Existing Barriers to the Development of the Climate Agenda for Banks

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Abstract. In the face of declining external demand for climate action and weak domestic competition, the climate agenda in Russia may be perceived by companies and financial institutions as additional difficulties in conducting their activities. Even in the presence of an evolving national regulatory environment, it is difficult for banks to quickly change internal processes in the interests of low-carbon development. Banking organizations face certain obstacles that the Russian financial market and business in general have yet to overcome. Despite the growing trend and attention to the climate agenda, not all banks understand the value of low-carbon investing. Banking organizations consider investment loans for green projects either less profitable or too risky. Low-carbon projects have not yet been widely developed in Russia, which does not allow in practice to assess the economic benefits and risks of investing in them.

1 Introduction

More than half of entrepreneurs consider the lack of state support to be an obstacle to the implementation of the ESG agenda. In the current environment, banks have an even greater responsibility and leadership role in encouraging their clients to implement a low-carbon development strategy. At the moment, the Government of the Russian Federation only plans to provide support to participants in climate projects. The main relief is the abolition of value added tax on income from the sale of works and services in climate projects, as well as from the sale of carbon credits [1]. Also in April 2022, the Government of the Russian Federation was instructed to consider the issue of providing state support measures to participants in investment projects that meet the requirements of the concept of environmental, social and corporate responsibility, by January 1, 2023. At the same time, an active policy is being pursued abroad to support climate initiatives. Thus, the UK, the leader in the implementation of climate change policy, provides support at the state level in the framework of the development and implementation of low-carbon solutions in the following areas: and sustainable financial management standards, investment fund financial support in the early stages of the development of new clean technologies [2]. Support for enterprises in improving their energy efficiency (consultations, recommendations, simplification of requirements for enterprises to measure and report on energy use,

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development of joint sectoral plans for industrial decarbonization and energy efficiency improvement).

2 Research Methodology

However, banks can implement them to achieve their own sustainability goals with a focus on reducing the carbon footprint of the portfolio. As part of climate investments, companies will also be able to use generated carbon credits to offset their carbon footprint in the future. However, this will require the creation of the necessary infrastructure. Such an infrastructure has already begun to take shape in Russia. In September 2022, the carbon market was launched in the Sakhalin Region: the first carbon units issued from the climate project were registered in the region [3]. Later, the first auctions for the sale of carbon units were held. As a result of the first day, two purchase and sale transactions were concluded for a total of 20 carbon units, of which 10 were acquired by Sovtech Volgo-Vyatka LLC (part of the Sber Group).

The high rate of temperature increase in Russia can provoke natural disasters that will damage both the population and the economy. Thus, an abnormally hot summer and more frequent fires in 2010 in Russia caused losses in the amount of $500 billion, or 1.2% of the gross domestic product (hereinafter referred to as GDP) of that period. As a result of the drought, crop losses have become more frequent [4].

In the “State report on the state of protection of the population and territories of the Russian Federation from natural and man-made emergencies in 2021”, the total material damage from emergencies (hereinafter referred to as emergencies) was estimated at 47.9 billion rubles, of which from natural Emergency — 44.6 billion rubles.

3 Results and Discussions

Russian banks face difficulties in directly assessing their indirect impact on climate change - assessing the carbon footprint of a bank’s investment portfolio. At this stage, difficulties arise with the lack or lack of information. As a rule, this concerns both the data provided by borrowers and the understanding of approaches and algorithms for collecting such information [5]. As a consequence, banks cannot be completely sure of the accuracy of the calculated results. Despite the active expansion and updating of the national methodological base (Orders of the Ministry of Natural Resources No. 371 and 330) for calculating greenhouse gas emissions, it is still difficult for banks to assess the volume of their main source of emissions - the loan portfolio. There is no methodology for calculating the amount of emissions from this source in Russia, banks can use The Global GHG Accounting & Reporting Standard for Financial Industry developed by PCAF. The development of a unified national system for calculating the carbon footprint of projects and organizations financed by the bank will help mitigate the risks associated with the use of foreign standards [6].

Since 2020, the climate agenda in Russia has begun to develop at an accelerated pace, which has created a need for high expertise from financial market participants. However, the insufficient level of competence within the framework of the sustainable development agenda of most banking organizations did not satisfy the demand [7]. The lack of qualified personnel with a high level of expertise in climate change and climate risk management creates an additional barrier to the creation and implementation of decarbonization strategies for Russian companies. According to a study by Deloitte in 2021, commissioned by the Association of Russian Banks, less than 15% of national banks believe that they have the competence to analyze ESG risks, including climate risks, in full. The lack of...
expertise and knowledge is also noted in the international arena, which creates difficulties in taking into account climate risks and their impact on their own operational and business processes. In July 2022, the European Central Bank published the results of a climate stress test involving 104 banks[8]. The test results showed that most banks do not include climate risks in their lending models: about 60% of participating banks do not yet have a well-integrated climate risk stress testing system. In most financial companies, there is a shortage of employees with the necessary competencies, since previously the domestic education system did not train ESG specialists on an ongoing basis. Against the background of the growing demand for employees with a high level of expertise in the management of sustainable and low-carbon development, specialized educational programs are beginning to appear [9].

Despite the fact that some drivers of the development of the climate agenda in banks and in the Russian market as a whole have lost their strength, and most of the barriers have remained, it can be assumed that Russian banks will continue to take further steps to develop and implement climate strategies that will affect their borrowers. This is due to several key factors [10]:

- Russia remains committed to the national goal of carbon neutrality;
- in new and promising markets for Russian products and financial markets, we can expect the introduction of similar Western requirements for the carbon intensity of products, climate risk management and disclosure of relevant information;
- The actions of the government and regulators, as well as the market response to the demand formed in 2021 (for example, the launch of educational programs to saturate the market with qualified personnel), will lead to the alleviation of the main barriers and the simplification of the implementation of measures to combat and adapt to climate change by banks and businesses [11]. It is important to take into account that the new challenges faced by Russian banking organizations related to climate change and the implementation of the climate agenda not only create risks for the financial sector, but also open up a number of areas for development that will or are already an incentive to promote climate change agenda and the transition to a low-carbon economy. Let us consider in more detail the key vectors for the development of climate strategies for banks.

On the one hand, it is critical to build and maintain a national infrastructure for low-carbon development [12]. The Government of the Russian Federation and the Bank of Russia are actively working in this direction. In particular, within this area, in 2021, the Federal Law “On Limiting Greenhouse Gas Emissions” was adopted, which introduces mandatory reporting by enterprises in certain industries on greenhouse gas emissions and the implementation of climate projects on a voluntary basis, and the Ministry of Economic Development of Russia approved the rules for the implementation of climate projects, including their criteria, execution procedure and implementation report for legal entities and individuals, individual entrepreneurs. In turn, the Bank of Russia creates consistency in understanding the impact of climate risks on financial stability, generates valuable reviews and recommendations, and in the future may move on to regulating the climate agenda of credit institutions and public joint-stock companies [13]. However, despite the creation of appropriate infrastructure, business may not be ready to take part in the transition to a low-carbon economy without government support. It is expected that in order to implement the strategy of development with low greenhouse gas emissions, the state will provide direct support for climate initiatives. Support measures may vary - these may be subsidies, preferential interest rates, tax breaks, etc. It is the government and regulators who will have to set the framework for the climate agenda and provide mechanisms for implementing climate initiatives for both banks and companies in the real sector.
The climate agenda allows banks to expand the range of financial and non-financial products and services. Achieving climate goals requires funding for projects, often taking the form of large-scale upgrades and equipment replacements [14]. Banks are an integral part of this process, providing loans for the implementation of green or adaptation projects (in accordance with the national taxonomy approved by Decree of the Government of the Russian Federation of September 21, 2021 No. 1587) or helping clients issue bonds - green, adaptation, climate, and also related to goals sustainable development. The corresponding amendments to the Securities Issue Standard were made by the Bank of Russia [15]. Also, in addition to the “standard” products listed above, there are other innovative proposals. For example, an alternative to insurance against weather disasters are derivative financial instruments - weather derivatives, which should help reduce the impact of the consequences associated with adverse weather events. Weather derivatives are financial contracts, the payouts of which are directly dependent on weather conditions. This connection to the weather allows derivatives to be used to protect and preserve a company’s profits from adverse environmental conditions. Weather risk hedging was first introduced for North American energy companies. Then large financial companies (such as Societe Senegal, AXA, DrKW) also implemented this product. Banks can only achieve their climate agenda by working closely with their customers. Following this principle, Australia and New Zealand Banking (ANZ) has set a goal to support its top 100 borrowers in developing and strengthening low-carbon transition plans and to support initiatives to protect biodiversity by 2024. By advancing the climate agenda and supporting clients in their low-carbon transformation efforts, banks can expand their ecosystem and service portfolio through advisory services. This will allow to use and expand the expertise and experience in the field of climate change or introduce non-banking services to the market. In particular, banks can provide support to clients in the following areas [16]:

- inventory and quantification of greenhouse gas emissions;
- creation of a system for accounting for emissions and removals of greenhouse gases;
- automation of accounting and quantitative assessment of greenhouse gas emissions;
- developing a climate strategy and setting goals to reduce greenhouse gas emissions and offset them;
- Identification and assessment of climate risks in accordance with TCFD recommendations;
- preparation of climate reporting; • implementation of climate projects.

4 Conclusions

Effective risk management in the loan portfolio by banking organizations requires the availability of reliable comparable data, both financial and non-financial, for assessment and modeling. Banks can obtain this information both from public reporting and directly, but the best practice is to make the information available to all stakeholders. Verified information about the sustainable and low-carbon development of the borrower will allow banks to conduct a competent assessment of potential risks and build a stable business model. At the moment, the level and amount of disclosure of public non-financial reporting, in particular information on the carbon footprint of Russian companies, is still insufficient for the full development of banks’ climate strategies in terms of portfolio assessment. In its report “The Impact of Climate Risks and Sustainable Development of the Financial Sector of the Russian Federation”, the Bank of Russia also noted the need to disclose non-financial information to disseminate the principles of sustainable development of the Russian financial sector as one of the development directions. The main obstacle is that at the moment the publication of non-financial statements is not mandatory. There is also not
enough motivation and standardization for disclosure. Companies see no objective incentives to disclose information and no clear framework on how to do so. Disclosure of information on sustainable development is currently not required from companies by either the stock exchange, or regulators, or the state. Nevertheless, the Ministry of Economic Development of the Russian Federation is working on the creation of a federal law on the publication of non-financial reporting by Russian companies, and the Bank of Russia in the summer of 2021 published recommendations on the development of public non-financial reporting for companies.

One of the barriers to the development of the climate agenda in banks is the lack of national methods for assessing greenhouse gases in the framework of the loan and investment portfolio. It is necessary to develop not only a methodology for assessing the carbon footprint of a banking portfolio, but also an approach to collecting the necessary initial data, which, in turn, must be verified. It is this algorithm that will make it possible to achieve confidence in the accuracy and reliability of the results obtained. The development of a national methodology will make it possible to take into account industry specifics at the national level, which will also allow achieving the most accurate assessment results. The presence of the Russian methodology will ensure independence from foreign standards in this area and will facilitate settlements by domestic banks. To solve this problem, it is necessary to increase human resources and develop the competencies of specialists in the field of climate. This task is being solved with the help of a number of educational programs opened at leading Russian universities in 2021-2022.

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