საქართველოს ეროვნული ბანკი
National Bank of Georgia

Sustainable Finance in Georgia

Status Report
2021

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I. Overview of Sustainable Finance Regulations and Policies in Georgia

NBG's Sustainable Finance Framework – brief overview

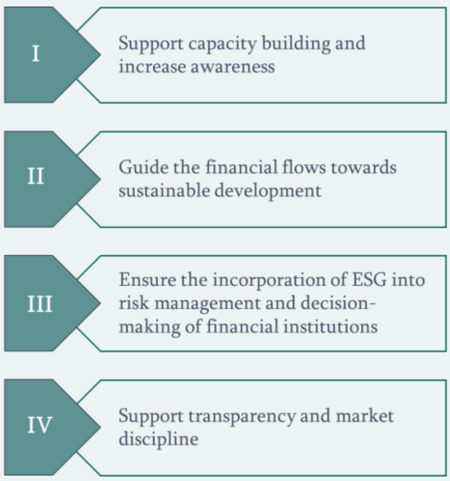
The sustainable development challenge that we are increasingly facing requires urgent actions to adapt public policies to this new reality. All of this inevitably require policy reforms to mobilize finance for economic growth that is green, stable, and inclusive. The financial system has a key role to play here, as there is no sustainable development without sustainable financing - 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 develop 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 consideration of Social, Environmental, and Governance (ESG) issues by the financial sector and capital market participants and managing risks associated with them, which is important for financial stability and sustainable development of the economy.

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.

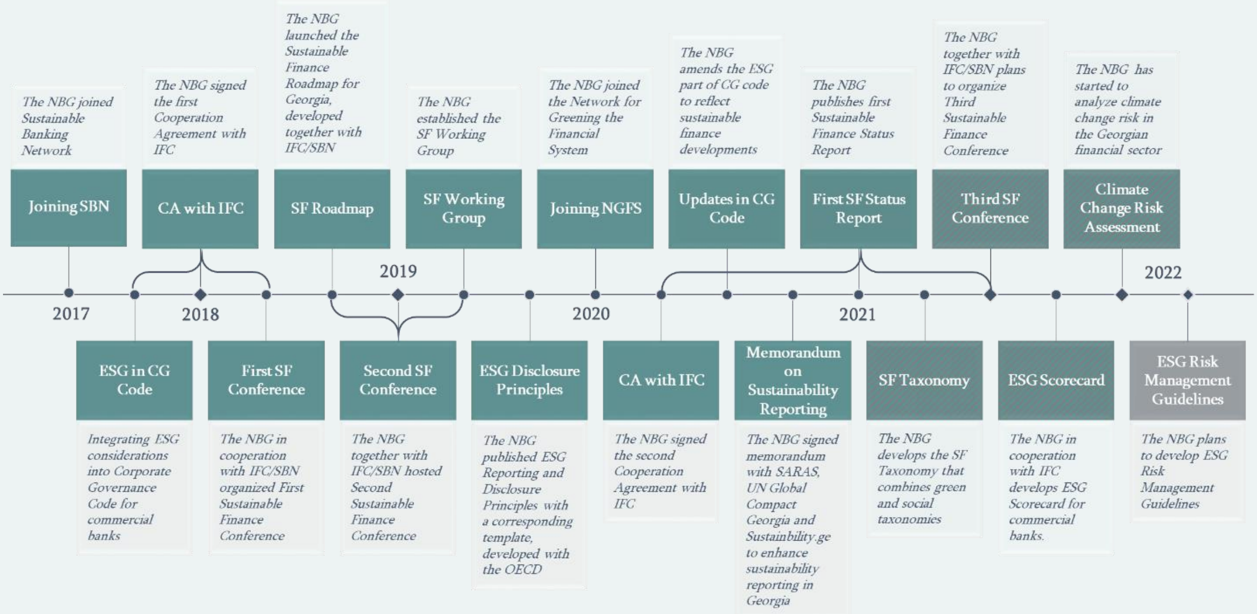
The actions listed in the Roadmap are grouped under four main pillars each of them serving different goals set out in the action plan.

<u>Pillars of the SF Roadmap:</u>



Most of the actions listed in the roadmap are already in progress. The NBG continues to develop SF framework and is gradually implementing the action plan outlined in the SF Roadmap. Diagram 1 summarizes the main actions that the NBG has implemented in this regard.

Diagram 1. NBG's Sustainable Finance Framework Implementation



Source: NBG

The development of the SF Framework and the implementation of the action plan[1] is carried out with collaboration and support from various international organizations including, International Finance Corporation (IFC), IFC supported Sustainable Banking and Finance Network (SBFN)[2], Organization for Economic Cooperation and Development (OECD), Finance in Motion, Green for Growth Fund (GGF) Technical Assistance Facility, German Sparkassenstiftung for International Cooperation (DSIK). Coordinating with financial institutions through Sustainable Finance Working Group and other local stakeholders, including various ministries, is also a part of the process. The NBG also is a member of Sustainable Banking and Finance Network (SBFN) since 2017 and Network for Greening the Financial System (NGFS) since 2020. The NBG has been a very active member of SBFN. The NBG is a part of SBFN Measurement Working Group and a co-chair of SBFN Data & Disclosure Working Group. During these years, the NBG has learned from and shared its national sustainable finance development experiences with other SBFN members. As the NGFS member, the NBG plans to issue an individual pledge as a part of NGFS contribution (NGFS Glasgow Declaration) to the 2021 United Nations Climate Change Conference (COP26). It will outline the main actions that the NBG commits to implement to follow the recommendations presented in the NGFS report A Call for Action.

[1] For a more detailed description regarding the SF Framework implementation, please see Financial Stability Report 2020, Box.5 and Annual Report 2020, Development of the Financial Stability Framework.
[2] Former Sustainable Banking Network (SBN)

Policy and Regulatory Highlights from 2021

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

- ✓ Second Cooperation Agreement with IFC - After the successful completion of the first Cooperation Agreement (CA) that was signed in 2018, the NBG signed a second CA with IFC, a member of World Bank Group, on February 5, 2021. The close cooperation with IFC started in September 2017, when the NBG joined IFC-supported Sustainable Banking and Finance Network (SBFN). SBFN is represented by 63 members from 43 countries, covering over 86% of banking assets in emerging markets. Since then, the NBG has been working with IFC/SBFN on the issues such as increasing awareness and capacity building, integrating ESG considerations into risk-assessment frameworks and decision-making processes of financial institutions, supporting market transparency, as well as actively sharing their experience with other SBFN members.

  The scope of the new agreement is broader and includes more comprehensive actions for the next two years. As highlighted in the agreement, the NBG will continue collaboration with IFC on awareness-raising events and capacity building. IFC will also provide support and expertise to the NBG while working on the development of Sustainable Finance Taxonomy, the aim of which is to provide the market with a homogeneous definition of green, social and sustainable economic activities. The CA also includes providing advice in the development of the corporate governance codes with a section on ESG matters to promote sound ESG practices among financial institutions and capital market participants. Activities to enhance ESG risk management among financial institutions also fall within the scope of the CA.

- ✓ Amendments in CG Code for Commercial Banks - 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 Commercial Banks in 2018. However, in the wake of the sustainable finance development and the steps taken by the NBG in that direction, it became necessary to integrate ESG issues in the CG Code in a more comprehensive and detailed way.

  The amendments made to the CG Code for Commercial Banks in 2021 specified and clarified the ESG considerations and related requirements. In particular, the amendments defined the responsibility of the Supervisory Board for integrating ESG issues into the Bank's strategy and risk management framework and their effective implementation. The changes also specified the ESG reporting form and referred to the NBG's ESG Reporting and Disclosure Principles for guidance. Furthermore, the ESG reporting form was added to the Pillar 3 Annual Reporting, and ESG related data is now disclosed under Pillar 3. Accordingly, the "Regulation on Disclosure Requirements for Commercial Banks within Pillar 3" was also revised.

These amendments aim to facilitate the proper integration of ESG considerations into the commercial banks' activities, effectively manage ESG risks and improve disclosure of ESG-related information. These, in turn, are important for ensuring financial stability and developing a sustainable financing framework in Georgia.

- ✓ Memorandum of Cooperation on Sustainability Reporting - Transparency is the key element for sustainable finance development. There are number of international standards on sustainability disclosure, however, the need for common reporting standards is emphasized widely. The European Commission is currently working on the Corporate Sustainability Reporting Directive (CSRD), which would amend the existing reporting requirements of the Non-Financial Reporting Directive (NFRD). The proposal also envisages the adoption of EU sustainability reporting standards, which will be built on and contribute to international standardization initiatives. The Association Agreement (AA) between the European Union (EU) and Georgia, signed in 2014, sets obligations to implement number of directives, including the NFRD. Moreover, IFRS Foundation is also working to develop global sustainability reporting standards. To follow these developments on sustainability reporting, support establishment of best international standards and, in general, enhance sustainability reporting in Georgia, the NBG, Service for Accounting, Reporting and Auditing Supervision (SARAS), Global Compact Network Georgia, and Institute for Sustainable Development signed memorandum of cooperation. By signing the memorandum, the parties aim to work together to develop a legislative framework for sustainability reporting and to implement best practices that will facilitate the fulfillment of the dynamic approximation obligations under the AA with the EU. The actions planned under this cooperation, among other things, include awareness raising and capacity building events.

- ✓ First ESG Disclosure from Commercial Banks – The CG Code sets the mandatory ESG disclosure requirements for commercial banks. To guide banks through this process and ensure that they are disclosing ESG information consistently and comparably, the NBG, with the help of OECD, developed the ESG Reporting and Disclosure Principles with a corresponding template. Such enhanced disclosure on ESG also aims to help Georgia's financial sector promote ESG risk management and improve transparency. Apart from that, the information disclosed will be used to monitor and evaluate the sustainable finance performance of financial institutions and therefore serve as one of the tools for measuring the progress of sustainable finance development.

2021 was the first year when commercial banks filled out the NBG's ESG reporting form and disclosed ESG information according to the ESG Reporting and Disclosure Principles. The completed ESG forms are now available on the NBG's webpage to facilitate access to ESG-related information for investors and other stakeholders. The main findings and key messages from these first reports are presented in the next chapter.

- ✓ Developing Sustainable Finance Taxonomy - Lack of common definitions and classification systems has been named as one of the main challenges for sustainable finance development. Thus, the need for establishing a clear taxonomy has been emphasized widely. Currently, the NBG, in cooperation with various local and international stakeholders, is working on developing the Sustainable Finance Taxonomy for Georgia. The Taxonomy aims to provide the market with a classification system for identifying activities and/or project categories that deliver on key climate, green, social, or sustainable objectives. The Taxonomy will include both green and social taxonomies. Green taxonomy provides a list of activities that aim to achieve environmental objectives and contribute to the development of a green economy while social taxonomy proposes a list of categories focused on achieving social objectives for the specified target population. The NBG will support financial institutions in the Taxonomy adoption process through consultations, training, and technical support. For this purpose, the NBG is starting a new project supported by the Green for Growth Fund Technical Assistance Facility. The main aim of the project is to develop screening and reporting tools, hold consultations with financial institutions, train commercial banks' representatives to effectively and consistently adopt the Taxonomy in practice.

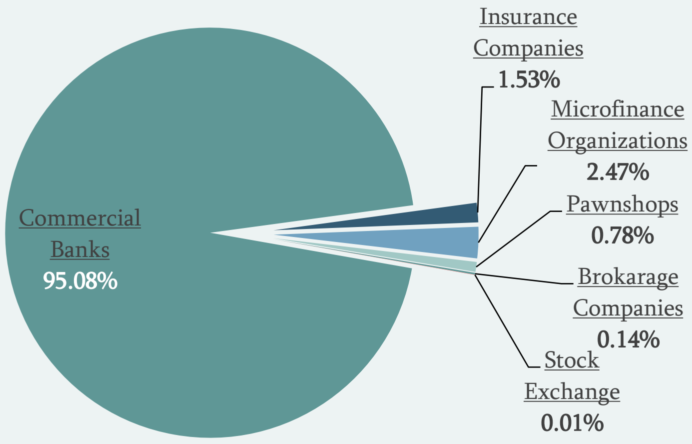
- ✓ Developing Climate Scenario Analysis for Georgian Financial Sector – The NBG has started working on climate scenario analysis. The exercise will be done in few steps. The first step will identify the economic sectors most vulnerable to climate change physical and transition risks in Georgia. During the next step, commercial banks' exposure to these vulnerable sectors will be assessed. After that, the NBG will use the NGFS Climate Scenarios as a reference to perform scenario analysis and analyze climate risk in the Georgian financial sector. This work is done in collaboration with German Sparkassenstiftung for International Cooperation (DSIK). Apart from that, the NBG plans to utilize the results and perform the climate stress testing exercise in the coming years.

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 fifteen commercial banks holding 95% of total assets in the financial sector. Apart from that, the concentration is high, with the two largest banks accounting for around 70% 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, currently, are mainly directed to 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. 2020



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.

2021 was the first year commercial banks filled out the ESG forms, which 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[3]. The disclosed information includes qualitative information such as business model, policies and due diligence, risk management, and quantitative information regarding the KPIs related to different ESG issues.

Analysis of the ESG related information from fifteen 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, there are some banks that have not implemented the ESG policies yet, 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.

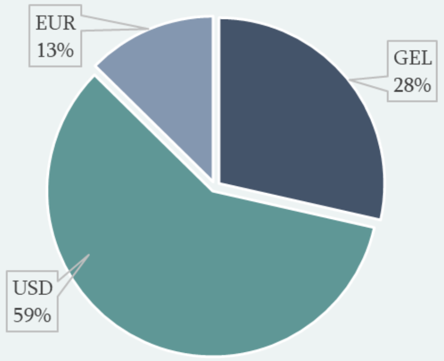
E - Environmental

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. Only 6 out of 15 commercial banks provided data on green loans. Among these six 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 2020, the reported volume of green loans amounted to around GEL 405 million (US $123 million[4]), most of which were denominated in USD (see Diagram 3). Among those banks that provided data on green loans, the share of green loans in the total loans issued during 2020, on average, was around 5%, ranging from 1% to 11%.

As for the total amount of green loans outstanding as of the end of 2020, it stands at around GEL 1.4 billion (US $416 million) (see Diagram 3). The share of USD denominated loans, in this case, is even higher (71%). As of the end of 2020, the share of green loans in the total outstanding portfolio, on average, is around 6%, with the highest share of around 17%.

Diagram 3. Currency Decomposition of Green Loans Issued in 2020

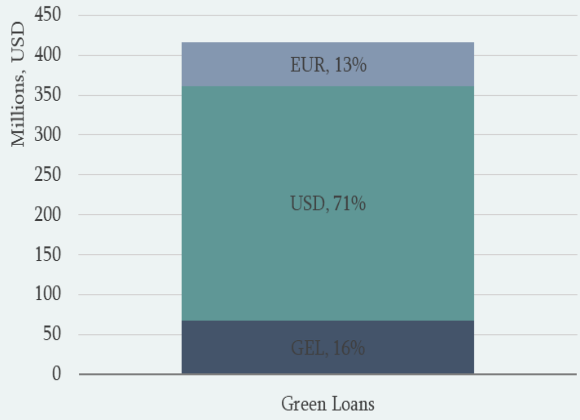


Source: NBG

[3] For more detailed information regarding each commercial bank, please visit: https://nbg.gov.ge/en/financial-stability/esg-reporting-and-disclosure
[4] The value is calculated using the end of Dec. 2020 Gel/USD and Gel/EUR exchange rates.

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, 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. Once the NBG adopts the SF Taxonomy and banks start applying it, green loan figures are expected to change and become more accurate and consistent.

Diagram 4. Total Green Loans Outstanding, Dec. 2020



Source: NBG

As of the end of 2020, none of the commercial banks has ever issued green debt securities.

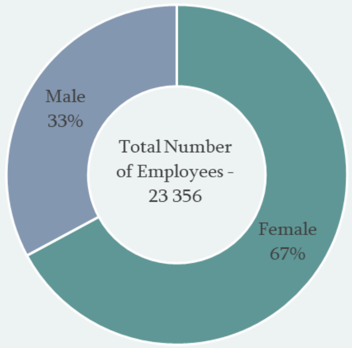
In terms of environmentally friendly activities, most banks have initiated some practices, mostly related to replacing vehicles with internal combustion engines with hybrid or electric cars and improving the energy efficiency of their offices and buildings. Apart from that, the majority of the commercial banks have waste management policies in place, mainly related to recycling, reducing, and separation. Only 3 out of 15 banks calculate and report Green House Gas (GHG) emissions, and even fewer has some specific target 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.

There are around 23 thousand people employed in the Georgian banking sector. In terms of gender diversity, as of the end of 2020, 67% of all employees were women (see Diagram 5). This result is quite similar across all commercial banks. However, the share of females in senior management (board of directors, supervisory board) stands at lower level and is 24%, on average. Apart from that, in this case, the difference among banks is more apparent - there are

Diagram 5. Gender Diversity in the Georgian Banking Sector, Dec. 2020

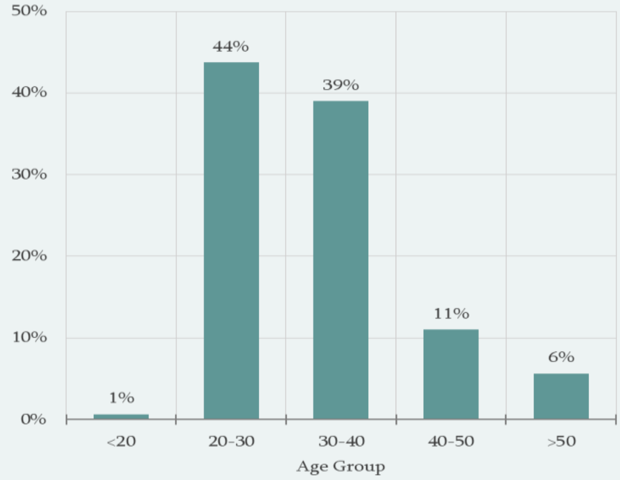


Source: NBG

some banks with less than 15%, while there are some outliers with 50-60%. As for the gender structure at the middle management level, by the end of 2020, on average, women held 43% of these positions. The numbers are consistent across banks.

In the Georgian banking sector, the highest share of employees (44%) are in the 20-30 age group (see Diagram 6). Next comes the 30-40 age group with a share of 36%. Age distribution has a similar pattern among commercial banks in Georgia. Regarding the employment of people with disabilities, only four banks indicated positive numbers, and the average share is around 0.5%. On the other hand, nine banks specified that at least some of their branches are adapted fully or partially and have special facilities and dedicated infrastructure for customers with disabilities.

Diagram 6. Age Structure of Employees in the Georgian Banking Sector, Dec. 2020



Source: NBG

During 2020, 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 average employee turnover rate[5] in the Georgian banking sector is around 12%. The numbers across banks are quite different, ranging from 2% to 27%.

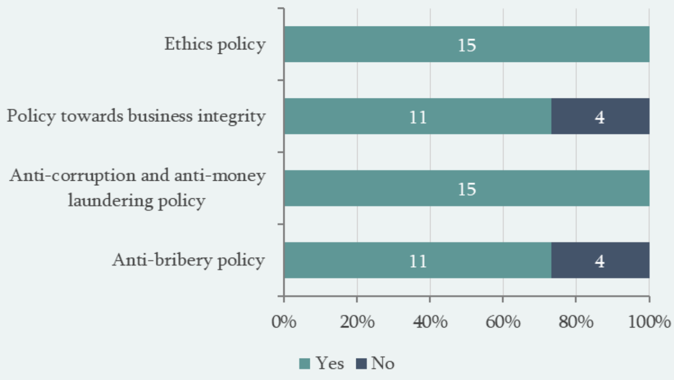
In terms of workplace health and safety, 87% of banks indicated that they have corresponding policies and procedures in place. Such policies include Occupational Safety Management Plan, Labor safety policy, Emergency action plan, among others. Apart from this, training on fire safety, emergency response, and other occupational safety issues is provided to the employees on a regular basis. Amid the recent pandemic, some banks also developed Covid-19 related policies as part of workplace safety.

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

G – Governance

The information provided in the ESG reporting forms indicates that the majority of commercial banks (eight banks) have a designated officer or body responsible for overseeing environmental and social policies and practices. Apart from that, nine banks reported that they have some ESG policies and procedures in place. 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 approves it.

Diagram 7. Number of Commercial Banks with Corresponding Policies in place, Dec. 2020



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).

Bond Market Highlights

The capital market, despite some progress, is still at an early stage of development in Georgia. Nevertheless, the domestic bond market has been expanding, and the corporate bond market has exhibited ample growth in recent years. Moreover, the share of domestically issued bonds denominated in the local currency has grown. Apart from that, the government securities market has expanded significantly throughout the past few years.

Sequential steps have been made to improve the Georgian capital market environment. The recent reform of the state pension fund, representing a source of long-term financing of unprecedented scale, previously not seen in Georgia, is expected further to deepen the domestic capital market. In addition, NBG and the Government of Georgia are currently working on a reform to transform the relevant legal and regulatory requirements. These reforms ensure the approximation of Georgian regulatory principles to those of the European Union.

Diagram 8. Outstanding corporate bonds issued in the domestic market (public offering)

Even though green and sustainable bonds have not been issued in the local bond market, Georgian companies have started issuing these types of bonds in foreign stock exchanges.

- ✓ JSC Georgia Global Utilities issued First Georgian Green Bond - In July 2020, JSC Georgia Global Utilities ("GGU") issued US $250 million green bond. The Notes were listed on the Global Exchange Market of the Irish Stock Exchange. The proceeds of the Notes will be used to refinance all existing debt of renewable energy and water assets of GGU and to finance capital expenditures in the water supply and sanitation business, including rehabilitating the water supply and sanitation system in Tbilisi and neighboring municipalities. The Notes are qualified as 100% Green. The environmental and social status of the relevant GGU activities was reviewed with the help of a qualified independent advisor. The activities were found to include a B+ environmental and social risk category. The second-party review of GGU's Green Bond Framework was provided by Sustainalytics.

- ✓ Symbiotics launches first Sustainability Bond in Georgia with JSC MFO Crystal - In May 2021, Symbiotics, a market access platform for impact investing, arranged the first Sustainability Bond ever issued in Georgia by raising USD 5 million in Georgian Lari equivalent for Crystal. The Sustainability Bond is listed on the Luxembourg Green Exchange, and the proceeds will be distributed over a 3-year period through social and green eligible loans and will be used towards the promotion of sustainable development, SME funding, energy efficiency, and renewable energy. The Social loans will be granted to microenterprises and SMEs to promote their development and support employment in the country. The Green loans will be used for financing energy efficiency, renewable energy, clean transportation, and sustainable agriculture projects.

- ✓ SC Georgia Railway issued US $500 million Green Bond - In June 2021, JSC Georgian Railway (GR), a state-owned railway company in Georgia, issued US $500 million 7-year green bond, listed on the London Stock Exchange. This is the first Green Bond issued by the company. GR's Green Bond Framework is aligned with Green Bond Principles, as validated by S&P Global. The bond proceeds will solely be used to refinance the Company's existing eurobond issued in 2012.

2, Sanapiro Str., Tbilisi 0114, Georgia
Tel.: (995 32) 2 406 488; Fax: (995 32) 2 406 577
Hot line: (995 32) 2 406 406
E-mail: Info@nbg.ge; www.nbg.ge