

A wide-angle photograph of a glacier lagoon. In the foreground, several large, white icebergs with blue-tinted interiors float in the calm, blue water. The water reflects the sky and the icebergs. In the background, a range of rugged, snow-capped mountains stretches across the horizon under a pale, overcast sky. The overall color palette is dominated by blues, whites, and greys, creating a serene and cold atmosphere.

# Climate Risk Management Report

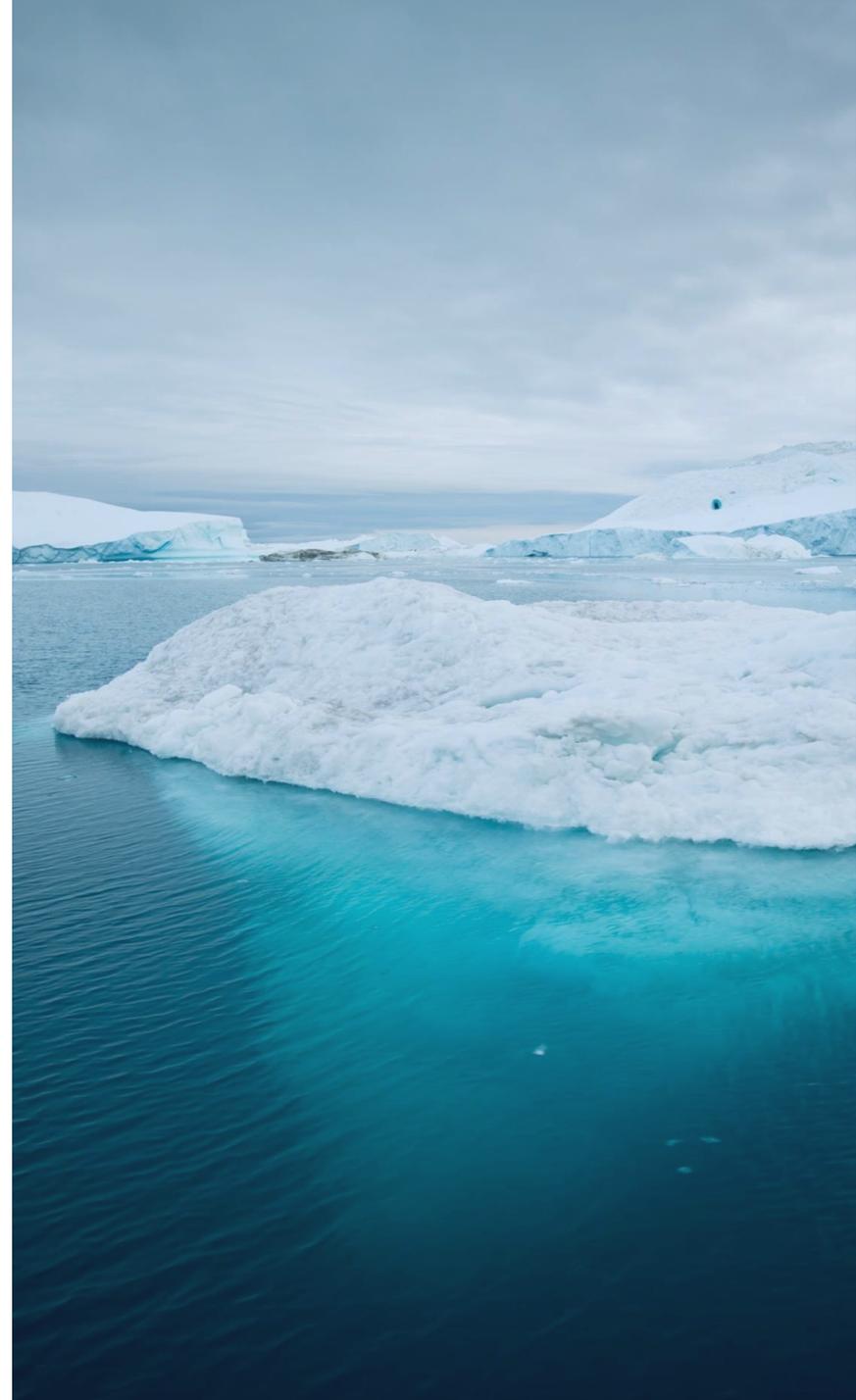
In accordance with TCFD

January 2022

 SOVCOMBANK

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# Introduction

Rapidly developing climate agenda stresses the importance of understanding climate-related risk facing organizations. In 2021 Russia embarked on an ambitious course towards low-carbon development and achieving the country's carbon neutrality by 2060. The Russian government has formulated a taxonomy of green and adaptation projects to support the development of a responsible investment system. The Central Bank of Russia has issued recommendations on the disclosure of non-financial information, within the framework of which it has made significant emphasis on the integration of climate risks into the risk management system. At the moment, a new version of the Russian Federation strategy for the socio-economic development until 2050 with a low level of greenhouse gas emissions is being developed. The strategy targets achieving carbon neutrality by 2060.

In Sovcombank ("the Bank", "we"), we consider that introduction of climate risk management is a critical near-term imperative for financial institutions. As a bank, we perform a major role in the transition to low-carbon economy. Therefore, we aim to become a leader among Russian banks in GHG emission reduction, as well as achieve net-zero GHG emissions by 2050 <sup>1</sup>. Our commitment to reduce the Bank's carbon footprint is in line with Russia's vision of low-carbon development.

We face climate risks from both our operations and financing activities. The former includes the potential harm for the Bank's facilities resulted from more frequent extreme weather events. The latter represent an impact

on financial performance of sectors which the Bank supports. To date, we performed climate risk analysis for our loan portfolio and in-depth assessment for carbon-intensive sectors included in it. Although large-scale and complex nature of climate change makes it uniquely challenging to estimate the potential financial effects, we consider qualitative assessment as an important step towards understanding our risk exposure.

We understand that climate change is an important issue for different groups of stakeholders. In this regard, the major aim of this report is to transparently outline the implications of climate-related risks for the Bank. We consider that clearly communicating our current practices in climate risk management, we help regulators, investors, and clients to decide on our performance.

This is the first report that we prepared to describe in detail the Bank's climate-related strategy. The disclosure follows the recommendations of the Central Bank of Russian Federation <sup>2</sup> and UNEP Financial Initiative, it is structured in accordance with the TCFD <sup>3</sup> Framework, covering the following aspects:

- **Governance** – key roles and responsibilities around the Bank's climate-related risks and opportunities,
- **Strategy** – our view on climate-related risks and opportunities and their potential impact on the Bank's business and strategy,
- **Risk management** – procedures to identify, assess, and manage climate-related risks,
- **Metrics and targets** – quantitative indicators used to assess climate-related risks and opportunities.

Due to fast changes in the global climate agenda and regulations, we wanted to promptly address recently published recommendations of the Central Bank of the Russian Federation on nonfinancial disclosure <sup>2</sup> and introduction of VEB.RF green financing criteria <sup>4</sup>. Therefore, we decided to conduct the climate risk analysis exercise in the midterm of our sustainability reporting cycle and defined the boundaries as of Q2 of 2021, including all the Sovcombank PJSC subsidiaries.

This report is a new milestone in our climate-related action and the starting point in our approach to consistently disclose climate-related risks and opportunities that arise in context of our strategy and operations. We believe that this step toward transparency enables us to set a baseline for future assessment of our progress.

# 01. Governance

**We see ESG as an integral element of our long-term success. We integrate ESG considerations into our governance mechanisms, including our risk management strategy, market strategy, and our approach to deliver products and services.**

In 2021, to take control over disruptive climate change impacts Sovcombank decided to include climate-related factors into the process of strategic, reputation, operation and regulation risks management, as well as into the priorities of the Supervisory Board oversight. Sovcombank applies the fundamental policy "Risk and Capital Management Strategy" ("Strategy") which defines the main principles, goals, and procedures of the Bank's risk management system. The Strategy is approved by the Supervisory Board and is annually reconsidered. Climate risks are managed according to the regulations described in the document.

The main goals of the Strategy include:

- Identification, assessment, aggregation of significant risks that can lead to losses significantly affecting the Bank's ability to maintain capital adequacy ratios,
- Improving the stability of the Bank's development and ensuring the normal functioning of the Bank in crisis situations,
- Compliance with the requirements of the state bodies of the Russian Federation regulating the Bank's activities.

Our corporate risk governance model serves achieving this set of goals. The model complies with Russian legislation and the requirements of the Central Bank of Russia. The main principle of the Bank's organizational structure and corporate risk governance model is to ensure continuous control over the Bank's operations and risk management activities. It includes 2 levels of risk governance which are illustrated on the following diagram:

- The highest regulatory level,
- Executive level.



## The highest regulatory level

The highest regulatory level performs ultimate oversight of Sovcombank's approaches to risks management and consideration of climate-factors. This regulatory level includes:

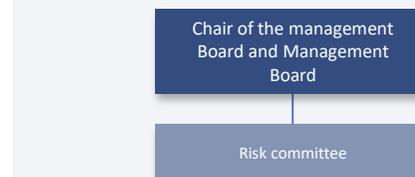
- General Meeting of Shareholders,
- Supervisory Board,
- Risk Management Committee,
- Audit Committee,
- ESG Committee.

**General Meeting of Shareholders** participates in election of the Supervisory Board. The General Meeting of Shareholders approves annual accounting statements and annual reports.

## The highest regulatory level



## Executive level



- Direct participation in climate risk management
- Indirect participation in climate risk management
- Subordination links

**Supervisory Board** oversees the implementation of the sustainable development goals, on annual basis reviews sustainability report and reconsiders the Risk and Capital Management Strategy. Supervisory Board is also responsible for approval of key internal principles of risk management, and risk appetite indicators. It also determines the procedures for managing the most significant risks and supervises their implementation, monitors the completeness and frequency of risk reports provided for the assessment, if necessary, takes measures to reduce risks and to prevent violations of legislation.

The Bank's Supervisory Board members have substantial knowledge and expertise in the industry at an international level, ensuring a robust approach to ESG matters. Also, the Supervisory Board regularly overviews climate-related issues within ESG committee's reports.

**Risk Management Committee** is a collegial deliberative body established to ensure the effective performance of the Supervisory Board in terms of risk management. The Committee preliminarily considers recommendations and approves issues related to risk management and risk strategy, considers the procedure of managing significant risks and risk propensity indicators. Risk Management Committee participates in consideration of stress testing scenarios, monitoring the effectiveness of the risk management system and culture, its compliance with the changing conditions of the organization's activities, and prepares proposals for its improvement. Other responsibilities of the Committee include interaction with the Audit Committee to exchange information on all types of risks inherent in the organization's activities, including potential risks, as well as to identify areas for improving the organization's risk management system.

**Audit Committee** ensures the effective performance of the functions of the Supervisory Board in terms of control over the financial and economic activities of the Bank. Some of the exclusive functions of the Audit Committee include control over ensuring the completeness, accuracy and reliability of financial statements, over the reliability and efficiency of the risk management and internal control system and ensuring the independence and objectivity of the internal audit function.

**ESG Committee** which was established in 2020, is responsible for overseeing the Bank's activities in the field of sustainable development and climate change. It considers emerging climate-related issues. Also, its tasks include monitoring the Bank's work for compliance with the accepted obligations and recommendations of international (TCFD, UNEP FI and others) and national (recommendations of Central Bank of Russia) standards on environmental and climate change actions and ensuring effective system for managing environmental and social risks.



## Executive level

The executive level is responsible for the implementation of Sustainable development strategy and overall management of the Bank's ESG activities. This level consists of:

- Management Board and Chairman of the Management Board,
- Risk Committee.

The Management Board follows the longer-term goals approved by the Supervisory Board in line with Sustainable development and climate strategy. The Chairman of the Management Board and his team perform final decision making in identifying and addressing ESG issues and their impacts, as well as climate-related risks and opportunities. The responsibilities of Management Board and Chairman of the Management Board in terms of risk management include approval of risk management procedures, regular (at least once a year) consideration of the need to make changes to the risk management procedures and resolution of conflicts arising from the functioning of the risk management system. The Management Board along with Chairman of the Management Board adopt measures to minimize the risks and make decisions on the admissibility of taking operational and non-financial risks.

Risk Committee annually reviews the Risk Management Strategy and the procedure for managing significant risks, reviews the report on significant risks and considers the need to make changes to the methodology and procedures for determining significant risks at least once a year. The Committee also considers the results of evaluating the effectiveness of the methodology and procedures for aggregating quantitative assessments of significant risks.

## 02. Strategy

### Understanding climate-related risks

The Bank recognizes importance of assessing the impact of its operations on global climate change. From 2021, we are committed to conduct climate risks and opportunities in-depth analysis of the Bank's portfolio on a regular basis. The analysis of the risks and opportunities of our financial activities allows us to build operational stability in context of the development of the climate agenda in the world at large and in Russia. As risks assessment tools will advance, we additionally plan to expand Bank's climate strategy and risk management.

As financial institution, Sovcombank influences society and environment directly through its operational processes, such as office building management and power consumption related to the Bank's facilities, and mostly indirectly through its financial products and services. One of the key goals of Sovcombank is to reduce the risk of having a negative impact on the environment. In this regard, we set one of the most ambitious targets among Russian banks to achieve net-zero emissions by 2030 (scope 1 and 2) and net zero emissions by 2050 (incl., scope 3).

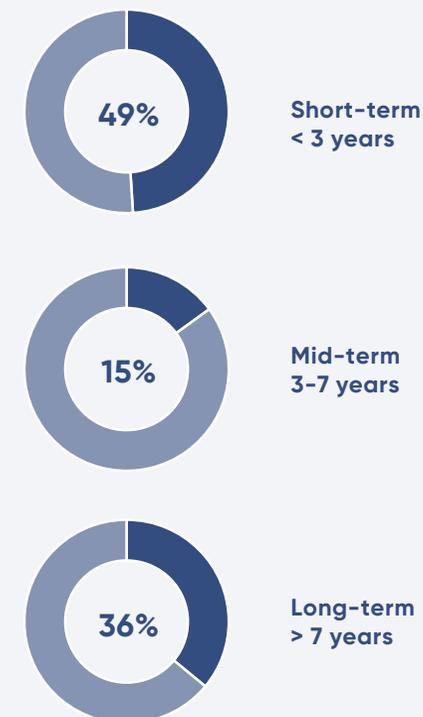
Due to this strategy set, we are to decrease negative impact of our operations. However, we do not see significant climate risks exposure for our facilities around Russia as the Bank's offices are primarily located in the rented facilities and we have well-established business continuity plans which will allow us to smoothly recover in case of severe natural hazards (such as we transferred to remote work with all necessary equipment during the COVID-19 pandemic).

At the same time, we understand that our loan book includes companies from carbon-intensive industries (e.g., metals and mining, energy, etc.), as well as industries exposed to a changing climate (e.g., real estate). Therefore, we focus our risk assessment on our corporate and retail loan portfolios. We excluded from the analysis loans to SMEs and Government and municipalities as, we believe that these institutions are subject to general Russian market trends, but are not majorly exposed to climate risks per se.

The understanding of the Bank's portfolio climate risks exposure is a starting point for us in pivoting the Bank's strategy towards low-carbon future. We recognize contradictory of "brown" companies within our portfolio as they not only bear climate risks, but also contribute to social issues. Therefore, we see the Banks's role in supporting clients' low-carbon transition by financing green projects, stimulating companies to improve their ESG metrics. We believe that this approach will allow us to effectively fight against climate change.

In climate risks assessment the Bank considers different time horizons. Since a significant portion of the corporate loan portfolio will be paid off within less than 3 years (49%), we define short-term horizon within this timeframe. Medium-term was determined as 3-7 years due to expected timeline for the technology and legal framework development in carbon management. Also, we expect low-carbon market development, customers attitude change and companies' reputation enhancement in the short- and medium-term periods. The Banks portfolio also includes long-term loans to medium and large corporations (36%) and mortgages (with 14-18-year tenor at average), so we consider the long-term horizon as more than 7 years period.

### Corporate and mortgage loan portfolios breakdown by loan repayment periods



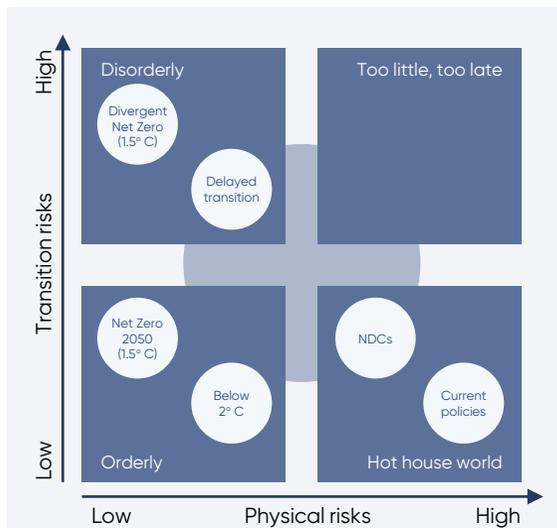
We review our loan portfolio in context of transition and physical risks according to TCFD recommendations risks classification. Also, we consider climate-related factors as a constituent part of traditional banking industry risk categories rather than stand-alone category of risk.

These factors may be translated into financial effects happening to portfolio companies, for instance, profit loss, additional capital expenditures or incremental emission costs. Current risks assessment allows Sovcombank to weight arising risks and opportunities and define further steps. Detailed description of the climate factors, relevant for the Bank's portfolio, and corresponding financial impacts are presented in table below.

Climate-related risk factors	Potential financial impact	Time horizons		
<b>Transition risks</b>				
Carbon Border Adjustment Mechanism (CBAM) introduction by EU Commission in order to leverage imported products prices compare to EU domestic products with higher impact towards carbon emissions reduction to promote transition to low-carbon economy (e. g. carbon leakage protection)	Additional tax burdens for materials manufacturers who export products to EU countries only due to exceeding of set GHG emissions intensity limits during production process. The list of regulated goods includes cement, electricity, fertilizers, iron and steel, aluminum		MT	
Carbon regulation scheme introduction <sup>5</sup> and enhanced GHG emissions reporting obligation <sup>5</sup>	Increased costs related to carbon process and mandatory annual GHG emissions quantification and verification	ST	MT	
Substitution of existing products and services with lower emissions options, e. g. low-carbon aluminum, steel, building materials etc.	Low-carbon products pose a profit loss risk to traditional operation processes associated with high GHG emissions during product lifecycle. This trend could reduce demand in conventional products		MT	
Unsuccessful investment in new technologies	Failure to achieve revenue indicators associated with the failure of technologies implemented to reduce carbon footprint		MT	
Lower emissions technologies emergence	Additional capital expenditures due to implementation of technologies targeting higher energy efficiency, energy consumption reduction, renewable energy sources, carbon capture technologies	ST		
Customers' behavior change: decrease in products and services competitiveness	Reduction of marginality and competitiveness of products and services due to company's immature climate strategy		MT	
Increased costs of raw materials	Additional costs for raw materials purchase		MT	
Sector stigmatization: perception of sector as "brown"	Investment and profit loss due perception of the sector as "brown" (e. g. coal mining and production)	ST		
Company's negative perception by investors and independent shareholders	Loss of capital investments due to undeveloped company's climate strategy (low CDP score, lack of climate policy, etc.)	ST	MT	
<b>Physical risks</b>				
<ul style="list-style-type: none"> <li>• Excess heat and cold</li> <li>• Strong wind</li> </ul>	<ul style="list-style-type: none"> <li>• Abnormal precipitation and flooding</li> <li>• Wildfires</li> </ul>	<ul style="list-style-type: none"> <li>• Companies' operational processes and supply chain interruptions, employee productivity decrease, additional energy expenditure</li> </ul>		LT
<ul style="list-style-type: none"> <li>• Average annual precipitation change</li> <li>• Sea level rise</li> </ul>	<ul style="list-style-type: none"> <li>• Permafrost degradation</li> </ul>	<ul style="list-style-type: none"> <li>• Decrease in the value of real estate</li> <li>• Households and businesses reduction in liquidity</li> </ul>		LT

In order to identify and assess potential outcomes of global climate change, we considered climate change scenarios outlined by Network for Greening the Financial System (NGFS)<sup>1</sup> for transition climate risks and SSP5-8.5 scenario for physical climate risks. These scenarios allow us to explore and develop an understanding of how the physical and transition risks of climate change may impact the Bank's portfolio companies.

NGFS has been developed Climate Scenarios Framework (see figure below) to provide a common starting point for analyzing climate risks to the economy and financial system, it includes three key groups of scenarios varying depending on the severity of transition and physical risks: namely, Orderly, Disorderly and Hot house world scenarios.



## Scenarios overview



**Orderly** scenarios assume climate policies are introduced early and become gradually more stringent. Net zero 2050 (1.5° scenario) was taken as a base for qualitative risks assessment.

We believe the Net Zero 2050 (1.5°) scenario to be the most applicable for Sovcombank in terms of transition risk, considering that the Bank joined Net-Zero Banking Alliance (NZBA), UN-convened alliance of banks worldwide and committed to align its portfolio with the net-zero emissions target by 2050. Thus, all further analysis is conducted in accordance with it.



**Disorderly** scenarios explore higher transition risk due to policies being delayed or divergent across countries and sectors. Carbon prices are typically higher for a given temperature outcome. It includes Disorderly 1.5°C scenario and disorderly 2° C scenario.



**Hot house world** scenarios assume that some climate policies are implemented in some jurisdictions, but global efforts are insufficient to halt significant global warming. Critical temperature thresholds are exceeded leading to severe physical risks and irreversible impacts.



**SSP5-8.5** or Shared Socioeconomic Pathway with very high GHG emissions was used for physical risks analysis. Estimated warming is 2.4° C by 2060. (IPCC, 6th Assessment Report). This high-emissions scenario implies high fossil fuel development world throughout the 21st century<sup>2</sup>. This scenario was taken as a base for physical risks assessment as allowing us to consider the most severe outcomes of physical hazards.

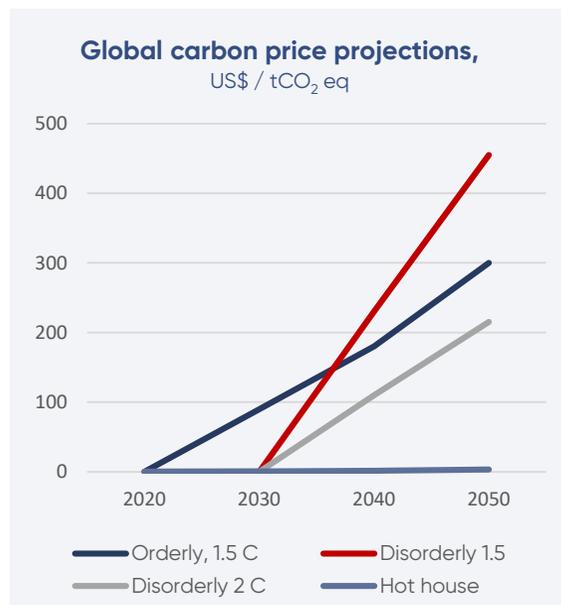


**Historical climate trends<sup>2</sup>** were in place to demine climate risk factors for scenario analysis.

### Bank's portfolio exposure to climate change

The most severe potential effect we see in introduction of carbon pricing since the imposed costs may diminish customers' financial conditions (see figure describing carbon price projections below<sup>10</sup>).

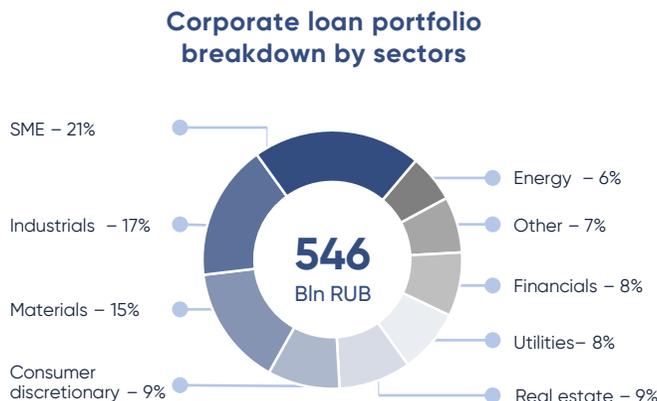
At the given moment carbon price mechanism is to be introduced in Sakhalin region. GHG emission quotas of the largest GHG emitters in this region will be issued. Introduction of quotas circulation will let emission "savings" be sold to other enterprises. Therefore, we considered sectors with relatively high carbon intensity - energy and materials sectors and geographical position in some areas of Russia - to be characterized as highly exposed to transition risks.



These sectors are more likely to be financially impacted than others due to high greenhouse gas (GHG) emissions, energy dependency associated with their operations and products.

Based on these assumptions we developed climate risks heat map to obtain a holistic view on our lending portfolio. The heat map provides a qualitative indication of climate risks exposure (low / medium / high degree) with a breakdown by economic sectors. The breakdown is performed according to TCFD recommendations and MSCI methodology<sup>11</sup> (additionally, we presented IFRS sector matching in the Annex section). The overall risks level is a sum of sector-related transition and physical risks described in the table above.

Sectors having high risk exposure, either from a physical or transition risk perspective, require more detailed risk assessments and thorough management. Sovcombank's current climate risk heat map is shown in the table on the right.



### Corporate portfolio heat map

Corporate portfolio sectors	Overall transition risk level	Overall physical risk level
Energy	High risk	Low risk
Materials	High risk	Low risk
Chemicals	Medium risk	Low risk
Construction Materials	Medium risk	Low risk
Metals & Mining	High risk	Low risk
Paper & Forest production	Medium risk	Low risk
Industrials	Medium risk	Low risk
Capital goods	Medium risk	Low risk
Aerospace & Defense	N/A	N/A
Building products	Medium risk	Low risk
Construction & Engineering	Medium risk	Low risk
Construction Machinery & Trucks	Medium risk	Low risk
Electrical equipment	Medium risk	Low risk
Industrial Conglomerates	Medium risk	Low risk
Machinery	Medium risk	Low risk
Trading Companies & Distributors	Medium risk	Low risk
Commercial & Professional Services	Medium risk	Low risk
Transportation	Medium risk	Low risk
Consumer discretionary	Medium risk	Low risk
Automobiles & Components	Medium risk	Low risk
Consumer Durables & Apparel	Medium risk	High risk
Consumer Services	Medium risk	Low risk
Retailing	Medium risk	Low risk
Real estate	Medium risk	High risk
Utilities	Medium risk	Low risk
Information Technology	Medium risk	Low risk
Communication Services	Medium risk	Low risk
Financials	Medium risk	Low risk
Consumer staples	Medium risk	Low risk
Health Care	Medium risk	Low risk
Public sector	Medium risk	Low risk
Other industries	N/A	N/A

Risk level  
 High risk (orange)    Medium risk (yellow)    Low risk (green)    N/A (grey)

\* The risk assessment for the mentioned sectors and industry groups was not performed due to lack of data on potential effects of climate change, GHG emissions and studies describing climate risks.

## Sector deep-dive risk analysis



### Energy sector

- Oil and gas extraction and processing
- Energy equipment & services

**Oil and gas extraction and processing** industry presented by large corporations and small and medium-sized enterprises (SME) which operate in Russia and CIS. The industry includes drilling, exploration and refining of oil, gas and coal fuel minerals. It also includes supplementary services like trading.

**Energy equipment and services** companies are involved in machinery repair and other services for minerals extraction and processing.

Oil and gas companies pay attention to environmental issues associated with field development and biodiversity conservation programs support. Currently, many of them are preparing to apply technologies for GHG emissions inventory. As one of carbon intensive sectors, it faces significant transition risks, as well as physical risks related to infrastructure damage caused by climate change.

Energy sectors needs significant transformation towards low-carbon economy globally. For transition risk associated with customers' demand shift we observe different pathways for oil demand (REMIND-MAGPIE, SSP2 model). According to orderly 1.5°C scenario, demand will decrease gradually to 0.6 bln barrels of oil equivalent per year by 2050<sup>12</sup>.

### The main sources of GHG emissions for the sector are:



The process of stationary fuel combustion with the emission of CO<sub>2</sub>



Combustion of natural gas in flare units during the production process with emissions of CO<sub>2</sub> and methane



Emissions of fugitive gases include emissions of methane and CO<sub>2</sub> resulting from technological operations



Refining processes including carbon dioxide emissions from industrial processes

### Transition risks

Policy and legal	GHG emissions payments and offsetting due to carbon price introduction and mandatory GHG reporting
Technology	CAPEX for transition to renewable sources of energy, energy efficiency measures and carbon capture
Market	Decrease in energy products competitiveness due to shift in customer preferences
Reputation	Loss of capital investments due to: <ul style="list-style-type: none"> <li>• Immature company's climate strategy (low CDP score, lack of climate policy, etc.)</li> <li>• Perception of the sector as "brown"</li> </ul>

### Physical risks

Acute	Operations and supply chain disruptions due to severe weather events
Chronic	Infrastructure damage due to permafrost degradation and sea level rise

Risk level

- █ High risk
- █ Medium risk



## Metals & mining

- Aluminum
- Gold
- Copper
- Tin
- Other minerals

The industry is presented by large corporations and SMEs which operate in Russia and CIS. Industrial production processes include exploration, open and underground mining and metals processing and refining.

Conventional methods of operations in metals and mining industry, for example, usage of metallurgical furnace in steel production process, produce significant amount of greenhouse gas.

To mitigate climate risks companies should introduce low-carbon technologies replacing conventional methods of operations. This transition will require significant capital investments that may reduce companies' profitability. Metals and mining companies in the Bank's portfolio monitor the environmental impact of their production processes and strive to reduce it by production modernization.

### The main sources of GHG emissions for the sector are:



The process of stationary fuel combustion with the emission of carbon dioxide.



Ferrous metallurgy with the emission of carbon dioxide.



Greenhouse gas emissions, including carbon dioxide and perfluorocarbons (CF<sub>4</sub>, C<sub>2</sub>F<sub>6</sub>) arising from the electrolytic process to produce primary aluminum.

### Transition risks

Policy and legal	Carbon Border Tax expenses for steel and aluminum exported to EU	GHG emissions payments and offsetting due to carbon price introduction and mandatory GHG reporting
Technology	Profit loss due to high product carbon footprint	CAPEX for transition to renewable sources of energy, energy efficiency measures
Market	Decrease in products competitiveness due to shift in customer preferences	
Reputation	Loss of capital investments due to Immature company's climate strategy (low CDP score, lack of climate policy, etc.)	

### Physical risks

Acute	Operations and supply chain disruptions due to severe weather events, open mining and tailings flooding
Chronic	Infrastructure damage due to permafrost degradation and sea level rise

Risk level

- █ High risk
- █ Medium risk



## Chemical industry

- Fertilizers, agricultural chemicals
- Commodity chemicals & plastics
- Industrial gases
- Specialty & diversified chemicals

The industry is presented by large fertilizers producers and SMEs which operate within the rest of sub-industries in Russia and CIS.

Chemical production for plastics and petrochemicals requires significant amount of energy to convert raw materials to commodity goods, thus producing high carbon footprint. Most GHG emissions arise due to chemical reactions requirements. Fossil fuel combustion largely used to provide the intense heat to bring physical and chemical transformations that convert raw materials into industrial products. These industries include production of chemicals and petrochemicals.

Chemical producers require to reduce carbon emissions in several directions. Fertilizer companies will be obliged to pay carbon tax for products exported to EU in case their carbon footprint exceeds the approved quantity. Petrochemicals and other industries with carbon-intensive production processes will require significant expenses to reduce GHG emissions by upgrading plants to best available technologies, switching fuel type, switching to CHP\* and introducing plastics recycling, however this is the only opportunity to mitigate climate change risks, to stay competitive and attractive for their investors.

### The main sources of GHG emissions for the sector are:



High energy consumption for chemical reactions in production of plastics and fertilizers



Nitrous oxide (N<sub>2</sub>O) emissions during production of adipic and nitric acids

### Transition risks

Policy and legal	Carbon Border Tax expenses for fertilizers exported to EU	GHG emissions payments and offsetting due to carbon price introduction and mandatory GHG reporting
Technology	Profit loss due to high product carbon footprint	CAPEX for transition to renewable sources of energy, energy efficiency measures
Market	Decrease in products competitiveness due to shift in customer preferences	
Reputation	Loss of capital investments due to immature company's climate strategy (low CDP score, lack of climate policy, etc.)	

### Physical risks

Acute	Operations and supply chain disruptions due to severe weather events	
Chronic	Infrastructure damage due to permafrost degradation and sea level rise	

Risk level

- █ High risk
- █ Medium risk
- █ Low risk

\* Combined heat and power



## Real estate

- Commercial real estate
- Residential real estate
- Mortgages for individuals

Real estate sector presented by commercial and residential real estate companies engaged in acquisition, development, ownership, leasing, management and operation. In this report, we performed deep-dive analysis of physical risks for mortgage portfolio as we see significant exposure to acute and chronic climate risks in long-term horizon for Russian regions.

Physical assets can be directly affected by the changing climate patterns. Such climate events are highly heterogeneous in the territory of Russia. Regions of Russia were analyzed according to climate change risk factors in accordance with SSP5-8.5 scenario mapping 2.4°C warming by 2060 for mean temperature, total precipitations and historical data for winds, wildfires, and permafrost degradation potentially resulting in:

- Strong wind and storms
- Heavy rainfalls
- Wildfires
- Flooding
- Annual precipitations change
- Sea level rise
- Permafrost degradation

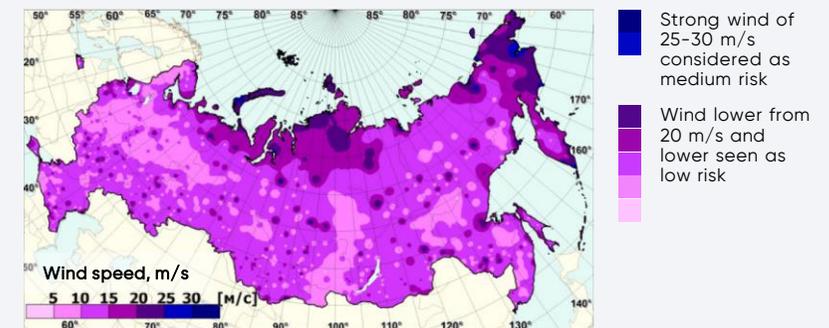
### Acute climate risks

Anomalies of abnormal precipitation occur in all regions of Russia, with the greatest increase in the North Caucasus, Siberia and Far East. The growth of wildfires is typical for most regions with a predominance in Ural, Siberia and Far East. The increase in the number of floods represents an average level of risk for the Southern and Ural regions and a high risk for the Siberia and Far East regions.

### Chronic climate risks

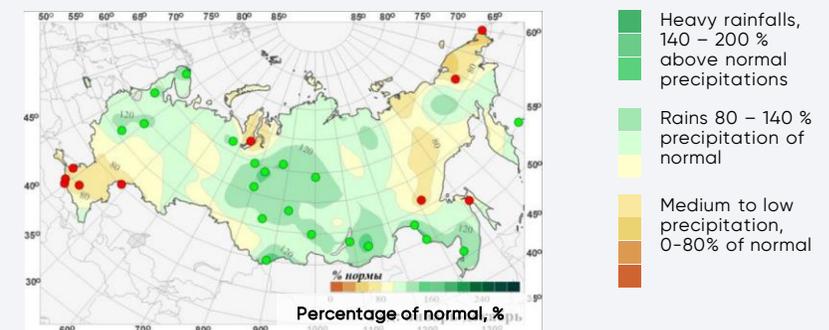
The greatest change in average annual precipitation is observed in the Far Eastern and Siberian regions. Sea level rise poses a risk in the Northwest and Far East regions. The risk of damage to infrastructure due to an increase in the thickness of the seasonally thawed soil layer is dangerous in regions with permafrost presence: Ural, Siberia and Far Eastern regions. The distribution of physical risk factors is shown in the figure on the next page.

### Strong wind



Source: FGBU "VNIIGMI-WDC", Average annual wind speed anomalies [13](#)

### Abnormal rains



Source: Roshydromet, Annual precipitation anomalies in Russia [14](#)



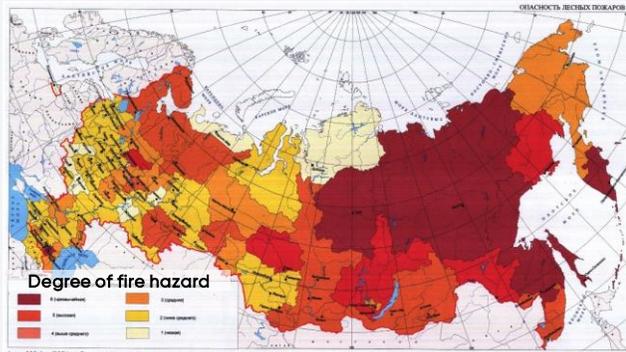
## Real estate

- Commercial real estate
- Residential real estate
- Mortgages for individuals

We see significant risk concentration in Siberian and Far Eastern regions. More detail insight into these regions in the next assessment stages will allow to differentiate territories within the regions regarding physical risks exposure.

This pilot test is an initial step in the assessment of physical risk in our commercial real estate and mortgages portfolio. By assessing physical climate risks on qualitative level, we can assess the impact climate change has on the real estate sector we finance and decide on appropriate mitigation and adaptation strategies. In the coming years, we are aiming to translate the climate change impacts into quantitative values.

### Wildfires



Source: Regnum information agency, Wildfires risks for the forest fund of Russia <sup>15</sup>

### Real estate physical risks heat map

Regions of Russia	Acute risks				Chronic risks			% of mortgage portfolio
	Strong winds	Heavy rainfalls	Wildfires	Floods	Annual precipit. change	Sea level rise	Permafrost	
Central	Low risk	Low risk	Medium risk	Low risk	Low risk	Low risk	Low risk	37%
North-Western	Low risk	Medium risk	Low risk	Low risk	Medium risk	High risk	Low risk	9%
Southern	Low risk	Medium risk	Medium risk	Medium risk	Low risk	Medium risk	Low risk	9%
North Caucasus	Low risk	High risk	Low risk	Low risk	Low risk	Low risk	Low risk	2%
Volga	Low risk	Low risk	Medium risk	Low risk	Low risk	Low risk	Low risk	16%
Urals	Low risk	Low risk	High risk	Medium risk	Medium risk	Medium risk	High risk	8%
Siberian	Low risk	High risk	High risk	High risk	High risk	Medium risk	High risk	13%
Far Eastern	Medium risk	High risk	High risk	High risk	High risk	High risk	High risk	6%

Risk level  
■ High risk    ■ Medium risk    ■ Low risk

## Climate change opportunities

Sovcombank sees new opportunities in rising global climate change and plans to leverage them to not only fulfill financial goals, but also achieve GHG emissions reduction. Climate-related opportunities for the Bank are formed along with TCFD recommendations: related to resource efficiency, cost savings, adoption of low-emission energy sources, development of new products and services, access to new markets, and building resilience along the supply chain. The list of opportunities is presented in the table below.

We see most material opportunities in financing low-carbon and green products. The Bank has already financed energy and transportation sectors companies and has ambitious plans within this area of activities. To embed these opportunities into the Bank's strategy we introduced green and social bonds, ESG-linked loans and financing of sustainability-oriented projects. This allows us to proactively participate in carbon emissions reduction and engage more companies into Russia's decarbonization commitments.

Portfolio sectors	Climate opportunities	Time horizons
 Energy	Renewable energy sources development and utilization	ST
 Metals and mining	Low carbon products such as green steel and aluminum, metals production for electric vehicle manufacturing (nickel, lithium, copper)	ST
 Agriculture And food production	Environmentally sustainable natural resources and land use management	MT
 Transportation	Electric and hydrogen fuel cell vehicles	MT
 Infrastructure	Climate change adaptation against severe weather events	MT - LT
 Real estate	Green building construction	ST
 Other industries	Circular economy, sustainable water management	MT

# 03. Risk management

The Bank's risk management system was developed in compliance with the recommendations of the Basel Committee on Banking Supervision, the legislation of the Russian Federation and the regulatory acts of the Central Bank of Russia. Considering the contribution physical and transition risks have on the economy change, we recognize these risks as a part of the general Bank's risk management system.

This year we piloted climate-risk analysis methodology based on a qualitative assessment of climate risks factors which may lead to negative financial effects for our clients. The terminology of climate risks is specified in accordance with the TCFD climate risk framework. We strive to further integrate climate-related risks in the standard Bank's risk management system, namely embed it in the Bank's risk taxonomy and general risk management procedures.

For this, we annually review our methodology standards, as well as our list of relevant and significant risks within the Bank's general risk management cycle. The process of risk management consists of three general steps:

1. Identification and evaluation of risks
2. Risk appetite assessment
3. Risk management procedures development

**At the first stage,** we review existing risks and analyze external sources, which allows identifying all the Bank's risks.

The expert group provides a more detailed risk evaluation in the form of a questionnaire, including assessing the materiality and probability of risk occurrence with a scale from 1 (low) to 4 (very high). An expert on climate-related risks will be added to the existing Expert group, who will be responsible for filling in information on risk in consideration with climate factors.

For identification of significant risks, we use the risk map tool, which reflects the probability of occurrence and the materiality of the impact of the identified risks. First, risk maps are built for the Bank's business units. Then, the risk maps for the Bank's business units are combined into a Bank-wide risk map in the order determined by internal procedures.

**At the second stage,** we define risk appetite, which refers to the maximum permissible level of risk that the Bank can take to achieve its goals and objectives. Due to limitations of existing methodology and data availability, this year we have not included climate-related factors in the Bank's risk appetite definition. However, we are looking closely for the future regulatory updates to be released.

**During the third stage** we define which risk management approach to be applied.

As for the climate-related risks, we currently consider the Bank's risk level to be acceptable, and therefore, apply monitoring procedures for this type of risks.

# 04. Metrics and Targets

The metrics used to assess climate-related risks and opportunities in line with our strategy and risk management process include metrics of our direct influence (associated with energy use and Scope 1, 2, 3 of GHG emissions) and indirect influence (sustainable finance). We use such metrics and monitor our activities to help us to quantitative feedback loop to support continuous improvement and achievement of our ESG-goals. Our metrics also provide investors and other stakeholders with important insights on the Bank's progress versus its commitments.

## Climate-related risks metrics

To assess climate-related risks and opportunities of the Bank's business we use portfolio exposure metric. We calculate exposure to the sectors, risk level of which we estimated throughout our climate strategy development.

According to our calculation, approximately 22% of borrowed funds from total amount of corporate loan book is categorized as facing high transition risk,

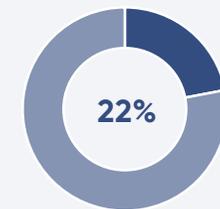
while 15% - as facing high physical risks. The rest of corporate loan portfolio is considered to be exposed to medium or low climate risks. The results of the analysis encourage us to focus on further financing the sectors with low to high risk exposure, but additionally continue monitoring critical "high risk" segments that are not numerous in our lending portfolio.

We also assessed retail portfolio exposure to physical climate risks for mortgage loans. Based on real estate physical risks heat map, approximately 19% of borrowed funds facing high climate risks exposure while 81% categorized as having low to medium climate risks exposure (see figure on the right).

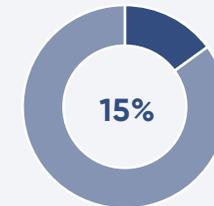
To determine the average tenor of our corporate portfolio we calculated weighted averages with a breakdown by sectors and defied an average time horizon corresponding to climate risk factor horizons: short-term (loan repayment date within the next 3 years), middle term (within the next 3-6 years) and long term (within the next 7 years and later).

We accept current risk exposure of the companies in our portfolio and are to support transition to the low-carbon economy by financing their projects.

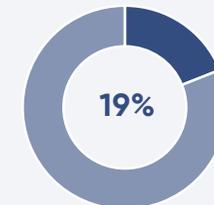
## Risk exposure of the Bank's portfolio



High exposure to transition risks  
Large corporations' loans



High exposure to physical risks  
Large corporations' loans



High exposure to physical risks  
Mortgage loans of retail portfolio

## Climate-related opportunities metrics

In 2019, Sovcombank aimed at becoming one of the nation leaders in green financing. Since then, we significantly increased our investment in environment-oriented initiatives. Our position is to support clients in all sectors of the economy, with no exceptions, through their transition towards low-carbon future.

We classified our environmental financing according to criteria ("Taxonomy") for sustainable finance identification in Russia<sup>4</sup>. In particular, we referred a loan to be environment-oriented if it was aimed to mitigate, enable sustainable use of water resources, protect healthy ecosystems, and other mentioned within the Taxonomy. By now, the focus of investments of our clients are nuclear energy, solar renewables, water supply, and other multiple criteria projects.

The Bank also became the major market maker of domestic green bonds issues in Russia by the number of arranged offerings. In 2020, we built a dedicated team to issue green bonds for our clients, some of which are the largest Russian corporations. Green bonds enable investors to direct funding towards environmentally friendly activities with a comparable risk-return profile to traditional bonds.

Environmental criteria	2019, \$MLN	2020, \$MLN	Q2 2021, \$MLN
 Energy (nuclear, solar) Incl., ESG-linked loans	-	377* 300	438* 300
 Waste management	13	-	-
 Water supply and disposal	0.3	0.6	-
 Other green projects (multiple criteria) Incl., ESG-linked loans	-	1 353*	1 244* 277
<b>Total</b>	<b>13.3</b>	<b>1 730.6</b>	<b>1 682</b>

\* Including green bonds issues arranged for Clients

## ESG-linked loans

In 2020, the Bank started to develop the methodology for screening corporate borrowers against the ESG criteria. By developing ESG criteria and implementing them into our lending conditions, we encourage our customers to focus more on ESG issues. These specific lending conditions are introduced as ESG-linked loans in which the contractual terms are linked to the improvement of certain preset indicators of environmental and social performance of the client. For instance, the interest rate for this credit line depends on the company's ESG rating score or environment covenants.

Considering the importance of these climate-related opportunities, we set out the following targets:

1. 30% of the Bank's loan portfolio is linked to ESG factors (ESG-linked loans) by 2025;
2. 50% of the Bank's loan portfolio is linked to ESG factors (ESG-linked loans) by 2030.

## Case study: Green and social bonds

As one of Russia's pioneers in ESG banking, Sovcombank participated in the first Russian placements of green bonds in 2020. In 2021 Sovcombank acted as the organizer of the placement of green bonds of the Moscow Government.

The issuer plans to use the proceeds to finance environmental projects in Moscow - the replacement of the bus fleet with electric buses and the construction of the Big Circle Metro Line. This will reduce the volume of GHG emissions and gaseous pollutants into the atmosphere. And we will continue to develop responsible financial products and offer ESG-linked loans to help our customers meet the Paris Agreement climate goals and the SDGs.

## Case study: ESG-linked loans

Sovcombank signed an agreement with the leading Russian air carrier, according to which the rate on the revolving line of credit is linked to ESG rating from the international agency.

Sovcombank signed an agreement with the largest geological holding company to switch to ESG financing to reduce CO<sub>2</sub> emissions during geological exploration. According to the signed agreement, Sovcombank reduces the interest rate after the company switches from the use of ground equipment and helicopters for geological exploration to unmanned electric aerial vehicles during airborne geophysical work. The transition to unmanned aerial vehicles will reduce CO<sub>2</sub> emissions during geological exploration to almost zero.

## Own operations metrics

Starting in 2020 the Bank assesses and discloses metrics of impact from its own operations. Our pilot metrics included energy consumption, GHG emissions, and water usage. To measure our GHG emissions we use the GHG Protocol Corporate Accounting and reporting Standard, Scope 2 Guidance, Corporate Value Chain (Scope 3) Accounting and Reporting Standard, as well as Technical Guidance for Calculating Scope 3 Emissions (Version 1.0). We report these metrics in detail in our annual Sustainability report.

We calculated energy consumption including energy used for heating, electricity, and fuel consumed for transportation. On top of the energy generated internally, we also captured the energy acquired by external providers.

Energy consumption	2019	2020
Energy consumption (GWh)	58	54
Energy consumption per employee (MWh)	4	3

We also conducted estimation of the water use. As our operations do not entail any water-intensive processes, we do not consume significant amounts of water. However, we aim to optimize water usage across all our business processes and consider efficient water consumption in terms of our "Green office" concept.

Water consumption	2019	2020
Water consumption (thsd m3)	46	53
Water consumption per employee (m3/FTE)	3	3

The calculation embedded GHG emissions of purchased cars, appliances, computers, air conditioners and furniture, as well as emissions from the security and offices improvement services we engaged throughout the year.

Looking ahead, we aim to decrease negative impact from our operations by introducing "Green office" concept, which will help us to improve energy efficiency of the Bank's facilities, as well as decrease water usage and waste. Also, we developed a set of measures to decrease the Bank's carbon intensity in the upcoming years and achieve the following targets in this domain:

1. Become a leader among Russian banks in GHG emission reduction (Scope 1 and 2)
2. Achieve net-zero GHG emissions (Scopes 1 and 2) by 2030
3. Achieve net-zero GHG emissions (including Scope 3) by 2050.

For more information on our environmental impact, please see our [Sustainability report 2020](#).

### GHG emissions, THSD tones of CO<sub>2</sub>e

	2019	2020
Scope 1 + Scope 2 + Scope 3	97	77
Scope 1 + Scope 2	17	16
Scope 1	2	3
Scope 2	15	13
Scope 3	80	61

### Greenhouse gas emissions intensity

	Unit	2019	2020
Scope 1 + Scope 2 + Scope 3 per employee	t of CO <sub>2</sub> e / FTE	6.2	4.6
Scope 1 + Scope 2 per employee	t of CO <sub>2</sub> e / FTE	1.1	0.9
Scope 1 + Scope 2 + Scope 3 per total assets	t of CO <sub>2</sub> e / RUB 1MM of total assets	1.0	0.6
Scope 1 + Scope 2 per total assets	t of CO <sub>2</sub> e / RUB 1MM of total assets	0.015	0.011

# Looking forward

By publishing this report in line with TCFD recommendations, Sovcombank makes a commitment to continue monitoring our progress in context of climate risk and enhance our risk management framework by further embedding climate factors.

Although our pilot analysis did not indicate that the Bank has a material financial exposure to climate change risks, we understand the complexity of the climate change phenomenon and velocity with which its moving forward. Therefore, recognizing the limitations of current methodology, in the coming years, we aim to strengthen our capabilities and expand the assessment approach with quantitative metrics or deeper scenario analysis.

By now, we face the following obstacles to improving our disclosure which we need to tackle in the future:

- Immaturity of the methodology on quantitative climate risk assessment and restrictions of automated tools for scenario analysis and financial impact identification which unable to account for the volatile long-term environmental projections.
- Limited availability of data describing our portfolio in terms of clients' exposure to climate risks, their business and environmental footprint.
- Diversity of Russian companies and scale of geographies which require more granular analysis and detailed asset-level understanding.

It will take time to overcome these challenges, nevertheless we are committed to collaborate and consult with our stakeholders on climate and on environmental issues on a large scale. We hope that this pilot report has provided an insightful outline of Sovcombank's approach to climate change management.



# Annex

In accordance with TCFD recommendations we applied MSCI industry classification for the climate risk analysis presented within the core part of the report. However, we understand that our stakeholders may require similar analysis in regard to our IFRS financial reporting. Therefore, to ensure comparability we provided the matching of the two classifications and a qualitative assessment of climate risks for both cases.

IFRS industries	Share in gross portfolio	Overall transition risk	Overall physical risk	MSCI sectors	Share in IFRS industry	Overall transition risk	Overall physical risk
Trade	11%	Low risk	Medium risk	Consumer discretionary	47%	Low risk	Medium risk
				Consumer staples	12%	Low risk	Low risk
				Industrials	12%	Medium risk	Low risk
				Materials	11%	High risk	Medium risk
				Energy	8%	High risk	Medium risk
				Health Care	5%	Low risk	Low risk
				Utilities	1%	Medium risk	Low risk
Mining	10%	High risk	Medium risk	Materials	64%	High risk	Medium risk
				Energy	36%	High risk	Medium risk
Energy	8%	Medium risk	Low risk	Utilities	100%	Medium risk	Low risk
State financial development institutions	7%	Medium risk	Low risk	Industrials	99%	Medium risk	Low risk
				Other	1%	Medium risk	Medium risk
Construction	7%	Low risk	High risk	Real estate	55%	Low risk	High risk
				Consumer discretionary	34%	Low risk	Medium risk
				Industrials	11%	Low risk	Medium risk
Metallurgy	6%	High risk	Medium risk	Materials	100%	High risk	Medium risk
Commercial real estate	5%	Low risk	High risk	Real estate	74%	Low risk	High risk
				Consumer discretionary	13%	Low risk	Medium risk
				Financials	8%	Low risk	Low risk
				Industrials	4%	Medium risk	Low risk

Risk level  
■ High risk    ■ Medium risk    ■ Low risk

IFRS industries	Share in gross portfolio	Overall transition risk	Overall physical risk	MSCI sectors	Share in IFRS industry	Overall transition risk	Overall physical risk
Other financial institutions	4%	Low risk	Low risk	Financials	90%	Low risk	Low risk
Manufacturing	4%	Medium risk	Medium risk	Industrials	50%	Medium risk	Low risk
				Consumer discretionary	24%	Low risk	Medium risk
				Materials	19%	High risk	Medium risk
				Health Care	6%	Low risk	Low risk
				Energy	1%	High risk	Medium risk
Transport	4%	Medium risk	Low risk	Industrials	100%	Medium risk	Low risk
Residential real estate	2%	Low risk	High risk	Real estate	96%	Low risk	High risk
				Consumer discretionary	4%	Low risk	Medium risk
Petrochemicals	1%	High risk	Medium risk	Energy	97%	High risk	Medium risk
				Industrials	3%	Medium risk	Low risk
Chemical and pharmaceutical industry	1%	Low risk	Low risk	Health Care	94%	Low risk	Low risk
				Materials	4%	High risk	Medium risk
				Industrials	2%	Medium risk	Low risk
Other sectors	7%	Low risk	Medium risk	Financials	43%	Low risk	Low risk
				Consumer discretionary	19%	Low risk	Medium risk
				Other industries	16%	N/A*	N/A*
				Industrials	12%	Medium risk	Low risk
				Materials	9%	High risk	Medium risk
				Real estate	1%	Low risk	High risk
SME	21%	N/A*	N/A*	Other industries	100%	N/A*	N/A*
Government and municipal institutions	2%	N/A*	N/A*	Public sector	100%	N/A*	N/A*

Risk level  
■ High risk    ■ Medium risk    ■ Low risk    ■ N/A\*

\* The risk assessment for the mentioned sectors and industry groups was not performed due to lack of data on potential effects of climate change, GHG emissions and studies describing climate risks.

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## Contact information

Sovcombank PJSC

Mailing address

46 Prospekt Tekstilschikov, Kostroma, 156000

Phone number

8 800 200 66 96 (for calls within Russia)

+7 495 988 00 00 (for calls from Moscow and international calls)

Email

[esg@sovcombank.ru](mailto:esg@sovcombank.ru)

Website

[sovcombank.ru](http://sovcombank.ru)