Sustainable Finance and Responsible Lending

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Let us first understand what is

- ## Sustainability

The word sustainability = "sustinere" in Latin

To sustain means to support or maintain or to endure.

Thus, sustainability means the ability to continue over a longer period of time.

Sustainability is defined as the processes and actions through which humankind avoids the depletion of natural resources in order to keep an ecological balance that doesn't allow the quality of life of modern societies to decrease.

- ## Finance

Management of large amount of money by government or by corporations.

Introduction to Sustainable Finance

Definition of Sustainable Finance

- Sustainable Finance also referred as Green Finance
- "Sustainable finance refers to the process of taking environmental, social and governance (ESG) considerations into account when making investment decisions, leading to more long-term investments in sustainable economic activities and projects." as quoted by the European Commission.
- The two main financial instruments in sustainable finance equity and debt. In the early stages of a project, equity financing is the main investment method used, and investors receive an ownership interest (stocks or shares) in the project in return for the amount of capital they invest.
- Sustainable finance is a subset of traditional financing and investing that seeks to place capital into projects reinforcing sustainable development.

Growing Emergence of Sustainable Finance in the year 2023

India holds the Presidency of the G20 from 1 December 2022 to 30 November 2023. The theme of India's G20 Presidency is - "VasudhaivaKutumbakam" or "One Earth . One Family . One Future"

India's G20 slogan 'One Earth, One Family, One Future' signals a clear sustainability thread that runs through its presidency.

The objectives of G-20 :Green Development, Climate Finance & Lifestyle for Environment (LiFE)

The first weeks of 2023 opened with a flurry of sustainable finance announcements in India

- Union budget identified green growth as a priority
- Government also issued its first green sovereign bond, raising $1 billion at a lower cost of capital than conventional debt.
- Reserve Bank of India, announced that it will be issuing new guidelines on climate stress testing,
- 2023 will also be the first year that India's 1,000 biggest corporates have already been disclosing a Business Responsibility and Sustainability Report (BRSR),

The flow of Sustainable Finance

Investors

Government agencies

Domestic companies

International organisations such as Asian Development Bank(ADB)

World Bank

Green Projects

eg. Renewable Energy

Climate Change

Clean transportation

Sustainable water

Improve Standard of Living

Provides a better future

Improves Quality of life

Sustainable Finance initiatives around the globe

International Platform on Sustainable Finance(IPSF)

- Launched on 18 October 2019 by the European Union,
- Objective - to scale up the mobilisation of private capital towards environmentally sustainable investments.
- Offers a multilateral forum of dialogue between policymakers that are in charge of developing sustainable finance regulatory measures
- Help investors identify and seize sustainable investment opportunities that truly contribute to climate and environmental objectives.
- Through the IPSF, members can exchange and disseminate information to promote best practices, compare their different initiatives and identify barriers and opportunities of sustainable finance
- The members of the IPSF are relevant public authorities, which are willing to advance on environmentally sustainable finance and are in charge of developing environmentally sustainable finance policies.
- Existing members- European Union and relevant authorities from Argentina, Canada, Chile, China, India, etc

Why is sustainable finance the need of the hour?

- We need to preserve the environment
- Eradicate poverty
- Reduce pollution
- Safeguard natural resources for the next generations
- Better waste management
- Promote recycling and reuse. At the 2021 UN Climate Change Conference (UNFCCC COP26), Hon'ble Prime Minister of India Shri Narendra Modi announced Mission LiFE, to bring individual behaviours at the forefront of the global climate action narrative.
- LiFE envisions replacing the prevalent 'use-and-dispose' economy—governed by mindless and destructive consumption—with a circular economy, which would be defined by mindful and deliberate utilization.

Huge gaps in green financing in India

India managed to raise only $44 billion in the financial year 2019-20, approximately 25% of the total target of the required budget every year for a green transition, notes a report published by Climate Policy Initiative (CPI).

India requires approximately ₹162.5 lakh crore ($2.5 trillion) from 2015 to 2030 or roughly ₹11 lakh crore ($170 billion) per year to achieve its Nationally Determined Contributions (NDCs) under the Paris agreement.

Major part of finance was raised domestically.

Most international private capital flows, according to experts, lean towards well-established industries such as renewable energy and take the least risky route.

India's green sector is not able to lure foreign investment,

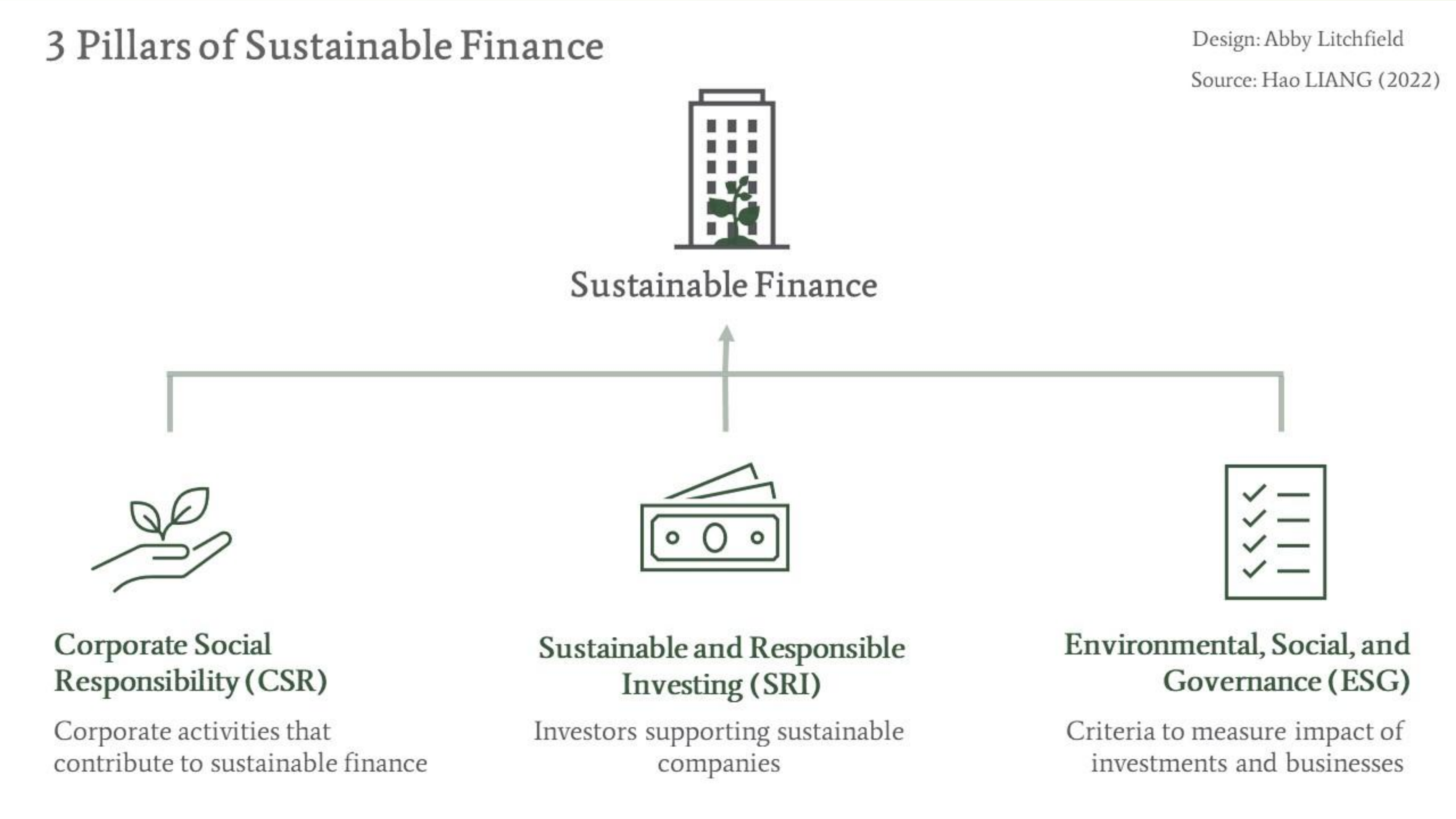
Why?Hedging costs which can be a pain point for foreign investors. Hedging is a financial strategy used to safeguard investments from adverse circumstances that could result in a loss of value.

Sustainable Financing
The benefits and roadblocks

Benefits
1. Recognition
2. Easier to raise finance
3. Stronger stakeholder relationships.
4. Improved efficiency and cost savings across the business as a whole.
5. Improved reputation.
6. Better access to, and retention of, staff.

Roadblocks
1. No Tax Benefits
2. Long term investment
3. Lack of awareness
4. Lack of incentives

Pillars of Sustainable Finance



3 Pillars explained

From a company's perspective, sustainable finance refers to Corporate Social Responsibility (CSR).

- CSR refers to the set of corporate activities that improve human or environmental well-being.

From an investor's perspective, it is Sustainable and Responsible Investing (SRI).

- Through SRI, investors put their money into companies with good CSR activities. Institutional investors are leading in this area; these are mutual funds, pension funds, sovereign funds, insurance companies, banks and financial institutions, family offices, and corporate investors.

Continued….

For everyone — companies, investors, and policymakers — Environmental, Social, and Governance (ESG) data matter.

The ESG framework imposes additional compliance obligations on entities based on the nature of their operations

- Here's how these concepts relate:

When companies care about stakeholder welfare, they engage in CSR.

When investors put their money in businesses with greater CSR engagement, they make SRI.

For both CSR and SRI, we measure them using ESG.

ESG-A brief synopsis

What is Environmental, Social and Governance(ESG)

- **ESG stands for environmental, social and governance. These are called pillars in ESG frameworks.**

Why is ESG here to stay?

- **More and more investors are incorporating ESG elements into their investment decision making process, making ESG increasingly important from the perspective of securing capital, both debt and equity**.

Examples of companies having a positive ESG impact in India.

- ITC, Wipro, Mahindra and Mahindra
- 43% of ITC energy consumption is from renewable energy sources

ESG Criteria

Environmental	Social	Governance
Waste Reduction	Fair pay and living wages	Corporate governance
Climate Change Strategy	Equal employment opportunities	Risk management
Carbon footprint reduction	Employee benefits	Compliance
Greenhouse gas emissions	Workplace health and safety	Ethical business practices
Energy usage and efficiency	Adherence to labour laws	Avoiding conflict of interest
Biodiversity loss	Community engagement	Accounting integrity and transparency

Means of Sustainable Finance

- **Impact Investing** -Impact investors consider companies' ESG performance and corporate social responsibility credentials when making investment decisions.
- **Green Finance** - Green finance is any financial activity used for the **environmental part** of ESG. With a narrower scope than sustainability, green finance allows investors to focus solely on financing environmental issues, such as decarbonization and biodiversity loss. There are many examples of green finance, such as green bonds, green loans, and green mutual funds.

What is Impact Investing?

- Impact investing refers to investments "made into companies, organizations, with the intention to generate a measurable, beneficial social or environmental impact alongside a financial return“ Wikipedia
- Impact investing directs capital to enterprises that generate social or environmental benefits. Thereby balancing Commerce and Compassion.

ESG Vs Impact Investing (give examples)

- ESG investing refers to the infusion of funds in companies that meet ethical considerations of environmental, social, and governance standards. Impact investing, on the other hand, refers to funds allocated to businesses driving environmental or social change, thereby creating impact.
- thus we can say that ESG investments are based on the records of the past performance of any company while impact investments are based on a company’s plans to generate impact in the future wherein the investor can decide what kind of impact they intend to invest in through the company.

Types of Green Finance-progressively Gaining in India

1. Green deposits

   Green deposits are a financial product that enables individuals and organizations to deposit their funds with banks and NBFCs, specifically to finance environmental-friendly activities and projects.

   These deposits serve as a means to mobilize resources and direct them towards sustainable initiatives.

   Green deposits come in various forms, catering to the diverse needs of depositors. Some common types of green deposits include fixed deposits (FDs), savings deposits, recurring deposits, and certificate of deposits.

   RBI has also come up with a Green Deposit Framework

Government Initiatives Promoting Sustainable Finance in a phased manner

Framework for acceptance of Green Deposits

- The green deposit framework is the first step taken by the Reserve Bank of India (RBI) towards sustainable and green finance.
- The framework came into effect on June 1, 2023
- To encourage regulated entities (REs) to offer green deposits to customers, protect interest of the depositors, aid customers to achieve their sustainability agenda, address greenwashing concerns and help augment the flow of credit to green activities/projects.

A brief on the framework

REs shall issue green deposits as cumulative/non-cumulative deposits.

On maturity, the green deposits would be renewed or withdrawn at the option of the depositor.

The green deposits shall be denominated in Indian Rupees only.

The tenor, size, interest rate and other terms and conditions (as applicable to the RE) as defined in the Master Direction - Reserve Bank of India (Interest Rate on Deposits) Directions, 2016 dated March 03, 2016, Master Direction - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 dated August 25, 2016 and Master Direction - Non-Banking Financial Company - Housing Finance Company (Reserve Bank) Directions, 2021 dated February 17, 2021, as amended from time to time, shall also be applicable to green deposits mutatis mutandis.

Actionables under the Framework-Great area of work for Consultants

1. Policy on green deposits
2. Financing Framework for allocation of proceeds
3. Third-party verification of allocation of fund
4. Impact assessment of use of proceeds
5. Reporting Requirements

2.Green Bonds/Climate Bonds/ Sustainable bonds

On February 1st, 2022, Union Minister for Finance and Corporate Affairs, Ms. Nirmala Sitharaman announced the Government of India's plan to issue sovereign green bonds to mobilize resources for green infrastructure

A green bond is a fixed-income instrument designed to support specific climate-related or environmental projects.

Green bonds may come with tax incentives to enhance their attractiveness to some investors.

The proceeds of these bonds are used only for environmentally conscious, climate-resilient projects.

Risk and returns are similar to those of traditional bonds.

On January 25, 2023, India issued the first tranche of its first sovereign green bond worth INR 80 billion (equivalent to $980 million)

Indian green bond issuances have reached a total of $21 billion as of February 2023.

3.Green bank/Ethical Bank/ Sustainable Bank

Green Banking entails banks to encourage environment friendly investments and give lending priority to those industries which have already turned green or are trying to go green and, thereby, help to restore the natural environment.

There are no specific RBI regulations/guidelines for banks on green banking.

SBI being India's first green bank

Green car loans – Customers are offered lowered interest rates for purchases of electric or low-emission vehicles.

loans for businesses who want to go green

Home Finance- Bank offers reduced processing fees to

customers who purchase homes in 'Leadership in Energy

and Environmental Design' (LEED) certified buildings

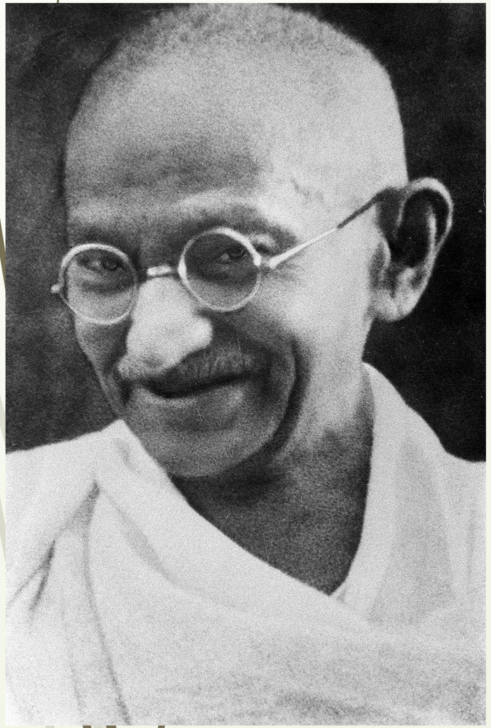
Responsible Lending-Explained

- Responsible lending is to act in a customer's best interests, ensuring affordability, transparency of terms and conditions and supporting a borrower if they experience repayment difficulties.
- It is the lender's decision to put the customer first.
- Currently, lenders have "responsible lending" obligations that require them to assess te loan the customer is seeking is both not unsuitable given their requirements and objectives and also able to be repaid without the consumer facing any substantial hardships .
- Lenders have a responsibility to make sure borrowers understand the details of a loan and carry out thorough checks on any borrowers, so they can be confident that what customers will receive will be suitable for their circumstances.

Importance of Responsible Lending

- Helps the customer take an informed decision
- By having all the product information the customer can compare two products
- Customer receives the loans as per his need
- Protects the consumer
- Builds long term consumer relationships

Conclusion



Mahatma Gandhi quotes all sustainable practitioners should live by

- be the change you wish to see in the world. ...
- in a gentle way, you can shake the world. ...
- what we do today, is our future.

Responsible lending

"Borrowing and lending carry equal weight of sorrow. But your sorrow weighs more when you lend what you borrowed."

So lend responsibly.