitness.	**Traffic light** - Economic activities are either categorised directly as green (15 economic subsectors) or as yellow (904), in which case they must meet certain prerequisites to qualify. Activities must substantially contribute to environmental objectives. Activities must meet Essential Criteria: EC1: Do No Significant Harm (DNSH), EC2: Remedial Measures to Transition (RMT); EC3: Social Aspects (SA) **Environmental Objectives:** (1) Climate change mitigation; (2) Climate change adaptation; (3) Protection of Healthy Ecosystems and Biodiversity; (4) Resource Resilience and the Transition to a Circular Economy **Categories of economic activities:** Based on Indonesia’s NDC and its own KBLI (Indonesia Standard Industrial Classification). 919 economic activities (out of 2.733) mapped and defined in 5 broad categories: Energy, Forestry, Agriculture, Industrial Processes and Product Use, and Coal and Lignite Mining.

RegionalCooperationCouncil

Trg BiH 1/V, Sarajevo
Bosnia and Herzegovina

Fax: +387 33 561 701
Phone +387 33 561 700

mail: rcc@rcc.int
website: www. rcc.int

@rccint
regionalcooperationcouncil_rcc
RegionalCooperationCouncil
RCCSec
Regional Cooperation Council
rcc.int

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