

# ESG banking in the transformational economy



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Chairman of the Board of Directors,  
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Vasily Vysokov founded Center-invest Bank jointly with a team of university professors in 1992.

Today Center-invest Bank is the biggest regional bank in southern Russia implementing ESG banking business model in practice.

Prof. Vysokov is an author of more than 350 works on the transformation of financial markets, SMEs, ESG banking.

He chairs the Committee on SME of the Association of Banks of Russia.

He is an organizer of the Forum "Positive economy" together with Jacques Attali ([positiveforum.ru](http://positiveforum.ru)), participant of EBRD, World Bank forums, winner of FT/IFC competition.

**T**he transformational economy is a new reality that requires managing constant changes in an environment of continuous crises. Russia is a unique arena for elaborating and testing new management methods in times of transformation.

Unlike speculative banking, which is concerned with buying and selling risks, ESG banking manages risks.

In a crisis, a speculative bank buys more expensive funding and passes the risks on to customers by increasing loan interest rates. In contrast, an ESG bank will work with customers to find ways to reduce risks in a crisis. This means that an ESG bank can reduce loan interest rates, while its customers gain competitive advantages and can repay their loans on time and in full.

ESG banking implements Environmental, Social and Governance principles. In effect, it combines many complementary ideas about "green", "ethical", "responsible", "sustainable" and "transformational" banking that have been developed as alternatives to speculative banking. Center-invest Bank has successfully implemented an ESG banking business model in the south of Russia.

The ESG banking business model considers a wider range of risks:

- environmental risks (physical – accidents, natural disasters, climate change; and transformational – changes in legislation and standards);
- social risks (inequalities based on income, gender, age and other characteristics, the accessibility of new technologies and resources);
- governance risks (transparency, efficiency, monitoring and reporting on the processes of reproduction of all types of capital: productive, financial, human, social, informational, intellectual and natural).

Each component of ESG risk management is important, and all the components are interconnected.

ESG banking finances real processes of transformation in its customers' lives and businesses. Center-invest Bank has obtained 82% of its income from lending to the real economy and has allocated its income to: the population (interest paid on deposits) – 36%; partners and suppliers – 23%; employees and the state – 19%; and shareholders (dividends and development) – 22%.

## Agribusiness

Agribusiness is considered a risky sector to lend to. It is true that if we focus on volatile weather, the risks of agribusiness lending are considerable. But if we consider more stable climates, productive soil and water resources, then the risks diminish. If you lend to agribusiness for a period of three years, two of those years might have poor harvests. But over a five-year period, there will be two good harvests – meaning that all loans can be repaid.

## SME lending

Small business is also considered a risky sector for lending. SMEs account for one third of Center-invest Bank's total loan portfolio. To reduce risks, the bank has provided entrepreneurs with non-financial services in addition to loans since 1997. These include consulting, auditing, outsourced book-keeping, legal support and tax advice. Even modest expenditure on this support reduces the risks from lending to small businesses that operate legally.

## Women in business

Lending to female entrepreneurs promotes gender equality and benefits from a generally lower risk profile. As women entrepreneurs tend to manage risks more carefully, we can lend to them at lower rates. At the same time, we can focus more on the quality of bank services and on establishing trusting relationships between the bank and its customers. There has not been one single default in the whole time we have been lending to female entrepreneurs.

Youth enterprise is expected to implement the creative ideas of the younger generation despite the constraints of existing rules and barriers to entrepreneurial activity. To support this, the bank offers new entrepreneurs training, preferential terms for business bank accounts and loans, and free advice and mentoring. The bank actively participates in sociological research into the challenges faced by young entrepreneurs and implements projects with university students.

## Social enterprise

It addresses community needs in a given market on the basis of more effective approaches, cost-recovery and financial sustainability; is scalable ("a good programme works even when the developer is absent"); effectively manages risks.

## Loans for business transformation

In response to COVID-19, government support for small business has been scaled up. Center-invest Bank is actively participating in government programmes and the post-crisis development programme. In a distance economy, the future of business will depend not on government support, but on the digital transformation of business.

## Energy efficiency

Modern energy-efficient technologies reduce energy consumption and cut CO<sub>2</sub> emissions. The comprehensive introduction of new technologies generates labour, creates other resource savings in addition to energy savings, and reduces losses. This results in a 2-3-year payback period for the cost of replacing equipment. When the bank conducts this analysis with the customer, the customer chooses the energy-efficient option. When they learn how their project will reduce CO<sub>2</sub> emissions, they become a proponent of ESG principles.

## Financing the renovation of apartment buildings

To fund the renovation of apartment buildings, the government proposes that residents save up money by making monthly contributions to a communal fund. But the best way to keep money for renovations is to take out a loan, do the renovations, and use the monthly contributions to pay back the loan.

Retail lending comprises 62% of the bank's loan portfolio. Center-invest Bank's ESG retail lending focuses on traditional secured consumer loans, mortgages and car loans. ESG banking finances the happiness of ordinary people.

Mortgage loans, which are the most popular and least risky loan product, account for two thirds of the bank's retail loan portfolio. The bank helps customers to find the best option for purchasing a property and helps them to consider incentives under government programmes, the environmental conditions of different locations, and energy-efficiency solutions for their new homes. In particular, the bank actively participates in a government programme for rural mortgages.

## ESG banking risk management

ESG risks (grouped by customers, products, transactions, and decision-making processes) and their impact on regulatory compliance and financial indicators can be assessed.

Unlike a business plan, the ESG strategy views the constraints of a mathematical model not as predetermined, but as variables. This allows for a range of growth trajectories that are balanced in terms of assets and liabilities. Taking into account geopolitical, environmental and social factors, as well as oversight and supervisory practice, we select the balanced solutions that are feasible.

ESG banking risk management entails:

- balancing long-term profitability, organic growth and risk;
- knowing the target markets, regional risks and a detailed analysis of borrowers' businesses in lending to the real economy;
- regularly re-assessing risks and covering risks with sufficient provisions and capital;
- minimizing risks by diversifying funding sources and prioritizing lending to local clients;
- a risk-management system combining formal and substantive risk-assessment procedures;
- transparency of deals and transactions;
- improving financial literacy among the population and providing free business advice;
- reducing the level of defaults (whether fraudulent or resulting from social or economic factors);
- continuous innovation to tackle new challenges.

The implementation of the ESG risk-management strategy is underpinned by Bank of Russia recommendations and requirements, Basel Committee recommendations, best international practice, shareholders' recommendations, the bank's 28 years' experience in managing regional risks, and the lessons drawn from the crises of 1998, 2008, 2014 and 2020.

ESG banking risk management is not a "product", but a continuous process. It takes into account changes in the operating environment, innovations in products and services, and regulatory requirements which are continually being updated.

**ESG reporting**

Thanks to its transparent reporting under Russian and international standards,

Center-invest Bank avoids the risks of unreliable reporting and is able to produce timely information about its participation in international programmes and national projects. The bank records the impact of its products on the implementation of the United Nations Sustainable Development Goals and Russia's National Projects. It can readily inform its depositors of how the money they have entrusted to the bank is being used to achieve global and national goals.

By using integrated reporting rather than just financial reporting, the bank has been able to assess in a new light:

- the impact of the bank's income on the interests of other stakeholders: the local population, employees, shareholders, customers and partners;

- the bank's development as a process of reproducing operational, financial, informational, intellectual, human and social capital.

Our independent financial ratings from Moody's (Ba3, stable) and ACRA (A (ru) stable), and our Vigeo Eiris ranking (17/76, Europe) have shown that ESGs bank can remain consistent in any frame of reference.

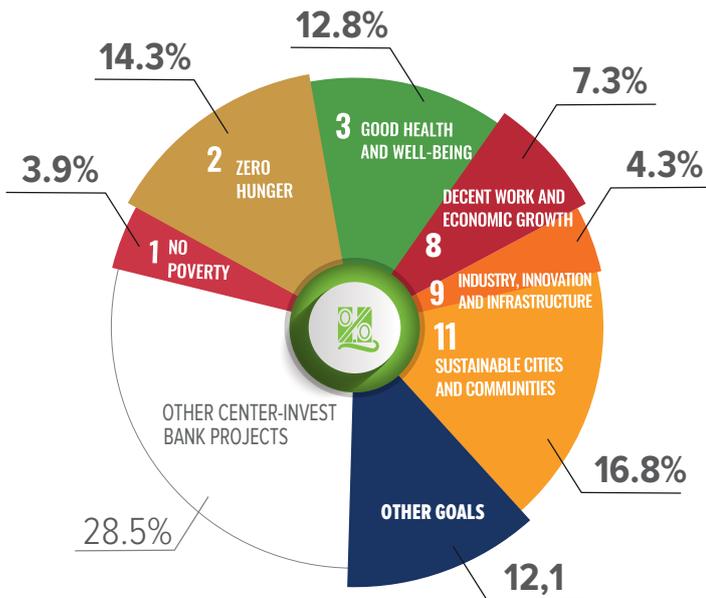
**Internal audit and compliance**

Internal audit in ESG banking must assess current operations for compliance with internal rules and regulations and national laws, as well as consider global trends in regulation. Regulators are paying increasing attention to ESG banking. The bank's experience clearly shows that having

► **ESG-investments 2019 - 9M2020 (for every P100 of deposit)**

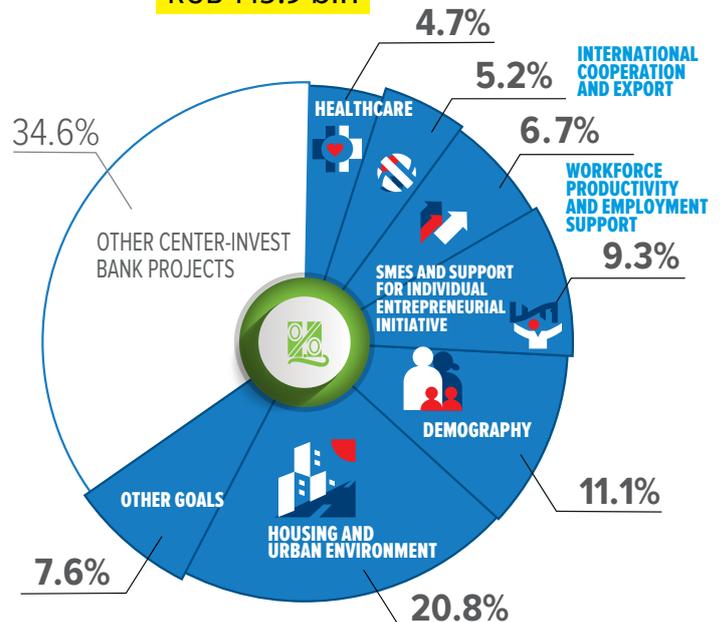
**In Sustainable Development Goals**

RUB 168.5 bln



**In National Projects**

RUB 145.9 bln



a more advanced knowledge of best international practice is becoming a competitive advantage when working with customers, employees, partners, the regulator and shareholders.

### ESG banking and personnel policy

Speculative banking uses headhunting. In contrast, Center-invest Bank nurtures potential employees. Every year, over 400 students are trained at the Financial Literacy Centres opened by the bank in partnership with universities in Rostov-on-Don, Krasnodar, Taganrog, Volgodonsk and Volgograd. The top students are invited to work placements at the bank, and the top interns are offered jobs with the bank. We also maintain contact with students who go on to work for other companies. A speculative bank trains young employees solely for its own needs.

### ESG banking and gender policy

In accordance with Russian legislation, national traditions and established practice, all of the bank's employees have equal rights, equal conditions and equal opportunities for career growth. Our support and respect for motherhood is reflected in the fact that the birth rate among our employees' families is four (!) times higher than the national average for Russia.

### ESG banking and communications policy

ESG banking requires regular communication with all stakeholders (regulators, shareholders, employees, customers and partners) not only about official reporting and positive events, but also about risks. There are more positives in the work of an ESG bank, but even this information must be presented to every

stakeholder in an accessible and clear format that uses specific messaging, slogans and catchphrases for each group.

### ESG digitalization

This is first of all a moral choice between risks and efficiency when using modern financial and digital technologies to support the long-term development of the bank and its customers through the creative use of quantitative assessments and continuous innovations.

ESG banking requires regular communication with all stakeholders not only about official reporting, but also about risks.

ESG banking ensures data protection and safe payments when introducing any new technology. In order to rapidly introduce new digital technologies, an ESG bank will actively collaborate with market leaders as a co-innovation partner. Big data integration and processing is used to create electronic customer profiles and automate product and service management.

Center-invest Bank is: a member of the Global Alliance for Banking on Values (GABV), which unites over 50 banks from around the world whose aim is to use finance to deliver sustainable economic, social and environmental development; a signatory to the Principles of Responsible Banking of the United Nations Environment

Programme Finance Initiative (UNEP FI), which unites more than 290 financial market participants.

The bank maintains relationships with participants of the ESG investment market and regularly informs them of its work.

### ESG banking against COVID-19

The COVID-19 pandemic is a typical "black swan" event – an unexpected phenomenon of large magnitude and catastrophic consequences. These are exactly the kind of risks that banks applying ESG principles should consider.

Analysis of the various alternatives allowed us to plan, prioritize and implement appropriate measures, including:

- *for retail customers:* enhanced contact centre service, 24/7 response on social networks, remote services, abolition of fees, free delivery of bank cards to customers aged over 65, preferential mortgage rates;
- *for businesses:* loan repayment holidays, interest-free loans to pay salaries, loans for business recovery and transformation (the bank's own loan programmes and government-subsidized programmes);
- *for staff and customers:* hygiene and infection control measures, transition to remote working for two thirds of employees;
- *for shareholders:* regular updates on the financial situation, monitoring of measures taken by government authorities.

Banks are the mirrors of the economy. In times of transformation, banks must not only reflect, but also focus their efforts on managing transformational risks. ■