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INTELLINEWS

July 2019

Romania reaches new historical levels of foreign debt

Demographic "tipping point" imminent for CEE labour markets

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US trails Russia and China in Arctic race

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## ENVIRONMENTAL, SOCIAL, GOVERNANCE: **RUSSIA EMBRACES THE NEW ESG PARADIGM**

Backlash against super polluter cruise ships in Croatia  
p.38

The Russian economy is stagnating  
p.42

Iran cranks up nuclear deal pressure with "20%" uranium threat  
p.50

ISSN 2059-2736

ESG has really only become an issue in 2018 and a public theme in the last year.

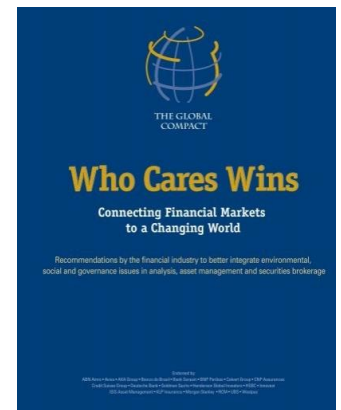
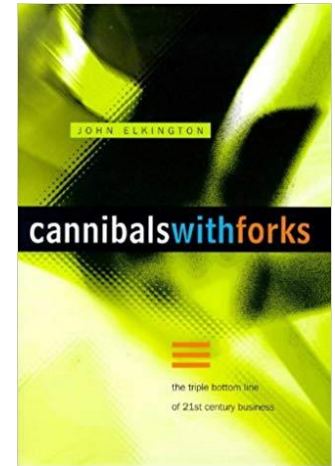
# Cannibals with forks

**EBRD** set up in 1989 and sustainability was part of its mandate from start

The idea of responsible investment was crystalised in a paper entitled “**Cannibals with Forks: the Triple Bottom Line of 21st Century Business**,” by John Elkington, co-founder of business consultancy SustainAbility, in 1998.

The triple bottom line is: **plant, people and profit**, which was an obvious precursor of the ESG ideas.

The term ESG itself was coined in 2005 by Ivo Knoepfel, who penned a landmark study “**Who Cares Wins**” that was presented at a conference in Zurich.



# Cannibals with forks

The first green bond issued in 2007, bulk of green bonds since 2015

Norway was the first to ban investments into non-ESG compliant companies in 2018

Russia introduces National Climate Plan, ratifies Paris Accord in 2019

EU introduces Green Laws in 2020, carbon zero by 2030

BoE will start stress testing companies in 2021 on different climate pathways as climate-related risks are increasingly seen as a potential threat to financial stability





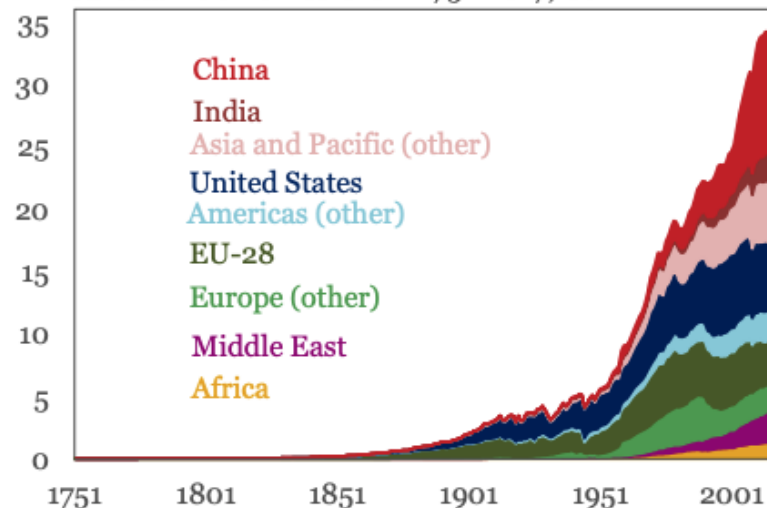
# 2020 Climate super-year



# 2020 Climate super-year

**Chart 4: CO2 emissions continue to rise steeply...**

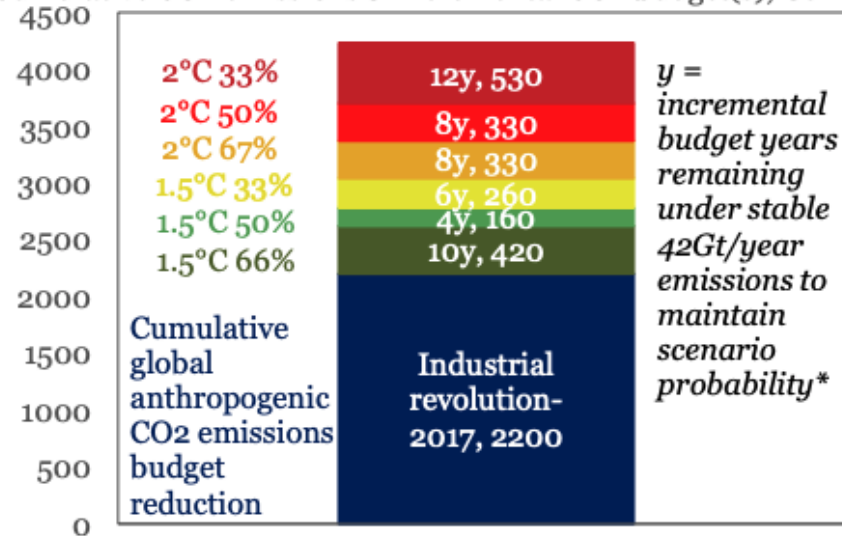
Annual total\* CO2 emissions\*\* 1751-2017, Gt



Source: GCP-CDIAC, IIF. \*Excludes international transport, statistical differences. \*\*Excludes other GHGs (CH<sub>4</sub>, N<sub>2</sub>O, F-gases)

**Chart 5: ...so mankind will likely soon exhaust the carbon budget to keep global warming to under 1.5 °C or 2°C**

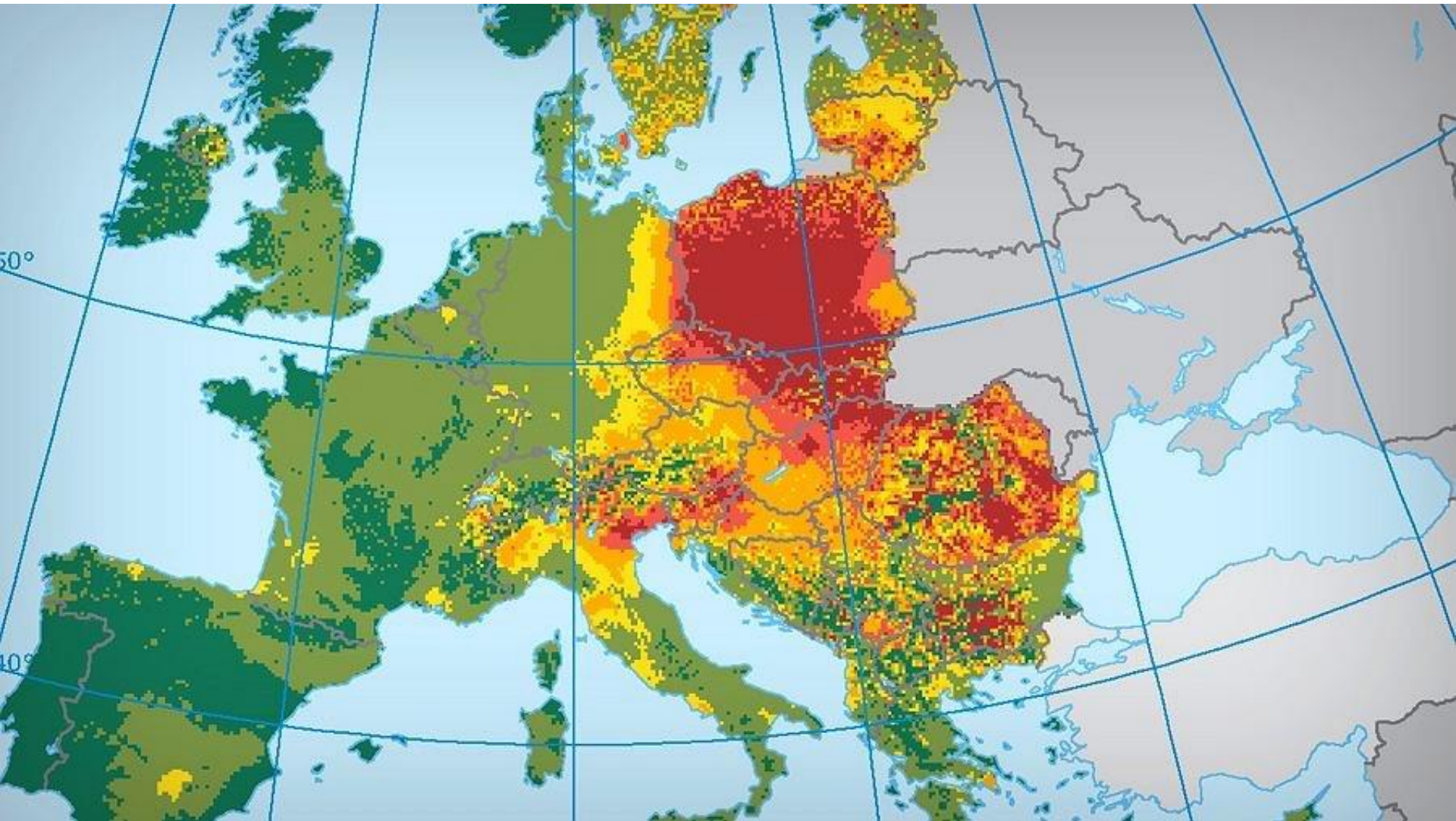
Cumulative CO2 emissions & incremental CO2 budget(s), Gt



Source: IPCC, IIF. \*linear simplification, subject to significant climate and policy uncertainty.



# 2020 Climate super-year





# 2020 Climate super-year



Uncontrolled\_Pollution



0-28

221-999



29-89

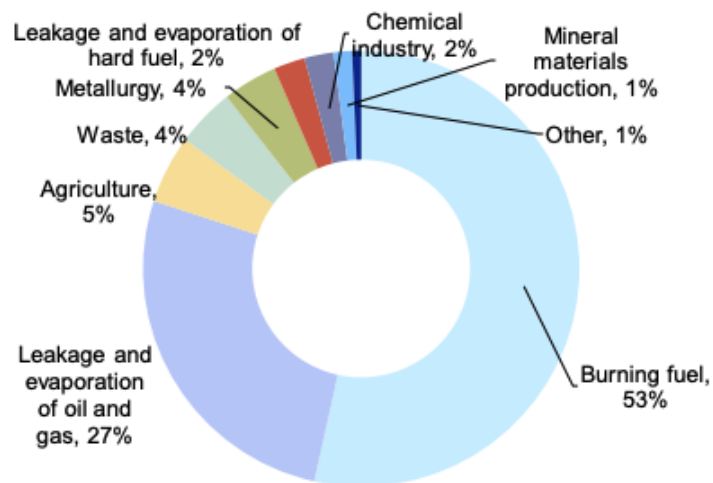
1000-4200



90-220

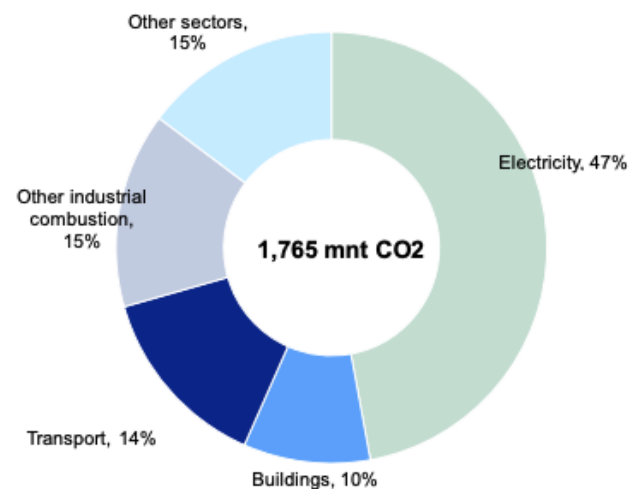
# 2020 Climate super-year

**Figure 6: Greenhouse gases by industry in 2016**



Source: Rosstat

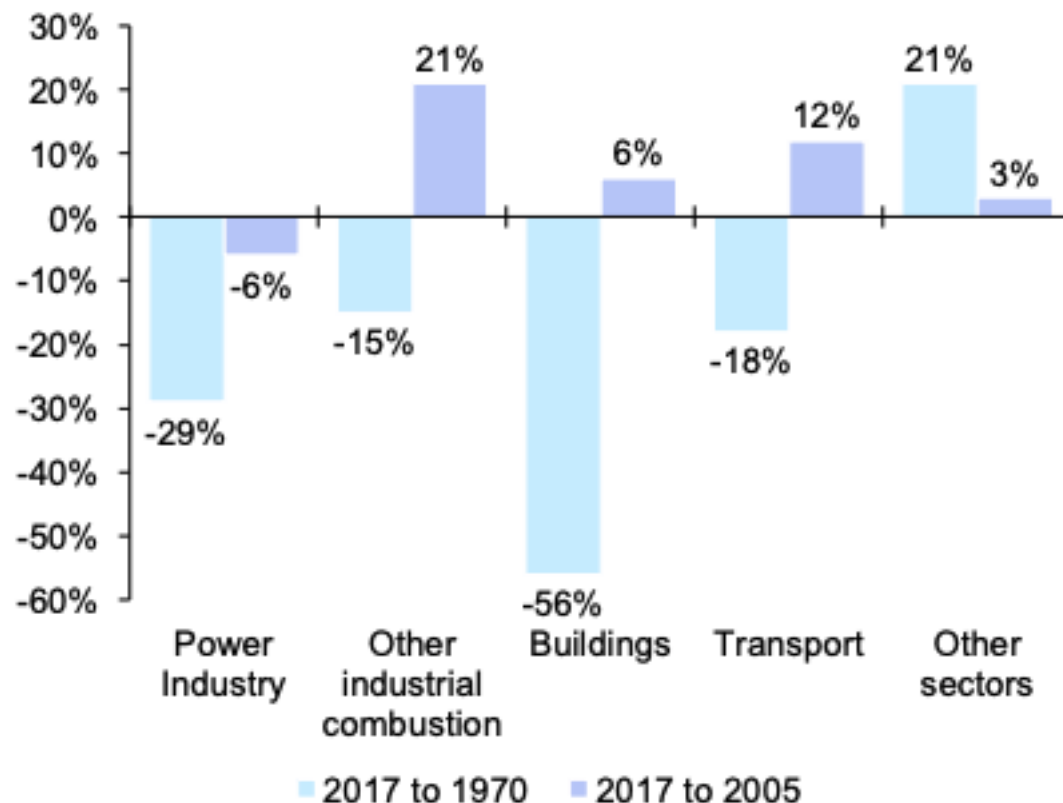
**Figure 3: Russian emissions split by industry, 2017**



Source: European Commission

# 2020 Climate super-year

**Figure 4: Russian emissions change**

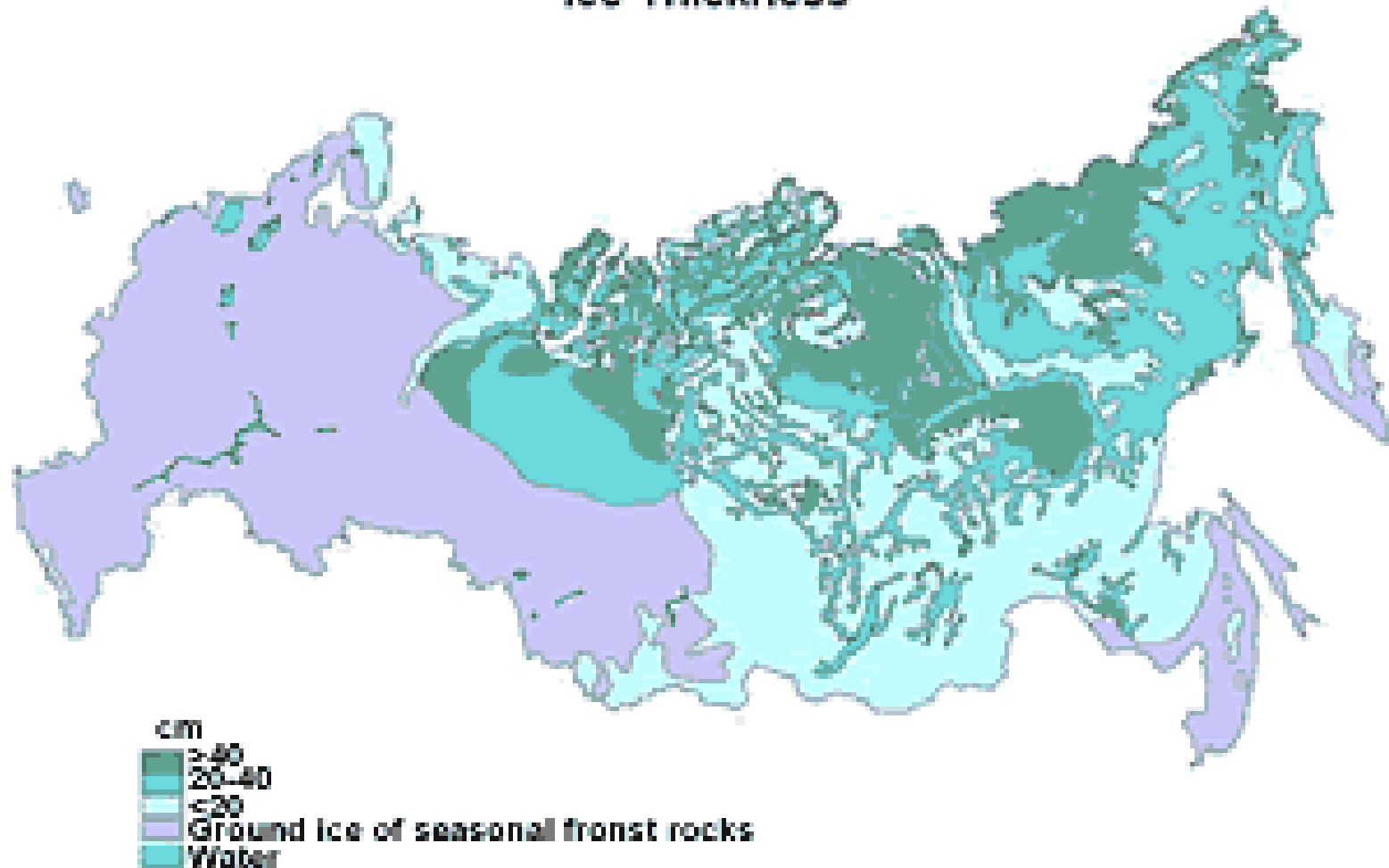


Source: European Commission



# 2020 Climate super-year

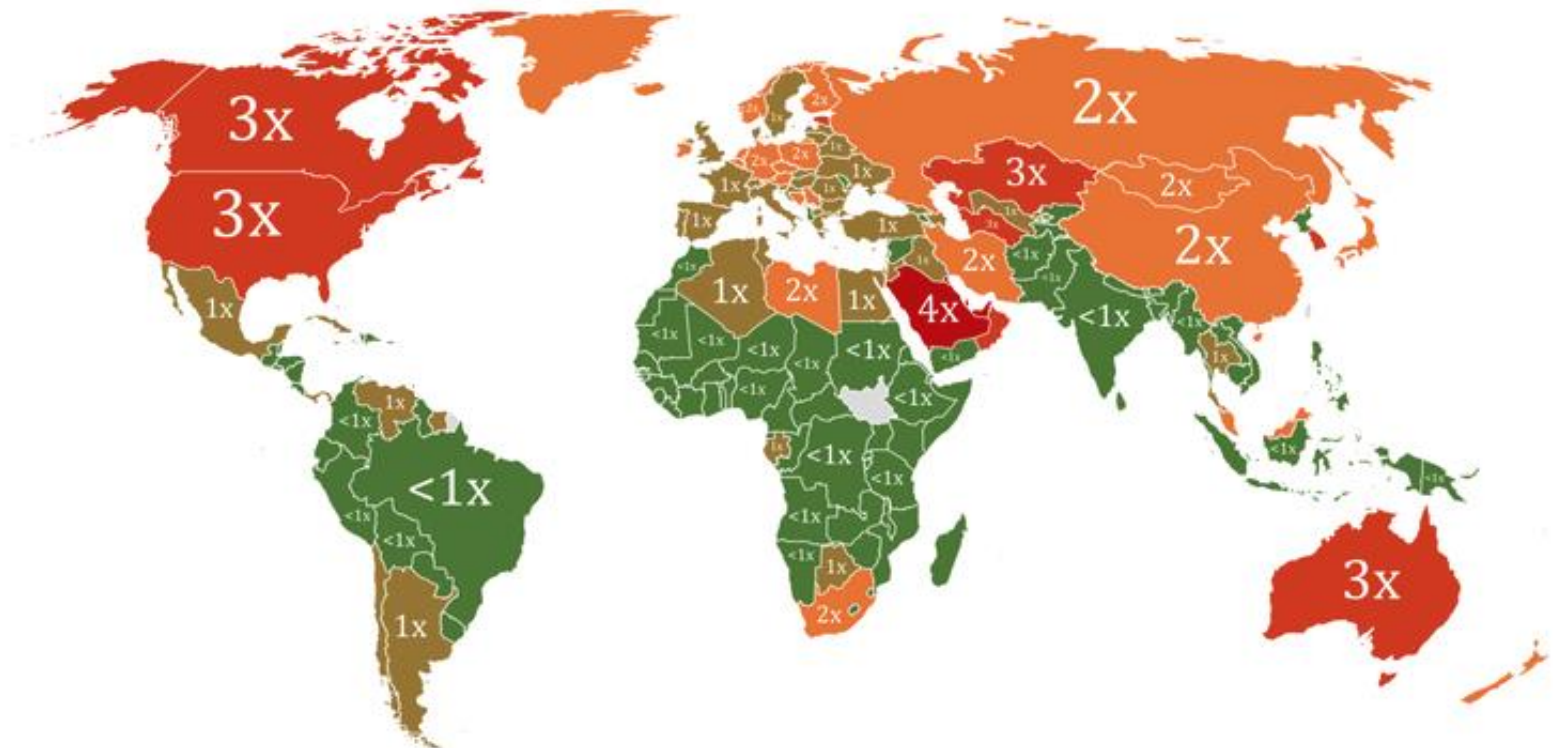
## Ice Thickness



# 2020 Climate super-year

## More Than Their Fair Share:

Which countries produce a greater proportion of global CO<sub>2</sub> emissions than their proportion of the global population?



Ratio of Global Emissions Contribution to Share of Global Population

# Cannibals with forks

**Norges**, Norway's biggest pension fund, implemented a set of sustainable investment rules in 2006 and banned non-ESG compliant investments in 2018.





# Scandinavia takes the lead

The Scandinavian regulator has already enacted rules forcing fund managers to look at sustainability when making investments and has banned investments into companies that are not ESG compliant.

The other big stock market regulators, especially in London, have not gone that far yet.

In Russia and US there are no restrictions on investing into non-ESG companies

**The market is still small:** The Institute of International Finance (IIF) reported in a note on the greening of capital that ESG compliant or “green bonds” still only account for 1% of the total outstanding bonds, although their share is growing fast.

## **Ranking and measuring the problem**

# Ranking

**MSCI:** Morgan Stanley Capital International's (MSCI's) ESG rankings. The MSCI group produce a number of benchmark indices and launched an ESG ranking in 2010 that covers 7,900 global companies and 650,000 equity and fixed income securities. However, this effort remains largely focused on the developed world and the ranking of emerging Europe ESG scores already covers 100% of the MSCI EM index.

**Sustainalytics:** The privately owned Sustainalytics also provides well developed independent ESG scoring for 13,000 global companies dating back to 2013 along similar lines to MSCI

**Fitch:** The only one of the big agencies that launched a detailed ESG rating service at the start of this year and at the moment it is making all the rankings publically available. So far, Fitch Ratings has published over 75,000 individual ESG Relevance Scores for over 5,250 entities worldwide, covering a variety of issuers including corporates, financial institutions, sovereigns and public finance. This list includes 50 leading Russian firms starting with Aeroflot and ending with the X5 Retail Group.

**Expert RA:** Launched a ESG ranking earlier this year



# Killing Kittens

*“We polled investment companies as to how rigid a role ESG compliance is relative to investment decision.*

*We asked if ESG compliance prohibits investing in certain non-compliant stocks (or bonds), or is it more about awareness of the investment managers.*

*Interestingly, out of 60% of funds where ESG plays a strong role, one third replied it is already a **matter of prohibition**; the remaining two thirds acknowledged it is **rather about awareness**.*

*In simple words – if a portfolio manager knows that a company is **killing kittens** as a part of its regular business, but still generates positive returns to its investors, then it is still a viable investment,” BCS GM*



# Restrictions are largely self-imposed

Moreover, there is a strong geographic spread to prohibition on investing in non-compliant ESG stocks.

European firms: **43%** of European firms (that includes Scandinavia) cannot invest into a company with a poor ESG score,

UK based firms: **7%** of UK-based funds can't.

Russia and the US: no restrictions on them at all.

# Lack of definition

There are still **no clear definitions** for the three components:

G – best defined

In Russia kicked off Yukos in 2000

E – measurable but needs laws

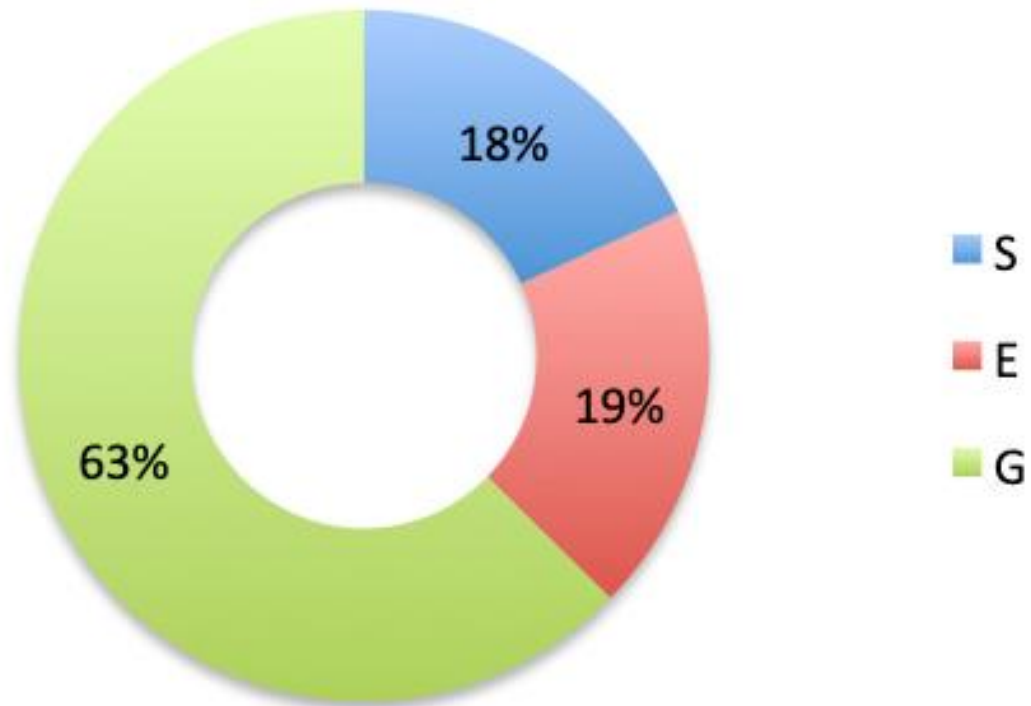
EU just putting through Green Laws but row over taxonomy  
(nukes aren't green)

Russia just passing National Climate policy  
but using 1999 as base year not 2005

S – this is very hard to define

# Weighting of importance

**Weight of importance in ESG**





# No Alpha in ESG

There is no reward for investing into ESG, but there are punishments.

- **Regain pool of investors**
- **Record inflows** of over \$15bn in October, net flows into ESG-dedicated ETFs have already topped \$40bn YTD —up over 65% from the same period in 2018.
- Overall **ESG bond market remains small**—less than 1% of the \$110 trillion global bond market.
- **The business is growing** with \$30.7 trillion of ESG related assets under management (using a broad definition) as of the end of 2018, up by a third (34%) from the year before, or about a third of all managed assets.
- **Norilsk Nickel stock** marketed up 25% from boom in catalytic converters
- **ENEL stock up** after sold its coal fired power plant in November
- **Rosatom** has \$137bn worth of orders on its books

# Upside

Professional investors **ESG stocks outperform** the market:  
28%

But most professional investors say ESG importance to market performance **will grow significantly** in the not too distant future

Professional investors said having money work in ESG-compliant themes **without performance deteriorating** is reason enough to invest

**Corporates** that believe ESG will improve market performance: 57%

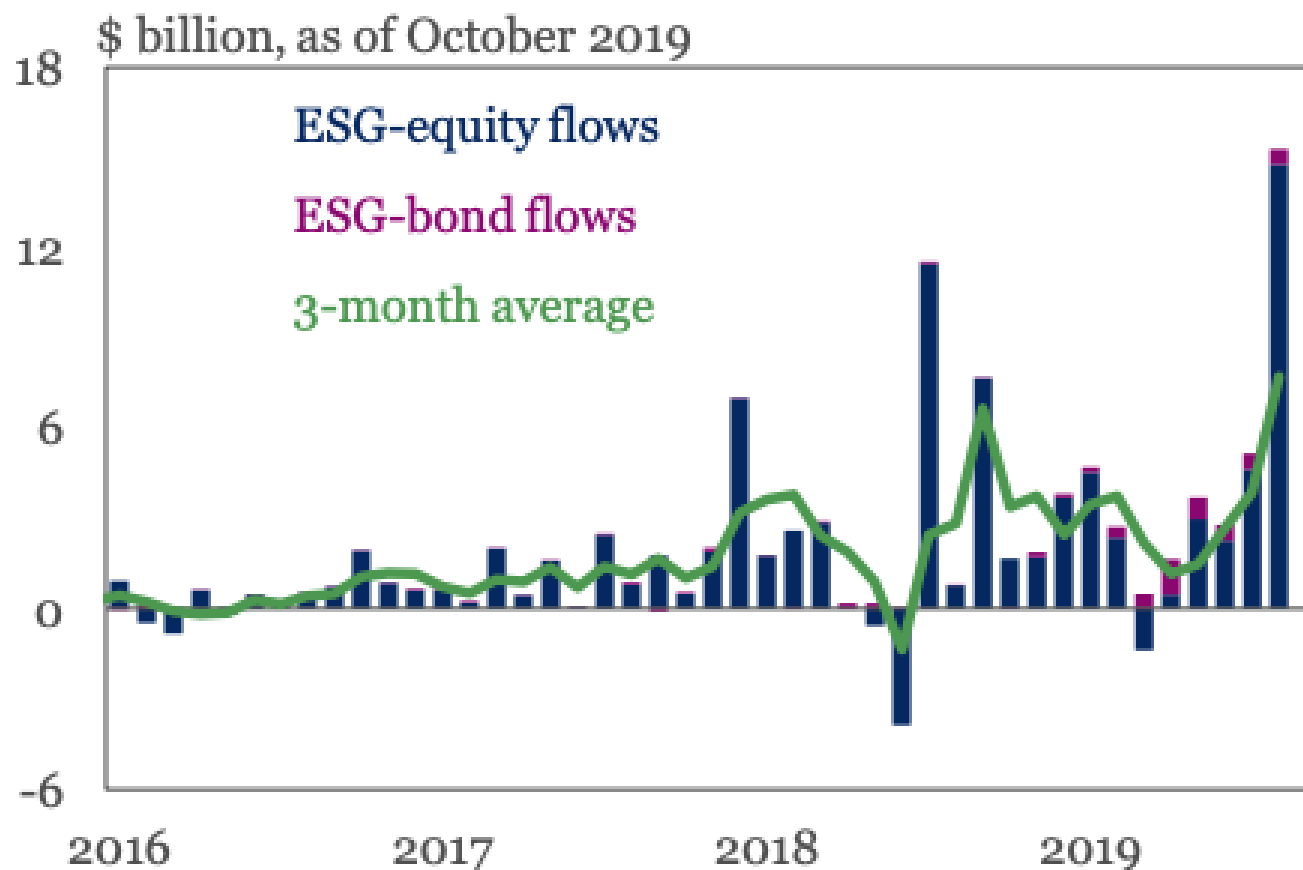
Corporates are much more focused on ESG than investors as their investment **pool is shrinking**

*"These days ESG has gone from a nice-to-have to a must-have thing. If you don't want to lose existing investors and want to attract new ones then this is already a must," says Oleg Goshchansky, chairman and managing partner of KPMG in Russia and the CIS*



# Consumers are driving ESG compliance

**Chart 1: Record flows into ESG-dedicated ETFs**



*Source: Bloomberg, IIF*



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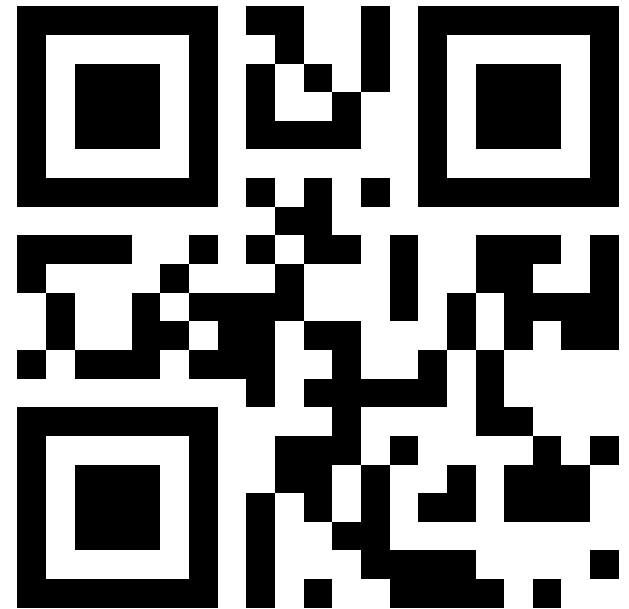


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