



ESG Banking in Russia Research

May 2021

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Foreword

It is our pleasure to present the findings of the ESG Banking in Russia study, which was initiated by the Association of Banks of Russia and conducted by Deloitte CIS.



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ESG banking has been gaining traction in Russia, in line with major global trends. In response to the changing expectations of society, customers, and regulators, banks in Russia and around the world will increasingly be integrating **environmental, social and governance (ESG) factors** into their business models. This approach is already an important differentiator on the highly competitive Russian market.

Major banks are ahead of other market players in terms of ESG transformation, which may further widen the gap between them and smaller banks. On top of that, banks have been increasingly active in driving a common ESG agenda across all sectors of the Russian economy.

Banks are realising the real benefits of this approach over business as usual: they see it as an effective tool for increasing customer and employee loyalty, attracting investors and business partners, minimising risks, and adapting business strategies to emerging opportunities.

Despite widespread awareness of the practicality of an ESG-oriented approach, the speed, sustainability and depth of ongoing change will largely depend on whether new regulatory requirements and government support programmes create significant economic incentives for such a transformation. The building blocks of a successful transformation include responsible business values shared at all levels of an organisation, an experienced board, a proactive management approach, and genuine motivation from within.

In recent years, global commitment to sustainability has become an integral aspect of civil life. Dramatic ESG-related shifts are happening in all areas, and Russia is no exception.

Banks cannot stand by as new rules of conduct emerge in the economy—they must help redesign clients' work, lead by example, and champion ESG practices.

Major Russian banks are gradually adopting the ESG standards, thereby becoming the driving force behind this disruptive trend. So far they are ahead of the pack, but we are already seeing examples of success from smaller regional banks that are also trying their hand at ESG banking. Banks with a basic license can make their mark here too.

We hope that our research—based on the global experience—will be useful for assessing the current situation, prospects and costs of introducing ESG banking in Russia, thereby helping banks that have not yet immersed themselves in these topics to envision directions for the future, better assess risks, and determine growth points when switching to a sustainable path. The transition to ESG-driven business can be a serious challenge for many organisations. Such a massive transformation requires government support and robust economic incentives for both banks and businesses.

Our association will continue working with regulators, the government and development institutions to address these challenges.

What is ESG banking?

As yet, there is no single definition of ESG banking in Russia.

Market participants interpret ESG sub-factors in various ways, only agreeing on the very general goal of protecting the environment for future generations. As part of this research, Deloitte and the Association of Banks of Russia have attempted to arrive at a definition of ESG banking that is acceptable to most of our respondents. Following a survey, we produced the following definition, which was used in this report.



ESG banking is a banking concept based on the principles of environmental, social and governance responsibility towards present and future generations, as well as on the initiatives to achieve the United Nations Sustainable Development Goals and other socially significant outcomes.

Promotion of the ESG principles as a key aspect of public policy



The global ESG agenda

Due to ongoing globalisation and the growing influence of multinational corporations, the central focus of the sustainability discourse has shifted from the national to the corporate level. More and more organisations are coming up with their own initiatives and standards for regulating and customising global best practices to assess social and environmental impacts more effectively. On the following pages, you will find an overview of the most popular guidelines and initiatives used by major international companies. Some of them are already being leveraged by Russian banks. Looking forward, we believe that global initiatives will continue to shape the trajectory and trends of ESG banking in Russia.

Legend:



Reporting and disclosure initiatives



Risk management initiatives



Other initiatives



1987

Sustainable development was first officially introduced in a report by the UN World Commission on Environment and Development (WCED) entitled *Our Common Future*.^{*1} The concept was defined as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'. Later, the UN defined sustainable development in terms of three interconnected domains: economic growth that does not harm the environment and contributes to the resolution of social problems while ensuring a balance between economic, environmental and social dimensions.



1992

The term 'sustainable development' gained wide recognition at the United Nations Conference on Environment and Development. The conference adopted the joint document *Agenda 21*^{*2}, which comprised a plan of action for sustainable development to be taken by national governments.



1997

This year marked the founding of the Global Reporting Initiative (GRI), an international voluntary reporting framework for organisations willing to disclose their sustainability performance. **The GRI standards focus on organisations' 'material topics', or activities that have the most significant impacts outward and must therefore be disclosed in the sustainability report.** In 2016, a set of three Universal Standards (GRI 101-103) was published to simplify the reporting process. The new structure included 33 specialised GRI standards, which reporters could choose at their discretion. As of April 2021, the global GRI reporting database contained published reports of more than 15,000 companies, including 10 Russian banks.



2000

The Carbon Disclosure Project (CDP), a not-for-profit charity that coordinates the disclosure of greenhouse gas (GHG) emissions around the world, was established in 2000. The CDP maintains a global base of GHG emission data and requests information on climate change-related risks and opportunities from the world's largest companies, assigning them climate scores. Russia joined the CDP initiative in 2009 by launching a survey among the 50 RTS-listed companies with the highest capitalisation.

*Source: see the relevant appendix.



2006

The Principles for Responsible Investment (PRI)^{*3} were developed at the initiative of the UN Secretary General. PRI signatories commit to incorporating ESG issues into their investment analysis and decision-making processes. By 2020, over 3,000 organisations had signed up to the PRI. A number of Russian banks also declared their commitment to these principles.



2007

The Climate Disclosure Standards Board (CDSB)^{*4} was created. The CDSB provides a framework for reporting sustainability-related information. What differentiates the CDSB is that it does not seek to create new standards, but rather leverage existing ones.



2009

The Global Alliance for Banking on Values (GABV) was established. Its mission is to use finance to deliver sustainable economic, social and environmental development. At present, the GABV includes 62 banks. The only Russian member bank—Center-invest Bank—joined GABV in 2019.



2011

The Sustainable Development Accounting Standards Board (SASB) was created. The organisation's mission is to establish and improve industry-specific disclosure standards for financially material environmental, social, and governance topics^{*5}.

In Russia, these standards have been adopted by Sberbank, among others, as demonstrated in their 2020 Sustainability Report.



Anatoly Chubais

Special Presidential Representative for Relations with International Organisations to Achieve Sustainable Development Goals



ESG and sustainable development are among the most pressing items on the global agenda. As a member of the international community, the Russian Federation is directly involved in many initiatives, including the recent climate summit. Russia has signed the Paris Agreement, developed the national project 'Ecology' and presented the first Voluntary National Review (VNR) of its progress in achieving the UN SDGs.

Starting from 2020, the Executive Office of the Russian President, the Government of the Russian Federation and the Bank of Russia have intensified their efforts in this area. The achievement of these goals hinges on the effective collaboration of all market participants—from scientists and experts to banks and regulators. The UN platform and other international initiatives are a convenient tool for this purpose. Russia is willing to exchange knowledge and experience in order to achieve the best possible outcomes. We are confident that the environmental and sustainability goals pursued by the global community can only be accomplished through joint efforts.





2014

The European Commission adopted the EU Directive on Non-Financial Reporting,^{*6} which applies to large companies with over 500 employees operating within the EU. Companies affected must disclose information on their social and environmental impacts. The European Commission plans to adopt a revised version in 2021, which will introduce single-format requirements for non-financial reporting. Russian companies and borrowers that interact with EU markets will also have to comply with these rules.



2015

The UN adopted the 2030 Agenda for Sustainable Development, which established 17 long-term Sustainable Development Goals (SDGs)^{*7} seeking to end poverty, conserve the planet's resources, and promote well-being for all. Russia is among the 193 countries to endorse the SDGs. In July 2020, Russia presented its first Voluntary National Review of progress towards the UN SDGs^{*8} to the UN High Level Political Forum, as well as its first independent Voluntary Civil Society Review (*A Decade of Action in Russia: Challenges and Solutions 2020-2030**⁹).



2016

At the G20 Summit, the Green Finance Study Group (GFSG) presented a report^{*10} outlining the importance, goals and prospects of sustainable development. In 2018, the Green Finance Study Group was transformed into the Sustainable Finance Study Group (SFSG) and its remit was expanded. In March 2021, the SFSG met with the G20 to develop a multi-year G20 Roadmap for Sustainable Finance addressing key barriers and actions for sustainable development in the G20 countries.



2017

The Task Force on Climate-Related Financial Disclosures (TCFD) developed recommendations for voluntary disclosures of the financial risks presented by climate change^{*11}.

In December, the Network for Greening the Financial System (NGFS) was created, which includes 83 central banks and other financial supervisors.

The Bank of Russia joined NGFS in December 2019. In the same year, NGFS published a report on the impact of climate risks entitled *Climate Change as a Source of Financial Risk*.



2019

In late July, the UN Environment Programme Finance Initiative (UNEP FI) published the Principles for Responsible Banking,^{*13} which aim to provide a common framework for the sustainable banking industry. These principles define the role and responsibility of the banking sector in building a sustainable future in line with the UN SDGs and the 2015 Paris Agreement. In Russia, the Principles for Responsible Banking have been endorsed by Sberbank, Sovcombank and Center-invest Bank.

In September, at the UN General Assembly session on climate change, banks announced the signing of a Collective Commitment to Climate Action (CCCA).

In December, the European Commission adopted The European Green Deal^{*14}, which aims to achieve a significant reduction in GHG emissions by 2050.

*Source: see the relevant appendix.

The World Economic Forum presented a new initiative called the ESG Ecosystem Map^{*15}, which brings together all the crucial initiatives in the field under one umbrella. This map provides an overview of the ESG reporting landscape and acts as the basis for sustainability dialogue between investors, companies and other industry players.

2020

In 2020, for the first time in history, climate risks topped the agenda of the World Economic Forum's Global Risks Report^{*16}.

In February 2020, the Basel Committee on Banking Supervision (BCBS) established the Task Force on Climate-related Financial Risks (TFCR). The TFCR intends to develop guidelines for measuring, assessing and overseeing the mitigation of relevant risks by mid-2021.

2021

Entities covered by the Sustainable Finance Disclosure Regulation (SFDR) must comply with the rules for EU financial market participants coming into effect in 10 March 2021^{*17}. Such organisations must also comply with periodic sustainable finance reporting requirements that enter into force on 1 January 2022.

In April, the Net Zero Banking Alliance, a new finance sector association, was convened by the UNEP FI. Today the Alliance unites over 45 banks from 23 countries that are all committed to aligning their lending and investment portfolios with net-zero emissions by 2050.



Anatoly Aksakov

Chairman of the Russian State Duma Committee on Financial Markets



The Carbon Border Adjustment Mechanism creates a transition risk for Russian companies in terms of the climate agenda, which demands attention from both exporters and their creditors.

Adjusting the economy to emerging business standards requires the active participation of banks that integrate global and national approaches to ESG banking through dialogue with business and regulators. Banks should also refine their risk assessment practices—not just by improving their reporting processes, but also by encouraging the economy to embrace the ESG concept and green finance projects.

Adopting the ESG principles inspires banks to develop their own climate strategies and risk management processes while factoring in the growth of funding for green finance initiatives. However, banks should extend their focus from simply lending to green industries or companies with high ESG rankings to analysing movements in borrowers' ESG rankings as part of loan covenants. It is also important to communicate best practices and demonstrate the benefits of ESG integration both through client service and industry associations.



^{*}Source: please see the relevant appendix

ESG banking in the world

Many foreign companies are actively funding ESG initiatives and developing new products to integrate ESG solutions into their policies. This helps them lower their negative environmental and social impacts. In 2020, investments in ESG funds exceeded USD 50 billion, a two-fold increase from 2019. Global ESG assets are growing annually and will continue to grow over the next 15 years, experts say¹.



230%

the increase in the number of ESG teams in the world's top 30 asset management companies from 2017 to 2020²



USD 50 trillion

the investment potential created by the transition towards an environmentally sustainable global economy



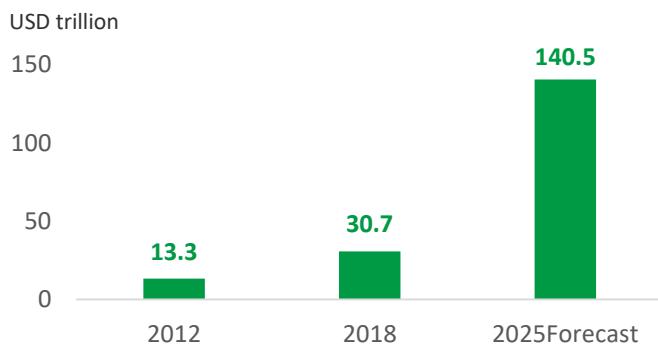
fivefold

the increase in sustainable investment assets globally. ESG assets are expected to reach USD 140.5 trillion by 2025³



USD 152 billion

the inflow of investments into global ESG funds in Q4 2020. Eighty percent of this amount went to European funds⁴



¹ Source: International Institute for Sustainable Development, 2020 (Sustainable Investing: Shaping the future of finance)

² Source: Opimas, 2020 (<http://www.opimas.com/research/570/detail/>)

³ Source: Visual Capitalist, 2020 (<https://www.visualcapitalist.com/rise-of-sustainable-investing/>)

⁴ Source: Reuters, 2021 (<https://www.reuters.com/article/us-global-funds-sustainable-idUSKBN29X2NM>)

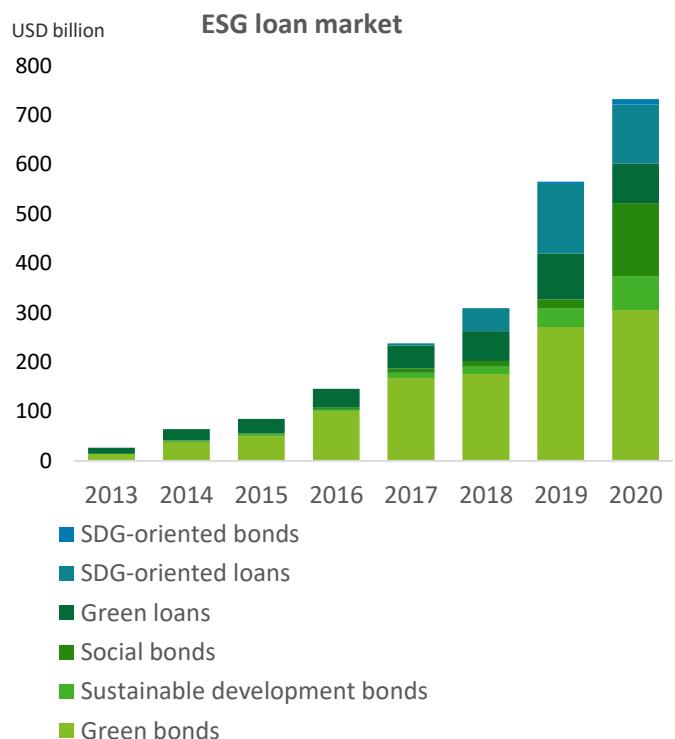


≈USD 730 billion

the size of the global ESG borrowings market in 2020 (bonds and loans)¹

Of these, a little more than USD 300 billion are green bonds, and roughly USD 150 billion are social bonds. The value of investments increased by 13 percent and more than 700 percent respectively compared to 2019.

Remarkably, ESG-linked bonds grew by more than 100 percent, to nearly USD 11 billion.



Borrowings	2019 USD	2020 USD	Change, USD	Change, %
Green bonds	271.1 billion	305.3 billion	34.2 billion	12.6%
Sustainable development bonds	37.9 billion	68.7 billion	30.8 billion	81.1%
Social bonds	18 billion	147.7 billion	129.7 billion	720.3%
Green loans	93.4 billion	80.3 billion	(13 billion)	(14%)
SDG-oriented loans	140.1 billion	119.5 billion	(20.6 billion)	(14.7%)
SDG-oriented bonds	5 billion	10.6 billion	5.6 billion	112.5%
Total	565.5 billion	732.1 billion	166.6 billion	29.5%

¹ Source: 'The Sustainable Debt Market Is All Grown Up', Bloomberg (<https://www.bloomberg.com/news/articles/2021-01-14/the-sustainable-debt-market-is-all-grown-up>)

Adoption of the ESG principles in Russia

Driven by their direct impact on ESG performance, as well investors' expectations, heavy industry and mining companies have been the first to take up opportunities to extensively and systematically integrate ESG factors. Financial institutions, which play an integral role in the financial system, are stepping up their efforts to include these factors into their business models, seeking to improve risk management and gain a strategic edge. The Russian legislative and regulatory framework for ESG issues is still nascent, which poses a challenge to implementing the ESG principles. Below is an overview of the key national initiatives that are shaping the development of the ESG agenda in the country.

2016

Russia signed the Paris Agreement on Climate Change^{*18}, which was adopted at the Paris Climate Conference in 2016. The agreement seeks to combat global warming and regulate carbon dioxide emissions into the atmosphere. Russia ratified it in 2019, joining 188 other signatories. To perform its obligations under the agreement, Russia plans to reduce GHG emissions 'by 70 to 75 percent of the 1990 level by 2030, subject to the capacity of Russian forests to absorb carbon dioxide'^{*19}.



Maksim Reshetnikov
Minister of Economic
Development of the
Russian Federation



We are seeing a global trend towards financing green projects. As a result, the Russian government, central bank and development institutions have been active in drafting national regulations in this area.

To date, Russia has adopted new issuance standards for securities, which also cover green and social bonds. The Moscow Exchange already has a sustainable development sector consisting of three independent segments: green bonds, social bonds, and national projects. New issuances of green and social debt securities that comply with international standards are already underway.

However, Russia needs its own eligibility criteria for sustainable investment projects that will be recognised by its foreign partners. We have created a cross-departmental working group to develop such criteria jointly with VEB.RF and the Russian Government. A set of documents has already been prepared with respect to national standards. We expect to introduce the first green bonds compliant with the Russian and international verification standards by the end of 2021. Our efforts will ultimately help revamp the Russian economy and give it a competitive advantage on the world stage.



*Source: please see the relevant appendix.

2018

In May, the Russian President signed Decree No. 204 ‘On the National Goals and Strategic Development Objectives of the Russian Federation for the Period to 2024’^{*20}. The tools for achieving these goals include the national project ‘Ecology’^{*21}, which seeks to:

- Remove all illegal landfills identified in a number of Russian cities in 1 January 2018
- Increase the share of processed waste from 12 percent to 60 percent, as well as the share of recycled waste from 7 percent to 36 percent
- Reduce emissions in the most polluted cities by more than 20 percent
- Create 24+ protected areas with the necessary infrastructure for ecotourism
- Purify and conserve water in water bodies
- Improve the quality of drinking water by increasing the share of water utilities with advanced water treatment technologies from 20 percent to 90 percent
- Restore 1.5 million hectares or forests annually, etc.

The project is being supervised by the Russian Ministry of Natural Resources and Environment.

The first Russian green bond was issued by Resursosberezhenie KhMAO in December 2018.

2019

In April, the Moscow Exchange began calculating and publishing daily sustainability indices in partnership with the Russian Union of Industrialists and Entrepreneurs (RSPP). The new indices, the MOEX-RSPP Responsibility and Transparency Index and the MOEX-RSPP Sustainability Vector Index, will be used to analyse the ESG compliance of Russian companies.

Russian Railways issued the country’s first euro-denominated green exchange-traded bonds in May 2018, and Center-invest Bank became the first Russian bank to issue green exchange-traded bonds in November of the same year.

In August, the Moscow Exchange launched a Sustainability Sector to finance environmental and socially significant projects.

2020

Issuers that want to be listed in the Sustainability Sector must file regular reports on how they use the raised funds, as well reports describing the nature of their bonds in the context of green and social factors.

In March, the Russian Ministry of Economic Development developed a draft long-term development strategy for Russia^{*22} that includes three scenarios for decarbonising the national economy, including the energy sector.

In June 2020, Russia presented its first Voluntary National Review of progress towards the 17 UN SDGs^{*23}, which covers the economic, environmental and social spheres. Among other things, the review sheds light on national initiatives aimed at implementing the UN’s 2030 Agenda for Sustainable Development.

In June, shares in Russia’s first exchange-traded mutual investment fund for responsible investors, established by RSHB Asset Management, were made available on the Moscow Exchange.

In July, the Russian Government, after consulting with the Bank of Russia, suggested that the Ministry of Economic Development should coordinate the non-public funding of ESG projects and the overall development of responsible investment in the country.

For this purpose, the Ministry of Economic Development created a cross-departmental working group that includes a number of federal-level organisations (the Ministry of Natural Resources, the Ministry of Transport, the Ministry of Construction, the Ministry of Industry and Trade, the Ministry of Energy, the Ministry of Finance, and the Bank of Russia, and others).

*Source: please see the relevant appendix.

In August, the Ministry of Economic Development prepared a draft concept of the Russian Carbon Unit Circulation Framework^{*24}. This project is the first in Russia that attempts to introduce a systemic approach to regulating climate projects.

In September, the Association of Banks of Russia created a project group for ESG Banking that seeks to suggest ways of building a legal framework for promoting the ESG banking model on the Russian market.

In November, the Ministry of Economic Development was approved as the responsible investment and non-public ESG funding coordinator for sustainability projects (including green initiatives). This includes determining the goals and key directions for sustainable development in Russia that must be taken into account when setting the criteria for sustainability projects and requirements for their verification^{*25}.

Also in November, the Russian Government approved VEB.RF as the hub for developing guidelines to facilitate impact investment and non-public funding of responsible development projects.

In December, Anatoly Chubais was appointed Special Presidential Representative for Relations with International Organisations to Achieve Sustainable Development Goals. He is now responsible for liaising with organisations within the UN system.

In December, the Ministry of Economic Development established an expert council for sustainable development that connects 30 leading Russian and foreign companies. Sberbank and Rosbank represent the Russian banking sector in the council's boardroom.

On 9 December 2020, the placement of a new RUB 300 million issue of Center-invest Bank green bonds began on the Moscow Exchange. Center-invest Bank was the first Russian bank to issue green ETF bonds that conform to both local and international standards for responsible financing.



Nikolay Zhuravlev

Deputy Chairman of the Federation Council of the Federal Assembly of the Russian Federation



ESG is a vibrant trend. In his address, President Vladimir Putin called for Russian GHG emissions to be lower than the EU's in the next 30 years. The financial sector will play a special role in tackling this challenge. ESG profiles are an increasingly major factor for banks giving out loans, and investment funds tend to check ESG ratings when deciding on the structure of their investment portfolios.

Organisations that want to raise investments must monitor their GHG emissions, recycle waste, restore forests, use natural resources sustainably, and so forth.

The demand for ESG financing tools is quite high, and it will continue to grow in the near future. ESG banking and sustainable development are not a private choice of an individual bank or even the whole real sector. These concepts represent a response to the expectations and demands of society and the state. Thus, the Russian financial sector acts as the champion of a greener economy, encouraging and aligning borrowers around the common goal of reducing their environmental impacts and preserving ecosystems.



^{*}Source: please see the relevant appendix.

2021

In late January 2021, Sovcombank completed the issuance of USD 300 million four-year social eurobonds.

In February, the Association of Banks of Russia published *Practical Recommendations of the Banking Community on the Implementation of ESG Banking in Russia**²⁶, designed to raise awareness of ESG principles on the financial market.

In February 2021, the Ministry of Economic Development presented a draft law to regulate GHG emissions.*²⁷ The goal is to create a carbon regulation mechanism and infrastructure to raise funding for climate projects. The draft law provides for the introduction of a step-by-step model for regulating GHG emissions without taxes and mandatory payments. Major issuers will be required to file mandatory GHG reporting.*²⁸ The draft will also create a legal basis for carbon trading, which can be considered a tool to reduce Russia's carbon footprint and attract investors, as well as an opportunity to create a new market in this area. Unlike the European regulation model, the Russian draft law sets neither

restrictions for businesses nor GHG quotas and fees. According to the Ministry's statement, the key priority is to protect the interests of Russian manufacturers. The draft was passed by the Russian State Duma at the first reading in the end of April.

In his April address to the Federal Assembly, President Putin highlighted the need to accelerate the adoption of a law that stipulates financial implications for companies that harm the environment.

VEB.RF plans to launch the national green finance system in July 2021, which will enable Russian companies to obtain loans for a total of RUB 50 billion to implement green projects.



For more information, please refer to respective sections of this report discussing other ESG initiatives of regulators or market participants.

Results of Deloitte's survey of banks



A Deloitte survey of Russian banks suggests that despite overall **low** awareness of ESG issues, interest is **growing**. So far, integration of the ESG principles into operating models has been rather fragmented. Banks believe that full integration requires amendments to the relevant Russian laws.

- ≈ 15%** of banks say that an ESG analysis is an essential part of their work.
- ≈ 30%** of banks expect ESG considerations to be significant for them in three years' time.
- < 20%** of banks understand what ESG-related information is most relevant for investor and lender decision-making.
- < 5%** of banks consider some ESG indicators when assessing their long-term performance.
- ≈ 45%** of banks cite the need to develop a standardised approach to assessing the social and environmental costs and benefits of ESG factors.
- ≈ 20%** of banks believe that the role of ESG scores in investor and lender decision-making will increase significantly over the next three years.



Less than a third of respondents think that climate change **will affect** their financial performance, which once again underlines the sector's low awareness of these matters.

- ≈ 30%** of banks believe that climate change will affect their financial performance.
- ≈ 40%** of banks expect that climate change will affect their financial performance in three years' time.
- < 15%** of banks believe they have the competence to perform a full analysis of ESG risks.

RUB 3 trillion

potential for the implementation of green technologies in Russia up through 2023 (according to the Russian Ministry of Economic Development)¹. Here, the term 'green technology' means technology that is environmentally friendly.

RUB 111 billion

Russian bonds that meet the green finance principles as of September 2020². In this report, green finance means financial investments flowing into sustainable development projects that deliver environmental improvements, mitigate the impacts of climate change and ensure more efficient use of resources.

¹ Source: the Russian Ministry of Economic Development

² Source: speech by Denis Shulakov, First Vice President of Gazprombank, at the Gaidar Forum in January 2021

Key barriers

The Russian government strives to set the stage for a sustainable economy in which companies need to prioritise the environmental, social and economic aspects of their activities. A similar trend can be observed in the country's financial sector. However, a number of factors still hinder the development of ESG banking in Russia and globally. These can slow down the economy in the face of new global challenges. It is essential to identify the barriers that are most relevant for the Russian market, where the ESG concept is still new. The key barriers voiced during Deloitte's in-depth interviews with market participants are listed below.



International barriers

- No single internationally recognised definition of ESG banking
- No standard interpretation of ESG risks
- No unified ESG risk management methodology
- No single taxonomy tailored to the banking sector
- No clear relationship between financial and non-financial reports that could be relied upon when assessing the impact of ESG initiatives on a bank's financial performance
- Different approaches to ESG assessment used across the financial market
- No single platform for sharing ESG practices and knowledge



Local barriers

- High dependence on commodities, which creates difficulties for a fast, low-cost transition to a sustainable economy
- As ESG banking is still at an early stage in Russia, there is some greenwashing going on
- No comprehensive ESG-related regulations from the government
- No customised ESG banking approaches that fit the Russian economy
- Different levels of financial and human resources allocated by banks to the development of ESG practices
- Low awareness among banks and borrowers about the benefits of ESG integration
- No single standards for issuing green loans





Vasily Vysokov

Chairman of the Board of Directors of Center-invest Bank,
Head of the ESG-Banking Project Group of the Association of Banks of Russia



ESG banking is more than just a global trend—it is a robust business model for regional banks. ESG banking broadens the universe of bank risks (by adding environmental, social, and governance risks) and their time horizon in the interests of current and future generations. This broader range and time horizon increase costs for banks but help them consider a wider variety of alternatives and tools. It also helps them adapt more quickly to never-ending disruption in an age of continuous crises.

The experience gained from rethinking their goals has given Russian banks in the post-Soviet era an advantage when it comes to redesigning all components of ESG banking (taxonomy, organisation, planning, risk management, reporting). The broad use of state-of-the-art IT technologies enables banks to undertake ESG-focused digitalisation of business processes and financial markets at an early stage. Long preparatory periods have given way to fast transitions to ESG models for the banks, the regulator, government agencies, legislators, customers, and business partners. It is therefore essential to retain and strengthen the key advantage of Russian ESG banking—creative thinking.



Infrastructure

The right infrastructure is a critical driver for ESG banking, and Russia has all the necessary components for successful ESG development. Detailed interviews with market participants undertaken as part of this research have confirmed that the country possesses adequate financial infrastructure. All major infrastructure players are actively involved in the development and implementation of ESG initiatives and tools, largely focusing on the best international standards.

It bears remembering that the effective functioning of any infrastructure requires appropriate steps from regulators. Thus, the Russian Ministry of Economic Development coordinates the development of green and sustainable investment and crafts initiatives to

raise non-public funding for ESG projects. The Bank of Russia requires that all issuers of green and social bonds comply with international principles and standards for non-financial reporting (including the UN SDGs). The Moscow Exchange has launched the Sustainability Sector to fund ESG projects. It maintains a list of rating agencies and companies and compiles their opinions to designate bonds as sustainable development bonds. VEB.RF provides guidelines to organisations from the financial sector, and it has developed a taxonomy of green and transitional products.

Initiatives of the Moscow Exchange (a component of the trading infrastructure)

In April 2019, the Moscow Exchange joined the Stock Exchanges for Sustainable Development initiative, which brings together 100 stock exchanges from around the world.

In August 2019, the Moscow Exchange published new listing rules that incorporate the new Sustainability Sector, which was established to fund environmental projects and social initiatives.

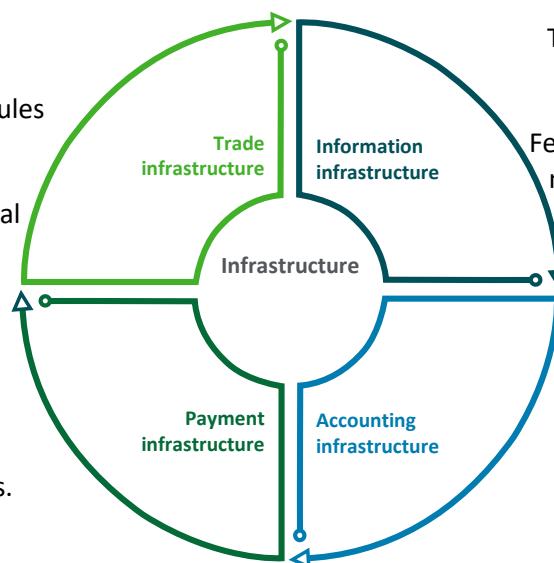
In June 2020, the Moscow Exchange published its first Sustainability Report for 2019 in line with GRI reporting standards.

Initiatives of rating agencies (a component of the information infrastructure)

Russian rating agencies perform valuations of financial instruments, including green bonds, social bonds, sustainable development bonds, green loans, etc.

They also perform ESG assessments of businesses, organisations, constituent entities of the Russian Federation, or individual portfolios of management companies (open-end and closed-end mutual investment funds, etc.).

Russian agencies have developed their own guidelines for assigning non-credit ESG ratings to various groups of issuers.





Yury Denisov
Chairman of the Executive
Board,
Moscow Exchange



The Moscow Exchange is a key component of Russia's financial infrastructure, as we promote ESG banking in Russia. Our platform provides transparent pricing for many classes of assets, helping banks reduce risks from transactions in financial markets. MOEX works to expand the scope and improve the quality of the ESG-related information disclosed by banks and other issuers. We implement a variety of responsible investment initiatives, having developed a best practice guide on sustainable development that all issuers—including banks—may find useful for managing their sustainability efforts. We calculate sustainability indices in partnership with the Russian Union of Industrialists and Entrepreneurs. Several ETFs have already been created for this purpose. The MOEX's Sustainability Sector welcomes bonds issued by banks and companies that seek to raise capital for environmental and social initiatives.



ESG banking potential in Russia

In Russia, ESG banking is still in its early stages, but we see significant potential for its growth, both in the banking sector and in the economy as a whole. The growing focus on the ESG agenda in Russia suggests that this trend permeates all sectors of the national economy. With its cases of best regulation practices and a number of ESG principles embedded into banking models, Russia can benefit from being ‘the fast second’, embracing ESG banking as a tool for building a greener, more sustainable and diversified economy.

As ESG banking is a new long-term objective for the country, virtually no observable data is available to date.

Financial institutions play a crucial role in crafting a widely recognised model of economic development with an embedded sustainability strategy. This role entails proactive, self-imposed development of ESG and risk management strategies with robust support from the regulator. These activities should cover three main areas:

-  Developing ESG criteria for financing traditional industries
-  Offering support to new industries that have a higher impact on the ESG agenda (hydrogen and other alternative energy sources, social entrepreneurship, manufacturing, etc.)
-  Driving innovation and resilience in traditional industries (fishing, forestry, agriculture, etc.)



Alexander Vedyakhin

First Deputy Chairman of the Executive Board,
Sberbank



The development of the ESG financing market in Russia is at an early stage, but it is progressing rapidly. Originally issued by international banks, ESG loans are now available from major Russian banks, including Sberbank. Green and social bonds have been floating on the Russian market for a long time, but their number and the number of issuers are still limited. We expect that sustainability-linked bonds (a new type of ESG debt security) will appear on the domestic market in the nearest future. These instruments have the potential to open the sustainable finance market to companies without significant green expenditures. There is also a chance that the market will welcome sovereign ESG bonds issued by the Russian government. Their issuance will mark an important milestone in the development of the country's green finance initiatives, helping improve its image among international investors. We estimate the potential volume of the Russian green financing market at roughly 3 RUB trillion by the end of 2023. However, unlocking this potential will require adequate support from the government. A number of initiatives, affecting both borrowers and investors, are being discussed widely.



As of 2020, the Russian economy comprises the following industries:

Industry	% GDP ¹
Manufacturing	15%
Commerce	13%
Real estate	11%
Mining	10%
Public administration and social policy	8%
Transportation and storage	7%
Construction	6%
Finance and insurance	5%
Professional services, science and technology	5%
Agriculture, forestry, hunting, fishing, and fish farming	4%
Health care and social services	4%
Education	3%
Other industries	11%

The uneven spread of ESG practices across industries creates room to optimise their economic, environmental and social impacts. Given the established practice of foreign banks, which scrutinise the ESG profile of borrowers when lending to various industries, as well as the low adoption of ESG banking in Russia and the relative increase in the share of ESG-active industries, we see significant potential for the development of ESG banking in the country. We anticipate growing demand for ESG-linked products (mainly SDG-oriented loans and bonds) from companies that seek to integrate ESG factors into their business models and strategic plans.

All else being equal, this model is a win-win for all, as it ensures better risk management for borrowers and adds more value for the lender's stakeholders.



≈ USD 160 trillion

the outlook for global ESG assets by 2036²



≈ RUB 360 trillion

the outlook for ESG assets in Russia by 2036 (if current trends persist)³



≈ RUB 1.3 trillion

the outlook for green and SDG-oriented loans in Russia by 2030 (if current trends persist)³

Ultimately, the key drivers of ESG finance in Russia go beyond preferential conditions for ESG funds offered to financial institutions. The national market needs a more consistent and comprehensive approach to raise general awareness of sustainability benefits and to encourage the effective integration of relevant practices into existing and emerging business models. This will help banks and borrowers align and balance their interests while also creating value for stakeholders.

¹ Source: Rosstat, gross value added by industry

² Source: International Institute for Sustainable Development | IISD.org (<https://www.iisd.org/publications/sustainable-investing-shaping-future-finance>)

³ Source: Deloitte estimates

The regulator's role in promoting ESG banking

The Bank of Russia maintains a strong focus on the sustainable development of the national banking sector, which it pursues by adopting prudential and supervisory measures. The regulator maintains contact with financial institutions in order to explore and gradually implement global best practices of ESG investing. The regulator sees its main goal as creating conditions for funding projects that are aimed at achieving the UN SDGs and fighting climate change while also maintaining financial stability.

2014

In late March 2014, the Bank of Russia issued a corporate governance code for public companies^{*29} and state-owned corporations.

2015

The Bank of Russia published its first annual review of corporate governance practices at Russian public companies for 2014.^{*30} The purpose of the review was to monitor the implementation of corporate governance principles recommended for public companies, as well as to boost the efficiency of their corporate governance procedures.

2017

At the end of August 2017, the Bank of Russia launched an outreach program focusing on financial culture (fincult.ru), which helps citizens raise their financial literacy through a variety of useful materials.

In September, the Russian Government and the Bank of Russia adopted a strategy to improve the financial literacy of the Russian population in the period from 2017 to 2023^{*31}. This strategy is a roadmap that describes a number of steps that can be taken to include financial literacy classes in the curriculum of Russian educational institutions.

2019

In 2019, the Bank of Russia's Task Force on ESG Finance developed a blueprint for developing guidelines to promote green financing and responsible investment^{*32}.

Starting in October of that year, Russian banks issuing new loans totaling RUB 10,000 and more are required to assess the borrower's debt burden.^{*33} This requirement was introduced to slow down the rapid growth of unsecured consumer loans.

2020

The Bank of Russia's draft Regulation 'On the Issuance Standards for Securities,'^{*34} which also covers green and social bonds, came into effect in January 2020. The standards were revised in April 2020^{*35} to incorporate rules for issuers of green, social and infrastructure bonds. In May 2020, issuers were also permitted to label their bonds green as long they meet eligibility criteria covering use of proceeds and other requirements.

In May, the Bank of Russia published a public consultation report on climate risk impacts and the sustainable development of the Russian financial sector^{*36}.



In July, the Bank of Russia developed guidelines for institutional investors on responsible investment principles^{*37}. The guidelines stress that ESG factors should be among the key considerations for investors deciding where to put their money.

At the end of 2020, the Bank of Russia established a working group led by First Deputy Chairman Sergey Shvetsov, which will be responsible for financing sustainable development projects. A number of smaller subgroups will deal with the integration of ESG factors and risks across organisations and building sustainability infrastructure and tools.

2021

In February, the Bank of Russia announced plans to promote green and social bonds and green mortgages. They will become a source of preferential funding for those who wish to purchase apartments in energy-efficient and eco-friendly buildings. These initiatives will be implemented by a working group dedicated to sustainability. The group comprises several subgroups that include representatives of federal executive agencies, development institutions, associations, self-regulated organisations and professional non-profit associations for financial market participants.

In February, the market learned that the Bank of Russia, jointly with the Russian Ministry of Economic Development and VEB.RF, were developing eligibility criteria for sustainable development projects, as well as basic guidelines for verifying green instruments. The regulator is currently assessing systemic risks posed by climate change and the climate agendas of foreign countries for the financial market and the economy as a whole.

^{*}Source: please see the relevant appendix

In March, the Bank of Russia announced the completion of a draft guidance on disclosing non-financial information for public companies. In a commentary following a meeting to discuss the Bank of Russia's regulation of commercial banks,^{*38} Mr. Shvetsov stated that the project was being finalised by the working group.

In April, as part of the same commentary, he shed light on the bank's plans to make responsible financing a key focus area to be outlined in the *Main Development Vectors of the Russian Financial Market for 2022, 2023 and 2024*.

In the same month, the Bank of Russia announced that the remit of their working group on sustainable development would henceforth include drafting regulatory instruments to help non-green companies from the real sector raise funding for their climate transition.

Government agencies engaged in shaping the ESG agenda in Russia



MINISTRY OF ECONOMIC DEVELOPMENT
OF THE RUSSIAN FEDERATION



Bank of Russia

The Central Bank of the Russian Federation



Росприроднадзор



MINISTRY OF FINANCE
OF THE RUSSIAN FEDERATION



MOSCOW
EXCHANGE



MINISTRY OF NATURAL RESOURCES
AND ENVIRONMENT OF THE
RUSSIAN FEDERATION



Ministry of Labour
and Social Protection





Sergey Shvetsov
First Deputy Chairman of
the Bank of Russia,
Member of the Board of
Directors



Sustainability and ESG are high on the agenda for the Bank of Russia. We are currently focusing on two key goals in this area.

First, we want to create favourable conditions for financing sustainability projects in Russia. This includes empowering every citizen to contribute to a better future for their children and the whole planet by leveraging infrastructural and institutional opportunities, as well as empowering corporations, Russian constituent entities and municipalities to raise money for environmental and social projects.

Second, we seek to help the financial market adapt to emerging risks (primarily climate risks). The financial sector must be able to account for the risks associated with achieving sustainable development goals and understand that ignoring ESG factors results in a higher risk. Hence, it is necessary to create frameworks for identifying, assessing, monitoring and stress testing ESG risks. This work is new and challenging, and we are undertaking it together with our stakeholders in Russia and international standard setters, such as the Basel Committee on Banking Supervision,

the Financial Stability Board, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), and the International Organisation of Securities Commissions (IOSCO). We are confident that this work will bear fruit, and that our efforts to address ESG risks and opportunities to achieve SDGs will help enhance the resilience and competitiveness of both the banking sector and non-financial sectors.



A close-up photograph of a small, bright yellow flower with many petals, growing from a narrow green stem. The stem is emerging from a dark, textured crack in a light-colored, possibly concrete or stone, surface. The background is blurred, showing more of the same textured surface.

ESG banking in Russia

Overview of banks' adoption of ESG principles

We analysed the public discourse surrounding ESG initiatives and the projects of all banks registered in the Russian Federation (nearly 400) to understand the maturity level of ESG banking in the country. All banks were reviewed for compliance with each ESG factor. Overall, the share of adopters is low, but major banks demonstrate a wider use of ESG practices. These insights were also confirmed through a series of interviews. The key ESG initiatives undertaken by Russian banks are listed below, although particular practices and their applicability vary greatly from bank to bank.

10% — the share of banks that have embraced some ESG practices

40% — the share of banks that have embraced some CSR practices

E Environmental

- Environmental policies, environmental assessments of projects to be financed, adoption of policies that disallow investments in environmentally controversial industries
- Green lending policies
- Green bonds
- Assessing borrowers for environmental risks
- Establishing ESG consultation centres for clients in order to restructure business processes to meet the SDGs
- Financing energy efficiency projects
- Taking part in syndicated loans with an ESG tranche
- Establishing mutual funds for ESG purposes
- ESG digitalisation of banking processes
- Financing projects to create green landfills for solid municipal and industrial waste
- Financing supplies of green energy equipment

- Financing transport infrastructure projects (detours)
- Financing the construction of polymer processing plants, waste-to-energy plants and steel plants using direct reduced iron technology
- Structured products that include shares in European Green Agreement beneficiaries
- Sustainability-linked loans (SLL)
- Biodegradable plastic cards
- Electronic registration of transactions with real estate
- Less/no plastic/cash initiatives (cards, banknote packages, containers)
- Updating the vehicle fleet (purchase of e-vehicles)
- Partnering with other organisations to promote climate-focused transformation



S

Social

- Offering ESG loans (including loans for medical professionals)
- Organising and hosting events on sustainability and ESG
- Organising and hosting educational events on responsible financial management
- Creating charitable foundations, hosting charitable events
- Offering clients the option to send accumulated bonus points to charity; providing no-fee services
- Developing policies to regulate charitable activities
- Sponsorship of sports organisations and events
- Sponsorship of orphanages, boarding schools, veterans of war, disabled people and people facing difficult situations
- Sponsorship of Russian cultural heritage
- Social care products for retirees
- Increased cashback for purchases from organisations that drive positive social change
- Engaging employees in donor campaigns
- Bank cards issued in partnership with public organisations (charitable foundations)
- Social cards
- Community clean ups
- Global environmental campaigns
- Social benefits for employees
- Encouraging internal work-life balance and healthy lifestyle projects

G

Governance

- Establishing ESG committees that report to the board of directors
- Observing the Bank of Russia's corporate governance recommendations
- Complying with the code of ethics/conduct
- Publishing CSR reports
- Creating internal communication channels for bank employees
- Organising employee meetings with bank management to discuss performance or pressing issues
- Implementing the recommendations of the Basel Committee on Banking Supervision and the Financial Stability Board
- Complying with listing requirements
- Conducting regular in-house training sessions
- Following regulatory instructions and guidance



Overview of governance, reporting, disclosure and regulation of ESG risks

Sustainability governance is a complex banking challenge that requires both financial and human resources. Furthermore, having only a couple of employees responsible for an organisation's sustainability agenda, while the rest of the staff and management go about business as usual, is the wrong approach. Regardless of the resources in an organisation, sustainable development goals should be ingrained into its day-to-day operations across all departments (including through sustainable KPIs). The key role of the Chief Sustainability Officer* is to integrate and coordinate the sustainability efforts of all departments and to cultivate corresponding expertise on the board and amongst executives. In this context, sustainability governance refers to analysing ESG factors that are significant for a bank's strategic and operational decision-making. A consistent and aligned approach is key for ensuring robust risk management and a more informative strategy.

The further evolution of ESG banking at individual banks requires that their corporate governance and operational management adapt by developing and empowering existing employees. It also calls for the creation of separate governance structures and units to deal with ESG matters in various areas. It is essential that banks consider introducing the position of chief sustainability officer. During the in-depth interviews conducted as part of this research, several banks claimed to have chosen to appoint a CSO with the appropriate remit. However, most of the surveyed banks cited an intent to rethink or expand the existing responsibilities of other executives. We also noted the following initiatives that Russian banks implement to manage their sustainable development efforts:



Creation of dedicated departments and committees

- Board ESG Committees
- Committees for the implementation of long-term ESG strategy integration plans
- Committees for the development of a policy to create an ESG strategy
- Sustainable Development Departments
- Working groups for the improvement of internal procedures and implementation of the ESG strategy
- Dedicated teams based in the Risk Management or Investor Relations departments



Management of ESG risks

Good ESG risk management is the main objective of ESG banking. Given the amount of resources needed to develop these capabilities, many banks that are new to the field do not go beyond minimal adjustments to their risk management functions. Due to the strategic nature of ESG risks, their integration into the conventional 'three lines of defense' (3LOD) model seems to be the preferable approach. However, this practice is not sufficiently widespread in the Russian banking sector because of the lack of sufficient experience, resources, and innovative approaches.

*For more details on the CSO role, please refer to study *The Future of the Chief Sustainability Officer* (<https://www2.deloitte.com/global/en/pages/financial-services/articles/the-future-of-the-chief-sustainability-officer.html>)



With ESG banking still emerging in Russia, banks tend to focus on preparing sustainability reports, which mostly describe social and environmental initiatives.



Key areas of ESG disclosures by Russian banks

- ESG assessments of corporate borrowers
- Sections on ESG performance in the annual report
- ESG assessments of investment projects for clients
- ESG training materials
- Environmental performance reports
- Sustainability Reports (including GRI disclosures)
- ESG digitalisation strategies
- Responsible investment policies

Disclosure level of ESG information in publicly available Russian banking data

ESG disclosure at Russian banks has been extremely limited and fragmented, with most of them skewed towards social and governance rather than environmental factors. Therefore, banks are striving to expand their ESG disclosures while factoring in global best practices and new regulatory requirements.



Sustainability disclosures by Russian banks

- < 1% of banks publish an ESG report either as a separate document or as part of their annual report
- ≈ 10% of banks publish a CSR report either as a separate document or as part of their annual report
- < 150 banks report on compliance with the corporate governance code



The main ESG topics disclosed by Russian banks

- Lists of implemented environmental (E), social (S) or governance (G) initiatives
- Statements of compliance with international standards
- Their level of contribution to achieving the 17 UN SDGs globally
- Strategies for developing ESG products
- Disclosures of/reports on their ESG loan portfolio
- Disclosures of/reports on their ESG product portfolio
- Strategies for developing new ESG practices



Vladimir Chubar

Chairman of the Management Board, Credit Bank of Moscow



It is only recently that Russian banks have embarked on comprehensive ESG disclosure, publishing sustainability reports or separate sections of annual reports. Moreover, certain factors, namely social and governance factors, are generally disclosed more thoroughly than environmental ones. Russian banks are lagging behind their leading international peers, which are driving the ESG agenda, reporting on sustainability and climate risk goals and strategies, and providing detailed digital data on their direct and indirect impacts. Nevertheless, amid rapid change and paradigm shifts, Russian banks have become more interested in detailed ESG disclosures and are already showing some progress. Transparent ESG information is fundamental for promoting stakeholder engagement and interests, getting in the good books of credit and ESG rating agencies, attracting investors, and adding business value.



Some ideas on how to promote ESG banking in Russia



ESG as a component of a bank's corporate culture

As a mechanism for fulfilling an organisation's mission and values, corporate culture is an important building block of the strategic planning process at any corporation. Bearing in mind the long-term and fundamental nature of these processes, they cannot be properly executed if ESG factors are ignored. In this section, we will look at the importance of the ESG concept for corporate culture and identify the key steps to consider when pursuing ESG banking.

Corporate culture

Research¹ shows that public demand for responsible business practices is a major driver of ESG implementation. Sustainability efforts have been increasingly important for attracting and retaining employees and customers. This driver entails medium and long-term risks, as well as opportunities that organisations can embrace by promoting a responsible corporate culture.

Many companies are aligning their strategic missions with responsible business practices. To accomplish these objectives, it is important that both the boardroom and staff share responsibility before a wide array of shareholders.

Banks, which have traditionally offered similar products (ready cash), now see the arena of competition not in terms of value creation, but rather in terms of new practices that create such value. The battle for talent is also changing in character. Thus, shared values are a key motivator in the workplace (especially for young hires).

The relevance of this approach is showing already. For instance, the Deloitte Global Millennial Survey 2020² suggests that millennials pay a great deal of attention to ESG factors. Another Deloitte study³ that focused on the relevance of ESG factors for people choosing a bank

found that a responsible stance wins customers. After reviewing best practices and research⁴ in this area, we were able to identify the main features of a corporate culture that creates long-term value for a broad range of stakeholders:

- Integration of ESG factors in the corporate mission
- Shared values at all levels of the organisational hierarchy
- ESG-inclusive risk management and strategy
- Dialogue with the public

¹ Source: "2030 Purpose: Good Business and a Better Future", Deloitte (<https://www2.deloitte.com/ru/ru/pages/risk/articles/2017/sustainable-development-goals.html>)

² Source: "The Deloitte Global Millennial Survey 2020", Deloitte (<https://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html>)

³ Source: "Making an impact: ESG factors are a priority for customers when choosing a bank", Deloitte (<https://www2.deloitte.com/uk/en/pages/press-releases/articles/making-an-impact-esg-factors-are-a-priority-for-customers-when-choosing-a-bank.html>)

⁴ Source: "Building The Resilient Organization. 2021 Deloitte Global Resilience Report", Deloitte (https://www2.deloitte.com/content/dam/insights/articles/US114083_Global-resilience-and-disruption/2021-Resilience-Report.pdf?cid=learn_more_content_click)

Risk Management

Once organisations realise that robust ESG risk management is an important aspect of ESG banking, they must ensure consistent and systematic integration of such factors into risk management processes while considering them together with the overall risk management landscape. Given the complexity of ESG risks, it is best to embed them into the risk management framework and make sure that all the risk management staff have relevant ESG competencies. For the same reason, we think it is advisable to integrate ESG risk management into organisations' 3LOD model (first line: management's responsibility for risk management; second line: identification of emerging risks; third line: objective and independent assurance). Enterprise Risk Management (ERM) provides a comprehensive way to address risks by raising risk awareness among executives and building a culture that promotes collaboration between all employees involved in the risk assessment process.

Strategic planning

Another important aspect of ESG banking is the identification of business opportunities associated with ESG factors, which need to be leveraged and woven into the corporate culture. With sufficient ESG competencies, the boardroom, strategic staff, and all managers will be able to consider these factors when developing new products and services. Different departments will collaborate to integrate ESG factors into the bank's business model, which is key for keeping pace with upcoming global developments. Thus, improving ESG competencies would be the best approach in terms of strategic planning.



Yuri Soloviev

Yuri Soloviev, First Deputy President and Chairman of the Management Board, VTB Bank



We believe that banks act as catalysts for ESG transformation by creating green products that meet the needs of today's businesses and wider society and by shaping their own ESG culture. In recent years, the VTB Group has invested significant resources into the development and implementation of sustainable development principles.

The ESG principles are reflected not only in our business strategy, but also in our corporate culture and internal communications. We are guided by these principles and our code of ethics when designing new products and services for customers, and we strive to ensure the financial transparency of VTB's operations. Just as importantly, we are constantly searching for and implementing innovative and technology-based solutions to reduce the group's negative impact on the environment. We are keen to improve employee engagement in business processes, leveraging their creative potential and developing their key performance management competencies. VTB has historically focused on charitable activities and sponsorship of social and environmental projects, both at the company level and at the level of individual employees, who take part in volunteering initiatives all across the country.



ESG reporting and disclosures

Non-financial reporting is a basic aspect of a banks' dialogue with stakeholders. It helps demonstrate the transparency of operations and progress towards the ESG agenda. Recently, we have seen a significant improvement in the quality of non-financial reporting at a number of Russian banks. However, there are also significant gaps in their non-financial reporting processes as compared to their leading foreign peers. In our opinion, best practice in this area entails conducting a detailed analysis of risks and opportunities associated with ESG factors, using materiality matrices (where corporate governance, risk management and responsible financing are usually shown as the most material categories), and releasing high quality, relevant GRI disclosures. We also note the importance of integrating climate disclosures in accordance with the TCFD guidelines and independent assurance of non-financial reports.

Non-financial reporting

With sustainability becoming more and more prominent on the global agenda, ESG factors are increasingly being incorporated into businesses processes and investment decisions. The key task for banks is to determine the long-term ESG priorities that are most essential for their specific business model. These priorities will shape not only corporate reports, but also all other ESG activities undertaken by banks.

Regulatory requirements for non-financial reporting are already in place in the UK and the EU, and they are underway in Russia.

Globally, the main non-financial reporting initiatives are:

- *Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation*¹ — a report developed by the World Economic Forum in cooperation with Deloitte, EY, KPMG and PwC
- *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting*² — a joint initiative of the CDP, CDSB, GRI, IIRC and SASB
- *Hybrid Metrics: Connecting Shared Value to Shareholder Value* — a report introducing a new approach developed by the FSG jointly with the Enel Foundation³

Aspect	Non-financial reporting
Presentation format	A free format/a generally accepted format
Users	Internal and external
Reporting frequency	Annual
Horizon	Past performance, current position and future plans of an organisation
Compliance with standards	Voluntary compliance with the established standards
Legislative framework	Only a few countries have an established legal framework
Mandatory or not	Mandatory for public and state-owned companies in some jurisdictions
Independent assurance requirements	Independent assurance is required from public and state-owned companies in some jurisdictions

¹ Source: World Economic Forum Report "Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation"
(http://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf)

² Source: Statement of Intent to Work Together Towards Comprehensive Corporate Reporting (<https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>)

³ Source: FSG (<https://www.fsg.org/publications/hybrid-metrics-connecting-shared-value-shareholder-value>)

Key features

- Promotes stakeholder confidence through more **transparent processes**
- Ensures regulatory compliance
- A tool to **manage reputation** and react to media coverage
- Provides an opportunity to **assess the maturity and efficiency** of business processes
- Enables **comparison** of an organisation's non-financial **performance** with that of other market players (a tool for **investors**)



Anna Kuznetsova

Deputy Chairman of the Management Board,
Russian Agricultural Bank



Given the soaring demand from everyone in the market—from regulators to investors and shareholders—multinational corporations and banks must come up with unified ESG reporting standards in the nearest future. In the absence of national ESG reporting standards, organisations pursuing the ESG principles in Russia can use internationally recognised benchmarks such as documents developed by the Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), Sustainability Accounting Standards Board (SASB), Carbon Disclosure Project (CDP), Climate Disclosure Standards Board (CDSB), and Task Force on Climate-related Financial Disclosures (TCFD), as well as relevant UN guidelines. With the number of Russian companies and banks that prioritise ESG principles growing by the day, it is all the more important to have unified disclosure frameworks. Going forward, we hope to see convergence between international standards, as well as between international and future Russian standards.



Materiality principles in non-financial disclosures

Research¹ shows that banks focusing on significant ESG categories perform better in the long term. In view of this correlation, stakeholders, ESG rating agencies and credit rating agencies are very scrupulous about the impacts that businesses have and their ESG disclosures that are significant for the industry.

We noted that in their non-financial reports, Russian banks place particular emphasis on environmental and social initiatives, while international banks tend to concentrate on material topics and demonstrate their progress consistently from year to year. In other words, it's better to disclose not only initiatives, but also their materiality in terms of environmental and other impacts, as well as the real progress made. This approach seems to be best for the banking market, and we are seeing its growing adoption in Russia, as more and more banks integrate ESG factors into their business strategies.

Each bank makes its own contribution to achieving the UN SDGs. However, we can identify a number of priority areas for disclosure. The table below gives a high-level view of these areas and the respective ESG metrics. Notably, these aspects are more than just a formality—they require a close focus on improving the bank's existing processes.

The materiality of non-financial data for banks is evidenced by the detailed disclosures of a number of categories—such as corporate governance, strategy, risk management, information security, ethics and compliance—in their annual or combined reports. In non-financial reporting, these categories should be disclosed with reference to the relevant GRI indicators ('Management Approach' - GRI 103-1, 103-2, and 103-3).



¹ Source: GABV, EIB, Deloitte, KKS Advisors 'Do sustainable banks outperform? Driving value creation through ESG practices' (<https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/Banking/lu-do-sustainable-banks-outperform-driving-value-creation-through-ESG-practices-report-digital.pdf>)

Category	Criteria	GRI indicator	SASB indicator
Sustainable financing	True and consistent integration of ESG factors into a bank's business model; target setting and an analysis of impacts	-	FN-CB-420a.2
Corporate governance	An informed strategy that leverages ESG opportunities and minimises the associated risks	GRI 102-18 – GRI 102-39	FN-CB-550a.2
Human capital	Development of talent across an organisation as the key competitive advantage and innovation driver	102-8, 102-35, 102-36, 102-38, 102-39, 102-41, 102-44, 201-3, 202-1, 401-1, 401-3, 403-1, 403-3, 403-5, 403-6, 403-7, 403-8, 403-9, 404-1, 404-2, 404-3, 405-1, 405-2, 406-1, 410-1, 412-1, 412-2	FN-IB-330a.1
Risks and crisis management	A holistic and proactive risk management model with a detailed focus on ESG risks, in particular climate risks	102-15, 201-2, 102-30	FN-CB-550a.2
Innovation	Development of ESG-friendly products and services that meet customers' needs (especially relevant for the retail banking industry).	-	FN-AC-410a.3

Management of ESG risks

Stewardship of environmental, social and economic risks is a key tool for banks that wish to create long-term value for all stakeholders. Stewardship here means comprehensive, consistent, forward-looking management of risks using national, supranational, industry or corporate ESG risk monitoring methodologies. In terms of environmental risks, organisations should bear in mind that new regulations generally do not affect existing methodologies, but rather render them more relevant (as regulators are recommending certain standards). In this regard, a ‘beyond compliance’ approach (adhering to higher risk management standards before they become mandatory or recommended) would be a best practice. Notably, all opportunities that banks miss to attract and retain customers, employees, investors or business partners, as well as their failures to develop a forward-looking business strategy, should be considered risks.

This section outlines the main drivers of ESG risks cited by representatives of the Russian financial sector during in-depth interviews conducted as part of our research. While acknowledging that the above ESG risks are representative of the general risk landscape and relevant to Russian banks, we emphasise that each of these risks requires a customised management approach, tailored to the scale and structure of the bank’s business, as well as its goals and capabilities. For your information, we have provided examples of such approaches below. For banks, environmental risks are mainly associated with their own operations, loan portfolio and other segments of the group’s business (asset management, brokerage, etc.) and can have a direct or indirect impact on the climate, environment and biodiversity. In ESG rating agencies’ methodologies for rating the banking industry, environmental factors range from 10 to 20 percent of the total score.

Environmental risks

Risk drivers

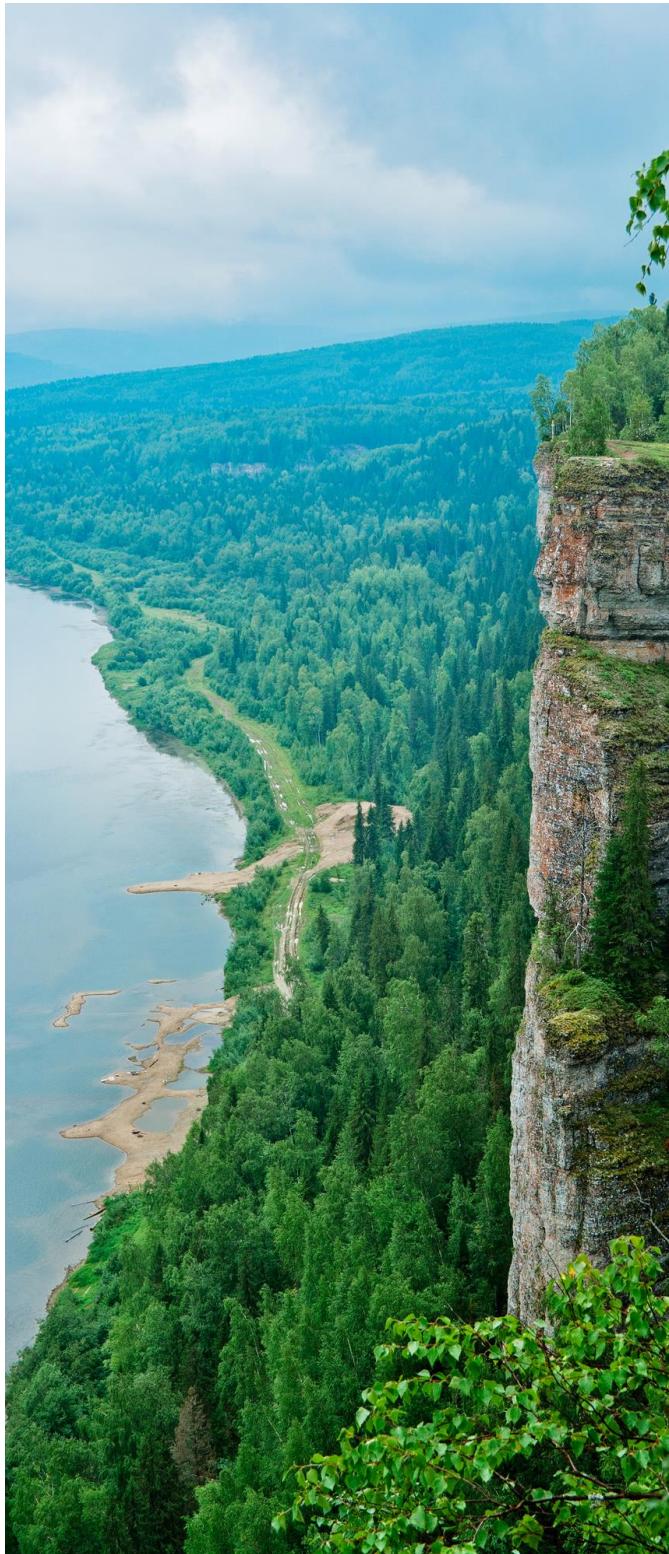
- 1** There is a risk of lagging behind on performance benchmarks due to a bank’s outward impacts (including environmental impacts) and the goals set in its climate strategy.

- 2** In the event of climate risks (physical or transition), the business models and supply chains of a bank’s customers may face new challenges, which will affect the bank’s revenue and the quality of its loan portfolio.

Risk management practices

With intense competition for investors and customers, organisations must regularly analyse their positions in ESG ratings and consumer surveys, benchmarking themselves against specific ESG metrics and the overall ESG ambition level.

It makes perfect sense to address climate risks as part of financial risk management, especially through green supporting factors and brown penalties for carbon-intensive borrowers.



Elena Borisenko

Deputy Chairman, Bank
GPB (JSC)



Ever since the 2015 Paris Agreement, the environmental factor has been getting increasingly important for business, becoming a decisive element for the development of policies and approaches, both at the country level and at the level of regulators and market participants.

For many years, projects aimed at minimising negative environmental impacts have been among the bank's top priorities.

Significant resources, including funds raised from financial institutions, are required to mitigate associated risks and transform the business model into a sustainable one. Alongside their traditional role, banks can serve as centres of excellence for their clients by developing strategies to mitigate risks and improve their ESG profile. Gazprombank has already created relevant product offerings for corporate clients, and it is working to further develop them.



The banking sector (especially retail banking) is significantly affected by social factors, which it in turn impacts through the public nature of the business, media activity, its large headcount, and its sizeable base of individual customers (as well as potential ones).

These and other stakeholders regularly communicate with banks, expecting them not only to meet their needs, but also drive positive social and environmental change. For the banking sector, the weight of social factors in ESG rating agencies' methodologies is usually 30–40 percent.

Social risks

Risk drivers

- 1** Continued lack of education and financial literacy; risk of inability to attract new customers, including those who have never used banking services before.
- 2** Supporting entrepreneurship as a basis of the middle class; generating local jobs and contributing to social and economic balance, especially in local communities.
- 3** Human rights and work environment. In addition to zero tolerance to human rights violations throughout the value chain, it is critical for banks to consider the work environment of their own employees. The importance of this factor was underscored once again by the massive overtime scandals in the largest international banks, resulting in sizeable salary increases and one-off compensations to employees.
- 4** Changes in consumer preferences; the risk of losing customers looking for positive environmental and social change through conscious consumption.

Risk management practices

- By increasing financial inclusion and developing educational programmes for people who have not previously used banking services, banks expand their client base and enhance their image in their regions of presence.
- Top banks offer special conditions to existing SMEs and hold workshops and accelerators to help new businesses emerge.
- Understanding the competitive importance of attracting and retaining the best talent, as well as shifting the focus of qualified personnel from compensation packages to business responsibility criteria, banks are developing comprehensive strategies to improve their employer brand and increase employee satisfaction.
- Creation of new financial instruments that explicitly include ESG factors (also in retail banking). For instance, green mortgages, preferential loans for purchasing sustainable vehicles, carbon footprint calculators for shopping, green deposits, etc. are becoming more widespread across the globe.



Alexei Miroshnichenko
First Deputy Chairman,
Member of the Board,
VEB.RF



First of all, companies should define the goals they wish to achieve through ESG risk management, besides simply increasing the quality of life in local communities. When it comes to environmental risks, such goals could include preventing breaches of environmental legislation (and associated fines) or strategically reducing specific GHG emissions (and, over the course of several years, reducing costs associated with emission quotas or trans-carbon taxes). For social risks, such goals could include reducing staff turnover, as well as attracting and retaining talent (including through corporate policies ensuring that the entity welcomes diverse employees). For governance risks, an example of such goals would be improving investor relations by improving the company's transparency (e.g., by enhancing the quality of reporting). Thus, the company's ESG goals could include technology upgrades (E), human capital management (S), or improved investor relations (G). When achieved, these would bring tangible material results to the company.



Economic factors are explicitly included in the operational and strategic planning of banks. Therefore, their role is recognised by ESG rating agencies as the most significant, accounting for 50-60% of the final rating. Corporate governance, risk management, cyber security, ethics and compliance, strategic planning, and innovation have a direct impact on banks' position and the satisfaction of their stakeholders.

Economic risks can result in serious downgrades and even exclusion of companies from the ESG-focused stock index, as well as regulatory sanctions, withdrawal from the capital of ESG-oriented investors, and difficulties in placing public debt with rates pegged to ESG indicators. They can also lead to credit rating or ESG-rating downgrades. Along with loss of trust—which is an important aspect of the banking business—the implications of emerged economic risks on companies' business can do long-term damage.

Governance risks

Risk drivers

1 Compliance risks and business ethics. Risk of abuse, non-transparency in marketing and tax policies, unfair competition and illegal actions are subject to close scrutiny by ESG ratings and regulators.

2 Risks of compromising cyber security and customer data leakage.

3 Risks of mismanagement and uninformed business decisions can result in complete or partial loss of investment due to incorrect assessment of the investee's ESG risks.

Risk management practices

Business ethics are continuously monitored by regulators, investors, and banks themselves. Best practices for ensuring compliance with ethics standards call for streamlined and independent communication systems (both the policy and the implementation mechanism) to report unethical behavior, as well as a communication channel on ethical issues between stakeholders and the board of directors.

Banks should adhere to the best practices in IT architecture and perform regular independent security reviews.

When companies go to IPO, investment banks faced heightened investor attention to their ESG risks and opportunities, which may affect their final valuation. Engaging specialised experts or creating a dedicated ESG team allows both the issuer and the investment bank to better understand the impact of ESG factors on the results of the placement.



Nikita Patrakhin
Head of Investment
Banking at Raiffeisen Bank,
Member of the Board at
Raiffeisen Bank



It is impossible to establish a sustainable banking system without introducing ESG principles at all levels of the business. In Europe, the demand for green operations and sustainability has been evolving over the past several decades. Raiffeisen Bank International was the first Austrian bank to sign the UN Principles for Responsible Banking. Meanwhile, markets are steadily moving towards greener operations and social responsibility. Businesses' value is being assessed not only based on financial ratios: they must create long-term value for the community and customers while promoting sustainability and minimising negative environmental impacts. We are also observing a growing interest in sustainability amongst our business partners, regulators, customers, and employees. We believe that the role of banks lies in increasing the availability of financial capital for responsible businesses, and we are actively developing a product line of 'responsible' financial instruments, including ones tied to sustainable development indicators. As we see it, facilitating access to debt and equity capital for businesses on their way to low-carbon operations is a field where banks can play a leading role in implementing ESG principles in the real economy.



The Carbon Border Adjustment Mechanism

The forthcoming introduction of the Carbon Border Adjustment Mechanism (CBAM) in the EU is one of the most immediate risks for banks and numerous other sectors of the Russian economy.

Already, some Russian banks are actively analysing their borrowers in terms of potential environmental damage, examining factors such as their carbon footprint.

Other banks are offering incentives to companies that position themselves as advocates of reducing GHG emissions and their carbon footprint.

However, there is currently no standard approach to assessing such risks that would impose additional restrictions on how they are managed. According to the Carbon Disclosure Project, the carbon footprint of banks' loans and investment portfolios exceeds the carbon footprint of the banks themselves by 700 times.

The global trend towards reducing carbon footprints, and certain countries' desire to create carbon neutral regions, will require additional investments aimed at decarbonising the economy and increasing its sustainability. This makes it highly probable that banks will be the source of capital for achieving these goals.



The Carbon Border Adjustment Mechanism is a means of implementing the European Green Deal, which was adopted by the European Commission in December 2019. As part of the initiative, the EU plans to reduce its GHG emissions by 50% over the next 10 years and turn Europe into the world's first carbon neutral continent by 2050. Currently, the draft law is under development, and the methodology for calculating the tax levy is not yet fully known. The tax is expected to come into effect in 2022, and it will be calculated based on the volume of carbon emissions involved in the production of imported goods, i.e. their carbon footprint. The tax itself will take one of the following forms:

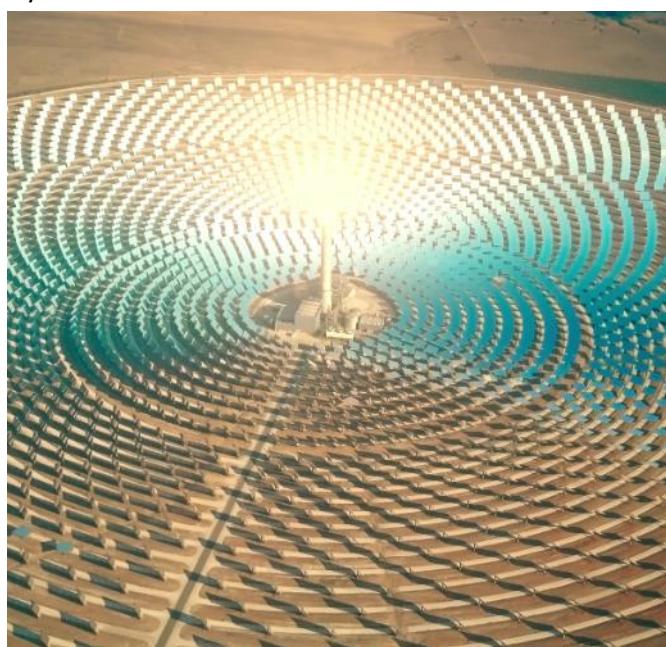
- a carbon border tax that varies based on the industry and the product's carbon intensity;
- the inclusion of importers into the current EU emissions trading system with subsequent sale/purchase of allowances;
- the introduction of VAT for all producers of carbon products (both external and internal).

Such initiatives can have significant implications for the EU's trading partners, including Russia, at all levels of the value chain.

The new tax will mostly affect energy, chemical, paper and mining, metallurgy, and lumber exporters. When introduced, the restrictions will affect the competitiveness and profitability of Russian companies on the European market, since the carbon footprint of many Russian companies is relatively high. According to experts, the carbon levy will reduce the profitability of crude oil supplies to the EU by 20% given an oil price of USD 30-40/bbl. Wood exporters could lose up to 65% of their profits.

The deteriorating financial position of the real sector reduces its investment potential, creating additional transition risks for financial companies. Thus, carbon regulation is one of the most serious ESG challenges that Russian banks will face in the near future.

To save Russian exporters from new taxes or duties, the Government of the Russian Federation has developed the draft Federal Law ‘On State Regulation of GHG Emissions’, which envisages the introduction of carbon taxes in the country. Thus, in the beginning of 2021, the Government of the Russian Federation proposed developing a system for trading carbon units. The idea of introducing emission quotas and infrastructure elements to support climate projects has been considered as part of an experiment in the Sakhalin Region. Thus, the Russian Government plans to create an environment conducive to implementing technologies aimed at reducing greenhouse gas emissions and achieving carbon neutrality in the region by 2025.



¹ Source: European Parliament (<https://www.europarl.europa.eu/news/en/press-room/20210304IPR99208/meps-put-a-carbon-price-on-certain-eu-imports-to-raise-global-climate-ambition>)

² Source: Directive 2003/87/EC of the European Parliament and of the Council (<https://eur-lex.europa.eu/eli/reg/regulation/2003/87/oj>)



Ivan Kukhnin

Deloitte CIS, Partner
Sustainability Services
Leader, Diversity &
Inclusion leader



In March 2021, the European Parliament adopted a resolution approving a WHO-compatible Carbon Border Adjustment Mechanism (CBAM)¹. It intends to introduce the mechanism by 2023, and we expect a final decision to be made in June-July 2021.

We assume that compliance with WTO rules would make the mechanism non-discriminatory (by equalising the fiscal burden on European manufacturers and Russian suppliers). Today, large European producers are governed by Directive 2003/87/EC², which sets forth maximum specific GHG emissions. We believe that the future CBAM will be based on Directive 2003/87/EC indicators. The CBAM could take the form of a tax or a customs duty extended to either all industries covered by Directive 2003/87/EC or merely to certain companies that fail to meet benchmarks. The variables for benchmark calculations for Russia is another controversial issue. Moreover, there is no clear understanding of how the CBAM will be integrated into national GHG emission regulation systems to avoid double taxation. All these aspects could significantly change the final calculation formula and the company’s tax burden.



Incentives and support for ESG banking

The ESG concept in Russia is still at a formative stage: not all Russian companies have espoused responsible investment, and most of them are not ready to incur the additional costs associated with developing sustainability strategies and consistently implementing ESG initiatives. An analysis of ESG practices in the financial sector showed that banks will soon be the ones setting the ESG agenda in Russia. By implementing business objectives tied to ESG metrics, they will promote sustainable practices among borrowers while financing sustainable projects; meanwhile, the availability of additional incentives and support for ESG banking will accelerate this process. Globally, the emergence of ESG banking was brought about by a high level of social responsibility among all market players (both investors and banks themselves), who are confident that the introduction of ESG will help mitigate risks and contribute to sustainable development.

In Russia, the government should act as an important driver for the development and implementation of ESG principles in pursuit of a less carbon-dependent economy. Since April 2021, the Ministry of Economic Development and the Bank of Russia have been developing an initiative to encourage Russian companies to implement green investment projects with monetary and non-monetary government support. Government incentives can facilitate the transition to an ESG approach for a greater number of market participants, including those who do not yet see a real benefit in it.

Some potential supporting measures

- ESG instruments could be given a separate category to enable more appropriate regulation. Creating a special category would help draw the attention of market participants, also entailing a set of incentive regulatory measures whose limitations could start at one year, with regular measurement of their effect. Such measures would create a significant volume of securities circulating on the market and ensure their liquidity.
- Special regulations could be applied to ESG-financial instruments of non-governmental pension funds and insurance companies.
- Subsidies could be provided to help finance projects that meet the criteria for green, social, sustainable, or transitional loans, as well as loans aimed at sustainable development. Such projects would need to be evaluated by independent verifiers.
- Reduced risk ratios could be applied to ESG financial instruments when calculating adequacy ratios. Additional mechanisms could also be used to reduce the burden on capital and apply special conditions for provisioning under such projects.
- Subsidised coupon rates could be considered for green bonds. This would involve the creation of accessible and transparent mechanisms allowing issuers to obtain subsidies for the coupon rate.
- A simplified procedure could be created to include ESG bonds on the Lombard List of the CBR, provided that the issue meets the rating requirements.
- Government orders could be assigned that increase the number of green investment projects and encourage banks to work with ESG-responsible companies.
- It could be possible to ease (change) the requirements surrounding the composition of portfolios of institutional investors that include sustainable finance instruments.

- The possibility of a reduced tax rate could be considered to increase the investment appeal of green bonds.
- ESG principles and criteria (estimated ratios of industry risk based on borrowers' social and environmental risks) could be consolidated at the legislative level for each industry when banks assess borrowers (e.g., in PD models).
- Regular communication should be maintained between the regulator (the CBR) and companies' boards, shareholders, and investors regarding issues surrounding ESG risk accounting.

Incentives could include mandatory ESG reporting for banks in accordance with international ESG standards.

An alternative way to incentivise the development of green finance would be to tighten regulations surrounding 'non-green' instruments recognised as harmful to the environment.

Such government support could drive demand for ESG in Russia among foreign investors. However, to make ESG a long-term trend in the country, the importance of ESG principles must be promoted at the level of each company and individual. To do this, the ESG approach must gradually be popularised at the national level by communicating its long-term benefits to all stakeholders. When most people realise the need to comply with sustainability standards, all companies will have to adhere to the ESG approach. Improving the financial literacy of investors will allow them to make more informed decisions when purchasing securities.



Alexei Moiseev

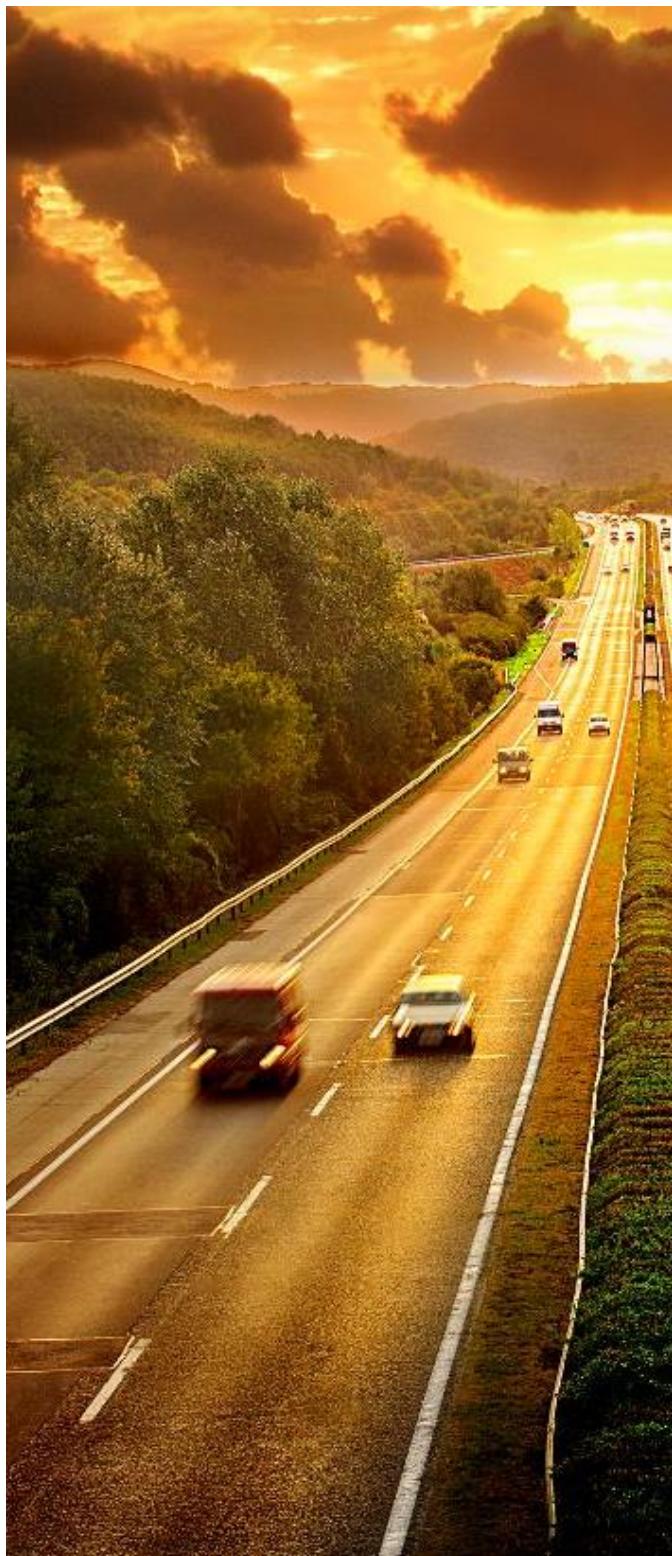
Deputy Minister of Finance
of the Russian Federation



ESG banking is a relatively new concept in Russia. However, given the annual increase in resources devoted to ESG policy, it is becoming increasingly popular. Of course, embedding ESG principles into corporate governance and encouraging clients to increase their resilience by complying with requirements for improving non-financial indicators will entail additional time and organisational costs for market participants. However, this will also ensure steady and sustainable development in the long term. For our part, we understand that the responsible financing market in Russia is in its formative stages and therefore requires close attention from the government.

Today, a top priority is to identify the key parameters of the sustainable finance market and develop potential incentive measures. At the same time, the Russian Ministry of Finance bears in mind the need to adhere to an integrated approach to regulation (that factors in changes in tax legislation in the context of the transition to a low-carbon economy) and a balance between the responsibility imposed on business and government support measures.





Dmitry Gusev
Chairman of the Executive
Board
Sovcombank PJSC



In Russia, the ESG agenda is mostly the domain of banks who wish to attract foreign investment through capital or bonds, as foreign investors are obliged to disclose the ESG component of their investments.

Making low carbon projects a top priority for Russian investors would necessitate certain measures. These include the creation of a Russian taxonomy, a unified ESG scale and rating methodology and, most importantly, economic incentives (regulatory and legislative) for investors such as tax benefits, reduced risk ratios for the purpose of adequacy ratio calculations, and additional tools to reduce the capital load on such investments.



The role of ESG factors when determining credit ratings

To a certain extent, rating agencies have always included ESG factors in their credit rating assessments. However, the growing focus of investors on the ESG agenda is pushing agencies to pay more attention to these factors and explicitly highlight them in their methodologies and conclusions.

Some agencies have expanded the set of ESG sub-factors used for credit risk assessments. Today, credit agencies and their affiliates have concentrated their ESG-related efforts into three areas:

- Credit ratings (assessing the impact of ESG factors on the rated entity's creditworthiness)
- ESG verification (projects and instruments are assessed against sustainability standards and principles)
- ESG ratings (assessing the entity's commitment to UN SDGs, as well as the impact of ESG-related long-term risks and opportunities)

Credit ratings

ESG factors may cause credit ratings to be lowered or upgraded. In its report for 2019, Moody's noted that 'ESG risks were a material credit consideration in 33% of Moody's Investors Service's rating actions for private-sector issuers in 2019'¹. For credit rating purposes, governance was more salient than other ESG factors. The report stated that in 2019, 29 percent of credit actions concerned corporate governance issues, 6.6 percent were attributable to social issues (S), and in 5.3 percent environmental (E) issues were quoted. In some cases, changes were driven by several ESG sub-factors.

The materiality of environmental risk assessments is also gradually growing. Agencies have started to consider companies' commitments to biodiversity (forest conservation), GHG emissions, hazardous waste disposal and utilisation, and energy consumption. Social factors are also getting more attention. Thus, S&P included human rights and ethics commitments to the social factors affecting companies' credit score.

Environmental and social factors may often imply long-term impacts (such as climate change) and

political/regulatory implications (such as hydrocarbon regulation) that affect credit ratings.

The growing consideration of ESG risks in credit ratings has encouraged EU regulators to pay more attention to this subject. As a result, in 2018 the European Commission developed a sustainable finance roadmap that embeds tasks for introducing ESG factors into credit risks.

In 2019, the European Securities and Risk Association (ESMA) issued technical guidelines for integrating ESG factors and risks into the Undertakings for Collective Investment in Transferable Securities (UCITS), the Alternative Investment Fund Managers Directive (AIFMD), and the Markets in Financial Instruments Directive (MIFID). This established a set of ESG factors to be considered for credit rating purposes:

- To prevent the issuer's final assessment from being misrepresented, the credit analysis should include only those ESG factors that could affect the company's credit rating;
- Information about all considered ESG factors should be disclosed in a volume and format that allows investors to independently reproduce the analysis;

¹Source: Moody's: https://www.moodys.com/research/Moodys-ESG-risks-material-in-33-of-Moodys-2019-private--PBC_1218114

- To protect investors and prevent risks to financial stability, credit rating agencies should ensure independent and high quality analysis of ESG factors;
- Neither the European Commission, nor ESMA, nor other regulators can force credit rating agencies to take ESG factors into account for credit rating purposes.

ESG factors considered by international and Russian rating agencies

Environmental	Social	Governance
<ul style="list-style-type: none"> • Air, soil, and water pollution • Carbon emission regulation • Natural and anthropogenic threats • Land use restrictions • Climate risks 	<ul style="list-style-type: none"> • Working environment and safety • Volunteering and charity • Occupational health and safety • Access to basic services • Education level • Respect for human rights and freedoms 	<ul style="list-style-type: none"> • Organisational structure (competences, composition, experience) • Ownership structure • Ultimate beneficiaries • Management and corporate governance, business processes, information transparency, and disclosure • Business reputation • Development strategies

ESG verification

In Russia, ESG verification is performed pursuant to global sustainability principles and standards (ICMA and CBI) that govern the issuance of green and social bonds. Guidelines issued by local methodologists such as VEB.RF are also used.

As part of verification, the CBR assesses new projects against UN SDG principles and standards, evaluating the level of information disclosure and its current state.

The Moscow Exchange has defined a list of 17 verification companies (including three rating agencies) and included them in a specially created sustainable development category. In Russia, 18 of the 22 project verifications were performed by credit rating agencies (ACRA, Expert RA, RAEX-Europe), while the rest were reviewed by Sustainalytics.

Importantly, large international agencies use their subsidiaries when verifying companies to avoid conflicts of interest.



ESG ratings

The growing demand for responsible investments has led to the establishment of specific non-credit ESG ratings. To avoid conflicts of interest, the international rating agencies Moody's, Fitch, and S&P do not independently assign such ratings: they are assigned by other companies of the group instead. ESG ratings are also assigned by companies that are not credit rating agencies, such as MSCI, Sustainalytics, Bloomberg, REPRisk, and CDP. Russian national rating agencies (ACRA, Expert RA, NRA) also assign their own non-credit ESG ratings.

The ESG diagnostic tools used to prepare ESG ratings are also applied for credit rating purposes. Additionally, the final assessment takes into account the degree of compliance with international non-financial reporting standards (GRI, SASB, CDP, and TCFD). Unlike credit ratings, non-credit ESG ratings emphasise a company's commitment to responsible environmental, social and economic operations. ESG ratings are a strategic tool that help investors identify a company's risks and opportunities while determining its long term sustainability.

The key factors considered in the assessment are the company's environmental, social and management risks. It is important to note that ESG rating methodologies, scales and assessments vary significantly depending on the agency, which limits their comparability.

To reduce risks and improve the quality of ESG ratings, in January 2021 ESMA proposed developing a system for regulating ESG ratings to the European Commission. This would involve:

- Developing a generally accepted definition of ESG ratings;
- Organising control over the assignment of ESG ratings; developing requirements for participants and their admission to relevant activities;
- Determining requirements for data used in ESG ratings, rating methodologies, and information disclosure;
- Eliminating potential conflicts of interest.



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About the research

Goal

Carry out a comprehensive study of trends and prospects in Russian ESG banking initiated by the Association of Banks of Russia.

Objectives

- Provide an overview of the key ESG initiatives in the global pipeline
- Assess the potential of ESG banking in Russia in light of the present obstacles and challenges
- Review and assess the level of implementation of ESG principles and individual ESG initiatives by Russian banks
- Assess the level of ESG banking incentives offered by regulators
- Assess the level of ESG disclosures in publicly available data from Russian banks
- Develop recommendations on how to promote ESG banking in Russia based on the analysis performed

Legend:



Reporting and disclosure initiatives



Risk management initiatives



Other initiatives

Research methodology

We collected data by checking whether each of the covered banks disclosed information on how they integrate ESG principles (relying on the available set of definitions of ESG banking). We also conducted a survey and held interviews with representatives of banks, strategically important Russian companies, and government agencies. We performed an in-depth analysis using the following techniques:

- 1) Gathered data about all banks incorporated in Russia in terms of the following concepts: ESG, sustainable development, corporate governance, social responsibility, corporate CSR reports, environment, responsible financing, green financing, charitable activities, and the corporate governance code;
- 2) Classified and analysed the data obtained by identifying the most frequently adopted initiatives for each of the ESG factors.

Interviews with regulators and industry experts: all interviews were handled by Deloitte in April-May 2021.

Interviews with major banks: the list of banks for interview was compiled based on data showing which banks most actively promote the ESG agenda in their corporate activities. All interviews were conducted by Deloitte in April-May 2021.

An online survey among Russian bank executives: we collected the data through an online survey and face-to-face interviews with the banks' leadership. The survey was held by Deloitte in March-April 2021.

Contact information

If you have any questions about this report, please contact us.



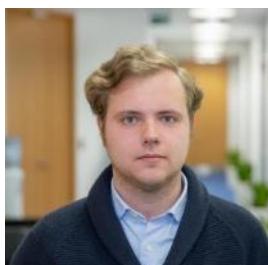
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