

ESG-lending in the Russian economy

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Abstract. The purpose of the article is to consider the current state of ESG lending in the Russian economy, the features of ESG rating of Russian financial companies and approaches to potential borrowers, and to identify the most relevant areas for the development of ESG lending to Russian companies. Despite the fact that Russian companies and the Russian economy are under sanctions and the opportunities to enter foreign markets are significantly limited, ESG remains relevant. An analysis of ESG practices in the banking sector conducted in 2022 by Expert RA showed that only large credit institutions follow the ESG concept. More than 50% of the top 20 banks have implemented KPIs for ESG indicators in their lending and investment processes. In the practice of Russian banks, ESG-assessment of credit risks includes indicators of default probability, analysis and evaluation of portfolios in terms of industry/geographical concentrations, exposure limits, borrowing strategies, scenario analysis and/or stress testing. It is concluded that Russian companies in the financial sector use ESG approaches for their own strategic development and for lending to their clients, and that government support is required for the ESG transformation of the banking sector.

1 Introduction

Lending has traditionally been a key function of commercial banks, which carried it out exclusively based on the criteria of commercial expediency, subject to banking standards established by the market regulator. Recently, political, economic and technological changes have taken place in Russia, which have influenced the approaches and processes of lending, as well as attitudes about lending. As a result, we can talk about a multidimensional transformation of the mechanisms, methods and operational processes for lending and assessing the creditworthiness of potential borrowers.

The strongest influence was:

- digital transformation of the financial sector, as a result of which lenders and borrowers began to apply digital innovations at all stages of lending [1, 2];
- Emergence of new financial technologies. As a result, lending has ceased to be exclusively a function of commercial banks and has spread to non-financial organizations,

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as well as to fintech companies thanks to open interface technologies (API) [3]. Consequently, the structure of the market supply of credit has changed;

- recognition of the ESG concept, which forced banks and other financial organizations not only to be involved in compliance with the ESG principles themselves, but also to use ESG indicators in assessing creditworthiness when making decisions on issuing loans;
- financial sanctions and restrictions on external financing. These circumstances made it necessary to choose borrowers more responsibly and set financing criteria based on the strategic goals of long-term sustainable development.

2 Materials and Methods

The purpose of the article is to consider the current state of ESG lending in the Russian economy, the features of ESG rating of Russian financial companies and approaches to potential borrowers, and to identify the most relevant areas for the development of ESG lending to Russian companies.

This study is based on internationally recognized norms that establish the postulates and rules for the strategic development of modern civilization: the UN Global Compact, the UN Sustainable Development Goals, the Principles of Responsible Banking of the UNEP Financial Initiative, the National ESG Alliance, the Climate Governance Initiative Russia and others. For many decades, scientists around the world have been engaged in economic research that combines the interests of man, society and the environment.

A great contribution was made to the development of modern credit theory based on ecosystem principles and approaches that do not include long-term sustainable development [4-8]. The solution of certain practical issues of lending from the point of view of modern digital innovations is considered in detail in [9-12], including in the territorial and sectoral aspects [13-15].

The author's theories of sustainable development, philosophy and economic concepts on which ESG are based are detailed in [16-21].

At the same time, there is a discrepancy between classical theories of credit, theoretical studies of corporate lending and modern practical experience in their application for sustainable development in accordance with the principles of ESG. This study aims to bridge the gap between traditional approaches to lending and global trends towards long-term sustainability.

3 Results and Discussion

3.1 Status of ESG rating of Russian financial companies

In world practice, there are about 600 different ESG criteria and there are about 100 organizations that evaluate business structures according to these criteria and, depending on the result, assign them appropriate ratings. In the US, the ESG rating was assigned to over 800 companies, in Russia - no more than 135 companies.

In Russia, national companies are rated by the Expert RA Rating Agency, the National Rating Agency and others. Russian companies are also assigned an ESG rating by the Independent European Rating Agency RAEX-Europe.

Table 1 shows the result of the rating conducted by the RAEX-Europe Agency for Russian companies in the financial sector. The rating covers 160 Russian companies, among which a number of financial companies are in the top 100.

Table 1. ESG ranking of Russian companies in the financial sector according to the RAEX methodology (as of 06/01/2023).

	Industry	ESG Rank	ESG rating
Credit Bank of Moscow	Banks	7	A
AFK Sistema	Financial services	12	A
Moscow Exchange	Specialized financial services	15	A
SBER	Banks	48	BB
Sovcombank	Banks	50	BB
VTB Group	Banks	51	BB
Bank "FC Otkritie"	Banks	52	BB
AK BARS Bank	Banks	58	B
UniCredit Bank	Banks	59	B
Rosbank	Banks	62	B
Bank "Saint-Petersburg"	Banks	64	B
Tinkoff bank	Banks	66	B
Raiffeisen	Banks	68	B
Rosselkhozbank	Banks	74	B
Gazprombank	Banks	79	CCC
Citibank	Banks	84	CCC
"Russian regional development bank"	Banks	92	CCC
Promsvyazbank	Banks	97	CCC

ESG Rank shows the company's place in the overall ranking of all assessed companies in various industries in Russia. Despite the fact that Russian companies and the Russian economy are under sanctions and the opportunities to enter foreign markets are

significantly limited, ESG remains relevant. The main goal and incentive for obtaining a favorable ESG rating is the opportunity to access global sales markets, cooperate with global companies and create new value chains.

For example, Sberbank is driving the ESG agenda and one of the pioneers in responsible finance in Russia. The Bank provides customers with demanded ESG products and services in all business segments. At the end of 2022, Sber's ESG loan portfolio amounted to RUB 1.3 trillion, and revenue from the sale of non-credit ESG products amounted to RUB 461 million. BEAC also compiles ESG profiles of 85 regions of the Russian Federation in order to understand the differences in approaches to lending to companies from each region. The number of retail ESG clients doubled over the year to 15.2 million.

3.2 ESG in the activities of Russian financial companies

The operating activities of companies in the financial industry, including FinTech companies, are subject to ESG risks to a limited extent. But, being financial intermediaries, financial companies are indirectly involved in the promotion of ideas and practical ESG support programs and participate in the financing of ESG projects (circular economy, green bonds, social bonds, carbon credits, etc.). ESG banking is different from other banking business models (public funding, speculative banking, sustainable banking, Islamic banking) that operate in Russia. Russian ESG-banking is focused on the real sector of the economy, long-term business development of clients and regions of presence, self-regulation in risk management and training of own personnel.

An analysis of ESG practices in the banking sector conducted in 2022 by Expert RA showed that only large credit institutions follow the ESG concept. More than 50% of the top 20 banks have implemented KPIs for ESG indicators in their lending and investment processes.

The top 100 banks lag behind the leaders in ESG business transformation. Only 15% of the top 100 banks have active sustainable development strategies or environmental policies.

Lower results in banks with KPIs for sustainable investments, which were implemented by 4% of respondents in 2021, while 46% of banks set the goal of introducing such practices in subsequent periods, the rest of the banks did not consider including such KPIs in their strategic documents. Among the top 20 banks in 2021, 40% had KPIs for investments in sustainable instruments, which created additional demand for green and social bonds in the financial market.

In the business models of the FinTech industry, the application of ESG principles finds application in terms of using equipment that, due to the specifics of companies, is energy-intensive, wears out quickly, requires frequent replacement due to rapid obsolescence, capital-intensive, multi-component, technically complex, innovative, etc. Thus, the VTB ecosystem follows an internal philosophy based on the mission of maintaining a “clean environment”.

Optimization of internal business processes of FinTech companies, associated with trends in building their own ecosystems, has set the task of replacing outdated banking equipment, computing systems and servers, data storage systems, uninterruptible power supplies, ATMs, peripheral payment and other equipment, and so on. and robotization of business processes. The environmental responsibility of FinTech companies and adherence to the principles of ESG is manifested in the fact that not recycling is carried out, but a full cycle of processing components of decommissioned objects. According to the Cash

Services Department of the Operational Business Support Department of VTB Bank, 35-37% of the upgraded cash registers are transferred for disposal with full waste processing. The Russian company ECOPOLIS is engaged in processing the equipment of financial organizations. This is the only holding in Russia that is engaged in the environmental disposal of waste electronic and electrical equipment and the production of secondary raw materials from it. The recycling complex was created taking into account the principles of the circular economy. and consists of three full-fledged factories. The ECOPOLIS holding includes the ECOTEHPROM company, which annually processes up to 75 thousand tons of waste electronic and electrical equipment, the ECOPLAST company, which recycles up to 25 thousand tons of case plastics from banking electronics and household appliances, the AURUS company, which processes up to 12 tons of copper scrap and scrap of printed circuit boards.

3.3 The state of ESG lending to the economy by Russian banks

ESG lending in Russia is carried out by the state corporation VEB.RF and commercial banks. The state priority is ESG lending in the following areas of activity: waste disposal and processing, electric power industry, construction, industry, transport, water supply and sanitation, forestry, conservation of natural landscapes and biodiversity, information and communication technologies.

ESG-assessment of borrowers was implemented only by a third of the largest market players. In the first half of 2022, the portfolio of ESG loans to corporate borrowers amounted to about RUB 400 billion, at least 96% of which was formed by systemically important banks. The structure of corporate ESG loans is as follows: 70% - energy (including nuclear), 14% - green metallurgy, 7% - mining, that is, we observe a high industry concentration, due, on the one hand, to a small period of such lending practices, on the other hand, the requirements of the world market for exporters.

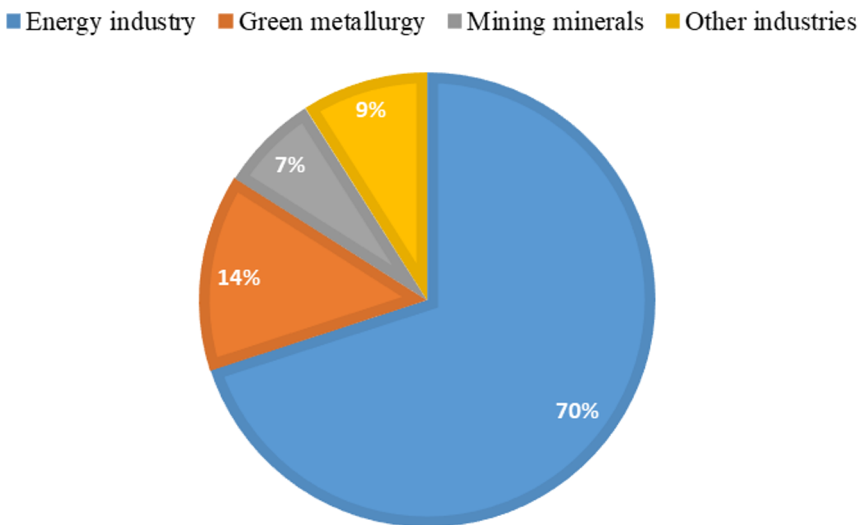


Fig. 1. Structure of corporate ESG loans issued by Russian banks in 2022

In the practice of Russian banks, ESG-assessment of credit risks includes indicators of default probability, analysis and evaluation of portfolios in terms of industry/geographical concentrations, exposure limits, borrowing strategies, scenario analysis and/or stress testing. The assessment is carried out at all stages of lending, in the risk profile of sectors and geographical areas, in risk classification procedures, in the assessment of collateral. The price of a loan incorporates various climate and environmental risks and costs through various cost drivers (cost of capital, green bonds, financing or credit risk).

4 Conclusion

Russian companies in the financial sector continue to use ESG approaches for their own strategic development and for lending to their clients. A survey of more than 100 Russian banks showed that government support is required for the ESG transformation of the banking sector. Banks propose to introduce provisioning incentives and lower risk weights for ESG loans (57% of surveyed banks), as well as tax incentives for projects that meet ESG criteria (30% of surveyed banks). Less than 10% of respondents voted for the introduction of a unified taxonomy (that is, the establishment of unified evaluation criteria). This indicates concerns that strict criteria for selecting ESG projects will only reduce the motivation of banking market players.

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