Chapter 25
Implementation of Sustainable Development Principles into Corporate Risk Management

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25.1 Introduction

Corporate governance is a tool for achieving strategic development goals of the companies, while the most important for the mature corporate risk management system is given priority to identify internal and external risks critical for sustainable development, assessing them and finding optimal ways to minimize, retain and transfer if necessary. Such corporate governance policies and practices may be based on international risk management standards, such as COSO or ISO, specified for various sectors of the economy and types of risks, or adopted by national regulatory authorities in the industries most significant for the national economy. In Russia, such tools are among the requirements ensuring industrial safety, GOST standards, and not the least also, following the acceleration of the trends in the transition to sustainable development, the regulatory leadership of the Bank of Russia.

The influence of regulatory rhetoric, recommendations and finally, various regulations adopted by the Bank of Russia is certainly becoming mandatory for financial organizations under supervisory functions of the Central Bank. However, the Bank of Russia sets the tone in the regulatory impact on public joint-stock companies and creates corporate governance standards, largely determining the requirements for listing such companies on the Russian stock exchange.

The purpose of this paper is to compile different approaches to how climate risks and ESG management can be incorporated into the general governance of the companies.

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25.2 Methodology and Materials

At the current stage, very few native publications on the issue can be found within the Russian scientific landscape as the issue is very new on the corporate and regulatory agenda. This is why our research focuses on the study of regulatory initiatives of the Bank of Russia and recommendations of international public institutions such as COSO and Task Force on Climate-related Financial Disclosures. As in many cases, most of the required changes are still considered as the recommendations in the used materials (Information Letter of the Bank of Russia, 2021; Information letter on recommendations…, 2021; COSO, 2018; Recommendations of the Task Force on Climate-related Financial Disclosures, 2017; The Bank of Russia, 2020).

Climate risks impact quite often requires assessment of the new risks, which in most cases increase corporate exposure to environmental pollution. In ESG strategy, it should be considered as one of the key risks and mitigation of the consequences by buying pollution insurance which can be the easiest and most efficient solution. Necessary facts and illustrations of the problem are based on the research of the Skolkovo task force (Moscow School of Management SKOLKOVO, 2020) and the Russian statistic database (Federal State Statistics Service (Rosstat), 2020).

25.3 Results

The Bank of Russia was one of the first among Russian regulatory bodies in formulating the need to consider the threats of the climate risks to the Russian economy and their influence on the sustainability of economic agents, releasing for public discussion in May 2020 the position paper "The Impact of Climate Risks and the Sustainable Development of the Financial Sector of the Russian Federation" (The Bank of Russia, 2020). For the first time in the Russian Federation, a discussion on the problem of the impact of the climate risks on the short and medium-term sustainability of economic entities within the framework of the Goal 17 of the UN Sustainable Development Goals, "Combating climate change" was initiated. Climate risks in the mentioned position paper, following the understanding of the international non-governmental organizations (Recommendations of the Task Force on Climate-related Financial Disclosures, 2017), are understood as the risks associated with natural disasters and these affecting business organizations:

- physical risks (physical risks: emergency and systemic).
- transitional risks: risks of transition to a low-carbon economy, including political, legal, technological, market and reputational.

Climate risks are caused by global warming, recorded in the observations since the mid-70 s of the last century, and most scientists associate this phenomenon with an increase in greenhouse gas emissions as a result of human activity. This provokes the acceleration of adverse weather events, such as floods, hurricanes, heatwaves,

wildfires, up to the melting of the polar ice and permafrost. In total, according to experts, the damage caused can be estimated at more than 5 trillion US dollars within the last 20 years (Moscow School of Management SKOLKOVO, 2020).

For the Russian economy, such a long-term climate change can have a significant negative impact on the main players in the oil and gas, mining industries, the perpetuation of bioresources and ecosystems in the Far North, and not only, sustainability of the industrial facilities and leaving houses in these territories, the food security for the country population due to the increase in the duration of dry periods in the southern territories of Russia, and, as a consequence, on all other economic agents.

Subsequently, the Bank of Russia adopted further recommendations aimed at the managing of the climate and green transition risks in the corporate governance, in particular in the Recommendations of the Bank of Russia on Disclosure of Non-financial Information dated July 12, 2021 (Information letter on recommendations…, 2021), and the Information Letter of the Bank of Russia (2021).

Corporate governance usually develops based on two compulsions. The first compulsion is external, that is, arising out of the requirements of regulatory authorities. The second is those voluntary priorities that the economic agent sets for himself and implements through corporate policies. Adherence to a certain strategy, including the risk management strategy for the climate and environmental, social and governance (ESG) risks, is driven not only by the certain already formed regulatory pressure from the Bank of Russia but also by tectonic changes in the global economy. As the result of growing awareness of the need for the so-called "green transition" to a low-carbon economy, the need to reduce CO_2 gas emissions and the responsible economic behaviour of the agents in the global economy.

Main ESG factors impacting corporate governance require adopting a long-term development strategy including the achievement of Sustainable Development Goals. The second is the assessment of the climate risk exposure. The third is the assessment of environmental and social risks. All together these components should be combined in the Corporate Governance Code approved by the Board of Directors. For effective corporate governance, it is of utmost necessity that the Board of Directors designates the ESG agenda as a priority, appoint responsible persons engaged in developing the ESG strategy, monitoring the implementation of goals in the activity of all divisions and at all levels of the company ("tone from the top" in COSO standards (COSO, 2018)). Many economic agents are already noting the need for special ESG compliance procedures to achieve these goals, the creation of special units coordinating ESG policies and practices and the nomination of a special ESG-officer (Moscow School of Management SKOLKOVO, 2020) (Fig. 25.1).

At the same time, the company annual report, in addition to the financial statement, should disclose the provisions and metrics adopted to measure implementation of the ESG strategy, within non-financial reporting. However, all the priorities to achieve Sustainable Development Goals, ultimately, must have a material dimension.

The target metrics of the corporate strategy should be specific and achievable based on the global corporate governance and corporate risk management system (Table 25.1).

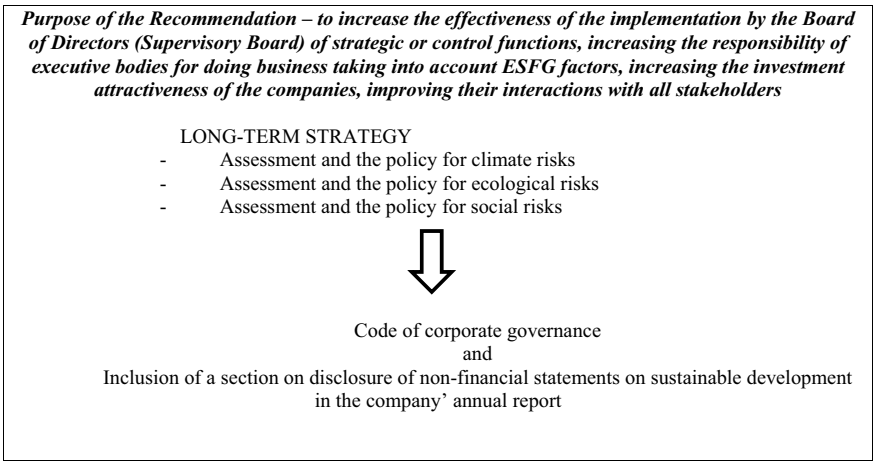

Fig. 25.1 Corporate governance code structure reflecting ESG impact. *Source* compiled by the author based on the publication of the Bank of Russia

Table 25.1 Structure and content of the non-financial report

Composition of non-financial statement on sustainable development in the company' annual report • Information about the sustainable development strategy • Information about corporate governance • Information about the business model • Information about policies and procedures, indicators (metrics) and their achievement • Information about the main risks and opportunities	
Sustainable development issues in the company corporate strategy, target metrics to reach, including Metrics from Paris agreement national strategical goals in ecology, social aspects and economy	
Information of corporate management in the company	
Business model	
Disclosure of substantial Information	
Description of substantial topics	Disclosure of the information for all relevant topics subject to the report structure
Policies and procedures	
Results of the implementation of policies and procedures	
New risks description and risk management of these risks and opportunities	
Key indicators of corporate efficiency	

Source Compiled by the author based on the publication of the Bank of Russia

The current stage of ESG management development assumes that the Board of Directors and top management of the company should develop and implement an assessment of ESG factors significant for achieving corporate goals in all three ESG components—the company itself, its suppliers and finally, consumers of the company production. When the first component reflects the company's own "carbon footprint" (or S1 as in the accepted international vocabulary (Recommendations of the Task…., 2017)), the next two (S2 and S3) require close cooperation with suppliers and consumers to access their carbon impact, and at the same time, these risks/exposures should be a part of operational and compliance risk management procedures.

The second direction of the corporate action, especially important at the present stage of the green transition in Russia, is education and implementation into the mentality and practical day-to-day activity of the employees' importance of the ESG agenda and its priority in the strategic development of the company.

It is customary in the risk management guides to distinguish two levels of the implementation of ESG principles. The first one, at the inner level, includes the internal rules of the company's activities and metrics, including electricity consumption, workplace ergonomics, employee behaviour, and so on. The second component includes the principles of the "foreign" policy in order to achieve ESG metrics. In the insurance, for example, it can also be divided into two parts: first, green insurance products, fast claim settlement, easy process to sign the insurance and pay the claims, and secondly, investment strategy as the insurers is one of the main players in the long-term financial markets, and with "green appetite" can strongly change the availability of the resources for the green transition.

Sustainable insurance as an important element of ESG risk management of economic agents significantly expands an offer of specially designed programmes to ensure a green transition in agribusiness, aviation, maritime transportation, transportation of dangerous goods, cyber security risks, and pollution insurance.

Let us consider in more detail the factor of the pollution insurance in case of industrial incidents or other sudden adverse events in the climate risks mitigation. The connection of the climate risks with a possible increase in the frequency of such incidents is considered as a consequence of the changes in the natural environment. As it was shown above, the melting of permafrost in the Arctic can lead to a change in the state of the soils on which large industrial facilities are built, which can entail the occurrence of emergencies with an increased number of cases of environmental pollution. Similarly, in the other regions, a change in the usual natural environment can trigger dangerous incidents, for example, overheating of equipment or oil storage facilities in the absence of additional cooling can lead to the explosions of fuel or lubricants and environmental pollution.

Only in 2020, Rosprirodnadzor initiated 632 cases of environmental damage of 234.7 billion rubles, and only 0.01% was paid by the harm-causing enterprises voluntarily, the remaining amounts are recovering in court. The average amount of the claim was 231 million rubles. However, the available examples show that the actual damage caused can significantly exceed the average values. When dams were breached and the Vilyu River was polluted in 2018, environmental damage amounted to 27 billion rubles. During oil spills in Yugra due to the deterioration of the pipeline infrastructure

in 2019, almost 2.7 thousand hectares of the land were contaminated with petroleum products and the amount of damage caused was more than 7 billion rubles. The fuel spill at the production facility of "Norilsk-Taimyr Energy Company" in 2020 caused damage to the environment in the amount of 148 billion rubles, according to Rosprirodnadzor. Ministry of Natural Resources reported that Russia loses 4–6% of GDP annually from environmental disasters, an increase in morbidity and mortality of the population. According to the experts, direct and indirect economic damage from emergencies caused by abnormal hydrometeorological and man-made catastrophes in the whole country on average is higher than 60 billion rubles per year (Federal State Statistics Service (Rosstat), 2020).

Insurance allows building a source to compensate damage or harm caused, independent of the financial state of the harm-doer or to compensate the harm-doer himself for the costs incurred in clearing contaminated areas, water or to finance the costs of restoring biological resources. The use of insurance can significantly reduce one-time costs for environmental restoration, and for this reason, the use of environmental insurance in climate risk management should be considered positively by ESG rating agencies.

Traditionally, pollution insurance involves the following types of compensation (payments of insurance compensation to the insured or payments to the owners of the nature protected objects and facilities):

- direct environmental damage (or restoration costs);
- expenses for clearing of the polluted territories, water, forests, etc.;
- payments for causing bodily injuries;
- payments in case of the business interruption for the period of the recovery after the incident and clean-up works;
- costs of biodiversity restoration.
- damage caused during the transportation of dangerous goods.
- expenses for the legal protection of the policyholder in court when suing state environmental authorities.

In the Russian specific case, the possibility of introducing mandatory environmental insurance as a form of ensuring the payment of the damage in the event of an industrial incident is being actively discussed. It must be recognized that in a country such as the USA or most European countries, which account for more than 60% of the global insurance premium and have a developed insurance market offering a variety of insurance products, where standards of corporate risk management are quite high, there is no need to consider the introduction of mandatory pollution insurance. Economic agents independently build their risk management systems considering the need for risk transfer in a case when risk appetite to keep pollution costs is low. On the contrary, for developing markets where legal practices for the recovery of the damages have not been fully formed, in countries such as Brazil, China and Russia, the topic of mandatory environmental insurance is being seriously discussed with the purpose to adopt limits of the insurance cover high enough to protect the interest of society in restoring damage caused to the environment.

Finally, the main concerns of the Bank of Russia are related to the impact of climate risks, if they can put significant pressure on the financial stability of financial institutions, both increasing its liabilities and reducing the asset value of the investments, which can suffer from the exposure to physical risks and risks of the green transition. The same leitmotif is presented in the latest study of the International Association of Insurance Supervisors and banks regulatory community. The tools for assessing the impact of such risks are scenario modelling, stress test modelling, and with this help, it is possible to prove to both the regulator and other stakeholders on how ESG factors affect the sustainability of the financial market players. The approbation and adaptation of such models to the specific environment of the economic agent should also be considered as an element of the corporate model for climate and ESG risks management.

25.4 Conclusion

We proved in the study that the traditional model of corporate management is under strong pressure by changing climate and ESG risks and regulatory pressure. These changes require logical changes in the corporate management practice following recommendations from international institutions such as COSO and Task Force on Climate-related Financial Disclosures and Russian Central Bank as well. Homework for the changes should include climate risks assessment and modelling of the potential damages to the environment. Role of the pollution insurance increase in the metrics of the management efficiency.

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