

Current Trends in Business Transition to Carbon Neutrality in the Framework of Sustainable Development and the Paris Climate Agreement

Nikonorov Sergei Mikhailovich, Doctor of Economics, Professor of the Department of Environmental Economics, Faculty of Economics, Moscow State University named after M.V. Lomonosov, Director of the Center for Research on Economic Problems of Arctic Development, PORA expert on sustainable development

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Sustainable development

- **Sustainable development** is a simple idea, where the main goal is to improve the quality of life of the population for the current generations and for the generations that will replace them. In the long-term regional strategy for low-carbon development of Russia until 2050, a balance of interests must be observed between three groups of stakeholders: society, business and government; balance of interests between social, environmental and economic factors of development.

ESG rating

- The cost of borrowing for companies that are ready to undergo an environmental and social audit is reduced by at least 10%, and sometimes by half. This directly affects the value of companies. If a company has a high ESG rating, then the debt burden decreases and the market value increases.
- For companies from the extractive industries, the effect will be more noticeable, since their rates include a premium to the wider market, that is, investors take into account potential environmental risks, and this makes the debts of oil workers, coal miners and metallurgists more expensive and shares cheaper.

What is ESG?

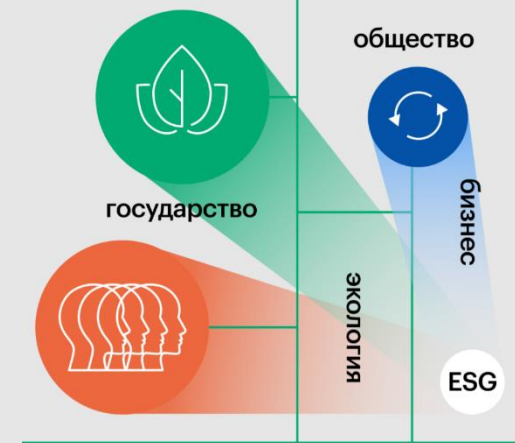
ESG is a set of non-financial performance indicators of a company



ESG factors

- ESG-factors (environmental, social, governance - environmental factor, social factor, factor of effective corporate governance) in the 21st century are developing exponentially. One of the green investment tools by specialists and experts is “green bonds”, which differ from ordinary bonds in that funds are directed to projects that, in addition to economic benefits, also pursue environmental ones. Today, the top three projects in which green bonds are invested are as follows: 1) renewable energy sources; 2) energy efficiency; 3) environmentally friendly transport.

The history of development



- **Peace**

- 1970 - Ethical outflow of investment in South Africa
- 2006 - the UN formulates principles for responsible investment

- **Russia**

- Mid-2017 - an expert council on the long-term investment market was created under the Central Bank
- 2018 - Responsible Finance Group convened
- 2019 - first green bonds

Green and other bonds

- Along with "green bonds", the following are now widely used: "blue bonds" to finance offshore projects; "Brown bonds" for projects in classically "dirty" sectors of the economy; natural bonds - to preserve biodiversity; carbon neutral bonds - to invest in projects that help achieve net zero emissions.
- ESG - consists of three dimensions, according to which companies provide sustainable development management. ESG criteria emerged as a response to environmental degradation, global warming, and increasing economic inequality between rich and poor countries, which created the basis for the development of new financial instruments.

ESG Issue Volume - Bonds

- Modern society began to impose additional requirements on the activities of companies and, in addition to financial statements, began to evaluate them in terms of investing in sustainable development. To be considered successful, a company must demonstrate not only sustainable growth in its financial performance, but also have a positive and recognizable brand. ESG support enables the company to improve its reputation and brand awareness.
- ESG bond issues doubled in 2020. In 2019, ESGs were issued in the world - bonds in the amount of \$ 350.0 billion, and in 2020 already for \$ 700.0 billion. But structurally, everything has changed. If green bonds were the undisputed leader in 2019, sustainable bonds came in second, and social bonds were in third. At the same time, the share of green bonds was 3 times higher than the share of social bonds and bonds related to sustainable development in the aggregate. In 2020, there was a sharp jump in the share of social bonds in the total portfolio of all bonds. The total share of social bonds almost equaled the share of green bonds, but bypassed the share of bonds related to sustainable development.

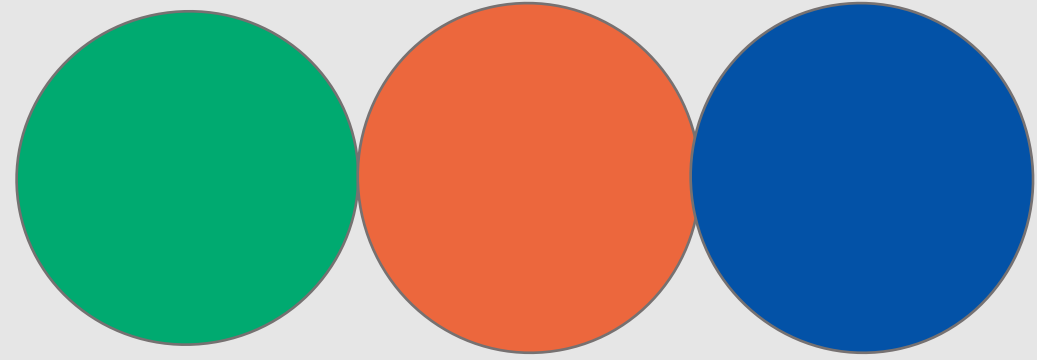
Investing based on ESG criteria

- A 2018 scientific study showed that about 97% of investors around the world conduct either an informal assessment of ESG indicators, or a structured and methodical analysis of non-financial data on companies that are potential investment targets. The number of such investors increased by 19% in just a year, since in 2017 there were only 78% of such investors. It is noteworthy that at the end of 2017, only 3% of investors reported that they were not interested in ESG factors at all.
- Investing on the basis of ESG criteria does not yet allow counting on fabulous profits and is aimed at a long-term strategy. Although funds, whose investment process is built around ESG, are actively gaining popularity. Globally, more than USD 20 trillion is managed using the ESG principle, which is one fourth of all assets held in trust.

Compliance with ESG principles

- Specialized ESG funds buy green paper, which allows the issuance of green bonds, through which to finance projects implemented for environmental purposes.
- Compliance with ESG principles is assessed through the disclosure of relevant information in the company's public non-financial statements or through an assessment of the effectiveness of ESG by a rating agency. Rating agencies have developed their own ESG methodologies. At the same time, the ESG rating is not a credit rating (determining the level of creditworthiness), but is mainly aimed at identifying the company's commitment to responsible business conduct.

ESG rating and ranking

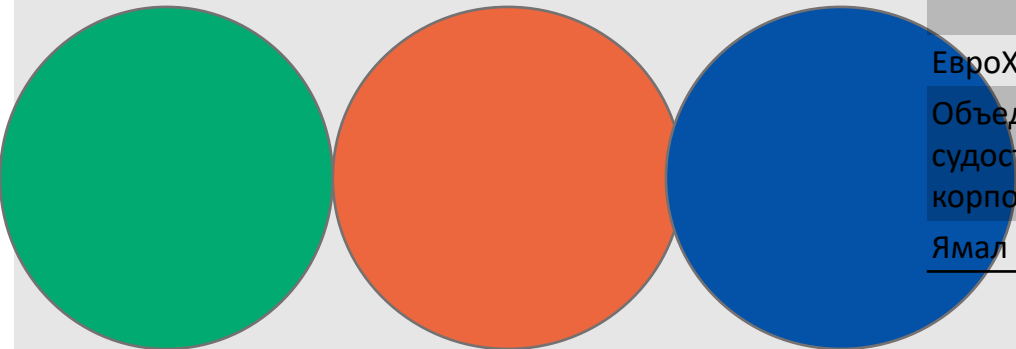


- ACRA: equal block weights (ecology, social responsibility and governance) - 33%. Six categories each in the ecology and social responsibility blocks and seven in the control block. Seven rating categories;
- Expert RA: differentiated weights of the main blocks, they also change depending on the type of company. Six rating levels.

RA Expert rating

| Фактор | Вес для финансовых компаний, % | Вес для нефинансовых компаний, % |
|---|--------------------------------------|--|
| I. Окружающая среда | 15,0 | 30,0 |
| 1.1 Экологическая политика | 1 | 6 |
| 1.2 Влияние на атмосферу | - | 4 |
| 1.3 Влияние на водную среду | - | 4 |
| 1.4 Влияние на землю | - | 4 |
| 1.5 Обращение с отходами | - | 4 |
| 1.6 Учет показателей, влияющих на окружающую среду | - | 6 |
| 1.7 План по снижению негативного влияния на окружающую среду | 1 | 5 |
| 1.8 «Зеленые» проекты в кредитном портфеле (только для банков) | 2 | - |
| II. Общество | 40,0 | 35,0 |
| 2.1 Политика в области корпоративной социальной ответственности | 4 | |
| 2.2 Оплата труда сотрудников | 3 | |
| 2.3 Социальная защищенность и профессиональное развитие сотрудников | 4 | |
| 2.4 Текучесть кадров | 1 | |
| 2.5 Охрана труда и производственная безопасность | 3 | |
| 2.6 Работа с клиентами | 2 | |
| 2.7 План по улучшению социально значимых показателей | 5 | |
| III. Качество управления | 45,0 | 35,0 |
| 3.1 Деловая репутация | 2 | |
| 3.2 Стратегия развития | 2 | |
| 3.3 Эффективность Совета директоров | 4 | |
| 3.4 Деятельность исполнительных органов | 4 | |
| 3.5 Система управления рисками | 4 | |
| 3.6 Степень прозрачности информации | 4 | |
| 3.7 Защита прав собственников | 5 | |
| Итого | 100% | 100,0 |

ESG ranking of Russian companies RAEX-Europe



| Компания | Сфера деятельности | ESG Rank | E Rank | S Rank | G Rank |
|--|---------------------------------------|----------|--------|--------|--------|
| СИБУР Холдинг | Нефтехимия | 2 | 2 | 6 | 20 |
| Лукойл | Интегрированные нефтегазовые компании | 3 | 4 | 16 | 3 |
| Полюс | Драгоценные металлы | 9 | 3 | 20 | 24 |
| Росатом | Атомная энергетика | 12 | 11 | 35 | 6 |
| Северсталь | Черная металлургия | 15 | 23 | 5 | 21 |
| Газпром | Интегрированные нефтегазовые компании | 16 | 8 | 19 | 33 |
| Роснефть | Интегрированные нефтегазовые компании | 17 | 6 | 21 | 40 |
| АЛРОСА | Драгоценные металлы и минералы | 19 | 17 | 26 | 12 |
| Россети | Энергоснабжение | 25 | 12 | 56 | 7 |
| ФосАгро | Агрохимикаты | 26 | 25 | 37 | 26 |
| НОВАТЭК | Интегрированные нефтегазовые компании | 31 | 26 | 27 | 43 |
| Транснефть | Транспортировка нефти | 35 | 35 | 58 | 8 |
| Газпром нефть | Интегрированные нефтегазовые компании | 37 | 43 | 40 | 25 |
| Норильский никель | Добыча прочих полезных ископаемых | 42 | 55 | 17 | 46 |
| Зарубежнефть | Интегрированные нефтегазовые компании | 53 | 48 | 66 | 57 |
| ЕвроХим | Агрохимикаты | 74 | 64 | 78 | 66 |
| Объединенная судостроительная корпорация | Судостроение | 101 | 115 | 122 | 86 |
| Ямал СПГ | Разведка и добыча газа | 102 | 79 | 133 | 95 |

Carbon neutrality

- 1,927 Companies around the world announce plans to achieve carbon neutrality. Investors began to divide the world's largest corporations into those who are able to earn their place in the "green" economy of the future, and those who risk being left in the "carbon" past. More than 90% of S&P 500 companies publish non-financial statements. But this is no longer enough. More important to the market is that 40% of the world's largest corporations do not yet have a carbon neutral agenda by 2050, according to a January poll by Fortune and Deloitte.
- Taking into account the raw materials orientation of the country's economy and the slow reaction of domestic business to the global climate trend, Russian companies are even more at risk. And they risk leaving the investment radar if they fail to pick up on new trends quickly enough.

Carbon neutrality

- The market today wants from issuers not abstract declarations or scattered facts of the ESG (ecology, social responsibility, corporate governance) agenda, but commitments to become carbon-neutral in the foreseeable future.
- Carbon neutrality means that the company is reducing its carbon dioxide emissions through renewable energy and technological improvements, as well as implementing projects to absorb carbon dioxide or to plant forests.
- The total number of companies in the world that have committed to zero greenhouse gas emissions has tripled since 2019 and exceeded 1,500, according to data from Data-Driven EnviroLab and NewClimate Institute at the end of 2020.

Low-carbon development strategy of the Russian Federation with low greenhouse gas emissions until 2050

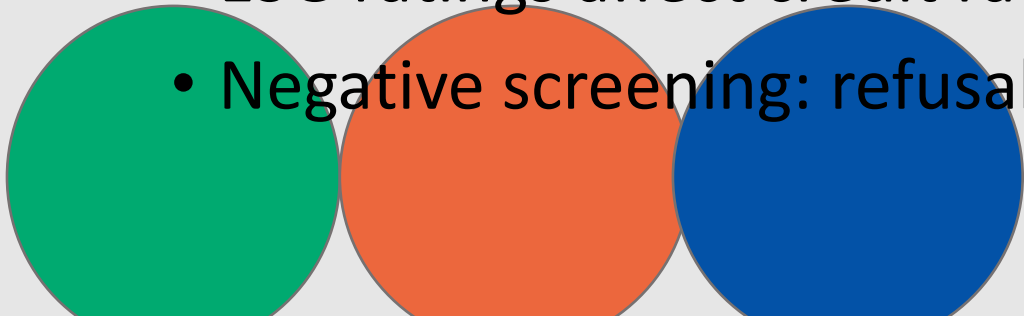
- After the adoption at the end of October 2021 of the Strategy for the socio-economic development of the Russian Federation with a low level of greenhouse gas emissions until 2050 (approved by the Chairman of the Government of the Russian Federation M. Mishustin on October 29, 2021), we will of course talk about regional strategies for low-carbon development in Russia. The Regional Strategies will, of course, be based on the principles of sustainable development and on the Strategies for low-carbon development of enterprises doing business in the region.

Carbon Footprint and Taking Steps Towards Emissions Reductions with Paris Agreement and European Green Deal in mind

- The most innovative Russian companies have assessed their carbon footprint and are taking steps towards reducing emissions, taking into account the Paris Agreement and the European Green Deal. Nevertheless, there are only a few companies that have announced plans to achieve zero greenhouse emissions by 2050: En + Group, Tatneft, X5 Retail Group, S7 Airlines. In addition, in most cases, companies have not yet developed plans that clearly outline the tools they will use to achieve carbon neutrality. Other Russian companies have more modest plans, but they are also making every effort to approach carbon neutrality: Rosneft (a 30% decrease in CO₂ by 2035 due to the intensity in oil and gas production), Lukoil (a 3.3% decrease in CO₂ to 2023 from the level of 2020), NLMK (decrease by 3.5% from the level of 2019).

Disadvantages of ESG Strategies and Complexity of Companies

- ESG analysis requires a lot of effort, time and expense;
- Rapid market development, which leads to high costs for the company;
- In the absence of well-coordinated work and well-built mechanisms, the development of ESG strategies is very complicated;
- Investors are ready to refuse to invest in companies with a low level of economic, social and management indicators;
- ESG ratings affect credit ratings;
- Negative screening: refusal to support companies of a certain profile.



ESG in the Arctic: what Russian companies are doing

- Norilsk Nickel: The Sulfur Project is a large-scale and costly environmental initiative that should make a significant contribution to improving air quality in the regions where it operates: the Kola Division and the Polar Division + Taimyr Development Program
- Rosneft: the flagship project "Vostok Oil", within the framework of which there is a constant modernization of production facilities and investments in educational projects
- Novatek: focusing on achieving environmental improvements
- Gazprom Neft: Strategy for Biodiversity Conservation in the Northern Seas

Recommendations and transboundary carbon regulation

- The Bank of Russia announced that it is developing recommendations for the disclosure of information on environmental, social and managerial factors of their activities by public JSCs and plans to publish them in 2021. However, against the background of the transition that has begun in the world to the next stage - to the obligatory disclosure of information on sustainable development - this step already looks rather belated. Russian issuers, investors and regulators are clearly lagging behind the global trend.
- The real threat of multibillion-dollar spending in connection with the introduction of the EU of cross-border carbon regulation, which is expected no later than 2023, has caused some administrative activity: the Committee on Climate Policy and Carbon Regulation was created in the RUIE, and the Expert Council on Sustainable Development under the Ministry of Economic Development was launched.
- The Faculty of Economics of Moscow State University, together with the Project Office for Arctic Development (PORA), have developed the Polar Index and the Barents Index, which includes ratings of sustainable development of regions and companies.
- But all this is still the first steps towards a real ESG - the transformation of regions, cities and companies in the Arctic.

THANKS
PER
ATTENTION

+ 79851159212

Nico.73@mail.ru

Sergey Mikhailovich Nikonorov