Discussion Paper on Climate Risk and Sustainable Finance | *Submission to the Reserve Bank of India*

September 2022

V | D H | Centre for Legal Policy

About Vidhi

Vidhi Centre for Legal Policy (Vidhi) is a not for profit independent think-tank doing legal research to make better laws and improve governance for the public good.

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Background

In furtherance to the announcement made in the Statement on Development and Regulatory Policies in April 2022, the Reserve Bank of India (**RBI**) released a Discussion Paper on Climate Risk and Sustainable Finance on 27th July 2022 (**DP**). It also released a report of the Survey on Climate Risk and Sustainable Finance carried out by the Sustainable Finance Group in the Department of Regulation, RBI in January 2022 (**Survey**) to assess the approach, level of preparedness and progress of 32 scheduled commercial banks.

The intent behind the DP appears to be to start a discussion on the strategy to address climate change by regulated entities of the RBI (**REs**), and move towards green financing and ensure long term systemic stability of the financial system. The DP delves into the two types of climate associated risks which may impact the financial sector: physical risks and transition risks. These risks may impact the internal functioning of the financial institution itself, as well as the core business of the financial institution in terms of lending, investment and acting as a financial intermediary. The DP sets out certain good practices for REs to follow, and ultimately provides a climate-related financial disclosure framework (**Proposed Framework**) which is largely aligned with the Task Force on Climate-related Financial Disclosures (**TCFD**) set up by the Financial Stability Board. The Proposed Framework is based on four thematic areas: governance, strategy, risk management, and metrics and targets, which seek to address the financial risks and opportunities posed by climate change in relation to regulated entities.

In terms of implementation of the Proposed Framework, the DP suggests a 'comply or explain' approach, with annual disclosures. Further, the DP also highlights the importance of capacity building as well as voluntary initiatives.

Our Submission

Comments and recommendations

A. DEVELOPING A GREEN TAXONOMY IN LINE WITH INTERNATIONAL STANDARDS

A.1. The need for a green taxonomy

Green taxonomy may be understood as a classification system for green activities, which helps in directing capital flows towards financial activities which are holistically and universally understood to be 'green' under the said taxonomy. It helps investors in understanding about investments which qualify as 'green' and certain financial products or corporate bonds use national labels to enhance investor confidence and awareness, create visibility and address the concerns of green washing. Green washing refers to the "*practice of gaining an unfair competitive advantage by marketing a financial product as environmental friendly, when in fact basic environmental standards have not been met*".[1] While many countries use national classification systems for green activities, this may result in different criteria being used by different countries, resulting in making it cumbersome for investors in making cross-border investments. It may also result in lack of regulatory clarity for banks, financial institutions, and issuers who may have a lack of understanding in terms of what qualifies as a green finance activity. Lack of a uniform classification system, more so at the international level, can be significantly burdensome on investors in terms of comparing financial products, may result in increase in costs and lack of investor confidence, all of which can have a highly detrimental impact on the green financing market.

A green taxonomy helps in achieving the following objectives: (i) creating a common understanding for various users (financial institutions, policymakers, investors) to identify and develop green projects, (ii) support investor confidence and prevent green washing, (iii) boost green finance flows from various sources such as private sector and international investors, (iv) track green finance investments, and (v) inform and help shape national policies and regulations on green finance.

[1] Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 [2020] OJ L198/13, Para 11 (**EU Taxonomy**)

The International Financial Services Centres Authority (**IFSCA**), which is the unified financial regulator in the IFSC in Gujarat, which is an international financial hub, released the Guidance framework on Sustainable and Sustainability linked lending by financial institutions in April 2022 (**IFSCA Guidance**).[2] The main requirement of the IFSCA Guidance is for banking units and financial companies in the IFSC to have in place a board approved policy on green and sustainable lending by 31 March 2023. However, in terms of the manner of assessment to determine whether a project meets the green criterion, the guidance stipulates that it may be done on a case-to-case basis, and based on mutual agreement of the borrower and lender. For short-term trade finance to be evidenced as green, again, the onus is on the board to develop an internal policy on such classification. The guidance refers to various international principles that may also be used, however, there is no way to determine if a common or uniform standard is being applied by all banking units and financial companies in the IFSC, as well as their borrowers. Further, it provides for de-classification of lending facilities based on a pre-agreed mechanism between the borrower and lender. Thus, it appears that the method to determine whether a financial activity qualifies as 'green' is not uniform and differs on a case-to-case basis.

The Security and Exchange Board of India (**SEBI**) in its consultation paper on "*Green and Blue Bonds as a mode of Sustainable Finance*" recognizes the issue of green washing and the need for having a green taxonomy to prevent it.[3] It further mentions that in absence of widely accepted standards and taxonomies, banks and lenders are cautious about financing green bonds, and issuers are also cautious to not issue a bond which may not be sufficiently green due to lack of a green assessment framework as they would not want to risk their reputation. The operational circular for the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021[4] requires the issuer of green debt securities to disclose the process followed in determining how the project fits with the definition of green projects[5] and provides an option to the

[2] The International Financial Services Centres Authority, *Guidance framework on Sustainable and Sustainability linked lending by financial institutions* (Consultation Paper, March 2022).

[3] Securities and Exchange Board of India, *Green and Blue Bonds as a mode of Sustainable Finance* (Consultation Paper, August 2022), Available at: https://www.sebi.gov.in/reports-and-statistics/reports/aug-2022/consultation-paper-on-green-and-blue-bonds-as-a-mode-of-sustainable-finance_61636.html (last accessed 20 September, 2022).

[4] Securities and Exchange Board of India, Operational Circular for issue and listing of Non-Convertible Securities (NCS), Securitised Debt Instruments (SDI), Security Receipts (SR), Municipal Debt Securities and Commercial Paper (CP) (August, 2021), Available at: https://www.sebi.gov.in/legal/circulars/aug-2021/operational-circular-for-issue-and-listing-of-non-convertible-securities-ncs-securitised-debt-instruments-sdi-security-receipts-sr-municipal-debt-securities-and-commercial-paper-cp-_51761.html (last accessed 23 September, 2022).

[5] Regulation 2(q) of the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021 defines "Green debt security" to mean a debt security issued for raising funds that are to be utilised for project(s) and/or asset(s) falling under any of the following categories, subject to the conditions as may be specified by the Board from time to time: (i) Renewable and sustainable energy including wind, solar, bioenergy, other sources of energy which use clean technology, (ii) Clean transportation including mass/public transportation, (iii) Sustainable water management including clean and/or drinking water, water recycling, (iv) Climate change adaptation, (v) Energy

issuer to appoint an independent third party reviewer / certifier for the same. It also requires the issuer to maintain a decision making process to determine the continuing eligibility of the green project. Entities such as State Bank of India have their own green bond framework, which relies on certain international standards to identify green projects, and allocate the proceeds of such green bond investments in specified sectors. It also has a green bond committee, a labeling mechanism for monitoring the project, followed by reporting, and assurance mechanisms.

From the above, it is clear that the financial sector in India lacks a uniform green taxonomy. The Department of Economic Affairs, Ministry of Finance, set up a Task Force on Sustainable Finance in 2021[6], where one of the terms of reference was to prepare a green taxonomy for sustainable finance. However, there seems to be no publicly available information for the same, and the DP also does not mention any progress made in this regard.

A.2. Components of a Green Taxonomy

An overview of the internationally developed green taxonomies reveals that the EU Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment[7] (**EU Taxonomy**) has been adopted by most countries. It applies to not just banks, but also to other financial market participants such as insurance companies, pension product manufacturer, portfolio management firms etc. Primarily, it establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable. For this purpose, it defines terms relating to green financing (such as climate change mitigation, climate change adaptation, environmentally sustainable investment etc.), lays down environmental objectives for which the economic activity is required to be calibrated for substantial contribution (such as climate change mitigation, climate change adaptation), sets out a technical screening criteria for each environmental objective and lays down provisions for setting up a platform on sustainable finance. In terms of sector specificity, the commentary to the EU Taxonomy states that the technical screening criteria for certain sectors such as infrastructure and transport[8] should be appropriately developed, taking into account special factors that affect the said sectors. Further, it states that relevant economic activities within a sector, which contribute equally to

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efficiency including efficient and green buildings, (vi) Sustainable waste management including recycling, waste to energy, efficient disposal of wastage, (vii) Sustainable land use including sustainable forestry and agriculture, afforestation, (viii) Biodiversity conservation, or (ix) a category as may be specified by the Board, from time to time (Source: https://www.sebi.gov.in/legal/regulations/apr-2022/securities-and-exchange-board-of-india-issue-and-listing-of-non-convertible-securities-regulations-2021-last-amended-on-april-11-2022-_58126.html)

[6] Ministry of Finance, Government of India, *Economic Survey 2021*-2022, (2022), page 255, Available at: https://www.indiabudget.gov.in/economicsurvey/ebook_es2022/files/basic-html/page255.html (last accessed 22 September, 2022)

[7] *Supra* note 1

[8] *Supra* note 1, para 44, 49.

the environmental objectives should be treated equally. The information regarding environmentally sustainable economic activities may be used in standards, labels, pre-contractual disclosures and periodic reports. The South African Green Finance Taxonomy, 2022[9] is largely based on the EU Taxonomy. However, it goes a step ahead and identifies economic macro-sectors for which technical screening criteria is developed. The identified sectors are: agriculture, forestry and fisheries; manufacturing industry; energy; water and waste; transportation; ICT; construction and enabling activities, system resilience and innovation. The IFSCA Guidance lays down a list of illustrative categories of green projects, which include climate change adaptation, clean transport, renewable energy etc., however, high risk sectors as identified in the EU Taxonomy and the South African taxonomy are missing.

Certain international climate finance related disclosure frameworks require banks to identify or provide mechanisms to identify high risk sectors. For example, the Singapore Guidelines on Environmental Risk Management for Banks released by the Monetary Authority of Singapore (**MAS**) in 2020[10] (**MAS Guidelines**) suggest that banks should apply risk criteria such as level of greenhouse emissions, vulnerability to extreme weather events, and linkages to unsustainable energy practices, deforestation and pollution to identify sectors with high risk. It states that they should develop sector specific policies for the purposes of risk identification and assessment, which sets out the banks' expectations from its customer, and also take into account internationally recognized standards and certification schemes. The Hong Kong Monetary Authority's (**HKMA**) Manual on Climate Risk Management[11] (**HKMA Manual**) also requires that for assessment of risk at the portfolio level, the financial institutions should identify high-risk asset portfolios based on sectors and geographical exposures by making reference to the TCFD documents, national and international standards and certification schemes. The TCFD 2021 framework requires that the entities identify significant concentration of credit exposure to carbon-related assets, where the term 'carbon-related assets' is suggested to be defined by banks as assets linked to sectors such as energy, transportation, materials and buildings and agriculture, food and forest products (and exclude sectors such as water utilities and independent power and renewable electricity producer industries).

[9] National Treasury, Republic of South Africa, *South African Green Finance Taxonomy 1st Edition* (March 2022), Available at: http://www.treasury.gov.za/comm_media/press/2022/SA%20Green%20Finance%20Taxonomy%20-%201st%20Edition.pdf (last accessed 20 September, 2022).

[10] Monetary Authority of Singapore, *Guidelines on Environmental Risk Management (Banks)* (December 2020), Available at: https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Commercial-Banks/Regulations-Guidance-and-Licensing/Guidelines/Guidelines-on-Environmental-Risk---Banks/Guidelines-on-Environmental-Risk-Management-for-Banks.pdf (last accessed 20 September, 2022).

[11] The Hong Kong Monetary Authority, *Supervisory Policy Manual: GS-1 "climate risk management"* (Guidance note, December 2021), Available at: https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/GS-1.pdf (last accessed 20 September, 2022).

In light of the above, developing a green taxonomy aligned with widely accepted international standards for the financial sector in India is recommended to be one of the immediate priorities for the regulator and the government in shaping the climate finance framework in India, as it will steer the framework in an organized manner from the very beginning. It should be complementary to the supervisory guidance that the RBI seeks to formulate as the next step to the DP (Supervisory Guidance). The taxonomy may apply across the financial sector for uniformity, and guidance in this regard to the banks and financial institutions is imperative, rather than leaving it on them to define such taxonomy on a case to case basis. Some of the significant components of the said taxonomy may include: defining terms for determining the scope of a green financial activity, setting out environmental objectives and identifying high risk sectors relevant from the Indian standpoint and laying down a screening criteria specific to such objectives and sectors.[12] It may also include mechanisms to determine continuing eligibility of a project classified as a green project.

B. INCORPORATING CLIMATE RISK IN THE EXTANT PRUDENTIAL AND REGULATORY REGIME OF THE RBI

RBI has put in place robust frameworks to ensure that banks and other entities regulated by it can handle the risks coming their way. It can, in fact, be said that the financial risks from climate change may be tackled within the extant prudential regulatory framework established by the RBI. However, there are gaps. The current prudential framework captures consequences of climate change to a limited extent as there is lack of granular data to fully incorporate climate factors, which in itself are complex and dynamic as well as hard to predict. Further, the micro prudential regime relies to a large degree on past data which enables taking into consideration most types of risks. However, climate change causes non-cyclical irreversible risks which are scattered yet increasing with time. These are the gaps that RBI's regulatory regime should target on filling. It is essential that RBI provide the market players explicit and targeted guidance in this regard, and some of the ways in which it can do so are set out below:

(i) The Basel III Capital regulations were implemented in India with effect from 1 April 2013 and have been fully implemented as on 1 October 2021 (**Basel III Master**

[12] Bhasker Tripathi, "India's Proposed Sustainable Taxonomy and the Complexity of Weighing Climate Gains with Capital Concerns, *Carboncopy*, (3 June 2020), Available at: https://carboncopy.info/indias-proposed-sustainable-taxonomy-lessons-to-remember-worries-to-address/ (last accessed 23 September, 2022).

Circular).[13] Basel norms have three pillars: Pillar 1 is the Minimum Capital Ratio while Pillar 2 and Pillar 3 are Supervisory Review Process (**SRP**) and Market Discipline, respectively. The Basel Committee on Banking Supervision (**BCBS**) upon review of the Basel framework concluded that the Core Principles for effective banking supervision and SRP are sufficiently broad and flexible to accommodate additional supervisory responses to financial risks emanating from climate change.[14] It is important to note that the RBI prescribes higher regulatory limits and minima compared to the Basel III capital regulations reflecting the regulator's conservative prudence.[15] **Similar prudence should be shown by RBI in sufficiently securing the future of the Indian financial system, against any economic turmoil on account of climate change by accommodating additional supervisory responses to risks emanating from climate change, supervisors' risks and guidance to foster alignment in terms of supervisory expectations for addressing these risks, as recommended by the BCBS.**[16] **It is recommended that RBI, in the Supervisory Guidance or in the Basel III Master Circular, clarify how considerations of financial risks emanating from climate change can be embedded therein. Further, RBI's Master Circular on Disclosure Norms for Financial Institutions**[17] **and the Master Circular on Disclosure in Financial Statements - 'Notes to Accounts'**[18] **which require disclosures with respect to the Basel III norms may also require incorporating climate risk related disclosures.**

(ii) Stress testing is a critical tool for identifying, measuring and controlling liquidity risks for banks and is also an integral to the internal capital adequacy assessment process (**ICAAP**).[19] On 2 December 2013, RBI updated the Guidelines on stress testing (**Stress Testing Guidelines**) taking BCBS Principles for Sound Stress Testing Practices and

[13] Reserve Bank of India, *Master Circular – Basel III Capital Regulations* (Master circular, 2015), Available at: https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=12278 (last accessed 21 September, 2022).

[14] Basel Committee on Banking Supervision, *Principles for the effective management and supervision of climate-related financial risks*, (June 2022), Available at: https://www.bis.org/bcbs/publ/d532.pdf (last accessed 21 September, 2022).

[15] *Supra* note 13.

[16] *Supra* note 14.

[17] Reserve Bank of India, *Master Circular, - Disclosure Norms for Financial Institutions* (July, 2015) , Available at: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/MC1039B6E8B6046CF4AF4ABE8D74BAF8D6FBC.PDF (last accessed 21 September, 2022).

[18] Reserve Bank of India, *Master Circular – Disclosure in Financial Statements – 'Notes to Accounts'*, (July, 2015), Available at: https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9906 (last accessed 21 September, 2022).

[19] Reserve Bank of India, *Guidelines on Stress Testing* (June, 2007), Available at: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/78232.pdf (last accessed 21 September, 2022).

Supervision (May 2009) into consideration. The DP suggests certain stress testing scenarios for climate change in the short, medium and long terms. Taking cue from the UK Prudential Regulatory Authority (**PRA**) and Australia Prudential Regulation Authority (**APRA**), which provide *legal certainty to regulated entities by stating the scope of the scenario analysis*[20] *in their regulatory frameworks*[21], **it is recommended that the Supervisory Guidance by RBI explicitly guide banks to take climate change related scenarios into consideration for stress testing. This can be done by providing illustration of scenarios and shocks for stress testing akin to other scenarios and shocks provided in the Stress Testing Guidelines. Further, RBI may consider whether a combined scenario analysis may be warranted in this regard for instances of extreme weather events during economic downturn.**

(iii) Climate change can raise serious concerns of credit risks for banks, i.e. possibility of losses associated with diminution in the credit quality of borrowers/counterparties/assets it has exposure to.[22] RBI acknowledges the effective management of credit risk is a critical component of comprehensive risk management which encompasses identification, measurement, monitoring and control of credit risk exposures.[23] For this purpose, RBI has mandated banks to put in place a credit risk rating framework (**CRF**) which deploys a rating indicating the risk associated with a credit exposure. **It is recommended that the Supervisory Guidance spell out how risks emanating from climate change can be embedded within the CRF. This can be done, for instance, by requiring banks to include analysis of climate change related risks while analysing credit portfolio correlation for the measurement and management of portfolio credit risks.**[24] Presently, banks analyse business risks associated with an exposure such as cyclicality of industry, threats to product or technology substitution etc. under CRF. **Guidance can be given for consideration of varied climate change related factors to be taken into consideration as part of business risks.**[25]

[20] For example, scenarios based around average global temperature increases consistent with, or in excess of 2˚C; and scenarios where the transition to a low-carbon economy occurs in an orderly manner, or not. Similarly, in Australia, the APRA also sets its expectations clear by requiring banks to identify material climate risks and their potential impact on the banks by scenario analysis of both shorter and longer term time horizon.

[22] Reserve Bank of India, *Guidance Note on Credit Risk Management,* (October, 2002), Available at: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/32084.pdf (last accessed 21 September, 2022).

[23] *Ibid.*

[24] Para 4.5, *Ibid*.

[25] Para 2.5.5, *Ibid.*

It is important to note that once the Supervisory Guidance has been developed by the RBI, a study regarding the relevant circulars[26] of the RBI which may require being aligned with the said guidance will require being undertaken.

C. IMPLEMENTATION TIMELINE AND PRIORITISATION OF DISCLOSURES

The DP raises a question on the overall timeline for implementation of the climate related disclosures as proposed therein, as well as the prioritization of qualitative vs. quantitative disclosures. A comparative analysis of four international jurisdictions: Hong Kong, Singapore, England and Brazil is useful in this respect, and the findings are laid down below.

(i) **Hong Kong**: The HKMA published the Supervisory Policy Manual on 30 December 2021 (**SPM**)[27] in which it outlined the steps that are needed to be implemented by regulated entities to manage the risks of climate change on the financial system. A time period of 12 months was provided for the implementation of the recommendations made in the manual.

While the SPM dealt with mandatory measures which are needed to be implemented by the regulated entities, on 30 June 2022, the HKMA came out with another document titled "Embedding climate risk in banking supervision" in which it laid out a two year plan for the integration of climate risk into the banking supervision process all the way upto 2024[28] which includes the following actions on the part of HKMA:

- Follow up with bank management to check on the progress made in the implementation of the recommendation in the SPM module on climate risk management as well as the adoption of certain best practices;
- Carry out thematic reviews in the areas of due diligence processes established by regulated entities with respect to their green and sustainable product offerings, and climate related risk governance;
- Conduct another round of climate risk test exercise to assess the readiness of regulated entities against adverse climatic, economic and financial environment;
- Attempt incorporating climate risk parameters into its Supervisory Review Process (i.e. Pillar 2 of the Basel regulatory capital framework) and also closely monitor international

[26] For example, circulars relating to corporate governance, exposure norms, loans and advances may require being examined.

[27] *Supra* note 11.

[28] Hong Kong Monetary Authority, *Embedding climate risk in banking supervision* (June 2022), Available at: https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220630e1.pdf (last accessed 22 September, 2022).

developments on refining the minimum capital requirements under Pillar 1 and the disclosure requirements under Pillar 3 to address climate risks.

Under Para 3.26 on the Section on Governance in the SPM, it has been mentioned that the consideration of climate risk will be qualitative initially in the company disclosure documents. However, over time, the regulated entities should focus on adopting quantitative metrics for reporting purposes.

(ii) **Singapore**: The MAS Guidelines[29] proposed that banks be given a period of 12 months for the implementation of the recommendations once the final guidelines are issued. On December 2020 the MAS came out with the final guidelines[30] to be implemented by banks by June 2022 i.e. giving them a period of 18 months for implementation. In a recent study by the MAS published as "Information Paper on Environmental Risk Management by Banks" the MAS has found that most of the banks are on track to implement the recommendations of the December 2020 guidelines by June 2022.[31]

The reports published by the MAS emphasize the importance of both qualitative and quantitative measures. However, they do not mention if qualitative should come first followed by quantitative measures.

(iii) **United Kingdom**: The United Kingdom, on 17 January 2022, in respect of certain companies and Limited Liability Partnerships (**LLP**), published the following regulations related to climate related financial disclosures: Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022.

The disclosure requirements in the above regulations are to be implemented for financial years starting on or after 6 April 2022. The above regulations apply only to certain specific companies and LLPs and includes banks and insurance companies beyond a specified size threshold, with the intent of engaging the most significant companies in economic and environmental terms in analyzing and disclosing their climate-related risks and opportunities. Banking, insurance and securities companies and banking LLPs with more than 500 employees are required to comply with the above regulations.

[29] Monetary Authority of Singapore, *Proposed Guidelines on Environmental Risk Management (Banks)* (Consultation paper, June 2020), Available at: https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Consultation-Papers/2020/Consultation-Paper-on-Proposed-Guidelines-on-Environmental-Risk-Management-for-Banks.pdf (last accessed 22 September, 2022)

[30] *Supra* note 10.

[31] Monetary Authority of Singapore, *Information Paper on Environmental Risk Management (Banks)* (May, 2022), Available at: https://www.mas.gov.sg/-/media/MAS-Media-Library/publications/monographs-or-information-paper/BD/2022/Information-Paper-on-Environmental-Risk-Management-Banks.pdf (last accessed 22 September, 2022).

As per a February 2022 document titled "Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs" published by the Department of Business, Energy and Industrial Strategy, all companies and LLPs which fall within its scope are required to disclose an analysis of the resilience of the company's/LLP's business model and strategy, taking into account consideration of different climate-related scenarios.[32] The document mandates that scenario analysis should be at least qualitative in nature and that it is not mandatory to produce quantitative scenario analysis. However, it also says that some companies and LLPs might find it useful to produce quantitative scenario analysis as well.

(iv) **Brazil**: The Banco Central Do Brasil (**BCB**) has introduced amendments in various regulations with the aim of addressing climate and environmental risk within the existing structure for capital and risk management.[33] Regulated entities under the supervision of the BCB have been divided into 5 segments (Segment 1 – Segment 5) depending on their size and international activity[34], based on which the BCB has fixed separate dates for implementation of some of the regulations (including the ones relating to climate risk) depending on which segment the regulated entities belong to. For such regulations, the dates have been fixed at 1 July 2022 for regulated entities belonging to segments 1 and 2 and 1 December 2022 for those belonging to the remaining segments.

The BCB published the Report on Social, Environmental and Climate-related Risks and Opportunities in which it provided a phase wise plan for implementation of the disclosure requirements on climate related risks.[35] In Phase 1, regulated entities were required to report only on qualitative aspects. This has been achieved as per the document published. In Phase 2, to be

[32] Department for Business, Energy & Industrial Strategy, *Mandatory climate-related financial disclosures by publicly quotes companies, large private companies and LLPs* (Guidance paper, February, 2022), Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1056085/mandatory-climate-related-financial-disclosures-publicly-quoted-private-cos-llps.pdf (last accessed 22 September, 2022).

[33] Banco Central do Brasil, *New regulation on risk management and social, environmental and climate responsibility* (September, 2021), Available at: https://www.bcb.gov.br/content/about/legislation_norms_docs/BCB_Risk%20management%20and%20social%20environmental%20and%20climate%20responsibility.pdf (last accessed 22 September, 2022).

[34] Segment 1: Universal banks, commercial banks, investment banks, foreign exchange banks and federal savings banks that have a: (i) size equal to or greater than 10% (ten percent) of the Gross Domestic Product (GDP) of Brazil; or relevant international activity i.e. when the total consolidated foreign assets of an institution are equal to or greater than US$10 billion, regardless of the size of the institution; Segment 2: Universal banks, commercial banks, investment banks, foreign exchange banks and federal savings banks whose size is less than 10% and equal to or greater than 1% of GDP, and other institutions whose size is equal to or greater than 1% of GDP; Segment 3: Institutions whose size is less than 1% and equal to or greater than 0.1% of GDP; Segment 4: Institutions whose size is less than 0.1% of GDP; Segment 5: Institutions whose size is less than 0.1% of GDP and that use an optional simplified methodology to calculate the minimum requirements of regulatory capital (PR), Tier 1 Capital and Core Capital, except for multiple banks, commercial banks, investment banks, foreign exchange banks and federal savings banks; and institutions that are not required to calculate PR.

[35] Banco Central do Brasil, *Report on Social, Environmental and Climate-related Risks and Opportunities, Volume 1* (September, 2021), Available at: https://www.bcb.gov.br/content/publications/report-risk-opportunity/Report_social_environmental_climate_risks_opportunities_0921.pdf (last accessed 22 September, 2022)

implemented by December 2022, regulated entities will be required to disclose quantitative aspects as well.

Based on the above, it appears that two jurisdictions have provided regulated entities under their supervision with a duration extending up to 12-18 months for compliance with climate related disclosures. The United Kingdom applies the compliance requirements on companies above a certain threshold, and Brazil gives a staggered timeline for implementation based on the size of the entity, based on GDP or volume of international activity. **It is recommended that the RBI consider the existing capabilities of the REs based on the size of their business or any other relevant criteria, and provide such segmentation in the Supervisory Guidance, as well as the appropriate timelines for compliance with the relevant framework or provide differentiated compliance requirements based on such size segmentation. The current version of the DP places the onus on the REs to determine the level of disclosures they can make, based on the size and nature of their business, which may result in different criteria being adopted by different REs. Further, the stance of jurisdictions such as Hong Kong may be considered by the RBI in developing a continuous supervision plan for implementation and assessment of compliance with respect to climate related disclosures, for the purpose of assessing the progress made by REs as well as drawing insights from their practices, to be able to develop the future course of regulatory action.**

With regards to the priority in making disclosures, most of the countries discussed above have preferred to focus on the qualitative aspects in the first instance. Following this, some have recommended that quantitative aspects of disclosures be incorporated at a later period in time. Considering that REs are completely new to making such climate risk related disclosures, it would be prudent on the part of the RBI to begin with disclosure around the qualitative aspects first. However, the RBI may make it voluntary on the part of REs to include quantitative aspects as well considering some might have the requisite skill and capacity required to make such disclosures and provide incentives for the same. The RBI may also segment the REs into different categories based on the available skill and capacity and mandate different timelines for including quantitative aspects in their disclosures.

D. RBI'S ROLE IN GREEN FINANCE INITIATIVES FOR REs

While the DP sets out certain voluntary initiatives for green finance, which the REs may follow on their own volition, there are several other such initiatives, which the RBI may explore, as set out below. They are based on international comparative research in countries such as Hong Kong, Singapore and the United Kingdom.

(i) Setting out best practices for banks to assist clients in transitioning to green finance

The HKMA in the HKMA Manual suggests that financial institutions may consider assisting their clients in transitioning to low-carbon activities through establishing performance targets with the client such as energy efficiency reduction and carbon emission reduction.[36] In another document titled "Sound practices supporting the transition to carbon neutrality"[37] which outlines some best practices in respect of climate risk management, the HKMA proposes that regulated entities assist their clients in transitioning to carbon neutrality. This is suggested to be done in several ways: (i) by offering transition loans[38] with sustainability-linked pricing structures to high-emitting clients; (ii) assisting their clients in obtaining third-party green certification with respect to their projects by entering into partnerships with certification agencies; and (iii) offering bespoke advisory services and capacity building to raise awareness of clients and help clients integrate climate related considerations into their business structures, by setting up dedicated teams which benchmark clients' risk profile against peers etc. The idea of sustainability financing is not new in India. The IFSCA Guidance elaborates on sustainability-linked lending according to which the interest margin is linked to the borrower's sustainability performance. In this way the borrower is incentivized to improve on their ESG scores, key performance indicators tailored to sustainability or Sustainability Performance Targets in return for a lower interest margin on their loans. In this context, RBI may also set out best practices in relation to REs assisting clients in transitioning to carbon neutrality and green finance.

(ii) Aiding in developing data repositories for channelizing green finance

The MAS introduced Project Greenprint on 9 November 2021 in partnership with the financial sector industry to pilot four digital platforms:[39](i) Greenprint Common Disclosure Portal which tries simplify ESG disclosures; (ii) Greenprint Data Orchestrator which will attempt at aggregating sustainability data from multiple sources to help in better analytics and investment and financing decisions; (iii) Greenprint ESG Registry which will record and maintain ESG certifications from around the world as well as data and metrics verified by third-party auditors; and (iv) Greenprint

[36] *Supra* note 11, Para 5.5.5.

[37] Hong Kong Monetary Authority, *Sound practices supporting the transition to carbon neutrality* (December, 2021) Available at: https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20211208e1.pdf (last accessed 21 September, 2022).

[38] It refers to finance which helps to bridge the gap between traditional and sustainable financing through which companies can obtain financing to adopt new technology and implement long-term changes to reduce carbon emissions as well as to progressively transform their businesses into greener and more sustainable models (Source: https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20211208e1a1.pdf).

[39] Monetary Authority of Singapore, 'MAS and Industry to Pilot Digital Platforms for Better Data to Support Green Finance' (9 November 2021), Available at: https://www.mas.gov.sg/news/media-releases/2021/mas-and-industry-to-pilot-digital-platforms-for-better-data-to-support-green-finance (last accessed 21 September, 2022).

Marketplace which will attempt at connecting green technology providers with investors for financing.

The BCB in its publication titled "Report on Social, Environmental and Climate-related Risks and Opportunities" mooted the creation of the Sustainable Rural Credit Bureau and establishment of incentives for sustainable credit operations. The entire scheme is aimed at rural credit[40] and aims at making information easily available for the purpose of financing and incentivizes the financing of projects which are sustainable and in consonance with various ESG considerations. This will also help the financing of projects with lower climate and other environmental risks and thus aid banks and other financial institutions in addressing climate risks to their portfolios.

Both the initiatives by the MAS and the BCB are aimed at making it easier for regulated entities to access information and to draw financing towards projects which are sustainable. RBI may explore similar initiatives to channelize green finance in a more efficient and organized manner.

(iii) Climate finance related disclosure by central bank to lead by example

The Bank of England (**BoE**), to set an example for regulated entities under its supervision, publishes annual reports on TCFD-aligned climate related disclosures from the year 2020 onwards.[41] The report includes details about BoE's governance structure and processes to tackle climate related financial risks, BoE's approach to setting climate strategy and managing the implementation of such strategy and its approach to climate-related financial risk management including targets and metrics used. While the TCFD framework is not meant for central banks, the BoE undertakes these disclosures with an intention to lead by example. RBI may also consider doing the same, as it will provide much needed impetus, and guidance to the REs, many of which are completely new to such disclosure requirements. RBI's own experience in making such disclosures may also help in shaping policy and regulatory requirements in this regard, in the future.

(iv) Setting targets for green lending

The IFSCA Guidance requires all banking units and finance companies to have at least 5 percent of their loan assets in the form of lending to green/social/sustainable/sustainability-linked sectors/facilities from the financial year beginning April 2023/calendar year beginning January 2023. Further it requires the above entities to submit reasons for the non-achievement of the above target in case the entity is unable to comply with the requirements, and submit future action plan to ensure

[40] *Supra* note 35, p. 42.

[41] Bank of England, *The Bank of England's climate-related financial disclosure 2022* (June 2022), Available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2022/june/the-bank-of-englands-climate-related-financial-disclosure-2022 (last accessed 20 September, 2022).

compliance. Similarly, an international example in this regard is that of Bangladesh, where all scheduled banks of Bangladesh are required to allocate a minimum of 2% of their financing towards environmentally friendly financing and 15% towards sustainable finance (including green finance).[42] The DP requires REs to set lending targets to increase green funding only as a voluntary exercise. The approval of the board is required for setting such targets and the RBI recommends reviewing such targets annually to assess the positive environmental outcomes. RBI may consider taking a middle path and may possibly introduce climate risk mitigation or climate adaptation as a priority sector in its Master Directions on Priority Sector Lending 2020 (**PSL Directions**),[43] to incentivize banks to align their portfolios with climate change. The PSL Directions already have 'renewable energy' as a priority sector, and indicate that they intend to encourage and support environment friendly lending, and hence, such an amendment may be timely and useful.

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[42] Sustainable Finance Department, Bangladesh Bank (January, 2021), Available at: https://www.bb.org.bd/mediaroom/circulars/gbcrd/jan112021sfd01.pdf (last accessed 20 September, 2022).

[43] Reserve Bank of India, Master Directions – Priority Sector Lending (PSL) – Targets and Classification (2022), Available at: https://m.rbi.org.in/scripts/BS_ViewMasDirections.aspx?id=11959#Renewable_Energy (last accessed 21 September, 2022).

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