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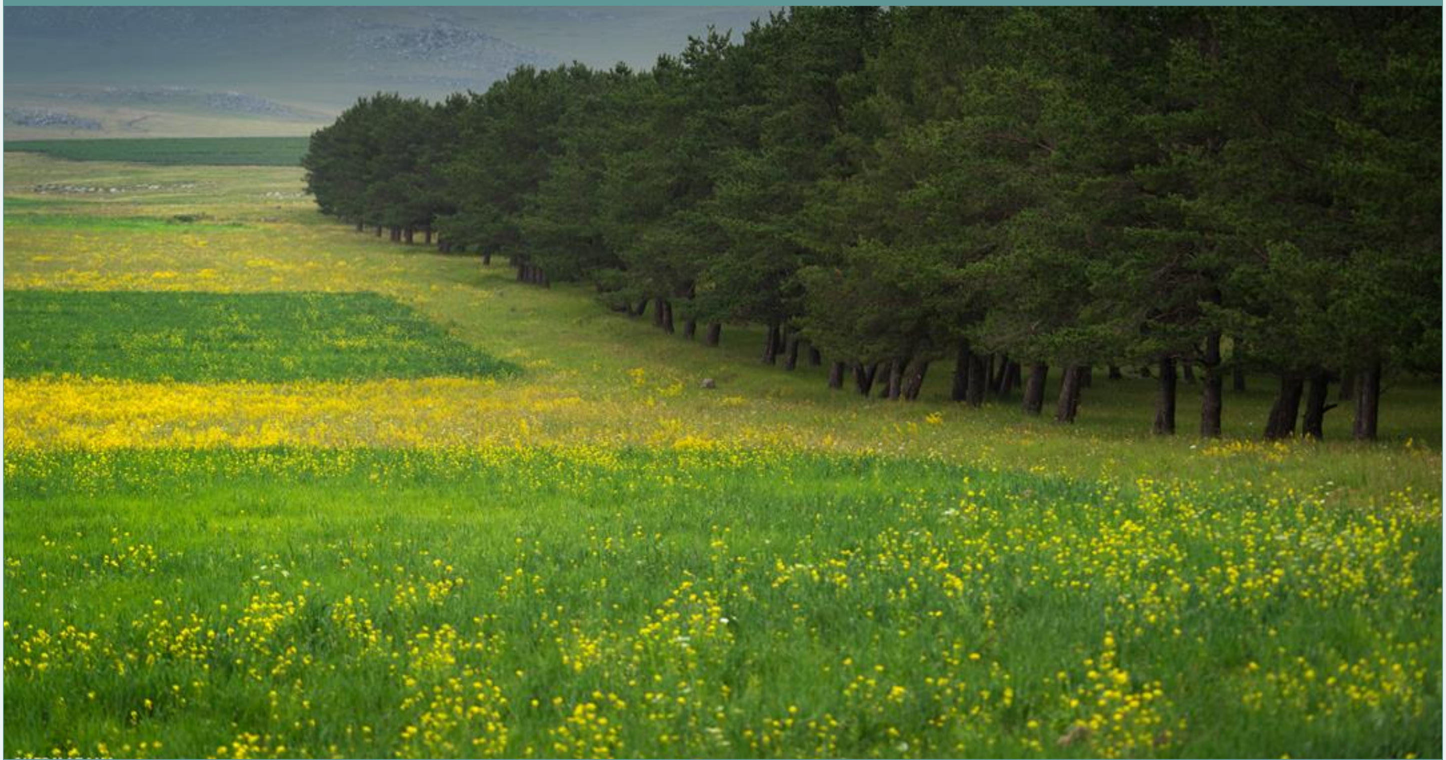
National Bank of Georgia



Sustainable Finance in Georgia

Status Report
2022

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SUSTAINABLE FINANCE IN GEORGIA

STATUS REPORT

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I. Overview of Sustainable Finance Regulations and Policies in Georgia

NBG's Sustainable Finance Framework – brief overview

The sustainable development challenges that the world is increasingly facing require urgent actions to adapt public policies to this new reality. All of this inevitably calls for policy reforms to mobilize finance for economic growth that is green, stable, and inclusive. The financial system has a key role to play in this process, as there is no sustainable development without sustainable finance - be it public or private. Reorienting private capital to more sustainable investments requires a shift in how the financial system works. This is necessary if we want to achieve more sustainable economic growth, ensure the stability of the financial system, and foster more transparency and long-termism in the economy.

In order to ensure financial stability and support sustainable development, it is essential to incorporate environmental, social and sustainability issues in the central banks' policies. The National Bank of Georgia (NBG), as the central bank of the country, supports strengthening the role of the financial sector in the sustainable development of the country and for this purpose develops a framework for Sustainable Finance (SF). This framework implies the integration of Environmental, Social, and Governance (ESG) issues into financial decision-making of the financial sector, managing ESG-related risks, and reorientation of financial flows to the projects that have positive environmental and/or social effects. All of these contribute to long-term economic sustainability and financial stability.

In 2019, the NBG launched the Roadmap for Sustainable Finance in Georgia as the main policy document. The Roadmap summarizes all the possible actions that the NBG intends to implement during 2019-2022 with the corresponding timeframe. The ultimate goal of this roadmap is to provide a credible, predictable, and stable regulatory framework and prepare the market for transitioning to sustainable finance.

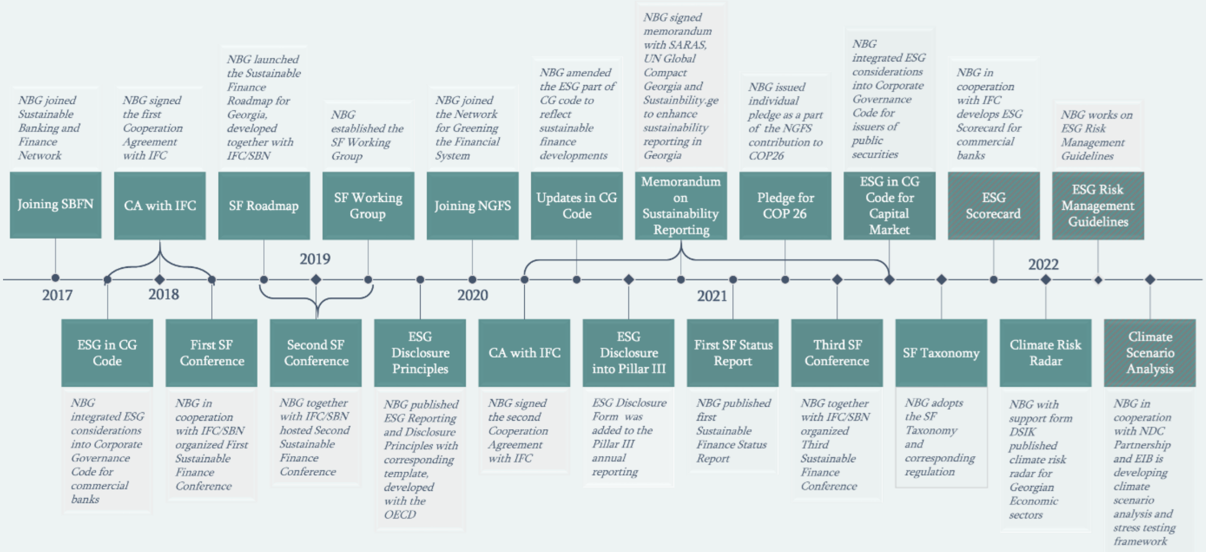
The actions listed in the Roadmap are grouped under four main pillars each of them serving different goals set out in the action plan.

Pillars of the SF Roadmap:

- I — Support capacity building and increase awareness
- II — Guide the financial flows towards sustainable development
- III — Ensure the incorporation of ESG into risk management and decision-making of financial institutions
- IV — Support transparency and market discipline

Most of the actions outlined in the roadmap are already implemented or in the development process. Diagram 1 summarizes the main actions that the NBG has taken over the past few years. The NBG continues developing SF framework and in 2023 plans to publish a new roadmap that will outline the action plan for the upcoming years.

Diagram 1. NBG's Sustainable Finance Framework Implementation



Source: NBG

The development of the SF Framework and the implementation of the action plan is carried out with collaboration and support from various international organizations, including International Finance Corporation (IFC), IFC-supported Sustainable Banking and Finance Network (SBFN), Organization for Economic Cooperation and Development (OECD), Finance in Motion, Green for Growth Fund (GGF) Technical Assistance Facility, German Sparkassenstiftung for International Cooperation (DSIK), NDC Partnership, European Investment Bank (EIB). Coordinating with financial institutions through the Sustainable Finance Working Group and other local stakeholders, including various ministries, is also a part of the process. Apart from that, the NBG has been an active member of Sustainable Banking and Finance Network (SBFN) since 2017 and the Network for Greening the Financial System (NGFS) since 2020. At this stage, the NBG has an appointee at the NGFS's Workstream on "Scenario Design and Analysis" and a representative at the plenary. At SBFN, the NBG is a part of the Measurement Working Group and one of two co-chairs of Data & Disclosure Working Group. During these years, the NBG has learned from and shared its national sustainable finance development experiences with other SBFN members. In November 2021, the NBG moved to the advancing stage of the SBFN progression matrix, which measures the progress of SBFN member countries in promoting sustainable finance. This advancement was the result of the actions undertaken by the NBG toward the development of the sustainable finance framework in Georgia.

Policy and Regulatory Highlights from 2021-2022

The NBG continues developing a sustainable finance framework and implementing the action plan outlined in the Roadmap. The list of activities implemented in 2021-2022[1], as well as some ongoing projects, include:

- ✓ Introduction of the Sustainable Finance Taxonomy – The NBG, in cooperation with various local and international experts and stakeholders, developed the Sustainable Finance (SF) Taxonomy, which was published in August, 2022. The SF Taxonomy adopts a broad definition of sustainable finance and provides a classification system for identifying activities that deliver on key climate, green, social or sustainability objectives. It is composed of green and social taxonomies. The green taxonomy provides a list of activities that aim to achieve environmental objectives and contribute to the development of a green economy. On the other hand social taxonomy proposes a list of categories focused on achieving social objectives primarily but not exclusively for the target population. Apart from that, green/social activities that have social/green co-benefits are considered as sustainable activities. SF Taxonomy is consistent and aligned with international best practices and principles, however, it is also tailored to the features of the Georgian economy and financial sector. The primary purpose of the Taxonomy is to support the development of a sustainable finance market and consequently contribute to the country's sustainable development.
- ✓ Adoption of the Sustainable Finance Taxonomy Regulation – In addition to publishing the Sustainable Finance Taxonomy, the NBG also adopted a Regulation on Loan Classification and Reporting according to the Sustainable Finance Taxonomy (Taxonomy Regulation). The Taxonomy Regulation formally defines green, social and sustainable loans and imposes reporting requirements for commercial banks on taxonomy-aligned loans. According to the Regulation, starting from 2023, the commercial banks shall only refer to the loan as green, social or sustainable if it complies with the technical criteria set out in the SF Taxonomy. The banks are also required to submit a monthly report on green loans through the Green Loan Monthly Reporting Form defined by the Taxonomy Regulation. Additionally, disclosure of green/social/sustainable loan-related information through ESG Reporting and Disclosure Form, which is part of the Pillar 3 annual report, should comply with the Taxonomy Regulation. All of these will ensure the availability of consistent and comparable data on green loans in the Georgian financial sector and support sustainable finance market development in Georgia.
- ✓ Development of Taxonomy Screening and Reporting Tool - In order to support the commercial banks in implementing the SF Taxonomy, the NBG, with financial support from the Green for Growth Fund (GGF) and technical assistance from

[1] The list of activities implemented during 2020-2021 is presented in the Sustainable Status Report 2021.

PricewaterhouseCoopers (PwC), is developing a Taxonomy Screening and Reporting Tool. The Tool is created in Microsoft Access and offers an easy way to check the compliance of the loan with the technical criteria set out in the Green Taxonomy. Based on that, the Tool indicates whether the loan can be classified as a green loan or not. The Tool can also be used as a reporting tool to generate different types of reports. This feature will support financial institutions in meeting reporting requirements set by the NBG in the Taxonomy Regulation. The NBG also supports financial institutions in the Taxonomy adoption process through consultations, training, and technical assistance.

- ✓ Publication of the Report on Climate-related Risk Radar – In July 2022, the NBG, in cooperation with German Sparkassenstiftung for International Cooperation (DSIK), published the report on Climate-related Risk Radar for Georgian Economic Sectors and its possible application for the Financial Sector. The report assesses the exposure of major economic sectors to climate-related risks and develops a climate risk scorecard. The risk radar covers both acute and chronic physical climate risks as well as transition risks. Other ESG-related risks are also considered but from a more high-level perspective. The scoring systematic of the risk radar has been applied to all main sectors in Georgia classified according to the NACE sector codes. This assessment has been conducted in a two-step process with initial desk research followed by a discussion and review workshop with local experts. After the sectors that are most affected by either physical climate risks or transition climate risks, or both are identified, commercial banks' exposures to these high-risk sectors are assessed using a heat map. The description of the methodology, detailed results and possible application are presented in the final report that is available on the NBG webpage.

- ✓ Issuing an Individual Pledge for COP 26 – In February 2020 the NBG became a member of the NGFS. Acknowledging the significance of addressing climate-related risks for ensuring macroeconomics and financial stability and understanding the importance of following the NGFS recommendations in this process, the NBG issued an Individual Pledge as a part of NGFS contribution (NGFS Glasgow Declaration) to the 2021 United Nations Climate Change Conference (COP26). The pledge outlines the main actions that the NBG commits to implement to follow the recommendations presented in the NGFS report A Call for Action. These include analyzing climate-related risks to financial institutions and building awareness about these risks; performing the climate scenario analysis; supporting efficient management of ESG risks among the financial institutions, etc. Most of these activities are either already implemented or ongoing.

- ✓ Introduction of the CG Code for Issuers of Public Securities – Proper governance of ESG issues is particularly important for the successful and effective development of sustainable finance. With this aim, the ESG considerations were incorporated in the Corporate Governance (CG) Code for Issuers of Public Securities. Sustainability related requirements include the incorporation of ESG issues into the entity's strategy, risk management framework, as well as ESG disclosure requirement. The code was developed with the active cooperation and involvement of the World Bank and IFC. It is based on international best practice. The CG Code entered into force on January 1, 2022.

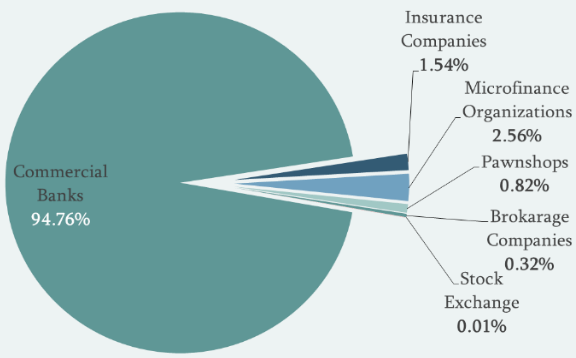
- ✓ Hosting Annual Sustainable Finance Forum – In November 2021, the NBG hosted an online Sustainable Finance Forum within the scope of the Sustainable Finance Roadmap. The event was organized in cooperation with IFC and SBFN with the support of the Swiss State Secretariat for Economic Affairs (SECO). The online forum was attended by European and Central Asian central banks and financial market regulators, representatives of SBFN member countries, IFC experts, and other stakeholders. This forum is the third event hosted by the NBG in partnership with the IFC/SBFN. The first meeting was held in 2018 and this has since become an annual event, a platform for fruitful discussions between various stakeholders on the development of sustainable finance in Georgia and other countries in the region. Sustainable Finance Forum will be held again this November in Tbilisi and will cover the latest developments in sustainable finance in Georgia and the region.
- ✓ Development of the ESG Risk Management Guidelines – In 2022 the NBG started developing ESG Risk Management Guidelines. The NBG already set ESG risk management requirements for commercial banks through the Corporate Governance Code. The Guidelines will serve as a guide for commercial banks and will outline the minimum steps that the banks need to follow in order to conduct proper management of ESG related risks. The Guidelines will be consistent with the best international practice, and will also take into account practices that are currently used by the local financial institutions. The Guidelines are expected to be finalized by the end of 2022.
- ✓ Conducting Climate Scenario Analysis for Georgian Financial Sector – The NBG has started working on climate scenario analysis. With the financial support from EIB through the NDC Partnership, the NBG, together with international experts, is using NGFS Climate Scenarios as a reference to develop climate scenarios for Georgia. The vulnerability of the commercial banks under these different scenarios will also be part of the scenario analysis. The results will be utilized further to perform climate stress testing, which is planned for the next year.
- ✓ Development of ESG Scorecard for Commercial Banks – The NBG, in cooperation with IFC, is developing the ESG Scorecard for commercial banks, which uses a scoring methodology to measure the banks' ESG-related practices and performance based on a number of ESG indicators. The goal of such rating system is to develop a comparable, consistent and sound system for evaluating the implementation of good ESG principles in the banks and to identify weakness and challenges and design polices to address them. The ESG Scorecard will serve as a progress measurement tool which will monitor and evaluate the steps taken by the financial institutions toward sustainable finance.

II. Overview of Sustainable Finance Market Development in Georgia

The financial sector in Georgia is mainly comprised of commercial banks (see Diagram 2). Currently, there are fourteen commercial banks holding almost 95% of total assets in the financial sector. Apart from that, the concentration is high, with the two largest banks accounting for around 76% of total assets. While the share of microfinance institutions (MFIs) is quite small, they play an important role, especially in financing SMEs and access to finance in rural areas. While the insurance market has been growing in recent years, it still has a relatively small share in the total assets of the financial sector.

Taking these characteristics of the Georgian financial system into account, the NBG's sustainable finance policies and regulations are currently mainly directed at commercial banks. However, the NBG also acknowledges the importance of the capital market for scaling up sustainable finance and thus, includes actions dedicated to capital market participants in its SF action plan.

Diagram 2. Structure of the Georgian Financial Sector by Assets, Dec. 2021



Source: NBG

Where the commercial banks stand in terms of ESG – evidence from ESG Reporting

The Corporate Governance Code for Commercial Banks sets the mandatory ESG disclosure requirements, while the "Regulation on Disclosure Requirements for Commercial Banks within Pillar 3" defines the ESG Reporting Form as a part of the Pillar 3 Annual Reporting and refers to the NBG's ESG Reporting and Disclosure Principles for guidance.

In 2022 commercial banks filled out the ESG forms for the second time. Reports from 2021 and 2022 are now available on the NBG's webpage. This section summarizes the main findings from these forms and highlights Key Performance Indicators (KPIs) on ESG for the Georgian financial system[2]. The disclosed information includes qualitative information regarding business model, policies and due diligence, risk management, and quantitative information on the KPIs related to different ESG issues.

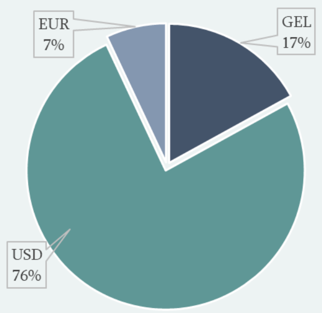
Analysis of the ESG related information from thirteen commercial banks shows that the ESG practices vary across the institutions. There are few commercial banks that are quite advanced in terms of sustainable finance and ESG risk management practices, and they also have other social and environmental policies in place. On the other hand, some banks have not yet implemented the ESG policies but are in the process of developing or plan to develop their ESG policies in the near future. Detailed results separately on E, S and G are presented below.

E - Environmental

The information from the ESG reporting forms indicates that the majority of the commercial banks do not have a definition or classification system for green loans and thus, do not have data on it. However, we see some improvement in this regard, compared to previous year more banks provided green loan data and some of them updated and revised the numbers. Out of thirteen commercial banks, seven banks provided data on green loans in 2022. Among these seven banks, most do not have a formal definition or classification system for green loans and only include loans related to energy efficiency and renewable energy projects in their reporting.

In 2021, the reported volume of green loans issued amounted to around GEL 470 million (US $152 million[3]). It is a 73%[4] increase compared to green loans issued in 2020, excluding exchange rate effect. Most of the loans issued in 2021 are still denominated in USD (see Diagram 3). The share of green loans in total loans issued in 2021 is 1.2% that is 0.3 pp higher compared to the previous year. Among those banks that provided data on green loans, the share of green loans in the total loans issued during 2021, on average, was around 4%, ranging from 0.4% to 8%.

Diagram 3. Currency Decomposition of Green Loans Issued in 2021



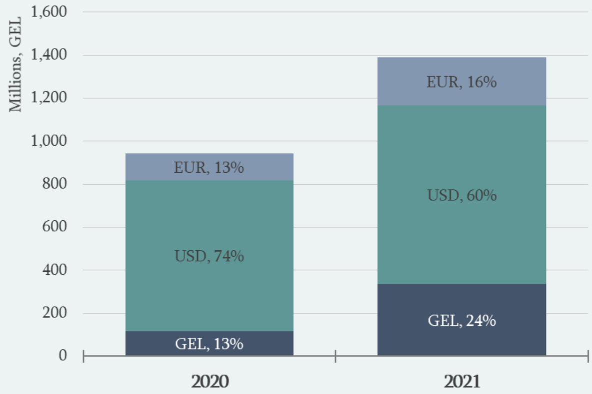
Source: NBG

[2] For more detailed information regarding each commercial bank, please visit: https://nbg.gov.ge/en/financial-stability/esg-reporting-and-disclosure
[3] The value is calculated using the end of Dec. 2021 Gel/USD and Gel/EUR exchange rates.
[4] The increase is partly due to the fact that more commercial banks started to disclose data on green loans and some banks also improved/revised the reporting.

As for the total amount of green loans outstanding as of the end of 2021, it stands at around GEL 1.4 billion (US $449 million) (see Diagram 4). The stock of green loans increased by 48% in 2021 compared to the previous year, excluding exchange rate effect. The share of USD denominated green loans decreased compared to the previous year and now stand at 60%. As of the end of 2021, the share of green loans in the total outstanding portfolio is 3.2% compared to 2.5% in 2020. At the bank level, on average, share of green loans is around 5%, with the highest share of around 15%.

It should be noted that given the fact that most of the banks did not report green loans, as they do not have green loan definitions, these numbers are underestimated. Apart from that, for the most of the commercial banks that reported green loans, data only included loans related to energy efficiency and renewable energy projects. This, once again, indicates the need for a common classification system and highlights the importance of having a Green Taxonomy. Given the NBG approved the SF Taxonomy and associated regulation, which will enter into force from January 2023, green loan figures are expected to change and become more accurate and consistent.

Diagram 4. Total Green Loans Outstanding, Dec. 2021 (excluding exchange rate effect)



Source: NBG

As of the end of 2021, none of the commercial banks has ever issued green/social or sustainable debt securities.

In terms of environmentally friendly activities, most banks have initiated some practices, mostly related to replacing vehicles with internal combustion engines with hybrid or electric cars and improving the energy efficiency of their offices and buildings. Apart from that, the majority of the commercial banks have waste management policies in place, mainly related to recycling, reducing, and separation. Out of thirteen banks, five banks disclosed data on Greenhouse Gas (GHG) emissions (only three banks provided this information last year), and only one bank has a target set in this regard.

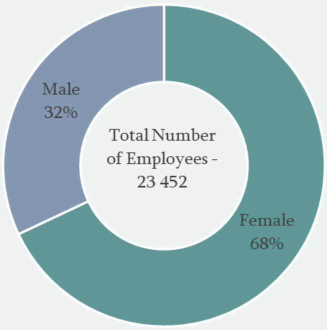
S - Social

The social part of the KPIs includes questions related to diversity in the workplace, training and education, customer privacy and satisfaction, workplace health and safety and other related topics.

By the end of 2021 there were around 23.5 thousand people employed in the Georgian banking sector (see Diagram 5). Compared to the previous year, employment in the banking sector only increased negligibly, by 96 people. In 2021 the average employee turnover rate[5] was 17% which is 5 percentage points higher compared to 2020. There have been some outliers with a turnover rate as low as 6-7% and as high as 27-29%.

In terms of gender diversity, as of the end of 2021, 68% of all employees were women that is one percentage point increase compared to 2020. This result is relatively similar across all commercial banks, with the lowest share being 50% and the highest at 71%. However, the share of females in senior management (board of directors, supervisory board) stands at a lower level and is 24%, on average. Even though there have been some changes across commercial banks, on average, the situation remained the same compared to the previous year. Apart from that, in this case, the difference among banks is more apparent – there are some banks with less than 15% of females in the senior management, while there are some outliers with 50-60%. As for the gender structure at the middle management level, by the end of 2021, on average, women held 45% of these positions. The numbers are comparable across banks.

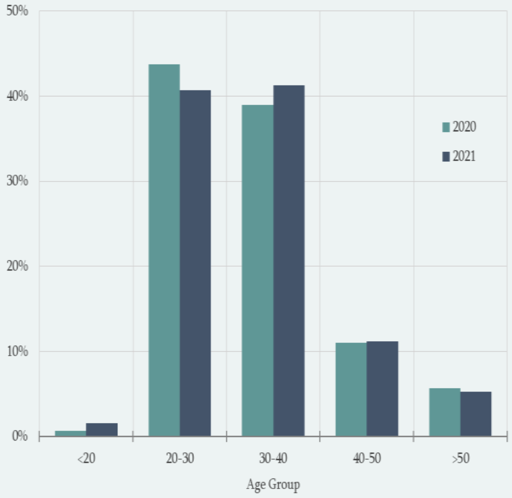
Diagram 5. Gender Diversity in the Georgian Banking Sector, Dec. 2021



Source: NBG

In the Georgian banking sector, as of the end of 2021, the highest share of employees are within the age groups of 20-30 and 30-40 with 40.7% and 41.4% shares respectively (see Diagram 6). Age distribution has a similar pattern across commercial banks in Georgia and has remained almost the same compared to the previous year. Regarding the employment of people with disabilities, only two banks, compared to four in 2020, indicated positive numbers, and the share in the total employment is below 1%. On the other hand, nine banks specified that at least some of their branches are fully or partially adapted and have special facilities and dedicated infrastructure for customers with disabilities. There has not been any significant improvement in this regard since 2020.

Diagram 6. Age Structure of Employees in the Georgian Banking Sector, Dec. 2021



Source: NBG

[5] annual turnover rate = 100*(number of employees who left)/ ((beginning + ending number of employees)/2)

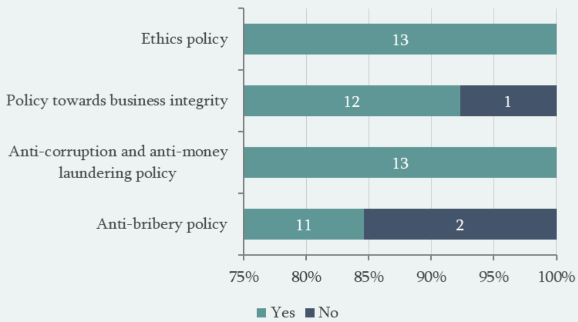
During 2021, all commercial banks have provided training for their employees, however, the coverage varies. There are few banks where only 20% or fewer employees have attended the training. More than half of commercial banks have organized training for 70% or more of the employees, while some of them even covered the whole personnel. The difference regarding average expenses on training per employee is also evident. The expenses also depend on the type of the trainings, since some banks mainly offered internal trainings, which are less costly, while others provided both internal and external trainings for their employees.

In terms of workplace health and safety, all banks indicated that they have corresponding policies and procedures in place. Such policies include Occupational Safety Management Plan, Labor safety policy, Emergency action plan, among others. Apart from this, training on fire safety, emergency response, and other occupational safety issues is provided to the employees on a regular basis. Amid the recent pandemic, banks also developed Covid-19 related policies as part of workplace safety.

G – Governance

The information provided in the ESG reporting forms indicates that nine out of thirteen commercial banks have a designated officer or body responsible for overseeing environmental and social policies and practices. Apart from that, with only a couple of exceptions, almost all banks reported having some ESG policies and procedures. In most cases, it is related to ESG risk management practices. However, some banks have also incorporated ESG consideration into their strategy. Moreover, results show that if there is an ESG policy in a bank, the supervisory board or board of directors approves it. Some banks have also established processes for consultation between stakeholders and the board of directors or supervisory board on environmental and social topics.

Diagram 7. Number of Commercial Banks with Corresponding Policies in place, Dec. 2021



Source: NBG

Besides the ESG risk management policies, most of the banks have also established policies related to ethics, business integrity, anti-bribery, etc. (see Diagram 7). While ethics policy and anti-corruption and anti-money laundering policies were in place last year as well, more banks adopted other policies during 2021.

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