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THE RELATIONSHIP BETWEEN ESG RATINGS AND THE RESPONSE OF MULTINATIONAL BANKS TO RUSSIAN AGGRESSION

Abstract. The study results of the influence of ESG and sustainability ratings on the multinational banks' war response strategies based on the Yale CELI database of companies leaving and staying in Russia are presented. The findings are interpreted through the nonlinear inverted U-shaped relationship between corporate social performance and firm value. The advisability of improving the methodologies of ESG rating providers is substantiated.

Keywords: multinational banks, business war response, ESG, SDG Impact rating.

Introduction. The international business community's ambiguous response to the full-scale armed aggression of Russia against Ukraine has brought to light the issue of identifying the factors affecting the decisions of transnational companies and banks regarding their further functioning in the market of the invading country. Based on the logical association of strong war response with corporate sustainability, some researchers have studied the influence of such factors as Environmental, Social, and Governance ("ESG") ratings [1; 2]. However, these studies do not take into account the banking sector specifics, and their results are inconsistent. The multinational banks that continue to do business in Russia play a significant role in supporting its financial system. At the same time, they declare commitment to sustainable banking principles and actively use non-financial reporting and ESG ratings in competition because it affects reputational risks. This determines the relevance of studying the dependence of the banks' decisions to leave the invading state on ESG rating assessments.

Purpose. This study aims to examine how multinational banks' ESG and social performance influence their strategies for presence in the Russian financial market due to armed aggression against Ukraine.

Results. The study was conducted on the Yale CELI dataset [3] and included two stages [4]. In the first stage, using the tree classification method based on the Chi-squared Automatic Interaction Detector (CHAID) and Exhaustive CHAID algorithms, the influence of ESG scores and Sustainable Development Goals (SDG) Impact rating on the bank's decision on whether to curtail operations in the invading country was examined together with some financial and country-specific factors.

The following ESG and SDG indicators provided by seven leading rating agencies were analyzed in the study as independent variables: S&P Global ESG Score, its Social component, Moody's Investors Service ESG Credit Impact Score (CIS), Social CIS, MSCI ESG Rating and ESG Controversies indicators, Sustainalytics ESG Risk Rating, ISS ESG Corporate Rating, ISS SDG Impact Rating, Refinitiv ESG Score, its Human Rights component [8], and CSRHUB ESG

Ranking. The impact of each indicator on the dependent variable was studied in separate models, as the assessment items were identical or similar. An exception was made for MSCI ESG Rating and MSCI Social Controversies as they refer to different dimensions of corporate sustainability and are not correlated. Therefore, their influence was examined within the same model.

The results of constructing a classification tree showed that none of the above indicators assessed by ESG providers influence the distribution of banks into groups based on their reaction to Russia's violation of international law (banks completely exiting the invading country or at least curtailing operations significantly, those holding off new investments and financial institutions doing business as usual). It should be emphasized that this conclusion is applicable not only to ESG metrics that assess the impact of a bank's environmental, social, and governance performance on its risk exposure and resilience but also to sustainability indicators that measure the influence of banking operations on society and the environment. Thus, the study provided no empirical evidence in favor of the hypothesis that the higher the ESG rating, its social and human rights components, and the SDG Impact rating of a bank, the more likely it will cease operations in the aggressor country, which is consistent with the research results of Ahmed et al. [1].

In the second stage of the study, the ESG and social performance indicators of those multinational banks that completely exited the Russian market or at least significantly curtailed operations there despite the sale restrictions were analyzed. Upon comparative analysis, the rating agencies evaluate them better than the industry average. This applies to all such banks, without exception, in the context of assessing the S&P Global Social Score, the Refinitiv ESG Score, determining the MSCI ESG Rating, and the CSRHUB ESG Ranking. It is worth noting that 80% of these banks have the highest category, according to CSRHUB. Moreover, among the banks demonstrating a strong war response, 92.8% have better than the average S&P Global ESG Score, and 73.3% - have a high ISS ESG Corporate Rating.

At first glance, the results obtained in the first and second stages of the study are contradictory to a certain extent. However, they can be explained by a non-linear inverted U-shaped relationship between corporate social performance and firm value, which is a decision criterion in most cases. [5]. The social performance that aligns with applicable laws, business rules, and customs maximizes the financial result. As a rule, poorer performance decreases firm value due to possible sanctions and negative stakeholders' reactions. The leaders' activities beyond the current legislation and business practice requirements often do not receive a positive assessment from the market on time, and the values of financial indicators may worsen.

In the context of the war response of multinational banks, the optimum point described above is determined by the financial sanctions of G7 and EU member-states, sell restrictions, and institutional pressure. It is widely known that these factors have a much more strong impact on banks headquartered in G7 and EU countries. Therefore, to continue operating in Russia, such banks need serious arguments, for example, justification for the impossibility of selling assets due to restrictions on sales. However, the current sanctions do not provide for a direct ban on the activities of multinational banks in the Russian financial market.

The research has shown that none of the G7 or EU banks with assets in Russia up to \$1 billion have conducted business as usual in that financial market despite being subject to sell restrictions. Even those who limit themselves only by holding off new investments do not formally violate the current legislation, business rules, and customs. Hence, there is no ground for reducing their ESG scores and ratings. To a certain extent, this also applies to banks with particularly significant assets in Russia that have chosen the "buying time" strategy, appealing to the lack of alternatives to their choice, primarily due to the sell restrictions. Such banks also argue to be driven by social responsibility to staff and customers, although this could be interpreted as "woke-washing" or "bluwashing" [6;7].

Based on the inverted U-shaped relationship between corporate social performance and firm value, acting beyond the current legislation and business practice requirements is much more likely for banks whose possible financial losses are compensated by a positive market reaction. The reaction to social initiatives mainly depends on the perception of the company's level of social responsibility [8]. If it is positive, the likelihood that social performance pays off

is high. The above explains why multinational banks with similar ESG scores may implement different war responses and why exit strategies from the Russian market are mainly typical for banks highly rated by ESG providers.

Since G7 and EU sanctions do not include a direct ban on the activities of multinational banks in the Russian market, their war response primarily depends on whether and how much it will affect the ESG ratings. The existing methodological approaches to ESG risks and SDG impact assessment suggest the possibility of evaluating the ethics issues of doing business as usual in an invading state. In particular, this applies to Moody's Investors Service cross-sector rating methodology that includes a risk subcategory called Social Responsibility, which falls under the Demographic & Societal Trends category [9]. Even more specifically, the possibilities for assessing these types of issues are provided by MSCI [10] and Institutional Shareholder Services. For example, according to the MSCI SDG Alignment Methodology, banks must contribute to reducing global violence and related deaths to achieve target 16.1. Peace, Justice, and Strong Institutions.

It should be noted that although the methodology allows for adjustments in the ESG score and SDG impact assessment based on a bank's decision to either remain in the market of an aggressor state or to leave, the rating agencies are implementing this opportunity too carefully for now. For instance, Sustainalytics has included an evaluation of Business Resilience Risk due to the war in Ukraine and the Repercussions of this war in its ESG Risk Ratings methodology. However, this evaluation only pertains to the risk of sanctions evasion relative to peers. S&P Global noted in its report that it credits the socially responsible exit of Societe Generale from Russia but does not yet reduce the ratings of banks that continue doing business as usual there.

Conclusions. The influence of ESG and sustainability ratings on the multinational banks' decisions on whether to leave the financial market of the invading state reflects the nonlinear relationship between corporate social performance and firm value. Improving the ESG providers' methodologies based on a clear definition of socially responsible business reaction to armed aggression is needed to stimulate the implementation of business strategies aimed at cessation of financing the invading country.

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