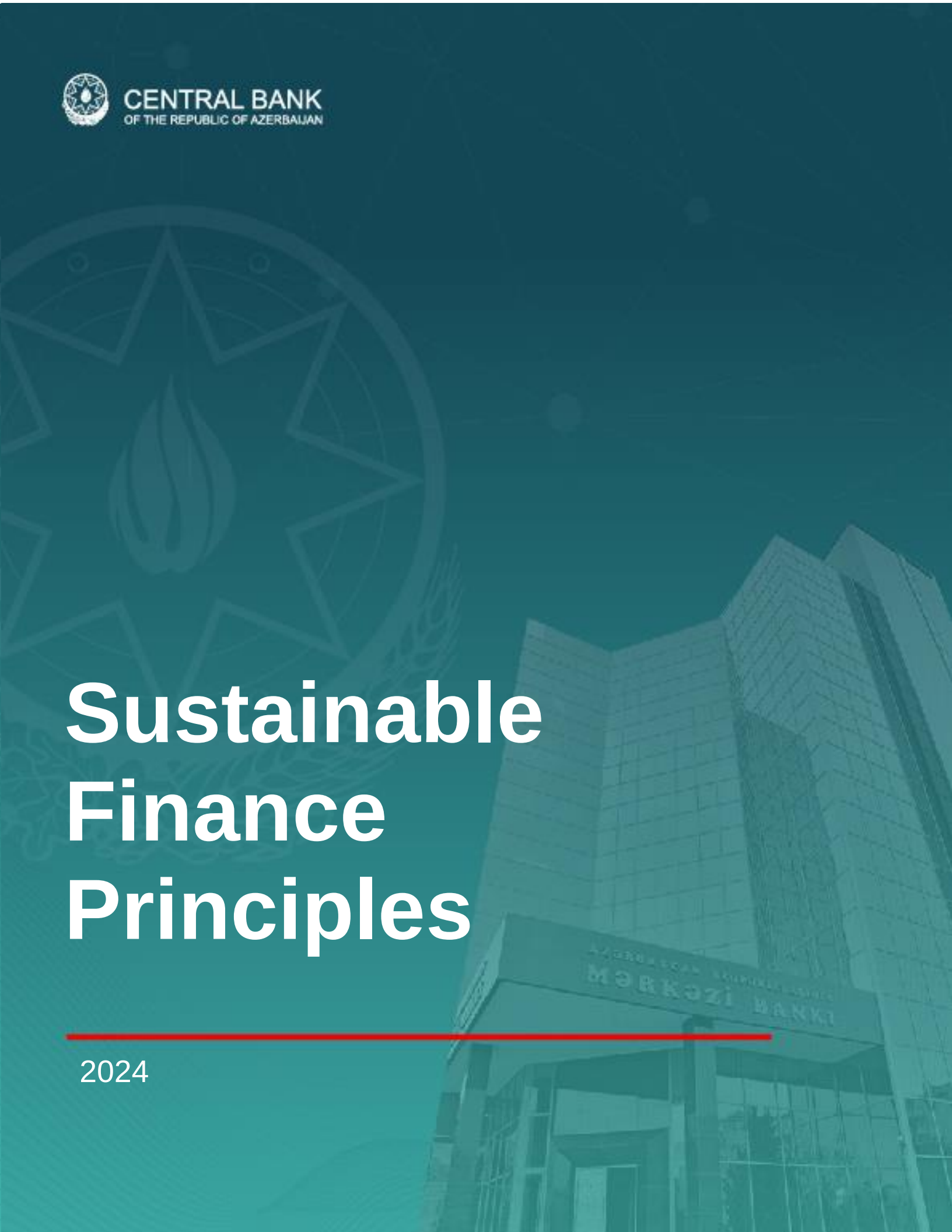
CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

Sustainable Finance Principles

2024



Contents

Abbreviations and Acronyms

CBAR	Central Bank of Azerbaijan Republic
ECB	European Central Bank
ISSB	International Sustainability Standards Board
IFC	International Finance Corporation
UN	United Nations
ESG	Environmental, Social and Governance
SDG	Sustainable Development Goals
WB	World Bank
SBFN	Sustainable Banking and Finance Network
BoD	Board of Directors
TCFD	Task Force on Climate-related Financial Disclosures
NGFS	Network for Greening the Financial System
SB	Supervisory Board
MB	Management Board
GAI	Global Accountability Initiative

Definitions

- **Sustainable finance** refers to financing and the associated institutional and market infrastructure that help deliver sustainable and balanced economic growth aimed at achieving the 17 SDGs adopted by the UN. In other words, sustainable finance is the process of taking due account of ESG factors in the decision-making of financial institutions.
- **Climate-related risks** refer to financial risks that financial institutions may face as a result of extreme weather conditions and the transition to a low-carbon economy. Climate-related risks can be decomposed into two broad categories, namely ***physical risks*** and ***transition risks***:
  - ***Physical risks*** are financial risks resulting from an increase in the frequency and severity of sudden natural events (floods, droughts, forest fires, landslides, storms, *ets*.), and gradual changes in climate indicators (temperature rise, increased precipitation, sea level rise, *etc*.)
  - ***Transition risks*** are financial risks that can arise in the process of adapting to a low-carbon economy.
- **Environmental risks** include financial risks arising from environmental issues such as mitigation of and adaptation to the adverse effects of climate change, environmental pollution, protection of natural resources and biodiversity, and addressing water scarcity.
- **Social factors** include equality, inclusion, data protection and confidentiality, labor standards, investment in human resources, poverty eradication, social welfare of the society, customer satisfaction, and other issues.
- **Governance factors** include such issues as organizational structure, top management compensation policies, audit committee structure, employee relations and *etc.*
- **Adaptation to climate change** refers to actions taken to adjust climate change and its impacts. Examples of such actions include building flood control dams, setting up an early warning system for cyclones, switching to drought-resistant crops, *etc.*
- **Climate change mitigation** involves actions to reduce greenhouse gas emissions.
- **Environmental and social risk management** involves integrating environmental and social risk management measures and standards into the financial institution's core business.

Introduction

Reducing greenhouse gas emissions and transitioning to a low-carbon and circular economy creates both risks and new investment opportunities for the economy and financial institutions. To support the development of a sustainable financial system integrating climate-related and environmental, as well as social and governance factors, and to ensure financial stability, CBAR adopted the "Sustainable Finance Roadmap: 2023-2026" (Roadmap) in February 2023.

The Sustainable Finance Principles has been developed within the framework of the Pillar 2 of the Roadmap *"Enabling environment for sustainable finance flows"* This document refers to IFC's Performance Standards on Environmental and Social Sustainability, and Corporate Governance Matrix, the TCFD Recommendations, the NGFS Recommendations, the Equator Principles, ECB's Guide on Climate-Related and Environmental Risks, the WB Executive Board's Assessment Framework and Methodology, as well as the experience of other advanced country central banks and financial market regulators, and taking into account local financial market conditions. This document seeks to enhance the expertise and promote best practices on managing climate-related and ESG risks, assessing opportunities and seamlessly integrate these considerations into their operational strategies within financial institutions, including banks, non-bank credit institutions, investment companies, insurance companies and also local branches of foreign financial institutions.

The sustainable finance principles cover four directions - (i) business strategy formulation, (ii) corporate governance, (iii) risk management and (iv) information disclosure (Box 1). Sustainable finance principle for each direction consists of a section reflecting its importance, expectations detailing its application, and practical questions. In addition, "Best practice" boxes highlight the best practices form international experiences. As complementary documents to the application of the principles of sustainable finance, detailed guidance documents on risk management and disclosure of information related to sustainable finance will also be made available to financial institutions.

The sustainable finance principles support CBAR's policy on transitioning to sustainable finance and are intended to serve as recommendations. It is expected that systemically important financial institutions will be exemplary in applying the sustainable finance principles and expectations of sustainable finance.

Box 1. Sustainable Finance Principles

Principle 1. Financial institutions assess the short-, medium- and long-term impact of climate-related and ESG risks and opportunities on their operations and the business environment in which they operate and integrate them into their business decisions.

Principle 2. Financial institutions' SBs (BoDs) ensure that climate-related and ESG risk management and opportunity assessment are integrated in the corporate governance system and determine the appropriate allocation of roles and responsibilities to ensure adequate decision-making.

Principle 3. Financial institutions integrate climate-related and ESG risks into their risk management and internal control framework and capital planning processes.

Principle 4. Financial institutions determine relevant indicators taking into account the CBAR's requirements for climate-related and ESG risks, and disclose them in the manner specified by the financial markets regulator.

CBAR will continue to take regular measures to improve the regulatory framework for climate-related and ESG risks and support financial institutions in this direction, taking into account advanced international practices and local market conditions. The sustainable finance principles will be integrated into the regulatory framework as their uptake by financial institutions deepens, also taking into account the Action Plan defined in the Roadmap and local market conditions.

Sustainable Finance Principles

Financial institutions integrate the sustainable finance principles into their business strategy formulation, corporate governance, risk management and disclosure processes.

With the implementation of the sustainable finance principles, it is aimed to achieve the following results:

1. The financial institution's SB (BoD) sets the strategic vision and goals for managing climate-related and ESG risks. The BoD ensures that the goals are achieved and that adequate resources are available to do so;
2. Financial institutions provide adequate corporate governance to manage climate-related and ESG risks, and to assess opportunities (roles and responsibilities, internal rules and methodological instructions, performance-based rewarding, audit procedures, disclosure of information, etc.);
3. Financial institutions ensure that policy, strategy, risk indicators, processes and procedures are in place to manage climate-related and ESG risks;
4. Financial institutions disclose climate-related and ESG risks and opportunities in line with best practices and international standards.

1. Business Strategy

Principle 1. Financial institutions assess the short-, medium- and long-term impacts of climate-related and ESG risks and opportunities on their operations and the business environment in which they operate and integrate them into their business decisions.

Importance of the principle

Climate-related and ESG risks, in turn, can have an impact on the factors that shape the business environment in which the financial institution operates - *macroeconomic indicators, competitive environment, regulatory and supervisory framework, socio-demographic indicators, geopolitical conditions.* Physical and transition-related risks are expected to significantly impact various economic activities and the financial system. While some physical and transition risks are already manifesting themselves, the negative impact of climate change will continue to increase over time. This impact may

manifest itself directly through a reduction in the profitability of the financial institution and the depreciation of its assets, or indirectly through changes in the macro-financial environment.

Therefore, the impact of climate-related and other ESG risks and opportunities, as well as the financial impact on the financial institution's business strategy and the sustainability and viability of the business model need to be assessed and addressed (see Chart 1). Integrating climate-related and ESG risks into business strategy will result in a better control mechanism against these risks in financial institutions' core business activities.

Moreover, a financial institution's activities may have a direct impact on the environment, ecology and society. In its strategic vision, a financial institution may consider mitigating negative impacts and transforming them into positive ones through innovative solutions in the following directions:

- efficient use of energy and water resources;
- efficient management of waste materials;
- meeting labor market and other social requirements;
- alignment with the country's national strategic development priorities.

Expectations regarding implementation

Expectation 1.1. Financial institutions determine how climate-related and ESG risks and opportunities impact their business strategy and business model in the short, medium and long term.

Financial institutions assess climate-related (including key physical and transition risk drivers[1]) and ESG risks and opportunities across business lines, geographies, and products and services. These assessments determine the financial institution's sensitivity to climate and environmental risks and the impact on its sustainability. The results of the assessment are incorporated into the business strategy and business model in the following directions:

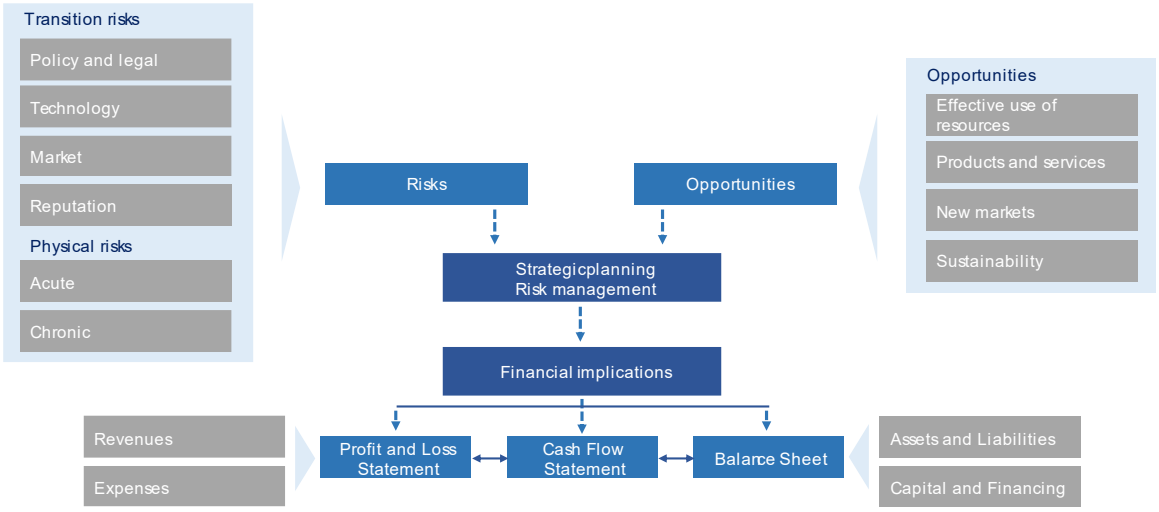
- organizational structure;
- business process and procedures;
- adequate capital level planning;
- product and services;

[1] **Physical risks** include financial losses related to climate change, extreme weather conditions, environmental degradation, air, water and soil pollution, water scarcity, loss of biodiversity and deforestation. Physical risks are classified as "acute" when they occur as a result of extreme events (droughts, floods, storms, *etc*.) and as "chronic" when they occur as a result of gradual events (rising temperatures, rising water levels, resource scarcity, *etc*.). Physical risks can have both direct (property damage, lost productivity) and indirect (supply chain disruption) effects. **Transition risk** is the financial losses associated with the transition to a low-carbon, environmentally clean and sustainable economic model. These financial losses can result from unexpected changes in climate and environmental policy and market sentiment.

- resource planning (financial, human resources).

This is done by stress testing and scenario analysis, as well as by using a judgment-based approach.

<u>Chart 1.</u> Climate-related risks, opportunities and financial impacts



Source: TCFD

<u>Expectation 1.2.</u> Financial institutions integrate climate-related and ESG risks in their business strategy and business model and monitor their implementation through quantitative and qualitative indicators.

Financial institutions can choose to develop a separate strategy to manage climate-related and ESG risks, or integrate it into an existing strategy. In formulating their business strategy, financial institutions take into account sustainable development, climate change and stakeholder expectations.

In order to ensure the effective implementation of the business strategy, the financial institution will define quantitative and qualitative indicators. Appropriate indicators are defined depending on the type of financial institution, as well as for the relevant business lines and at the portfolio level. Examples of such indicators include average mortgage portfolio energy consumption and asset carbon emissions.

<u>Expectation 1.3.</u> The financial institution incorporates the sustainable financial approach in its administrative activities (*e.g.,* using electricity and water in an efficient way, *etc*.).

In order to eliminate the negative effects of their activities on the environment, ecology and society and to increase their positive effects, financial institutions can take a number of actions:

- use and promote the use of alternative energy sources to achieve energy efficiency;
- use and promote the efficient use of water resources;
- provide efficient waste management, as well as paper recycling;
- carry out projects of social importance.

<u>Practical questions for implemention of the principle</u>

In order to implement the principle of business strategy by financial institutions, *a number of practical question examples* are provided:

i. Has the financial institution defined targets and action plans to support the implementation of decarbonization/zero emissions, taking into account national priorities for the socio-economic development of the country and commitments made under international agreements?
ii. Has the financial institution identified the sectors of the economy and the types of economic activities that are exposed to physical/transition risks and the significance of these risks?
iii. Has a business approach been defined for economic sectors and activities likely to be affected by physical/transition risks (should financing of high GHG emitting economic activities be reduced, stopped, continued, *etc.*)?
iv. Are measures in place to communicate the institution's approach to climate-related and ESG risks to clients and relevant stakeholders?
v. Has the impact of physical/transition risks on the financial institution's operations been assessed in light of changes to the business model?
vi. Has the financial institution defined the indicators that will contribute to the implementation of a sustainable financial approach during the establishment of business relationships with the financial institution's clients?
vii. Has an assessment been conducted to identify opportunities to become sustainable financed?
viii. Have systemic climate-related and ESG risks been identified for the financial institution's main activities (lending, investing, *etc*.)?
ix. Has the list of products, sectors and types of activities not recommended for financing by the financial institution (types of economic activities with high GHG emissions) been defined?

x. Has the financial institution's SB (BoD) (or equivalent) set targets for allocating capital to sustainable assets, projects, and relevant industries and activities?

xi. Has the financial institution set goals (*e.g.,* reducing paper use, improving waste management, using water more efficiently, *etc*.) for applying a sustainable financial approach to its operations?

2. Corporate Governance

Principle 2. Financial institutions' SBs (BoDs) ensure that climate-related and ESG risk management and opportunity assessment are integrated in the corporate governance system and determine the appropriate allocation of roles and responsibilities to ensure adequate decision-making.

Importance of the principle

A financial institution's corporate governance system provides information about its business activities and accountability to stakeholders on relevant issues. In light of current challenges, reputational, legal, and financial risks may arise if ESG factors are not taken into account in the financial institution's corporate governance structure. A transparent organizational structure, clearly defined roles and responsibilities, and elements of disclosure about the implementation of ESG principles are part of an appropriate corporate governance system that takes ESG factors into account.

In addition, it is important for a financial institution to assess and encourage the adoption of and compliance with ESG principles by its clients. In doing so, the financial institution protects itself from potential financial losses as well as legal and reputational risks.

Expectations regarding implementation

Expectation 2.1. **To manage climate-related and other ESG risks and assess opportunities, the financial institution determines the division of roles and responsibilities in the organizational structure.**

The financial institution integrates climate-related and ESG risks into its corporate governance system and its internal processes and procedures (*e.g*. loan underwriting, investment decision-making, risk management, *etc.*).

The SB (BoD) has a unique role in the management of climate-related and ESG risks and assessment of opportunities. The SB (BoD) takes into account both short and long term climate-related and ESG risks in the activities of the financial institution (budget planning, financial results, risk indicators,

etc.). Discussion of climate-related and ESG issues will be part of the agendas of existing committees. Thus, taking into account the organizational structure and risk profile of the financial institution, the SB (BoD) provides at least the following:

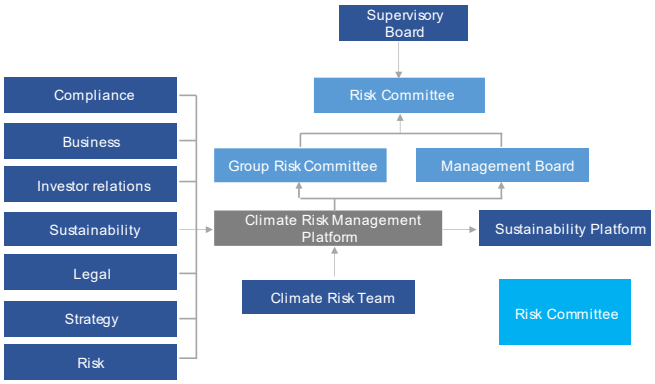
- establish roles and responsibilities for existing committees or form a new committee;
- approve quantitative and qualitative indicators to ensure the regular monitoring of climate-related and ESG risks and their management.
- identify employees responsible for climate-related and ESG risk management and opportunity assessment;
- align the evaluation of responsible employees with the established quantitative and qualitative indicators defined for the management of climate-related and other ESG risks and opportunities;
- determine division of duties and authorities across three lines of defence model:
  - *the first line of defense provides identification, assessment, management, reporting and monitoring of climate-related and ESG risks in business activities at the initial stage;*
  - *the second line of defense assesses the identification of significant climate-related and ESG risks by the structural units carrying out business activities, the effectiveness of mitigating mechanisms used, and risk tolerance.*
  - *the third line of defense, internal audit, evaluates the effectiveness of the first and second lines of defense in addressing climate-related and ESG risks at the level of the financial institution's operations, products, and services.*
- ensure the formation of climate-related and ESG risk reporting system;
- establish a clear, detailed, transparent and written segregation of duties and powers through internal documents, and ensure its operation.

In addition, the SBs (BoDs) of financial institutions include the management of climate-related and ESG risks and the assessment of opportunities among their duties and responsibilities.

Best practice

The following is a model for integrating climate-related risks into the corporate governance and risk management function of a bank operating in the United Kingdom. Given its importance to the business model and the customers it serves, the financial institution has integrated climate-related risk management into its Risk Appetite Statement. The financial institution has established a climate risk team within the second line of defense and appointed a Group Chief Risk Administrator for climate-related risk management at senior management level. To support the work of the Group

Chief Risk Administrator and ensure accountability, a Climate Risk Management Platform has been established, comprising senior business, risk and strategy specialists.



The financial institution's SB approved the Climate Risk Appetite Statement: *"The Bank aims to manage financial and non-financial risks arising from climate change and to reduce emissions in its operations and in the types of activities it finances according to the Paris Agreement."*

<u>Expectation 2.2</u>. The financial institution ensures that adequate resources are available for the management of climate-related and ESG risks and assessment of opportunities.

Through various training programs on climate-related and ESG risks, not only the risk management function, but also all relevant employees (front office staff, human resources staff, *etc*.) are sensitized and their skills are improved by the financial institution. At the same time, in order to make members of the SB (BoD) and executive bodies aware of important innovations and current challenges in this direction, their participation of the related persons in international events, conferences, *etc*. is ensured.

The financial institution develops a database to ensure appropriate internal decision-making on climate-related and ESG risks.

Practical questions for implementation of the principle In order to implement the principle of corporate governance by financial institutions, *a number of practical questions* are provided:

i. Does the SB (BoD) have a clear division of labor, authority, and responsibility for the implementation of green, social, and other sustainable investments?
ii. Has the SB (BoD) defined the division of duties, powers and responsibilities for the purpose of climate-related and ESG risk management?
iii. Does the internal code of ethics integrate ESG factors?
iv. Do the financial institution's policies and procedures address climate-related and ESG factors?
v. Has the SB (BoD) integrated climate-related and ESG factors in its strategy and set the targets?
vi. Does the internal audit plan consider verification of the implementation of ESG-related policies, strategies, targets and *etc*.?
vii. Do the agendas of SB (BoD) meetings include discussion of climate-related and ESG risks, including opportunities?
viii. Is at least one SB (BoD) member aware of climate-related and ESG risks and opportunities?
ix. Do members of the SB (BoD) participate in training programs to increase their awareness of the risks and opportunities associated with climate-related and ESG risks?
x. Are climate-related and ESG risks, including opportunities, included in the self-assessment of SB (BoD) members?
xi. Are climate-related and ESG risks integrated into the "three lines of defense" system?
xii. Has the financial institution established a training program to have the staff adequately trained in climate-related and ESG risk management and opportunity assessment, as well as in sustainable financial instruments?

3. Risk Management

Principle 3. Financial institutions integrate climate-related and ESG risks into their risk management and internal control frameworks and capital planning processes.

Importance of the principle

In carrying out their functions, financial institutions may be exposed to climate-related and other ESG risks as a result of the business activities of their clients. These impacts may result in environmental pollution, damage to human health, disruption of biodiversity, *etc*. Although climate-related and ESG risks have the potential to adversely affect business lines and risk types, there is insufficient information to

determine the magnitude and duration of the impact of these risks. For this reason, a financial institution integrates climate-related and ESG risks into its risk management system. As the exposure of financial institutions to climate and other environmental risks varies by type of financial institution, a financial institution should ensure that sustainable finance principles and expectations are embedded, and risk management tools and methodologies are used appropriately and relevantly in its operations.

Expectations regarding implementation

Expectation 3.1. Financial institutions integrate climate-related and ESG risks into their existing risk management and capital planning systems.

In advanced international practice, climate-related and ESG risks are not classified as a new type of risk, but are assessed according to how they affect traditional types of risk (Table 1). Financial institutions consider climate-related and ESG risk management in the following directions:

- risk strategy;
- risk policy;
- risk appetite statement;
- risk limits;
- relevant internal regulations and procedures to manage risks.

A financial institution's exposure to climate-related and ESG risks will depend on the following factors:

a) type of product and service;
b) type of economic activity and the geographical area where the customer of the financial institution operates;
c) ESG risk management competence and the extent and severity of the resulting potential impact.

Financial institutions shall conduct comprehensive written analyses of the impact of climate and environmental risks on existing risk types. These analyses should cover both on-balance sheet and off-balance sheet activities, as well as financial and non-financial risks.

Table 1. Transformation of physical and transition risks into traditional risk types

Risk types	Physical risks		Transition risks	
	Climate-related	**Environmental**	**Climate-related**	**Environmental**
	▪ Severe weather conditions ▪ Chronic weather conditions	▪ Water shortage ▪ Resource scarcity ▪ Destruction of biodiversity ▪ Pollution ▪ Other	▪ Policy and regulation ▪ Technological changes ▪ Market sentiment	▪ Policy and regulation ▪ Technological changes ▪ Market sentiment
Credit risk	Exposures to relevant economic sectors and/or geographies can lead to defaults and affect loss performance in case of default. Flood risk, for example, may reduce the market value of collateral in a real estate portfolio.		Energy efficiency standards can lead to increased costs and reduced profitability for financial institutions, which in turn can lead to higher probability of default and lower market value of collateral.	
Market risk	Acute physical risk events can lead to high volatility in market expectations and unexpected revaluations and losses across relevant asset classes.		May cause unexpected revaluation of securities.	
Operational risks (reputation risk, legal risk)	Severe weather can cause physical damage to property, branches, and data centers, disrupting the operations of financial institutions.		Changes in consumer sentiment related to climate change and environmental risks can give rise to reputational and legal risks.	
Other risks (liquidity, business model)	To eliminate losses due to physical risks, clients can withdraw funds from the account.		If appropriate adaptation and diversification measures are not taken, it may lead to strategic risk for certain business models.	

Source: European Central Bank

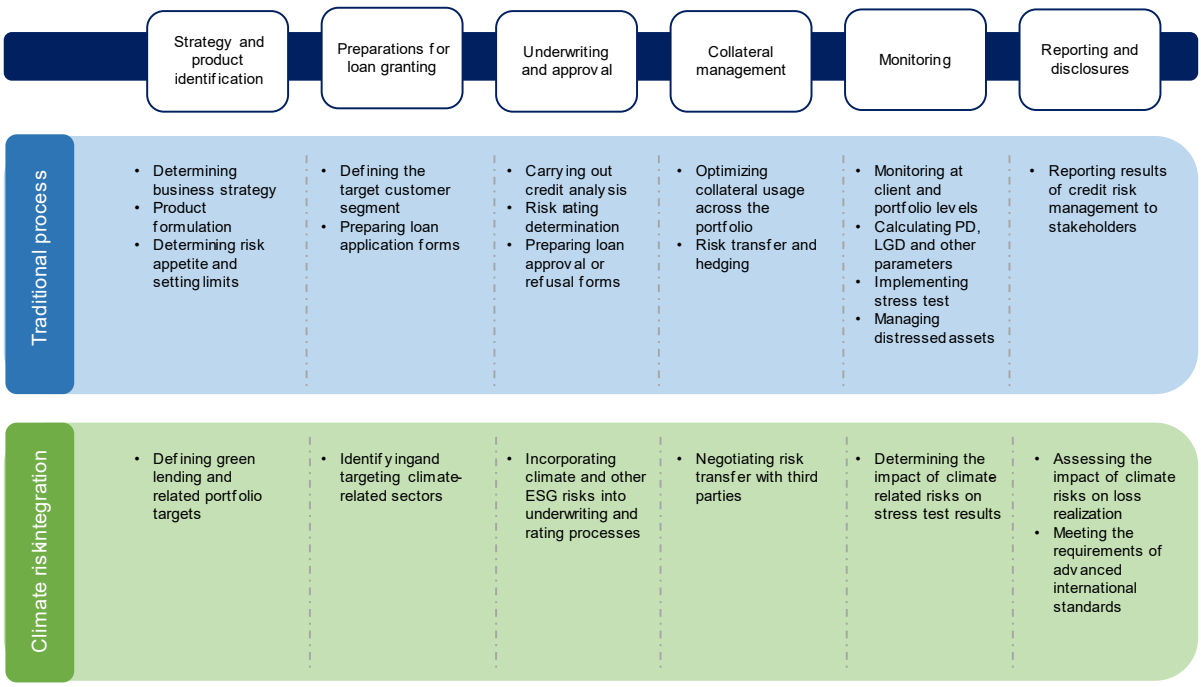
Financial institutions regularly analyze client relationships from a climate-related, environmental and social risk perspective. The integration of climate-related risks into the credit risk analysis process for banks is shown in Chart 2. In the insurance example, insurers consider the impact of significant climate and other environmental risks on their business lines in their risk assessment. For example, climate change may increase the frequency and severity of natural events. This requires a change in the risk models of relevant insurance products.

Best practice

One of Europe's leading reinsurance companies has identified natural catastrophes as one of the most important risks for insurance coverage in property, liability, auto, and other insurance products. The reinsurer's property risk modeling team develops and updates models to account for potential natural catastrophes (floods, tropical cyclones, windstorms, earthquakes).

Another reinsurance company has developed a risk management framework to identify, assess and mitigate potential environmental, social and reputational risks in both investment and underwriting activities. The risk management framework includes guidance on human rights, environmental protection, and more sensitive economic sectors. In addition, it describes in detail where each operation poses a sustainability risk, and a risk score is determined through an assessment using an online tool. Based on the risk score, a decision is made to continue the operation or to continue the operation under certain conditions or suspend the operation, with the involvement of environmental experts, if necessary.

Chart 2. Integrating climate-related risks into the credit risk analysis process



Source: Deloitte Company

The financial institution also considers the management of climate-related and ESG risks within the framework of group risks.

Expectation 3.2. Financial institutions have in place appropriate climate-related and ESG risk management methodologies and tools.

Financial institutions can manage climate-related and ESG risks in a variety of ways:

- define an exclusion list of companies, economic sectors and economic regions whose financing is not provided or restricted by financial institutions.
- define a positive list of environmentally friendly companies, sectors and regions for financing or investing by financial institutions.

Financial institutions use a variety of quantitative and qualitative indicators to determine the significance of risks, depending on the magnitude of the physical and transition risk drivers.

Best practice

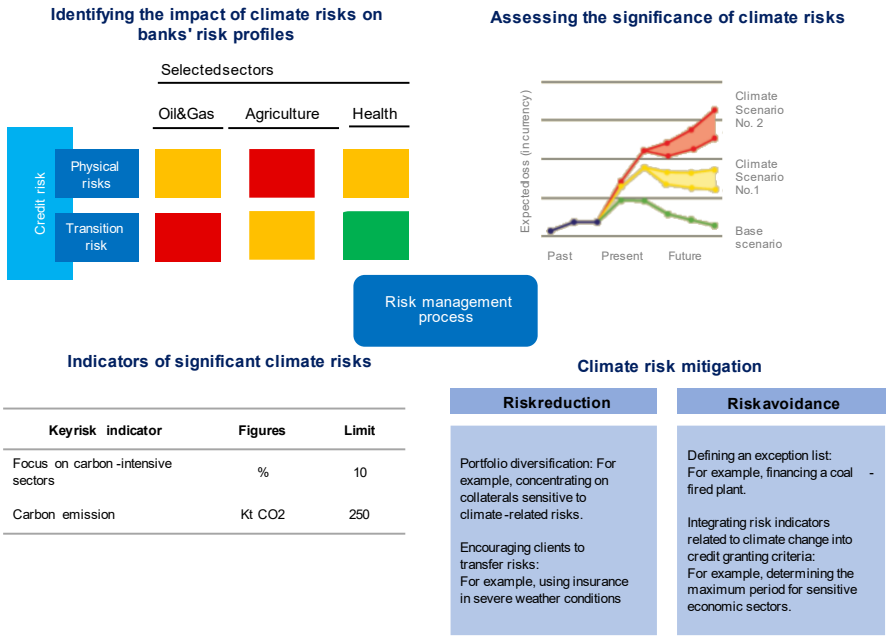
Financial institutions integrate the impact of climate change into their risk management frameworks (Chart 3). A heat map is used to identify potential climate-related risk concentrations. The heat map can be segmented by country/economic sector/geographical area. The segmentation can be based on the following indicators:

- CO2 (and other GHG) intensive industries;
- Collaterals located in areas of high flood risk, *etc*.

Financial institutions develop scenarios to identify short- and long-term risk drivers. In developing scenarios, a number of assumptions are used:

- Impact of climate-related policy changes and technological shocks
- Potential variation across geographic areas, countries and economic sectors
- Time required to implement changes and risks

Chart 3. Integration of climate change impacts into the risk management system



Source: De Nederlandsche Bank (DNB)

In addition, financial institutions are incorporating these impacts into scenario and stress testing analyses to properly assess the impact of significant climate-related and ESG risks. In this regard, financial institutions are developing scenarios for adverse natural events that they may face as a result of physical and transition risks, taking into account the institution's risk profile.

Clients with greater exposure to climate-related and ESG risks are subject to a more detailed and comprehensive assessment, and senior management is more closely involved in the decision-making process as the risk increases. The financial institution shall periodically evaluate the methods and procedures used to assess climate-related and ESG risks, as well as the quality of the data used.

Practical questions for implementation of the principle.

In order to implement the principle of risk management by financial institutions, *a number of practical questions* are provided:

i. Has the financial institution established an appropriate policy, rule, or management information system to address climate-related and ESG risks at the client, product, service, operation, and/or project level?
ii. Does the financial institution monitor climate-related and ESG risks at the client, product, service, transaction, and/or project level on a regular basis?
iii. Does the financial institution carry out regular portfolio-based monitoring of climate-related and ESG risks?
iv. Does the financial institution have systems, processes and procedures in place to monitor credit risk (*e.g*., non-performing assets, loan defaults, *etc*.) in relation to climate-related and ESG risks?
v. Has the financial institution conducted a significant climate-related and ESG risk assessment?
vi. Has the impact of climate-related and ESG risks on prudential requirements during the implementation phase been analyzed?
vii. Has the financial institution integrated climate-related and ESG risks into stress testing and scenario analysis?
viii. Has the impact of climate-related and ESG risks on the financial institution's current risks, risk appetite and risk limits been assessed?
ix. Have relevant guidance documents and/or tools (ESG risk management guide, ESG risk customer assessment, ESG action plan, monitoring template, performance indicators) been developed to integrate climate-related and ESG risks into business decisions?
x. Has the financial institution set targets (performance indicators) for reducing the impact of climate-related risks at the portfolio level?
xi. Has the financial institution integrated climate-related and ESG risks into its risk management framework?
xii. Do the financial institution's risk management policies, strategies and risk appetite integrate climate-related and ESG risks and opportunities?

4. Disclosure

Principle 4. Financial institutions determine relevant indicators taking into account the Central Bank's requirements for climate-related and ESG risks, and disclose them in the manner specified by the financial markets regulator.

Importance of the principle

Disclosure by financial institutions of relevant information on climate-related and ESG risks is considered important for determining the volume of carbon-based assets[2] in the financial sector and thereby ensuring appropriate decision-making when lending, providing investment services and underwriting insurance products.

Financial institutions develop indicators to manage climate-related and ESG risks and to assess opportunities. Both internal decision-making and public disclosure are based on these indicators. In determining the indicators, the financial institutions also consider implementing the principles defined in this document.

It should be noted that international principles and standards for improving climate-related and ESG risk disclosure continue to evolve.

Expectations regarding implementation

Expectation 4.1. Financial institutions disclose information on indicators related to corporate governance, business strategy formulation, integration of risk management and sustainable finance of climate-related and ESG risk management and opportunity assessment.

Examples of these indicators are:

- Organization of SB (BoD) oversight of climate-related and ESG risk management and opportunity assessment;
- Financial institution's identification of climate-related and ESG risks and opportunities in the short, medium and long term;
- Impact of climate-related and ESG risks and opportunities on the business activities, strategy and financial planning of the financial institution;
- Integration of climate-related and ESG risks into identification, assessment and monitoring processes;
- Target indicators established for climate-related and ESG risks and opportunities.

[2] Lending or investing to finance economic activities with high GHG emissions

Best practice

In its 2019 ESG Report, one of the leading banks in the United Kingdom identified six economic sectors with high carbon emissions and transition risks in 2018 to assess the impact of transition risks. In 2019, the bank held more than 3,000 meetings to identify strategies and approaches to manage the impact of climate change. In addition, the bank prepared a survey to study the approach to assessing the impact of climate change and collected information from 750 clients making 34% of the portfolio. The results of the survey enabled the bank to assess its clients' adaptation to changes and the identification of business opportunities.

The financial institution provides information on the indicators it uses in its climate-related and ESG risk disclosures, the methodology used to calculate them, as well as quality indicators and the concepts to which they refer. Financial institutions describe a methodology for assessing the materiality of climate-related and ESG risks in the disclosures. If the financial institution determines that the risks related to climate change are not material, it shall justify this with an appropriate quantitative and/or qualitative assessment.

In line with the TCFD recommendations, it is considered appropriate to disclose information on the directions in Table 2.

One of the key institutional components of the transition to sustainable finance is the disclosure of clear, detailed and comparable information on climate-related and ESG risks by financial institutions.

Practical questions for implementation of the principle

In order to implement the principle of disclosure of information by financial institutions, *a number of practical questions* are provided:

i. Has the financial institution set targets to contribute to the reduction of greenhouse gas emissions?
ii. Do financial institutions disclose information according to the methodology established in international practice (TCFD, ISSB, GAI, *etc*.)?
iii. Do financial institutions publicly disclose information on green, social and other sustainable finance and its outcomes/impacts?
iv. Do financial institutions publicly disclose information on climate-related and ESG risk management?

v. Does the financial institution's annual report include information on climate-related and ESG risks, including opportunities?

Table 2. TCFD Recommendations

Corporate Governance	Business Strategy	Risk Management	Indicators and Targets
Disclose the organization's management of climate-related risks and opportunities	Explain the impact on the organization's business strategy and financial planning if climate-related risks and opportunities are material.	Provide information on the organization's identification, assessment and management of climate-related risks	Disclose indicators and targets for assessing and managing climate-related risks and opportunities, where significant.