BANK CENTER-INVEST

EUROMONEY AWARDS FOR EXCELLENCE 2020

CEE's best bank for corporate responsibility

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Expectations of the European Central Bank and Center-invest Bank's Experience

The European Central Bank (ECB) has published a report on the state of environmental and climate risk management in the banking sector[1].
In 2020 the ECB issued banks with recommendations[2] in the form of expectations relating to climate-related and environmental risk management. The ECB expected supervised institutions to understand and consider climate-related and environmental risks (C&E risks) in their organisational structure, strategy, risk management, internal control and reporting.
The results obtained from 112 Single Supervisory Mechanism significant institutions[3] showed that *none of the institutions are close to fully aligning their practices with the supervisory expectations, and most are still in the early stages of development*.
The extent of compliance with the ECB's expectations for the integration of C&E risks varies for different aspects of bank management.

Business models. 39% of banks have integrated C&E risks in monitoring of the business environment, 11% in scenario analysis and strategy setting, and 25% in setting key performance indicators.
Governance. 43% of banks have integrated C&E risks in the roles and responsibilities of management bodies, 14% in reports for the management bodies, 17% in key indicators, and 7% in C&E data development.
Risk management. 46% of banks have integrated C&E risks in sector lending policies, 28% in credit procedures, 50% in assessment of continuity of operations, 11% in investment due diligence, and 23% in sensitivity analysis and stress tests.
Disclosures. Only 6% of banks have information policies that require disclosure of information about C&E risks.

The ECB recommended that all institutions develop implementation plans for the integration of climate risks, with road maps and measurable outcomes. More than half of the institutions will not have completed their plans by the end of 2022. The ECB has set up joint supervisory teams and included C&E risk plans in bank audits, supervisory stress tests and the Supervisory Review and Evaluation Process methodology[4].

The ECB noted the use of double materiality[5] in strategic planning as an example of best practice: to assess the impact of C&E risks on the business environment (financial sustainability) and the impact of the bank's operations on the environment (environmental sustainability). Regarding governance, it also noted that banks were appointing committees and bodies responsible for C&E risks and qualitative statements and quantitative indicators for risk appetite, reporting, customer engagement and data collection. When managing C&E

1 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202111guideonclimate-relatedandenvironmentalrisks~4b25454055.en.pdf
2 https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/climate-related_risks/ssm.202005_draft_guide_on_climate-related_and_environmental_risks.en.pdf
3 https://www.consilium.europa.eu/en/policies/banking-union/single-supervisory-mechanism/
4 https://www.bankingsupervision.europa.eu/banking/srep/html/index.en.html
5 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XC0705(01)&from=EN

risks, banks use special questionaries, market outlooks, scenario analysis, stress testing, and analysis of legal rulings to gradually reduce and exclude certain types of loans from their portfolios.

An analysis of ESG markets in banking and finance[6] shows that:
- Despite fivefold growth in ESG assets since 2016, they account for just 6% of the market;
- Only a third of firms have a clear engagement strategy for climate reporting and targets for their portfolios and customers;
- More than half of the largest firms (and one third of banks) are signatories to at least one of the many different ESG initiatives that are relevant to their business. However, less than half fulfil the requirements of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD)[7];
- For every dollar raised in capital markets by ESG companies to help address climate challenges, approximately ten dollars are raised by the companies that are causing the problems.

Our experience of the Soviet system of planned targets and Russian reforms allows us to avoid unrealistic expectations when introducing new business models: for success, consensus is more important than how radical the measures are.
ESG banking expands the sphere of the risks considered (environmental, social, and governance) and the time horizon (in the interests of current and future generations). Transitioning to ESG banking requires that the nomenclature of bank products and services for the various market segments be mapped against the sub-systems and the options available in each of the sub-systems. This is the approach that was used when producing the Practical Recommendations for Russian Banks[8] and *The Agile Digitalisation of ESG Banking* [9], and in staff training[10] and Center-invest Bank's practical work.

In 2021 Center-invest Bank achieved the following results for each of the sub-systems.

I. **Taxonomy.** The bank appraises all the taxonomies (RAS, IFRS, National Projects…) and selects the best ones. The Sustainable Development Goals are well-known and easy to understand, and updated statistics are available[11,12]. This allowed us to use the SDG taxonomy for our ESG reporting. We were the first bank in the world to do so!

II. **Governance structure.** ESG is a corporate culture, not just management bodies and procedures; it is a situation where everyone, from shareholders to tellers, can explain to any interested party what ESG is.

III. **Strategy.** A strategy is not a static document, but an electronic model which includes the following elements: 1) balance sheets, 2) regulatory restrictions, 3) risk probability, and 4) dynamic functions for the reproduction of all types of capital (financial, productive, intellectual, human, social and natural).

IV. **Risk management** requires that we produce a list of the ESG risks considered and assess their impact on the default probability function**.** Today this impact is marginal, but the bank is experienced in successfully managing risks in the following sectors: agribusiness, SMEs, housing and utilities, and female, youth and social entrepreneurship. In a crisis, ESG banking does not put interest rates up. Instead, it helps customers to survive the crisis and transform their businesses.

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6 https://www.luxembourgforfinance.com/wp-content/uploads/2021/10/2021.10-Benchmarking-ESG-in-banking-and-finance-New-Financial.pdf

7 https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

8 https://asros.ru/upload/iblock/160/PRAKTICHESKIE-REKOMENDATSII-BANKOVSKOGO-SOOBSHCHESTVA-PO-VNEDRENIYU-ESG_BANKINGA-V-ROSSII.pdf

9 https://www.centrinvest.ru/files/smi/pdf/Cifrovizatsia_ESG%20_%20bankinga.pdf

10 https://www.youtube.com/watch?v=9WDurPJpH2I

11 https://rostov.gks.ru/storage/mediabank/PO%20-%20движение%20к%20целям%20устойчивого%20развития(1).pdf

12 https://rostov.gks.ru/storage/mediabank/7DwI4Sd7/Цур_2021_сайт.pdf

V. **Reporting.** In addition to financial reporting, banks should provide non-financial reporting. This is not aimed at disclosing secrets; it is a key tool. The Basel Committee on Banking Supervision has published a Consultative Document "Principles for the effective management and supervision of climate-related financial risks"[13], which aligns to a considerable extent with Center-invest Bank's ESG business model.

13 https://www.bis.org/bcbs/publ/d530.pdf