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SUSTAINABLE DEVELOPMENT | RUSSIA

ESG BOND MARKET: WAITING FOR INCENTIVES

Results of the issue of ESG bonds¹ in Russia in 2022

- **The volume of placements of ESG bonds in the Russian market will exceed RUB 80 bln in 2022**, which is 36% lower than the record year of 2021, but higher than 2020. This result is comparable to trends in the bond market as a whole.
- **In 2023, the situation in Russia's ESG bond market will continue to be determined by several major issuers with state participation.** The volume of placements will be similar to 2022 in the absence of external shocks and regulatory incentives.
- **The global market of new ESG bond issues will shrink for the first time ever in 2022.** The volume of new placements will fall by at least 10% compared to 2021.
- **The performance of the global ESG bond market in 2023 will depend on the depth of the recession in a number of developed countries and interest rates set by central banks.** New instruments and Asian markets may act as drivers of the analyzed market.

According to ACRA's estimates, the volume of placements of new ESG bonds in the Russian market will exceed RUB 80 bln.

In 2022, the Russian ESG financing market managed to avoid a serious decline due to the general normalization of the situation in financial markets in the second half of the year, the entry into the market of several large issuers with state participation, as well as the implementation of previously postponed plans for the placement of ESG bonds.

According to ACRA's assessments, the volume of placements of new ESG bonds in the Russian market in 2022 will amount to more than RUB 80 bln, which is 36% lower than the record achieved last year. Given the placement of Specialized Project Finance Company Infrastructure Bonds worth RUB 15 bln in the segment of national and adaptation projects of the Moscow Exchange's Sustainability Sector, the total volume of bonds placed in this sector is expected at RUB 96.2 bln at the end of the year.

In the absence of external shocks similar to those of early 2022, ACRA expects that in 2023, the volume of new placements in the local ESG bond market will approach the indicator of 2022, even without any regulatory incentives.

In the medium term, it is highly likely that 2021 will remain a record year in terms of placements (RUB 126.5 bln²). In 2021, the market situation developed amid a spike in interest in various ESG instruments and the agenda as a whole, and also reflected

¹ For the purposes of this analytical commentary, ESG bonds are understood as green, social and adaptation bonds, sustainable development bonds, and sustainability linked bonds (SLBs).

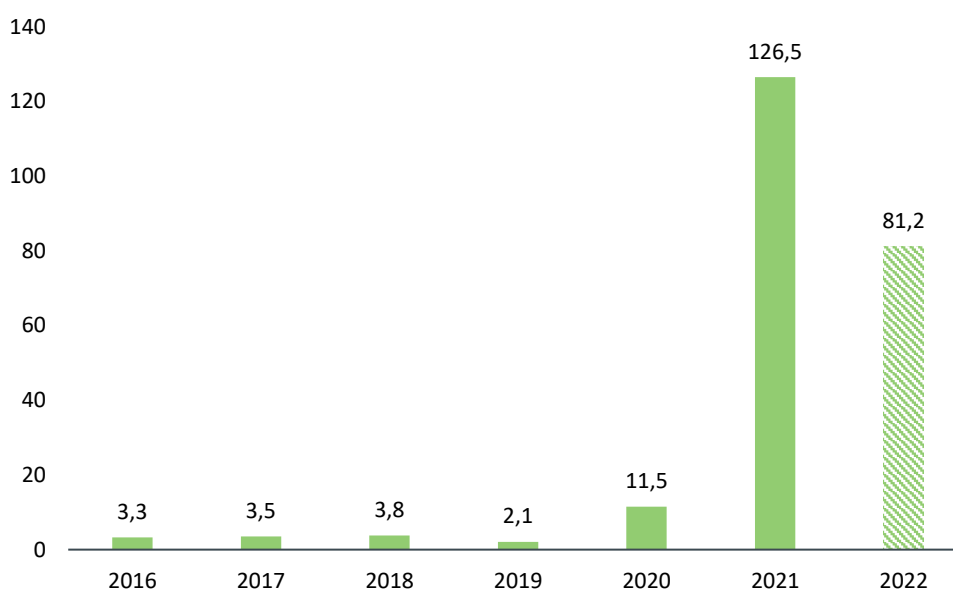
² This indicator does not take into account RUB 20 bln of Specialized Project Finance Company Infrastructure Bonds, which are part of the national projects segment; the secondary listing of SovCom Capital social bonds worth USD 300 mln; commercial bonds of EcoLine-VtorPlast LLC worth RUB 2

In the absence of external shocks similar those of early 2022, ACRA expects that in 2023 the volume of new placements in the local ESG bond market will approach the indicator of 2022.

certain expectations regarding regulatory incentives. These drivers have largely exhausted themselves by the end of 2022.

According to ACRA's preliminary estimates, instruments worth more than RUB 80 bln will be placed in the Russian ESG bond market by the end of 2022. The bulk of this (80%) is green bonds, including those issued by issuers with state participation (State Development Corporation "VEB.RF", LLC "DOM.RF Mortgage Agent" and JSC "Atomenergoprom"). The social bonds of two issuers account for the 20% share: LLC "DOM.RF Mortgage Agent" and PJSC Rostelecom. Expectations for the market entry of new instruments — sustainable development bonds — have not been met, which means they may appear in the future.

Figure 1. Volume of bond placements in the Moscow Exchange's Sustainability Sector³, RUB bln



Sources: Moscow Exchange, ACRA

Given the pause in ESG bond market placements, regulators continued to fine-tune infrastructure for financing sustainable development. In particular, in November 2022, the Bank of Russia expanded the range of regulated sustainable development finance instruments by making changes to the standards for issuing securities. In addition to green bonds, social bonds and sustainability bonds, Russian issuers can now issue adaptation bonds, sustainability-linked bonds, and climate transition bonds.

By the end of 2022, a new version of the national taxonomy of green and adaptation projects is expected to be approved (Government Decree No. 1587 dated September 21, 2021), which will clarify some criteria for existing project categories, as well as introduce new types of projects that can be recognized as green or adaptation projects. It seems that the discussion of the draft social taxonomy will continue in 2023, and the adoption of the document may be postponed indefinitely.

In ACRA's opinion, the expansion of the list of both financial instruments for sustainable development and green and adaptation projects will not become a major

bln, which were not placed in the Sustainability Sector (see ACRA's analytical commentary The Russian ESG Bond Market is Alive from August 18, 2022 for more details).

³ Only ruble-denominated green, social and adaptation bonds included in the Moscow Exchange's Sustainability Sector were taken into account (the bonds of the Transport Concession Company were included in this sector after their placement on the exchange). Placement volumes are displayed in accordance with the dates of placement of bonds on the exchange, and not in accordance with the dates of their inclusion in the Sustainability Sector. RUB 20 bln of Specialized Project Finance Company Infrastructure Bonds, which are part of the national projects segment, and the social Eurobonds of SovCom Capital worth USD 300 mln were not taken into account.

In 2022, the global market of GSS+ bonds will shrink for the first time ever.

driver for the development of the national ESG bond market. However, these changes expand the list of issuers who are potentially able to enter this market.

ACRA still considers the introduction of any benefits for ESG instruments to be unlikely in the short and medium terms. On the other hand, if such benefits (for example, lower risk weights for green bonds on the balance sheets of holders) are introduced, their impact on the market situation will be limited.

As before, the dynamics of the ESG bond market in 2023 will be determined by several large issuers (primarily, government-owned ones) and their issuance plans. In the absence of external shocks for the bond market as a whole, ACRA believes that the volume of new placements on the local ESG bond market next year will be close to that of 2022, while the share of these financial instruments will still be less than 1% of the total volume of the bond market.

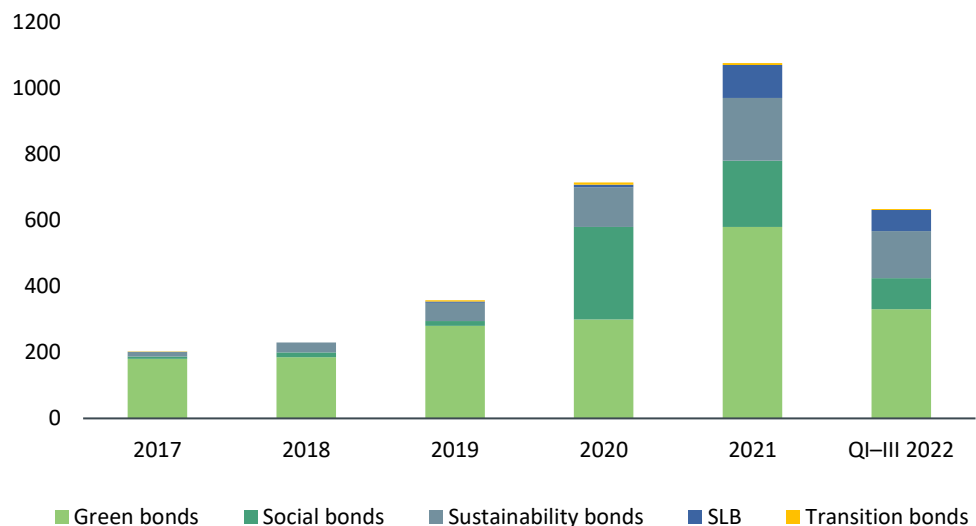
Geopolitical tensions, the cycle of increasing rates by central banks, and expectations of recession in a number of developed economies will result in **lower issuance of GSS+⁴ bonds in 2022, for the first time in the history of the global market.**

According to the Climate Bond Initiative (CBI), the global volume of new GSS+ bond placements decreased by 45% year-on-year in Q3 2022 (by 35% vs. Q2 2022) and amounted to USD 152.3 bln. The accumulated volume of GSS+ bonds issued over three quarters of 2022 exceeded USD 600 bln (Fig. 2).

The main share of GSS+ bonds issued over three quarters of 2022 is occupied by green bonds (52% of new issues). They are followed by sustainable development bonds (22.4%) and social bonds (14.8%). SLBs accounted for 10% of the issues, and less than 1% were transition bonds.

The high likelihood of recession in a number of developed countries along with the cycle of rising central bank rates will result in the global ESG bond market declining by 10–20% (volume of new placements compared to 2021) by the end of 2022. Additionally, the market is restrained by tightening regulatory requirements for ESG bond standards in key markets, primarily in the European Union.

Figure 2. Volume of CBI-certified GSS+ bonds issued globally, USD bln



Source: CBI

⁴ According to the CBI's definition, GSS+ bonds are a set of the following: green bonds, social bonds, sustainability bonds, sustainability-linked bonds, and transition bonds.

According to various estimates, the global GSS+ bond market accounts for about 10% of the global bond market, and this proportion is likely to remain unchanged over the next two to three years. However, as the global economy recovers from the crisis, the issue volume of ‘young’ financial instruments — sustainability-linked bonds and transition bonds — will grow at an accelerated rate. In addition, outpacing dynamics in this segment are expected in Asian countries, primarily in India and China, where the potential of the GSS+ bond market has not yet been fully realized.

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