Enabling the Climate Transition in India

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Former US President, Mr. Barack Obama said "We are the first generation to feel the effect of climate change and the last generation who can do something about it."

Climate change is manifesting itself at an alarming scale and pace globally, undermining livelihoods, infrastructure and endangering health, food, energy and water security. It poses a great threat to the long-term growth and prosperity and has the potential to create shocks to monetary stability, growth, financial stability and the safety and soundness of Institutions.

In 2021, at COP26, India presented 'Panchamrit' of India's climate action:

- Reach 500 GW non-fossil energy capacity by 2030.
- 50 per cent of its energy requirements from renewable energy by 2030.
- Reduction of total projected carbon emissions by one billion tonnes from now to 2030.
- Reduction of the carbon intensity of the economy by 45 per cent by 2030, over 2005 levels.
- Achieving the target of net zero emissions by 2070.

At COP-28, Prime Minister Shri. Narendra Modi highlighted the need to implement Nationally Determined Contributions (NDCs) and voiced concerns on behalf of the Global South. The initiatives launched, including LeadIT 2.0 for industry transition, the Green Credits Programme incentivizing pro-environment actions and the focus on the Himalayan region's vulnerability, demonstrated India's commitment to diverse strategies for sustainable development.

There is a growing recognition that even if Governments are the most influential agency for climate change, central banks and financial sector regulators/supervisors are also the major stakeholders because (1) financial institutions play a key role in intermediation and hence, have a more direct role in addressing climate change; and (2) climate change is impacting the achievement of their mandates of price and financial stability.

RBI, wayback in 2007, had first highlighted the Role of Banks, highlighting the importance of global warming and climate change in the context of sustainable development.

In 2021, the SEBI took a big leap in promoting sustainable practices in companies by introducing a framework for reporting such actions. Business Responsibility and Sustainability Report (BRSR) mandated the top 1,000 listed companies (by market capitalisation) to start reporting from FY23. It aimed to establish links between the financial results of a company with its environmental, social and governance responsibilities.

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RBI created a Sustainable Finance Group within Department of Regulations and in early 2022 conducted a Survey on Climate Risk and Sustainable Finance to assess the status in leading scheduled commercial banks. This was followed by a Discussion Paper on Climate Risk and Sustainable Finance that delineated in detail the sources of climate risk as also potential impact arising there from on the Regulated Entities (REs). It had also detailed therein the need for all REs to have appropriate governance, strategy and risk management structure to manage climate change risk.

More recently in February 2024, RBI decided to put in place a standard Disclosure framework for Regulated Entities on Climate-related Financial Risks. Climate-related disclosures by REs is an important source of information for different stakeholders (e.g. customers, depositors, investors and regulators) to understand relevant risks faced and approach adopted to address such issues. The REs are already required to disclose information on material risks as a part of their Pillar 3 disclosures. Given the growing importance of climate-related financial risks, there was a need for REs to disclose a more structured information about their climate-related financial risks. This will foster an early assessment of climate-related financial risks and opportunities and also facilitate market discipline.

How are Banks seeing these developments. I think Leaders at banks are unequivocal – climate change is the biggest emerging risk they face. As extreme weather events continue to affect all of us and the world moves toward establishing a lower-carbon economy, the banking industry is working on two intertwined objectives. At the same time as figuring out the impact of climate change on their own strategy and operations, banks need to help their customers navigate this complicated and fast-moving market dynamics too.

There are three challenges which most banks perceive:

Key challenge 1: Risk Assessment

Typically, banks put climate-related risks into two buckets:

- Physical risks cover those that impact the premises and operations of the bank, its customers and the wider economy. They include extreme weather events and long-term shifts in climate leading to the closing of branches or facilities, negatively impacting the creditworthiness of clients and adversely affecting asset prices.
- Transition risks cover those that impact a bank's products and services as a result of the move toward a lower carbon economy. They include the extent to which a bank funds or has stakes in companies that emit Greenhouse Gases (GHGs), evolving stakeholder expectations and associated legal or regulatory changes.

Both these risks have a direct impact on credit worthiness and likelihood of default for credit exposures. Effective management of climate risk requires its integration throughout existing workflows as a dimension of overall risk for banks. The integration enables banks to assess the impact of climate on their customers' credit quality to make an informed lending decision.

Key challenge 2: Lack of Industry Standards

The second challenge is that there is no standardized industry model for how to embed climate risk into risk management. Industry bodies at a global level remain some way away from consolidating frameworks and standards, so it is likely that banks will have to navigate their way through a range of different methodologies in the short term.

Further, Climate change regulation and disclosure requirements are rapidly evolving and are region-specific. The regulatory framework includes guidelines and standards for ESG reporting and disclosure, as well as requirements for companies to establish policies and procedures. Some of the prominent global ESG/sustainability disclosures and frameworks include the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), United Nations Global Compact (UNGC), and Carbin Disclosure Project (CDP). Each of these frameworks outlines specific Key Performance Indicators (KPIs) and principles that companies are required to disclose to showcase their sustainability efforts.

Bankers globally see a lack of necessary data, a lack of clarity around regulatory/supervisory expectations and a lack of agreed industry methodologies. This infact was a take away during our recent discussions with Board Members of International Banking Federation (IBFed) too.

Key challenge 3: Skills Shortages

The third challenge faced by banks– a lack of relevant skills. Executives with expertise in climate science and risk management are both thin on the ground and in high demand across all industries, so banks need to plan accordingly.

Role of Indian Banks' Association (IBA)

RBI's "Discussion paper on Climate Risk (CR) and Sustainable finance (SF)'', released in July 2022 mandated IBA to create awareness and capacity building among banks.

To embark on this journey, we constituted a dedicated IBA Standing Committee on ESG last year. As a part of our endeavour in capacity creation, we have been conducting series of webinars on different topics viz. Introduction to ESG, Transition Finance, Sustainable finance landscape, Risk Management, sector specific studies-from US/EU markets, focus on bio-diversity, Data use and climate strategy, financed emissions, Transition Planning/Finance and Taxonomy etc. and take up topics as desired by members in the specific subject area of ESG. This is being done in collaboration with various domestic and international organizations like AFD France, Climate Bond Initiative, Climate Policy Initiative, WWF India, Carbon4, Shakti Sustainable Foundation, Asia Securities Industry & Financial Markets Association (ASIFMA), PwC, BCG, ERM, RMI India, cKinetics, etc.

IBA is also working closely with Government, Industry bodies and their Associations, global-domestic Experts/various bodies, Banks/FIs, Industry etc. for the united approach of sectoral study on other hard-to-abate sectors like Iron & Steel sector, Cement, Power, Transportation, Refineries, Agriculture & Allied Sector, Chemicals, Pharma etc. will help to arrive on acceptable solutions, creating a definite roadmap with action plan for creating the necessary enablers in the ecosystem so as to reduce the carbon emissions in a targeted manner and achieve the desired net zero target towards our action on Climate change.

We at IBA had series of meetings with our member banks and are in discussions with RBI and SEBI in representing the banking side concerns on reporting requirements, like on the extent these KPIs may be attributable to the banking sector. Currently, the BRSR Core does not offer guidance on the extent of applicability, hence, the reasonable assurance provider is mandated to assess an entity on all 9 KPIs, even if certain KPIs may not be material/applicable for the nature of business of the entity.

Challenges

While it is important for India to raise the bar on ESG reporting, globally too ESG reporting is at an evolving stage. The RBI's climate-related financial disclosures will rapidly percolate ESG risk identification and management to the organized sector, as the banks will now request their borrowers to report both their emissions and their exposure to other climate risks. Longer timelines may be needed by banks to ensure readiness for compliance.

Conclusion

Most Banks in India have or are in process of formulating an approach to address risks emanating from climate change, as part of their Risk Management Framework. As climate risk management is at a nascent stage in the Indian banking industry and regulations in this regard are being formulated, Banks will ensure that gradually the approaches evolve and get refined for integration of climate risk management within the risk management framework. IBA as an Industry body along with IIBF will work on capacity building and skilling the banking sector as well as work closely with the Government, Regulators, Global Bodies and other stakeholders and help our country in transition and achieve its Net Zero Targets.

Climate change is the defining crisis of our time and it is happening even more quickly than we feared. But we are far from powerless in the face of this global threat. As UN Secretary-General said, "the climate emergency is a race we are losing, but it is a race we can win".

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BANK QUEST THEMES

The themes for "Bank Quest" are identified as:

1. July – September, 2024: Emerging trends in International Trade and Banking
2. October – December, 2024: Emerging opportunities for savings and investments
3. January – March, 2025: Cyber Risk Management

IIBF organised a Banking Conclave in collaboration with UNEP-FI and GIZ

IIBF organised a Banking Conclave on "Enabling the Climate Transition in India" in collaboration with UNEP-FI and GIZ on 10th June, 2024 at Taj Mahal Tower and Palace, Mumbai. The objective of Banking Conclave was to delve deeper into the roles and responsibilities of Board members and Senior Management of the Financial Institutions, in advancing India's climate ambitions. The event was attended by top dignitaries and Senior professionals from Banking & Financial Institutions and was appreciated by the attendees.