ESG in Russia – rising from a low base

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ESG development in Russia

There is a widespread perception that Russia ignores environmental, social & governance (ESG) principles. Compared to other countries, Russia has low ESG rating (Table 1). However, recent years have seen a number of initiatives by the Russian government and Russian companies to improve the situation.

The denial stage is far in the past, and the ESG awareness in the country is evolving. During last year and this, the authorities have approved several strategic policies and plans that could help to accelerate the improvement of the Russian economy from an ESG perspective.

Russian companies listed on international capital markets are in the forefront of ESG development in the corporate segment. Most such companies already exceed local ESG requirements, adopting ESG policies that comply with international rules. They are investing extensively in energy-efficient technologies and in improving the quality of their approach to governance.

Table 1. ESG Rating of Russia

<table>
<thead>
<tr>
<th>Rating agency</th>
<th>Russia’s position</th>
<th>Year of assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morningstar</td>
<td>47th out of 48</td>
<td>2021</td>
</tr>
<tr>
<td>RobecoSAM</td>
<td>54th out of 65</td>
<td>2018</td>
</tr>
<tr>
<td>Candriam</td>
<td>94th out of 123</td>
<td>2017</td>
</tr>
</tbody>
</table>

Source: RobecoSAM, Morningstar, Candriam

Development of ‘E’ (environmental) factors

Russia is the fourth-highest emitter of CO2 in the world after China, the US and India. It is responsible for around 4.7% of all global emissions, so the country receives a lot of attention in terms of ‘E’ concerns.

Graph 1. Top countries by greenhouse gas emissions (in GtCO2)

![Graph 1](image)


Meanwhile, the latest available data show that Russian emissions\(^2\) are at 52% of the 1990 benchmark level due to a significant fall after the collapse of the Soviet Union. This is the largest

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\(^1\) The latest data available

\(^2\) The latest data available is for 2018. Data includes emissions and removals from land use, land-use change and forestry (LULUCF)
reduction among large European countries. However, they are projected to rise in line with Russia’s GDP growth and may reach 90% of the 1990 level by 2050 if no preventive measures are taken by the government. To avoid this and keep in line with the Paris Agreement, which Russia ratified in 2019, the government has developed a long-term strategy for diversifying economic development and reducing greenhouse gas emissions (GHG). Russia’s target is to limit GHG emissions to 64%-67% of the 1990 level by 2030, and to 52%-64% of the 1990 level by 2050.

According to the United Nations Framework Convention on Climate Change (UNFCCC), nearly 80% of GHG in Russia are emitted by the energy sector, mostly in electricity production and oil & gas extraction, processing, transportation and use.

Graph 2. Dynamic of GHG emissions in Russia relative to 1990 level

Graph 3. Volume of GHG emissions by the largest emitting countries in 1990 and 2018 (in GtCO₂)

Source: Ministry of Economic Development of the Russian Federation

Data includes LULUCF. The percentages in brackets are the level of emissions in 2018 relative to those in 1990. Data for China and India is for 2017.

Source: UN Climate Change, Ministry of Economic Development of the Russian Federation

Graph 4. Russian GHG emissions by sector

Source: United Nations Framework Convention on Climate Change Climate Change
Russia’s electricity production mix is strongly dominated by natural gas, which accounts for 48%, and nuclear, hydro and coal accounting for 16%-18% each, according to the International Energy Agency. Currently there is a very little solar and wind production capacity, while other countries are boosting their electricity production from renewable sources. In 2020, wind and solar amounted to only 0.2% of electricity generation in Russia, compared to the world average of 10% and Europe’s average of 20%. While Russia is fourth in the world for overall electricity generation, it ranks 109th for renewable energy capacity.

However, the Russian government has now set a target to install 5.9 gigawatts (GW) of capacity from renewable energy sources (RES) (excluding large hydropower plants) by 2024, and 6.7 GW of RES capacity in the period 2025-2035, to 35.9 GW in total. But even after that, only around 3%-4% of electricity generated in Russia will be produced from renewable sources.

The breakdown of Russian GHG emissions emanating from the oil & gas industry shows that the largest volumes arise from gas extraction and pipeline transport.

**Graph 5. Breakdown of Russian oil and gas industry GHG emission sources**

![Graph showing breakdown of Russian oil and gas industry GHG emission sources](image)

- Pipeline transport: 20%
- Oil production: 15%
- Natural gas extraction: 14%
- Leakage and combustion: 12%
- Oil refining: 39%

Source: United Nations Framework Convention on Climate Change Climate Change

Major Russian gas producers and exporters are already adopting strategies aimed at improving their energy efficiency and reducing the carbon footprint of their products by investing in technology.

Moreover, Russia’s pipelines are considered to have the smallest carbon footprint associated with natural gas transport. A recent study, **GHG Intensity of Natural Gas Transport**, compared the two options for exporting natural gas to Europe, in terms of GHG emissions: Russian pipelines vs. transporting gas from US, Qatar, Australia and Algeria. The result showed that natural gas imports to Europe via Russian pipelines was preferable from an environmental perspective when compared with LNG import alternatives.
The Russian government wants to find ways to reduce the energy sector’s impact on the environment instead of full abandoning of traditional power generation. Several Russian energy companies have already published long-term targets to reduce GHG emissions. Some have declared their strategic commitment to carbon neutrality by 2050.

A further 11% of GHG emissions stem from industrial production, with the metals sector contributing the most because of the high amount of energy it uses. To reduce energy consumption and become efficient energy users, Russian metals companies are investing in energy-efficient technology. For instance, this year one of the major gold producers set a target to reduce its GHG emissions intensity by 30% by 2030. The company is investing USD 850 million in building its own solar and wind power plants, grid connections to remote assets and procurement of electricity supplies with the lowest available carbon footprint, as well as the electrification of its mobile mining fleet.

**Government efforts to reduce pollution**

Russia ratified the 2015 UN Paris Agreement on climate change in 2019. Moreover, the country has been a part of the Kyoto Protocol since 2004. The Russian government has adopted a series of regulations aimed at implementing measures to combat climate change. The main programme that it pushed through was the Climate Doctrine of the Russian Federation, approved in December 2009. This represents an overview of the goals, principles, substance and how to implement state policy related to climate change. Overall, the Doctrine serves as the basis for the formation and delivery of climate policy.

Furthermore, in 2019, the government set up a National Ecology project which aims to build an efficient waste treatment and recycling industry as well as to reduce air and water pollution by 2024. The programme is being carried out within the framework of the Russian president’s decree on national goals and strategic tasks for Russia’s development up until 2024. The main part of the project is concerned with improving the ecological situation in the 12 most polluted cities – such as Norilsk, Krasnoyarsk, Omsk, Chelyabinsk and Chita – by reducing emissions by 20%, or 1 501 000 tonnes in total. As at the end of February 2021, the actual reduction in the total volume of emissions is 68 600 tonnes. In total, 204 environmental projects are planned through to the end of 2024, 65 of which have been completed (as at April 2021).
In January 2020, the Russian government introduced the National Action Plan of economic adaptation to climate change. The plan outlines 29 measures to be taken until 2022, including upgrading the national climate monitoring system, preparing assessments of the impacts of climate change and developing adaptation strategies for specific sectors such as energy, transport and agriculture. The key strategic directions are expected to be announced by the end of Q3 2021.

Also in early 2020, Russia’s government released a draft of a long-term climate strategy for low-carbon development to 2050. The strategy focuses on a basic scenario and an intensive scenario. Under the basic scenario, the aim is to reduce GHG emissions by 33% compared to the 1990 level by 2030 and by 36% by 2050. The plan is to achieve this through:

- Large-scale increases in energy efficiency
- The introduction of carbon pricing
- Further development of nuclear and renewable energy
- Reducing deforestation and expanding protected forest areas.

Under the intensive scenario, emissions would be 36% below 1990 level by 2030 and 48% by 2050. If achieved, this would allow Russia to achieve carbon neutrality in the second half of the 21st century. Additional to the measures in the basic scenario, the intensive efforts would include reducing the carbon intensity of manufactured goods, energy, works and services. This would be achieved by:

- The large-scale electrification and digitalisation of transport and industrial production
- An increase in renewable energy
- The introduction of technology to capture, store and process carbon dioxide
- A halt in clear-cutting of forests and further expansion of forest protection.

The draft of the long-term climate strategy should be approved later this year.
For professional investors only

Graph 8. Russia’s long-term climate strategy for low-carbon development to 2050

In June 2020, the Russian government approved the new Energy Strategy, to run until 2035. This announces the major goal of Russia becoming a world leader in hydrogen production and export. The government plans to develop low-carbon technologies to produce hydrogen by methane pyrolysis, electrolysis and other means. It will also stimulate demand in the domestic market for hydrogen fuel in transportation, as well as use of hydrogen and hydrogen-based energy mixes as energy storage and a conversion tool to increase the efficiency of centralised power supply systems. The potential regions for hydrogen productions are Far Eastern Russia, St. Petersburg and the Leningrad region, Yamalo-Nenets AO and Siberia. Targeted export volume is 0.2 million tonnes in 2024 and 2-7 million tonnes in 2035, and up to 33.4 million tons in 2050.

In January 2021, the Russian Ministry of Economic Development introduced the first carbon trading pilot programme. The project involves the building of a carbon trading system on Sakhalin Island, with the aim of achieving carbon neutrality in the eastern region by 2025. Sakhalin is a testing ground for new GHG regulation measures, which could later be extended to other Russian regions. The roadmap developed for the project suggests the creation of a regional inventory of GHG emissions and potential removals by August 2021, which would define the economic activities that account for 80% of emissions in the region. By April 2022, the plan is to start testing an information system, including a carbon registry. The first transfers of carbon units between the participants of the pilot are planned for July 2022.

In March 2021, the government announced it is preparing legislative amendments that would prohibit the production and use of non-recyclable materials, such as coloured plastic and single-use plastic straws, tableware and cotton swabs. At the same time, the government plans to produce more plastics from recycled materials. The goal is to put 50% of all recyclable waste from construction, manufacturing and agriculture into making new plastics, thus shrinking Russia’s landfills by 50% by 2030. Amendments to the law are planned to be introduced to the State Duma in Q3 of 2021.
Development of ‘S’ (social) factors

Human development and gender equality

Russia is a country with a very high human development, according to the United Nations Development Programme (UNDP) assessment, holding 52nd place out of 189, with the Human Development Index (HDI) being 0.824 as at 2019. Over the last 10 years, Russia’s HDI has risen by 12%. Furthermore, the HDI for women in Russia is slightly higher than that for men (0.823 vs. 0.817 in 2019).

At the same time, the employment rate of women in Russia is lower than that of men (66.1% and 76.2%, respectively, for the age group 15-64, as of 2018), but still compares favourably to the emerging market (EM) average (45.6% of women vs. 76.1% of men).

According to the International Labour Organization (ILO), women account for around 40% of all managerial jobs in Russia.

Graph 9. Women’s share of employment in managerial jobs, 2012 and 2018

Nonetheless, there is a big shortfall in the representation of women on boards of directors. A recent World Economic Forum Global Gender Gap Report indicates that only 10.6% of board members in Russian companies are female, which is lower than in most emerging markets and dramatically lower than in developed markets. That said, the proportion has improved from just 7% since 2020.

Graph 10. Representation of women on boards of directors, % of board members, 2020 and 2021

Source: ILOSTAT and OECD

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Graph 10. Representation of women on boards of directors, % of board members, 2020 and 2021


3 The extent to which available labour resources (people available to work) are being used.
Additionally, the report indicates that income gaps remain persistently large, with average incomes of Russian women still less than 60% those of men. However, the empowerment of women in Russia is supported by government policies. For instance, in 2017, the government introduced the National Strategy for Women for 2017–2022. The strategy aims to promote the economic advancement of women, foster a continuous improvement of their income and welfare, and prevent social disadvantage and violence. It also targets the achievement of full and genuine participation of women in all areas of public life without gender restrictions.

Corporate social responsibility (CSR)

Most large Russian companies run various social programmes to provide a safe and healthy working environment for their employees and to successfully manage their stakeholder relations. They participate in voluntary medical insurance programmes, provide employee training and education, finance infrastructure facilities such as parks and schools, and implement charitable and sponsorship projects.

For instance, one of the largest banks has introduced a social initiative through which children and elderly people who get lost can find help at any bank branch. The bank’s employees call the emergency services and relatives and stay with the lost person until they arrive. The project includes events at which children and their parents are taught what best to do should a child become lost.

There are also large enterprises that build towns for employees around their production centres. These companies can be considered as leaders in CSR in Russia. Nowadays, there are some 320 such ‘monotowns’ in Russia (out of c. 1 100 cities overall), which were founded during the Soviet era. After the USSR collapsed, the companies to which these monotowns belonged were privatised and became responsible for the towns’ infrastructure. Examples include Magnitogorsk, which was founded around the iron and steel mining company, and Norilsk, located around Russia’s largest nickel producer. Both companies provide all the necessary infrastructure for living such as schools, hospitals and roads. For their employees, the companies provide professional staff development as well as supporting cultural programmes, sport events and healthcare programmes. As steel mining and nickel producing generate large amounts of CO₂ emissions, the companies invest in environmental programmes to combat pollution, which include technology upgrades.

Development of ‘G’ (governance) factors

Corporate governance historically has been the most essential factor for investors. Among the core elements investors focus on are the makeup of boards of directors, as well as companies’ dividend policy and minority shareholder rights.

There has been significant progress in corporate governance practices in Russia. Over recent years, Russian companies have improved their dividend policies. Back in 2012, the government obliged state-owned enterprises (SOEs) to pay out at least 25% of their net income in dividends. Prior to that, SOEs were paying out around 10%-15%. In 2016, the authorities issued a recommendation that SOEs increase their dividend pay-outs to 50%. Most were slowly complying with this recommendation, except some oil & gas producers, which resisted dividend pay-out increases for many years. However, in the first half of 2019, even they joined the mainstream. Today, most companies have increased the proportion of their free cash flow distributed to shareholders to 50% of net profit under the International Financial Reporting Standards (IFRS) accounting system, and the companies which had previously resisted are among them.
There has also been progress on improving minority shareholder rights. In 2017, the Russian government amended the Federal Law on Joint Stock Companies to ensure a high level of protection of the rights and legitimate interests of minority shareholders. The main amendment included giving minority shareholders who have ordinary shares the pre-emptive right to purchase placed preferred shares and equity securities convertible into shares in an amount proportionate to the number of shares of this category they already own. This was done to protect the minority shareholders from dividend rights dilution.

The development of minority shareholder protection is clearly shown by Russia’s strong performance in the World Bank’s minority investor protection index (see Graph 12). The index is the sum of the extent of disclosure, director liability, ease of shareholder suits, shareholder rights, ownership and control and corporate transparency indices.

The data is for 2019, the latest available

Source: The World Bank, TKB Investment Partners, June 2021
Yet, at the government level, Russia’s governance standards are on average comparatively weak, mostly due to corruption. Russia ranks 129th out of 179 countries on Transparency International’s 2020 Corruption Perceptions Index, up from 137th place in 2019. The organisation noted that this improvement in ranking was mainly due to changes in the values of the index for other countries, as well as the inclusion or exclusion of a number of states from the list. According to Transparency International, the fact that for many years Russia has had a low rating reflects the absence of systemic measures to combat corruption.

**ESG on the Russian equity market**

Most large Russian companies have been publishing sustainability reports for more than 10 years and seek to improve their practices to align with global standards. The majority of companies apply Global Reporting Initiative (GRI) Sustainability Reporting Guidelines when preparing their sustainability reports.

Graph 13. Companies from RTS index which include ESG considerations in their annual reports*

*Some of the companies even have a separate ESG report
Source: Companies’ reports for 2018 and 2020, TKB Investment Partners, June 2021

Many large Russian mining companies have already improved their MSCI ESG ratings. For instance, in 2020, Russian gas producer and the largest gold miner were upgraded by MSCI ESG from grade BBB to A. Another gold producer was upgraded to A in 2019. The improvements reflect the fact that Russia’s biggest companies are genuinely devoting resources to environmental and social issues.

Additionally, in April 2019, the Moscow Exchange introduced i) the Responsibility and Transparency index that includes the 29 leading companies in terms of ESG disclosure, and ii) the Vector of Sustainability index, which comprises 26 companies that have demonstrated the best progress in terms of ESG year-on-year. The indices were designed to evaluate organisations’ contribution to sustainable development. They thus aim to promote responsible business among Russian issuers, improve their transparency and investment attractiveness and strengthen investor confidence in them.
Graph 14. MOEX Sustainability indices (RUB)

Source: The Moscow Exchange, TKB Investment Partners, June 2021
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