

The Future of the Climate Agenda in Banks

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Abstract. Climate change is the main global risk in the next 10 years, and international organizations, businesses and governments are paying more and more attention to decarbonization strategies and energy transition. In line with the general trend, the popularity of the climate agenda in Russia has grown rapidly in recent years. Until recently, many Russian companies calculated their carbon footprint, planned the development and implementation of climate strategies, and the state was actively developing the regulatory infrastructure for low-carbon development. Banking organizations have also announced climate goals and implemented decarbonization activities. However, a sharp change in the geopolitical and economic situation calls into question the future of the national climate agenda. At first glance, it may seem that the importance of low-carbon development principles has decreased, and banks, which have just begun their journey within the framework of the sustainable development agenda, have lost momentum. Increasingly, there are opinions that the main driver for the development of climate strategies, the request of international investors, has lost its relevance.

1 Introduction

In 2021, Russian banks were at the initial stage of developing the climate agenda. The imposition of Western sanctions on many financial market participants and the worsening economic situation in 2022 shifted priorities, reduced attention to the sustainable development agenda, and introduced uncertainty about the implementation of decarbonization strategies for Russian financial institutions and companies in the real sector. It can be concluded that some of the previous drivers of the climate agenda have lost their relevance [1]. There is a need to revise the drivers of the sustainable and low-carbon development agenda, and special attention in this process should be paid to banks, since the actions of their borrowers depend on their climate strategies, especially in terms of the impact on the loan portfolio.

It is important to note that drivers related to demand from foreign investors and export competitiveness will increase in importance as demands from partners in the Asia-Pacific region and other countries develop [2]. Let us consider in more detail the current drivers of the development of the climate agenda in Russia, the relevance of which does not depend on geopolitical and economic factors.

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2 Research Methodology

The TCFD Working Group on Climate Change Financial Disclosure (hereinafter referred to as the Working Group) defined the perimeter of climate risks and proposed their classification [5]. In accordance with the document of the Working Group, risks are divided into two types: physical risks and transitional risks. Physical risks are associated with adverse natural phenomena resulting from climate change. They manifest themselves as part of the reduction in the predictability of the state of the climate and the increase in dangerous natural disasters [6]. Transition risks are associated with the transition to a low-carbon economy. They are implemented in the form of changes in legislation (introduction of obligations for the use of new low-carbon technologies, charging for greenhouse gas emissions, reduction in carbon-intensive activities), reduction in financing of carbon-intensive industries due to a decrease in investor interest [7].

The fact of climate change is generally recognized in the international scientific community [14]. This global process leads to physical consequences: a change in the average temperature level, an increase in adverse natural phenomena and dangerous natural disasters. The consequences of climate change both in the world and in Russia are large-scale and affect the economy and the financial industry. According to the report of the Federal Service for Hydrometeorology and Environmental Monitoring for 2019, the average growth rate of the average annual air temperature in Russia in 1976–2019 was 0.47 °C per 10 years, which is more than 2.5 times higher than the growth rate of the global temperature for the same period - 0.18 °C [15]. In 2021, the deviation from the national climate norm (deviation from the average for 1961–1990) was + 1.35 °C [16]. There have also been temperature changes at the country level. In July 2022, the Hydrometeorological Center established new climate standards in Russia: scientists updated them taking into account climate change over the past 30 years. So, for Moscow, the new normal temperature in July officially became 1.5 degrees higher than it was before.

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. Given that agriculture accounted for almost 4% of GDP in 2010, crop losses could have caused a 1% reduction in GDP. The economic impacts of climate change are also affecting the banking industry [8]. According to researchers, climate change will increase the frequency of banking crises around the

world (according to various estimates, the increase could be from 26 to 248%), while bailing out insolvent banks will lead to an additional financial burden of about 5 to 15% of GDP per year and an increase in public debt in relation to GDP by 2 times. Physical climate risks are among the most significant risks in terms of the possible size of economic losses and have a maximum implementation horizon. 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 [9]. (93.1% of the total damage), from man-made and biological and social emergencies - 1.3 billion rubles. and 2 billion rubles. respectively. According to Roshydromet data, four regions are most affected by climate change: the Voronezh and Kursk regions, the Republic of Crimea and the Stavropol Territory. The impact of natural disasters is manifested not only in Russia, but also at the global level. Global economic losses from natural disasters in 2021 amounted to about \$270 billion, and only 41% of this amount was insured - \$111 billion.

3 Results and Discussions

Obviously, climate change will have an impact on the fixed assets and infrastructure of Russian enterprises [10]. The destruction of buildings and structures associated with natural disasters, abnormal weather conditions and changes in average annual temperatures and precipitation patterns will lead to a deterioration in the economic performance of businesses, which in turn may affect their ability to return borrowed funds to banks. The degree of impact of physical climate risk on credit will depend on whether the damage is insured and to what extent. However, the primary problem is the identification and assessment of climate risk in different scenarios, which today in Russia are available only to the largest businesses [11]. The development of the climate agenda was an important criterion for Russian companies to be present in the international arena: Western investors demanded compliance with sustainable development practices as part of attracting funding, Western commodity markets developed plans to introduce cross-border carbon regulation. Despite the sharp reduction in interaction with Western investors, the “international” driver remains relevant with a turn to the East and increased attention to partnerships in the Asia-Pacific Region (hereinafter referred to as the Asia-Pacific Region). The Asia-Pacific region is actively developing the agenda of sustainable and low-carbon development. Asia’s economies are highly exposed to extreme weather conditions. According to a report by the Economic and Social Commission for Asia and the Pacific (ESCAP) in 2019, the annual economic cost of natural disasters in Asia and the Pacific is estimated at \$675 billion, which is 2.4% of the total GDP of the region [12]. Natural disasters also caused huge economic losses and between 1990 and 2018, the average annual damage across the region was 0.34% of GDP, which was higher than the global average of 0.22%. Asian banking institutions are also focusing on the impact of climate change on their operations, with 100% of risk directors prioritizing climate risk.

Despite high attention to the agenda in the region, not all Asian banks have integrated climate change management practices into their activities. In 2019, The South East Asian Central Banks (SEACEN) conducted a survey of their member banks to analyze their difficulties in transitioning to a low-carbon economy. A survey of 18 respondents from Asian central banks showed the following statistics [13]: 94% of those surveyed believe that their institution should encourage green enterprises and low-carbon financing. At the same time, in practice, only 22% of respondents out of 18 respondents used investment methods to attract private capital to low-carbon projects [14]. Only 29% have issued a low-carbon investment regulation policy, and 39% have trained their staff on the risks

associated with climate change. The climate agenda in the Asia-Pacific region is actively developing, Asian investors will apply requirements similar to European ones for compliance with ESG practices to Russian partners and promote climate standards. For example, since July 2020, the Hong Kong Stock Exchange began to require companies to disclose significant climate-related issues. In turn, the Shenzhen Stock Exchange has issued a number of provisions related to the disclosure of ESG information, but it does not yet require companies to publish ESG statements as a condition for listing on the exchange. The Shanghai Stock Exchange also does not require disclosure of ESG reporting for listing on the exchange. The national regulatory agenda has recently been developing rapidly, but this development is belated relative to the international level [15]. Despite this, many steps have been taken to date to develop internal carbon regulation, both at the country and company levels:

- Decree No. 666 was signed to reduce greenhouse gas emissions by 2030 to 70% of the maximum possible absorption capacity of forests.
- The government approved the Strategy for Russia's Social and Economic Development with Low Greenhouse Gas Emissions until 2050. • Federal Law No. 296 dated July 2, 2021 "On Limiting Greenhouse Gas Emissions" was adopted, which provides for state accounting of greenhouse gas emissions and the creation of a reporting system. The law introduces mandatory reporting for legal entities and (or) individual entrepreneurs on greenhouse gas emissions [16]. From 2023, reports will be submitted by companies with a mass of greenhouse gas emissions of 150 thousand tons per year or more for 2022, companies with a mass of greenhouse gas emissions of 50 thousand tons per year or more - from 2025 for the 2024 reporting period. Around the world, central banks are beginning to pay more and more attention to climate risks. In line with the trend, in 2021 the Bank of Russia conducted stress tests for the first time to identify the degree of impact of climate risks on the economy. Based on the results of such stress tests, it will be possible to identify specific costs for the financial sector in the face of climate variability. However, in order to support banking organizations and justify accounting for climate risks, regulators need to assess the impact of climate change not only on the economy as a whole, but also on the efficiency of the banks themselves. For example, the Bank of England has formally launched its Biennial Climate Research Scenario (CBES), in which lenders will have to model how climate change affects loan losses, while insurers will assess the impact of climate change on the value of assets and liabilities. The largest banks in the UK, including HSBC Holdings PLC and Barclays PLC, as well as insurers, including the British divisions of American International Group Inc. and insurance companies Lloyd's of London will have to assess their performance over the next 30 years based on three different scenarios. The scenarios provide for three outcomes: either early government action to combat climate change, or late action, or no adaptation action. Commitments to build the infrastructure for the transition to a low-carbon economy and the integration of climate risks into monetary processes can be assumed by central banks [17]. However, there is concern from market participants that expanding their powers to form a low-carbon economy will interfere with the implementation of the main goal of maintaining price stability.

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.

4 Conclusions

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. 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. Support for enterprises in improving their energy efficiency (consultations, recommendations, simplification of requirements for enterprises to measure and report on energy use, development of joint sectoral plans for industrial decarbonization and energy efficiency improvement).

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