



CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

SUSTAINABLE FINANCE SURVEY RESULTS

OCTOBER

2023

Contents

Abbreviations and acronyms

Abbreviations and Acronyms.....	3
Definitions	4
About the survey	5
1. Introduction	6
2. Results of financial market analysis	7
3. Banking sector	9
4. Capital market.....	15
5. Insurance sector	18
6. Conclusion	22

Abbreviations and Acronyms

CBA	Central Bank of Azerbaijan
UN	United Nations
ESG	Environmental, Social and Governance
SDGs	Sustainable Development Goals
WB	The World Bank

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, *etc.*), 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 and adaptation to the adverse effects of climate change, 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.*

About the survey

This Sustainable Finance Survey (the “Survey”) was developed as part of the implementation of the “Sustainable Finance Roadmap 2023-2026” approved by the CBA Management Board on February 15, 2023. The Survey was conducted in June-July, 2023.

The purpose of the Survey is to measure the awareness of financial institutions (banks, insurance companies and investment companies) of sustainable finance and ESG principles, to examine the actions taken and planned to be taken in this direction, and to collect initial indicative data. The Survey consisted of 4 sections and 33 questions.

Section 1. General awareness on sustainable finance and ESG principles (3 questions);

Section 2. Risk management (6 questions);

Section 3. Strategy and corporate governance (5 questions);

Section 4. Indicators related to sustainable finance and ESG (19 questions).

The results of the Survey were analyzed both for the overall financial markets and for each sector separately. The final part of the report presents the main findings of the Survey analysis and the next steps to be taken.

The survey will serve as an important tool for assessing the transformation of financial markets towards sustainable finance and the implementation of ESG principles. It should be noted that the survey will be carried out on a periodic basis and the structure of the survey will be adjusted considering institutional developments and the regulatory framework governing ESG in financial markets.

1. Introduction

It is important to enable ESG-relevant financial flows to implement the Socio-Economic Development Strategy of Azerbaijan for 2022-2026 and realize national priorities in key economic areas. In this context, to support the alignment of the country's economy with the challenges of sustainable development, CBA included the transformation of the financial sector towards sustainable finance among its strategic priorities and adopted the Sustainable Finance Roadmap 2023-2026 (the "Roadmap") on February 15, 2023.

The ultimate objective of the Roadmap is to promote the emergence of sustainable finance that takes into account climate-related and environmental risks, as well as social and governance factors and to ensure financial stability. In addition, the Roadmap will ensure that the risks posed by climate change and other ESG factors are managed and also emerging opportunities are realized. According to the WB's preliminary analysis results, physical and transition risks will not pass without affecting the financial markets, especially the banking sector. Thus, energy-intensive sectors of the economy may face solvency problems due to rising production costs and the transition to "greener" activities (transition risks). Extreme nature related events can cause direct and indirect damages to assets, as well as changes¹ in the supply chain and business model (physical risks). According to preliminary estimates, 55% of the banking sector's loan portfolio is made up of economic sectors² sensitive to climate change, and it is necessary to take timely and appropriate measures to address the physical and transition risks of the financial system.

CBA, in turn, implements relevant actions under the pillars defined in the Roadmap. This Survey was conducted under the Pillar 3 of the Roadmap (Integrating climate-related and ESG factors into risk management).

¹ For example, agriculture is considered an economic sector sensitive to physical risks.

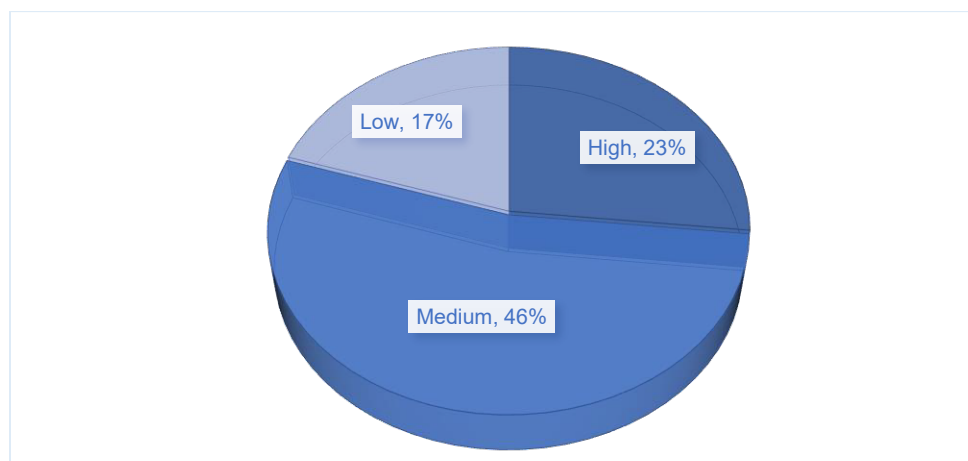
² Climate Policy Related Sectors (CPRS) are sectors with high greenhouse gas emissions (energy, industrial processes, agriculture, waste, etc.), sectors with high carbon intensity (mining, construction, transport), and sectors that are sensitive to the transmission channels of transition risks.

2. Results of financial market analysis

A total of 52 financial institutions including 24 banks, 11 investment companies and 17 insurance companies participated in the Survey. 95% of financial institutions responded to the Survey. The high level of participation indicates that market participants are aware of climate-related risks and sustainable finance challenges and are interested in implementing ESG principles.

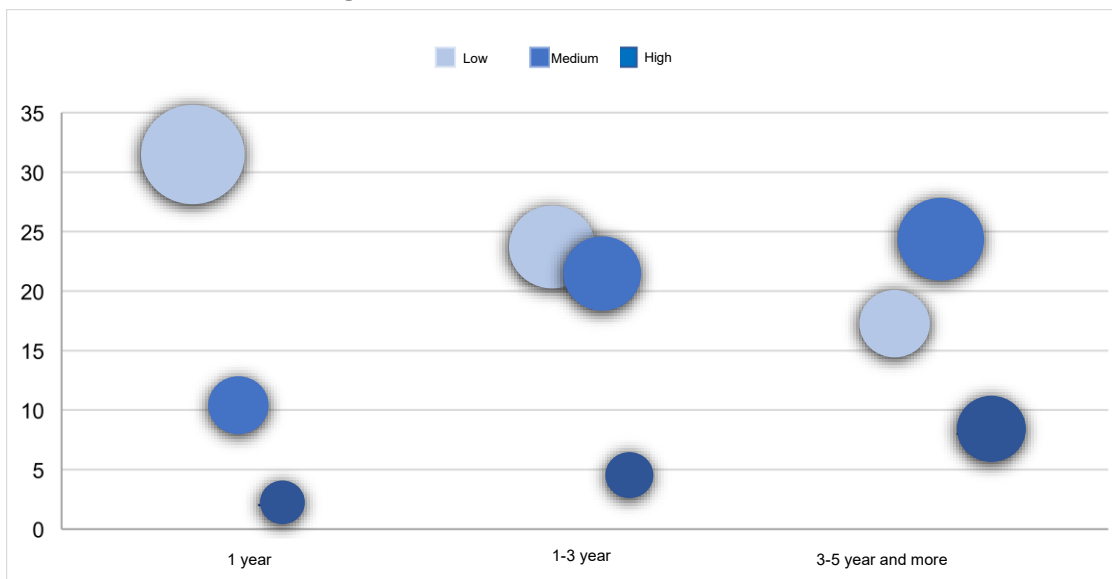
Based on the results of the Survey, **46% of financial institutions rated the importance of climate change and ESG risk management in the country's financial markets as medium** and 23% as high (Chart 1). 85% of financial institutions responded that they were not aware of the sustainable finance activities of other financial institutions in the sector they represent.

Chart 1. Financial institutions' assessment of the importance of climate-related and ESG risk management in financial markets



Although 46% of financial institutions (mostly banks) indicated that climate-related and ESG risks could impact their activities (implementation of business strategy, business model, financial planning, risk appetite indicators, *etc.*), 44% reported no analysis in this direction. Financial institutions expect the impact of climate-related and ESG risks to be low (73%) in the short term, **while in the medium and long term the impact will gradually shift to a medium and high-risk area (~60%)** (Chart 2).

Chart 2. Financial institutions' expectations regarding the impact of climate-related and ESG risks (low, medium, high)



Note 1: The diameter of the circles in the chart visually reflects the number of financial institutions.
Note 2: The vertical axis shows the number of financial institutions.

Respondents (73%) identified the **lack of sufficient awareness** as the main barrier to managing sustainable finance-related risks, integrating ESG principles into business strategy, and taking them into account in business activities. Other reasons cited were lack of a regulatory framework (48%), sufficient human capacity (52%) and regulatory requirements (23%) (Chart 3).

Financial institutions' main expectations for transitioning to sustainable finance and implementing ESG principles were to conduct awareness-raising activities, to develop a legal and regulatory framework, to establish disclosure requirements and to implement concessions to sustainable finance instruments.

Financial institutions have undertaken **a number of projects and business activities to support environmental protection and socially significant projects**. Examples include participating in tree planting campaigns, financing the installation of solar panels, insuring hybrid cars, recycling, supporting women entrepreneurs, *etc.*

Chart 3. Key barriers identified by financial institutions to implementing sustainable finance



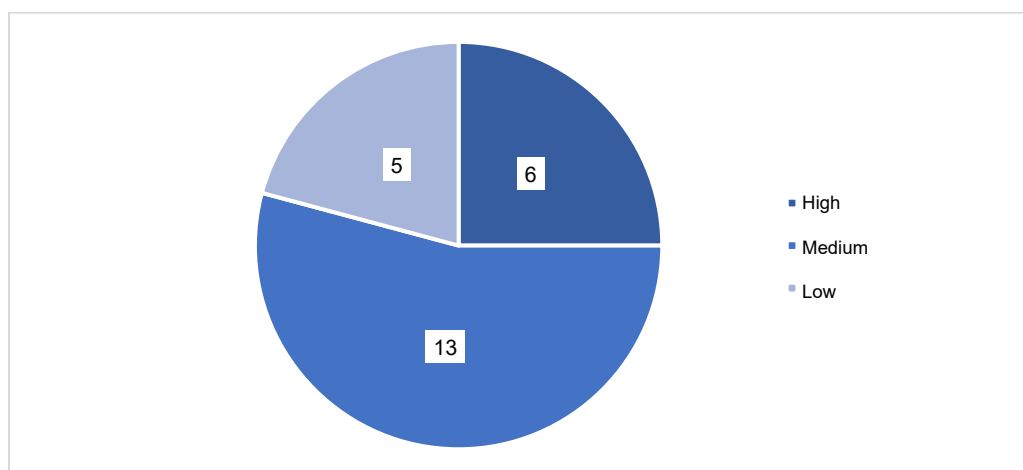
3. Banking sector

According to the Survey, 54% of banks rate the management of climate-related risks and ESG principles in financial markets as **moderately important** (25% - high importance, 21% - low importance) (Chart 4).

50% of banks have defined **sustainable finance/ green finance/ ESG and related concepts** in their internal bank documents. The documents in which these concepts are defined vary and are approved at different management levels. For example, some banks have defined these concepts in strategy and policy documents, others in code of conduct and a number of banks in specific regulatory documents dedicated to environmental and social factors.

75% of banks said they were not aware of other banks' sustainable finance activities. Despite the fact that banks have implemented various sustainable finance actions, the high level of unawareness indicates the need for improved reporting and public disclosure to increase transparency.

Chart 4. The importance of climate-related and ESG risk management in financial markets

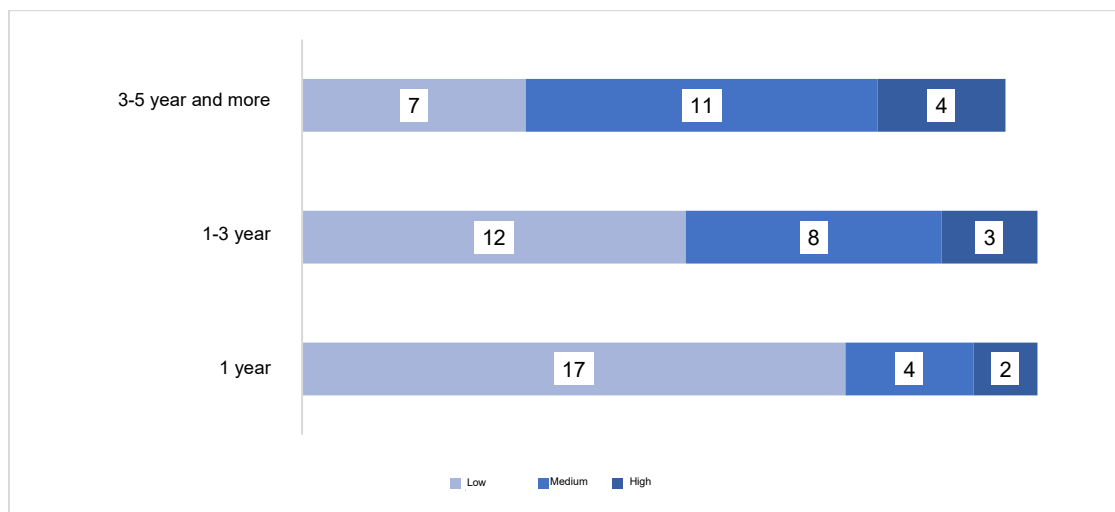


Note 1: The figures in the chart indicate the number of banks.

67% of banks reported that climate-related and ESG risks will affect the implementation of business strategy, business model, financial planning and risk appetite indicators. In this context, banks cited impact transmission channels such as the impact on the agricultural loan portfolio and supply chain, the lack of staff with relevant sustainable finance knowledge and skills, the deterioration of employees' working conditions as a result of environmental risks, the operational risks due to business disruptions caused by natural disasters, the decrease in the customer turnover and the depreciation of the collateral as a result of physical risks.

The results of the analysis show that banks expect the impact of climate and ESG risks to be low in the short and medium term (~60%). However, in the long term, there is a transition from "low" to "medium" (46%) in terms of sustainable finance risks (Chart 5). Banks expect that in the long term, the impact of climate risks will be felt much more strongly in the country's economy, especially in agriculture, that the business model will undergo significant changes, and the regulatory requirements will increase.

Chart 5. Banks' expectations on climate-related and ESG risk impacts in the short, medium and long term



Note 1: The figures in the chart reflect the number of banks.

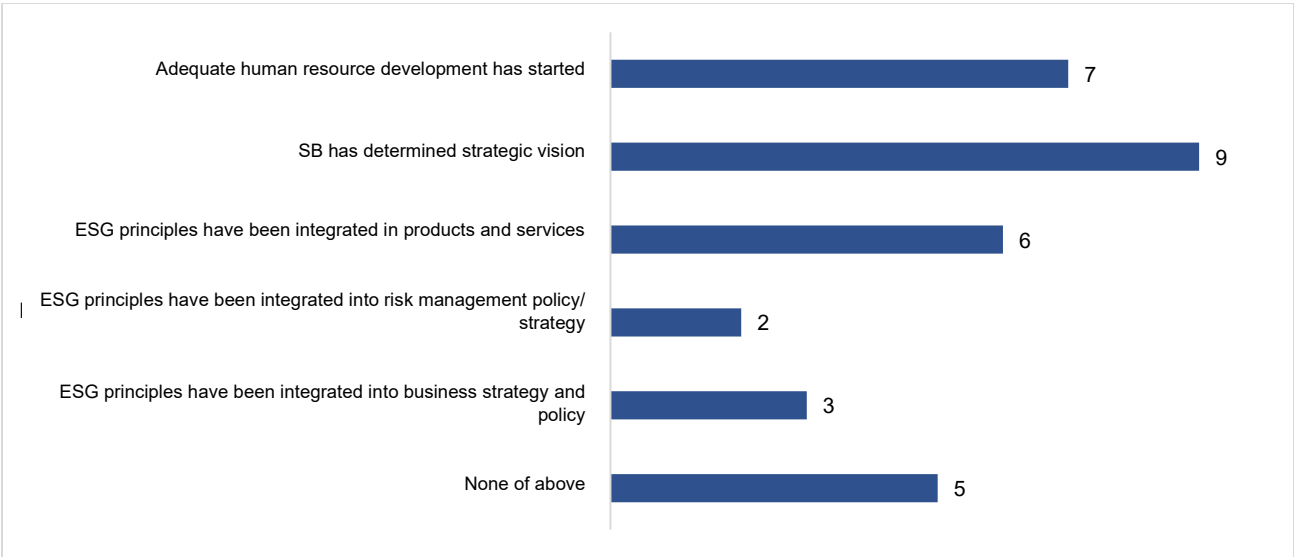
According to 46% of the surveyed banks, they have not carried out a **risk assessment of the impact of climate-related and ESG risks**. Some of the banks that conducted risk assessments reported conducting ESG risk assessments for securities and lending, annually determining the share of the bank's loan portfolio sensitive to environmental and social factors, incorporating ESG principles into stress testing based on expert advice, etc.

54% of banks indicated that climate and ESG risk assessments, including opportunities, have been integrated into the bank's activities over the past 5 years in the following specific directions:

- *restricting lending to businesses with high environmental and social risks;*
- *taking actions on gender equality;*
- *expanding educational opportunities for employees;*
- *supporting low-income families, as well as small family businesses owned by citizens from the vulnerable group;*
- *organizing internship programs for university students;*
- *setting limits by diversifying economic sectors and economic regions;*
- *ISO certification in environmental management, greenhouse gases;*
- *managing waste diversion and reducing paper consumption;*
- *participating in tree planting activities.*

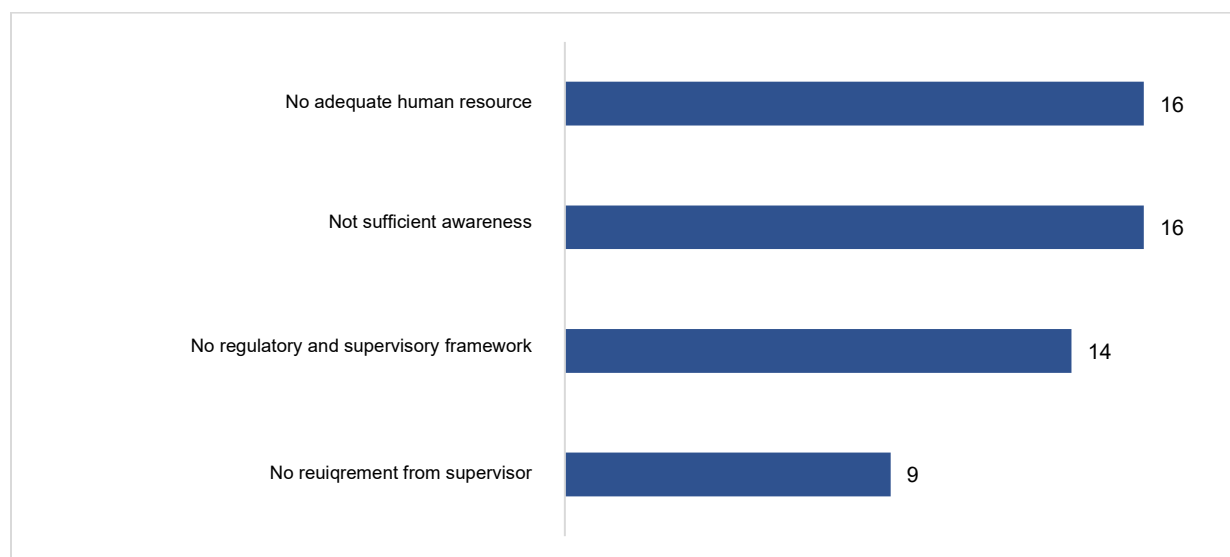
According to the Survey results, the main actions taken by banks in the area of sustainable finance and ESG integration are the establishment of a strategic vision on sustainable finance by the Supervisory Board, the start of human capacity building and the integration of the ESG principles into products and services (Chart 6). However, the integration of sustainable finance and ESG principles into business and risk management policy and strategy documents was implemented by 5 banks. Some banks are planning to develop a separate functional strategy for environmental and social factors.

Chart 6. Sustainable finance activities implemented by banks



Banks noted the lack of awareness, insufficient human capacity and lack of regulatory and supervisory frameworks as the main barriers to implementing sustainable finance (Chart 7). None of the banks considers sustainable finance to be unprofitable. This shows that there are opportunities for banks to attract green investment projects in the future. Other barriers include the lack of funds to support sustainable finance, the inability to assess the environmental and social impact of businesses, and the lack of environmentally friendly economic activities.

Chart 7. Barriers to implementing sustainable finance



Banks identified the following positive and negative environmental and social impact of their current business model and strategy:

- *Positive impact* – financing the construction of alternative energy power plants, contributing to youth education, supporting microenterprises, promoting employment, and regular tree planting activities.
- *Negative impact* – increase in carbon emissions, pollution, water consumption, paper consumption as a result of financed economic activities.

Regulatory concessions, financial support, and raising awareness, expertise, and skills through trainings are the main suggestions and expectations from regulators regarding the implementation of sustainable finance and ESG principles in financial markets.

67 percent of respondents reported having **projects or business activities that directly or indirectly support the environment**. The following projects were reported:

- *installing solar panels in the territories liberated from occupation;*
- *issuing eco-cards;*
- *integrating ESG principles into credit decision-making;*
- *lending for the purchase of hybrid vehicles, etc.*

88% of the banks surveyed report **that they have environmental protection activities** in place. Banks have worked towards reducing the volume of paper consumption, saving electricity,

participating in tree planting activities, cleaning up marine debris, creating a collection point for the proper disposal of electric batteries, reducing the use of plastic, and recycling waste.

13% of the banks surveyed have implemented environmental protection projects **with the material and/or technical support from international financial institutions**. These projects include issuing bank cards to support tree planting, developing ESG policies, determining exclusion list of economic activities, updating ESG reports, etc.

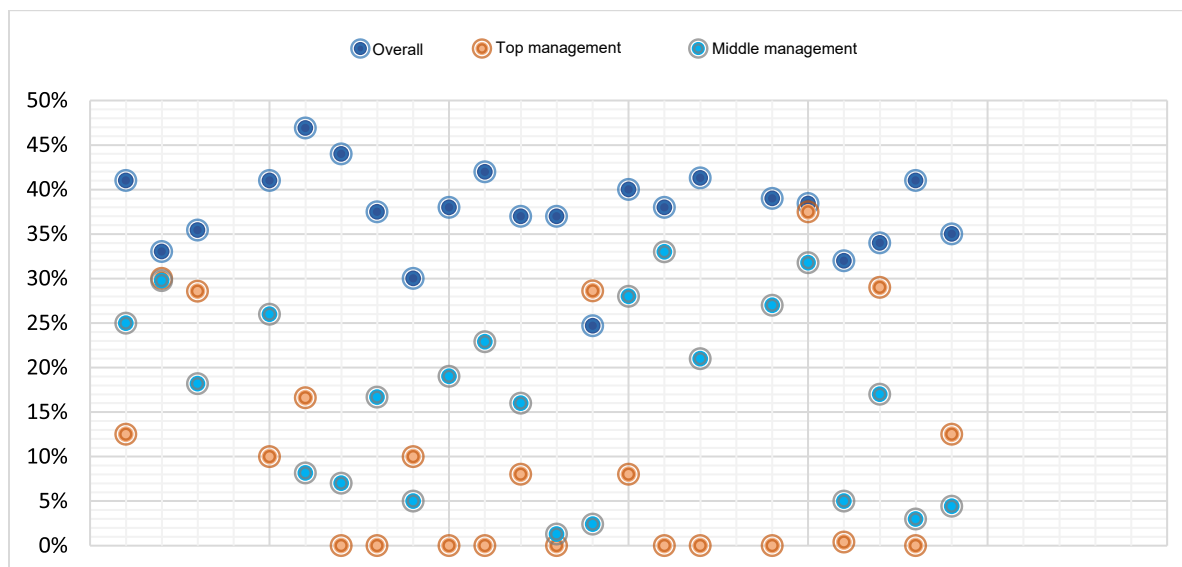
In addition, banks provided information on their **energy consumption, water consumption and paper consumption** for the years of 2021 and 2022 (this information was provided by 17 banks). Compared to 2021, in 2022, 3 banks reduced energy consumption, 5 banks reduced water consumption, and 8 banks reduced paper consumption. However, in general, energy, water and paper consumption increased across the banking sector.

79% of banks surveyed have implemented **projects and/or business activities of social importance**. These social projects include:

- *supporting children from martyr families;*
- *supporting women entrepreneurs;*
- *organizing internship programs for university students;*
- *participating in self-employment programs;*
- *providing medical insurance to employees;*
- *providing equipment to small business owners;*
- *providing food assistance to low-income families, etc.*

In terms of social indicators, banks have provided information on the number of female employees holding leading positions at different management levels, employees with physical disabilities, distribution of employees by age groups, employee turnover, training and education budget, number of employees on maternity leave, and occupational health and safety of employees. In general, the average share of female employees in total banking workforce is 38%, and the average percentage of female employees holding top and middle management positions is 11% and 17%, respectively (Chart 8). Employees with physical disabilities represent on average 1.5% of the total banking workforce. In terms of age distribution, 71% of employees are between 21 and 40 years old. A comparative analysis will be carried out as the database is built up following further surveys on other social indicators.

Chart 8. Share of female employees at different levels of management in the banking industry



In terms of governance indicators, banks reported on the availability and renewal of documents on remuneration, anti-corruption policy and code of ethics, discussions on the impact of climate and ESG risks on the bank's activities at meetings of the Supervisory Board and the Management Board, and the appointment of a structural unit or an employee responsible for integrating ESG principles into the bank's activities. Discussions focused mainly on participation in tree planting campaigns, paper use and social indicators, and only a few banks discussed the integration of ESG principles into the bank's business model and green loans.

7 banks reported of having a specific structural unit or an employee responsible for integrating ESG principles into the bank's activities. The banks used two main approaches in this context: (1) appointing ESG coordinators within the relevant departments and (2) appointing a senior executive. Only one bank has a dedicated team and a sustainability committee established for this purpose.

4. Capital market

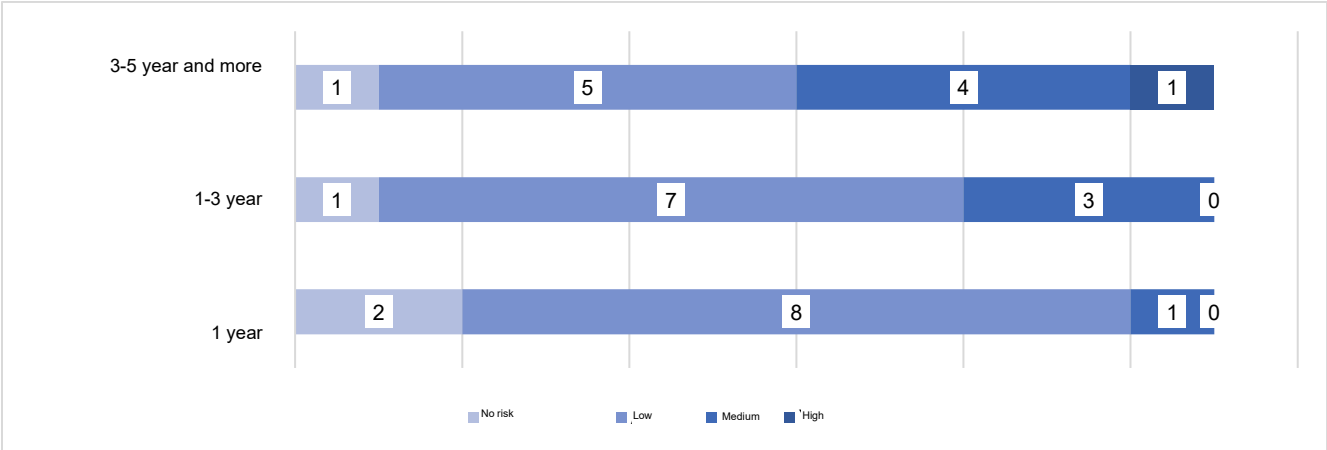
55% of investment companies rated the **management of climate-related risks and ESG principles in the country's financial markets as moderately important.** 91% of investment companies have not defined sustainable finance/ green finance/ ESG and related concepts in

their internal documents. Investment companies said that they were not aware of the work done by other investment companies in the area of sustainable finance. This highlights the need for greater accountability and public disclosure to increase transparency.

According to the responses, 64% of investment companies have not conducted any analysis of assessing the impact of climate-related and ESG risks on the implementation of business strategy, business model, financial planning, and risk appetite indicators. Investment companies that have conducted such analyses report that they expect losses due to climate-related impacts and reduced investor purchasing power.

The results of the analysis show that ~60% of investment companies expect the **impact of climate-related and ESG risks to be low in the short and medium term** (Chart 9). In the long term, sustainable finance risks will move from "low" to "medium" risk area.

Chart 9. Expectations of investment companies regarding the impact of climate-related and ESG risks in the short, medium and long term



73% of respondents said they had not conducted an assessment of the impact of climate and ESG risks on their business. The 2 investment companies that had conducted **risk assessments** reported that the assessments were conducted to research assets and new revenue opportunities. In addition, all investment companies reported that assessing climate-related and ESG risks, including opportunities, had not been part of their business activities over the past 5 years.

According to the Survey results, 82% of investment companies have taken no action on implementation of sustainable finance and ESG principles. One investment company reported an ongoing work to establish a strategic vision of the Supervisory Board and to build human capacity.

Investment companies cited the **lack of awareness, human capacity, and regulatory and supervisory frameworks as the main barriers to implementing sustainable finance** (Chart 10). Only one investment company considered sustainable finance activities to be unprofitable. Other barriers cited were lack of funds to support sustainable finance activities, lack of assessment of the environmental and social impacts of businesses, and insufficient green economic activities.

Chart 10 . Barriers to adapting sustainable finance and ESG principles



Investment companies have identified the following positive and negative environmental and social impacts of their current business model and strategy.

- **Positive:** representation of women in leadership positions, supporting the education of employees, implementation of internship programs, participation in regular tree planting actions.
- **Negative:** pollution, water consumption, paper usage.

The **main expectations of investment companies** in implementing sustainable finance and ESG principles are **to provide financial support, develop a regulatory framework and raise awareness.**

18% of investment companies reported having **projects and business activities that directly or indirectly support environmental protection.** This includes participating in tree planting activities, negotiating the issuance of green bonds, *etc.* 46% of investment companies carry out actions related to environmental protection as part of their business activities. These actions include reduction of paper consumption and paper recycling. Investment companies have not implemented environmental protection projects with financial or technical support from international financial institutions.

Socially important projects or business activities were reported by 27% of investment companies. Social projects included the creation of a women's investment club and participation in a campaign to help low-income families.

In terms of social indicators, investment companies have provided information on the number of female employees holding leading positions at different management levels, employees with physical disabilities, distribution of employees by age groups, employee turnover, training and education budget, number of employees on maternity leave, and occupational health and safety of employees. In general, the average percentage of female employees is 35%, and the average percentage of female employees holding top and middle management positions is 7% and 13% respectively. A comparative analysis will be carried out as the database is built up following further surveys on other social indicators.

In terms of governance indicators, investment companies reported the existence of documents on remuneration, anti-corruption policy and code of ethics, their updating, discussions on the impact of climate and ESG risks on the company's activities at meetings of the Supervisory Board and the Management Board, and the appointment of a structural unit or an employee responsible for integrating ESG principles into the company's activities. Over the past three years, there have been no discussions at investment company supervisory board and management board meetings about the impact of climate and ESG risks on the investment company's activities. Only one investment company indicated that its Legal and Compliance Department is the structural unit responsible for incorporating ESG principles into business activities.

5. Insurance sector

60% of insurance companies surveyed rated **the management of climate-related risks and ESG principles in the country's financial markets as medium or highly important**, while 30% said they were unaware of it. 82% of insurance companies have not defined the sustainable finance/ green finance/ ESG and related concepts in their internal documents. Only two insurance companies have defined these concepts in their strategy documents on sustainable development and ESG transformation.

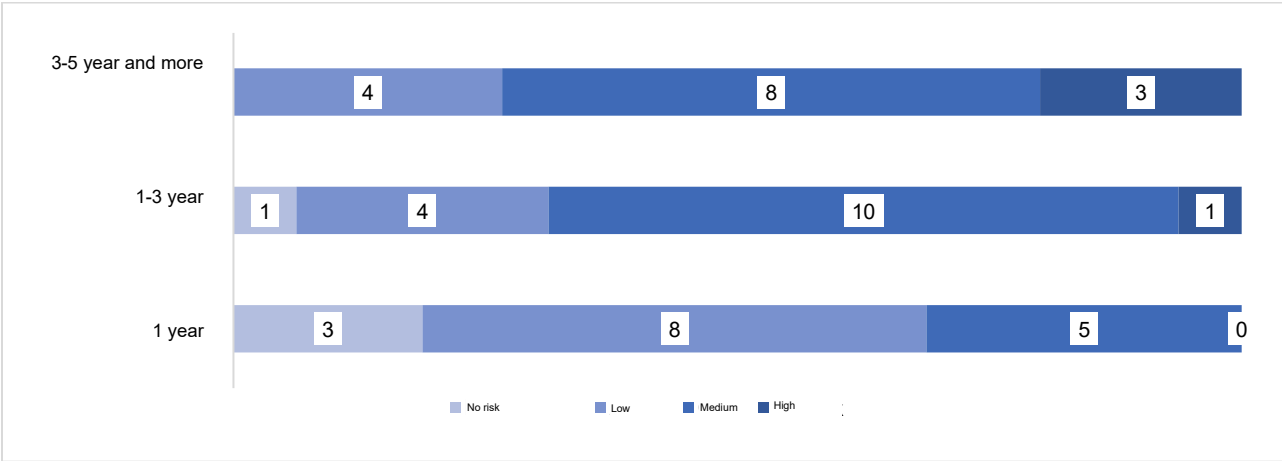
Insurance companies reported that they were largely unaware of the sustainable finance work being done by other insurance companies. This highlights the need for improved accountability and public disclosure towards greater transparency in both the banking and capital market sectors.

According to the responses, 60% of insurance companies noted that they have not conducted any analysis of the **impact of climate-related and ESG risks on the implementation of business strategy, business model, financial planning, and risk appetite indicators**. In general, insurance companies consider financial losses in property and agricultural insurance to be the most significant risks. Insurance companies have noted the insurance of electric vehicles and the preparation of a report on sustainable development among the work done on sustainable finance over the past five years.

Approximately 45% of insurance companies expect the impact of climate-related and ESG risks to be moderate in the short, medium and long term (Chart 11). In the long term, insurers' expectations appear to be shifting towards high risk zone. Insurance companies reported increased insurance events and losses due to drought, wildfires, catastrophic events, and the negative impact of environmental pollution on human health as reasons for plausible migration. A number of insurance companies said that the lack of statistical information on ESG risks made it impossible to make an assessment.

88% of insurers reported not conducting a risk assessment of the impact of climate and ESG risks on insurance companies. Two insurance companies that had conducted a risk assessment stated that the assessment was not related to specific ESG issues, but was part of PEST analysis³ and risk management.

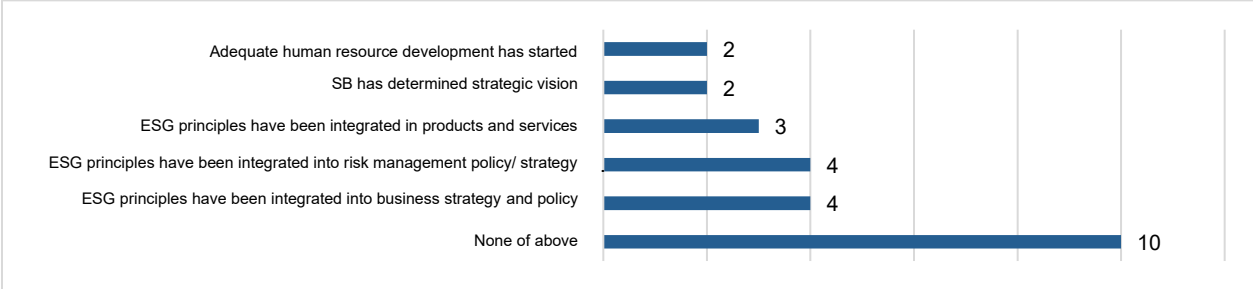
Chart 11. Insurers' expectations of the impact of climate-related and ESG risks in the short, medium and long term



³ A PEST analysis is a measurement tool to assess the political, economic, social and technological factors that could affect a business.

The Survey results show that **~60% of insurance companies haven't taken any action on sustainable finance and ESG integration** (Chart 12). Several insurance companies taking steps in this direction reported that they have initiated work on integrating ESG principles into their business and risk management policies and strategy documents, into the products and services they offer, developing a board strategic vision on sustainable finance, and building human capacity.

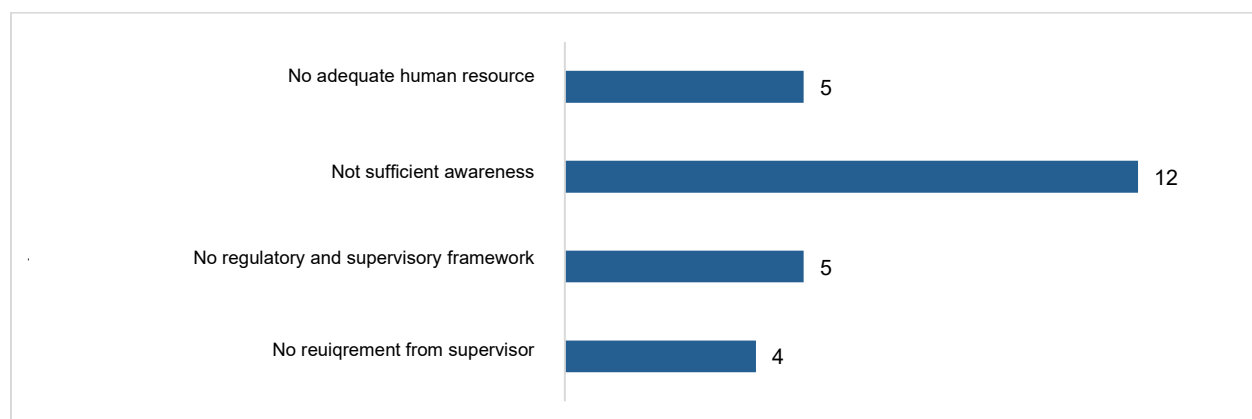
Chart 12. Actions taken by insurance companies on sustainable finance



Insurance companies cited the **lack of awareness, human capacity, and regulatory and supervisory frameworks as the main barriers to implementing sustainable finance** (Chart 13). None of the insurance companies considered sustainable finance activities to be unprofitable. The lack of promotion of ESG principles was also cited as a barrier.

According to insurance companies their current business model and strategy do not have any **negative impact** on the environment and society. Protecting the property interests of farmers, reducing resource and energy consumption by accelerating automation, and promoting environmental and social factors by engaging in tree planting and other social projects were cited as **positive impacts**. Insurance companies' proposals to implement sustainable finance and ESG principles in the financial markets were in line with those of banks and investment companies.

Chart 13. Barriers to adapting sustainable finance and ESG principles



41% of insurance companies reported having projects and business activities that directly or indirectly support environmental protection. Several insurance companies mentioned participation in tree planting activities. 46% of insurance companies said that they carried out actions related to environmental protection as part of their business activities. These actions include optimizing energy and water consumption, reducing paper usage and sending used paper for recycling, rejecting the use of plastic, participating in tree planting activities, etc.

In addition, insurance companies have provided information on energy, water and paper consumption for 2021 and 2022 years. In general, the energy, water and paper consumption of the insurance sector has increased. Insurance companies reported that the implementation of environmental protection projects did not have the financial and/or technical support of international financial institutions.

Socially important projects and/or business activities have been carried out by 41% of insurance companies. Insurance companies reported activities such as offering discounts on insurance products to employees, providing training on insurance products for women entrepreneurs, donating school supplies to low-income families and children of martyrs, and providing knowledge and work on entrepreneurship to spouses of martyrs and war veterans.

In terms of social indicators, insurance companies have provided information on the number of female employees holding leading positions at different management levels, employees with physical disabilities, distribution of employees by age groups, employee turnover, training and education budget, number of employees on maternity leave, and occupational health and safety of employees. In general, the average percentage of female employees is 40%, and the average percentage of female employees holding top and middle management positions is

23%. A comparative analysis will be carried out as the database is built up following further surveys on other social indicators.

In terms of governance indicators, insurance companies reported the existence of documents on remuneration, anti-corruption policy and code of ethics, their updating, discussions on the impact of climate and ESG risks on the company's activities at meetings of the Supervisory Board and the Management Board, and the appointment of a structural unit or an employee responsible for integrating ESG principles into the insurance company's activities. Over the last three years, 23% of insurance companies did not discuss the impact of climate and ESG risks on the company's operations at meetings of the Supervisory Board and Management Board. Only two insurance companies indicated that they have a structural unit/employee responsible for integrating ESG principles into the company's business activities.

6. Conclusion

Overall, the importance of ESG factors is relatively well understood by financial institutions, and environmental and social projects are implemented on a small scale. The main findings of the Survey can be summarized as following:

Financial institutions expect the impact of climate-related and ESG risks to be higher in the medium and long term;

The strategic vision of financial institutions' top management on ESG and sustainable finance does not well reflect the current challenges;

Although sustainable finance and ESG principles are not part of the current business strategies of financial institutions, some financial institutions reported plans to incorporate them;

A limited number of financial institutions have integrated sustainable finance and ESG principles into their corporate governance.

Although financial institutions are aware of ESG and sustainable finance concepts, they are not sufficiently prepared to manage these risks;

Among financial institutions, it appears that banks have a higher awareness about ESG principles and sustainable financial risks than other financial institutions.

Banks appear to be more active in implementing environmental and social projects.

The results of the analysis of the Survey calls for a **systematic approach** to sustainable finance in the fields of:

Raising awareness and capacity building;

Presenting guidelines and standards related to the implementation of sustainable finance to the market;

Developing a regulatory and supervisory framework;

Identifying relevant concepts on sustainable finance;

Developing a framework for integrating ESG principles into the activity of financial institutions;

Shaping accountability and disclosure on a periodic basis by determining key metrics and data (both qualitative and quantitative) for sustainable finance.

The results of the Survey will be taken into account in the implementation of the actions defined in the Roadmap.