

# Submission to Reserve Bank of India on 'Draft Disclosure Framework on Climate- Related Financial Risks, 2024'

The 'Draft Disclosure Framework on Climate-Related Financial Risks' released by RBI in February this year is meant to empower shareholders, customers and the general public with comprehensive information on the risks posed by the climate crisis to the investments of financial institutions (FIs). In a world beset by climate emergency investments by FIs face direct physical risks from rising temperatures, sea levels and melting glaciers, as well as risks arising from the fact that globally there is an attempt to switch to low carbon-producing technologies and infrastructures. How wise is it to lend to highway infrastructure and energy projects in flood-prone mountains caught amidst glacial collapse? Will profits on investments in coal be affected as the world commits to reducing its reliance on fossil fuel (coal, oil and gas) based energy? Will investments in renewable energy projects yield sufficient returns? **The framework on disclosures stipulates financial institutions (Regulated Entities, REs) to periodically report on the governance structures, strategies, risk management frameworks and targets they have set to address financial risks arising owing to climate change. Such disclosures are intended to produce greater transparency in the efforts by FIs to factor in climate change in their financial decisions and make them more accountable towards investors, shareholders, stakeholders and the general public.**

While it is a notable step from the RBI to emphasise greater transparency and accountability of REs towards climate-related financial risks, we feel that there is a need to broaden the scope of 'risk' as understood by the central regulator, enhance the level of disclosures obligated upon the REs and to also explore oversight mechanisms beyond disclosures to unleash the full breadth of climate accountability of REs.

**This is important because the global trend, owing to relentless interventions by affected communities and civil society, is to understand the accountability of financial institutions in an all-embracing manner which holds them responsible for the environmental, climate and social consequences of their investments. Such accountability is not and cannot properly remain limited to assessing only carbon emissions.**

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**The submissions are as follows:**

## **1. Broaden the perspective of the disclosure framework**

### **1.1 Need to see climate, environment and community together**

The disclosure framework suffers from a perspective that is delimited by its focus on climate-related financial risks faced by the bank's investment portfolio and does not consider the environmental and social impacts produced by REs and its investments. This is ironic, ill-considered and an opportunity lost. Ironic, because the climate crisis is in fact exacerbated by industrial and building activity financed by these financial institutions. It is ill-considered because there is a need for the disclosure framework to enlarge its perspective and see climate, environment and impacted communities in an interdependent holistic relationship. It is an opportunity lost because globally the push is towards financial institutions becoming accountable towards all impacts that they cause on the environment, climate, and society (health, labour, land acquisition, vulnerable communities etc.). Putting in place a disclosure framework was an opportunity for the central regulator to bring Indian financial institutions in line with international developments and take a step in the direction of public accountability of all impacts - environmental, social and climate - of their investments rather than just carbon emissions.

In addition, the social and ecological impacts also lead to significant financial risks, and REs need to avoid investing in projects which are likely to cause harm to communities, environment and climate.

### **1.2 Need for Impact Risk Perspective**

It follows from the above that what is missing in the disclosure framework is an 'impact risk' perspective. What are the risks posed by the RE's investments to people's health, livelihoods, land, environment and climate, is a question left unattended by the framework. An impact risk perspective goes beyond disclosing carbon emissions of Scope 1, 2 and 3, and takes into account project-specific as well as cumulative and evolving impacts of REs investments especially those in mega projects.

An impact risk perspective is desirable not only from the standpoint of affected communities, environment and climate but actually helps REs to avoid investing in activities which may run into opposition owing to adverse consequences for the people and environment. Thus, in addition to assessing transition risks and climate-related financial risks, assessment and disclosure of impact risks can save REs from bad investments and lead to greater public, investor and depositor accountability.

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## **2. Enhance the Scope of Disclosures**

### **2.1 Need for disclosures around specific investments/projects**

The disclosure framework stipulates that REs disclose their Scope 1, 2 and 3 greenhouse gas emissions for a particular industry or asset class of industry. This, while an RE might disclose that its exposures to thermal power plants result in X quantum of emissions, they may not reveal whether their money is used in project Y in Jharkhand. This project-based transparency is crucial because effectively speaking, most questions are raised by the local population and environmentalists pertaining to particular projects or a cluster of projects in a region. For ensuring full public accountability and holistic impact assessment (environmental, social and climate) of REs though, much more is required. For instance, REs need to disclose specific name-wise projects and activities where their loan financing is being deployed. This is essential so that independent observers, scientists and people can assess the claims made by the RE in its disclosure statements and bring to light any discrepancies.

### **2.2 Need for well-defined investment standards and goals**

A disclosure framework needs to be accompanied by clear statements of investment standards, goals, thresholds and redressal mechanisms. While the disclosure framework stipulates that REs should put in place investment targets that address climate-related financial risks, the discussion is limited to greenhouse gas emissions. Setting targets for reducing scope 1, 2 and 3 greenhouse gas emissions is crucial. At the same time, considering the impact of investments on the environment, people and climate a comprehensive set of standards is needed. For starters, such standards may be evolved in line with goals and targets set by international institutions.

For instance, the World Bank's private lending arm International Finance Corporation, has defined a set of performance standards which its investments strive to meet.

The Performance Standards consist of the following:

- 1: Assessment and Management of Environmental and Social Risks and Impacts
- 2: Labour and Working Conditions
- 3: Resource Efficiency and Pollution Prevention Performance Standard
- 4: Community Health, Safety, and Security Performance Standard
- 5: Land Acquisition and Involuntary Resettlement Performance Standard
- 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources Performance Standard
- 7: Indigenous Peoples Performance Standard
- 8: Cultural Heritage

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Mechanisms for disclosures and safeguards are developed in order to ensure that these performance standards are met. Moreover, these standards are publicly available so that clients and the bank can be held accountable for them in case of a possible violation. Thus, it is extremely valuable and desirable for the bank to develop its own standards on environmental and social performance which will help it to assess all project proposals and project performance during the operational stage. For a central regulator such as the Reserve Bank of India, while global standards like SDGs or Equator Principles are extremely important, there is a further need to evolve India-specific standards especially with regard to how climate change is affecting India, vis-a-vis rising temperature, erratic rains & crop loss, eroding coasts, and social characteristics like caste discrimination.

### **2.3 Non-binding, vague and aspirational criteria**

The Draft says “If the RE does not have the skills/ capabilities/ data availability/ resources to provide that information, RE may disclose by stating the reasons for not providing the information”. While it is possible that it may not be possible outrightly for the RE to share every detail, but the draft does not provide any remedial or procedural directive as to by which time the REs need to build its capacities, or after what time period, such inability would be unacceptable or even penalised.

## **3. Investments in Renewables Call for Greater Oversight**

### **3.1 The RE push towards renewables needs to be mindful of the fallouts of a reckless drive**

There is a push on the part of the RBI to enthrone the REs to aid the fulfilment of global commitments and climate goals of the electric power capacity target of 50% installed capacity from non-fossil-based energy resources by 2030. But the push towards renewables cannot be a reckless drive disregarding the environmental, social and climate impacts of renewables. In terms of impact, while scope 1, 2 and 3 of emissions is important, we also need to expand beyond that and also consider the impact on planetary boundaries. This is especially important when looking at so-called low-carbon projects. Banks need to exercise caution when investing in mega-renewable projects to avoid potential environmental and social harm for several reasons:

- **Environmental Impact:** While renewable energy projects aim to reduce carbon emissions and dependence on fossil fuels, they can still have environmental impacts. Mega projects, such as large-scale wind farms or hydroelectric dams, can disrupt ecosystems, affect wildlife habitats, and alter water flow patterns, leading to unintended consequences for local environments. For instance, the dam disaster in Sikkim in October 2023 owing to the Glacial Lake Outburst Flood is an example of investments by a conglomerate of public sector banks despite repeated warnings not just from independent experts about the risks of GLOF in the region due to climate change, but also from government-appointed committees (about earthquake risks).

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- **Social Displacement:** Large renewable energy projects, be it the scale of mega solar parks or the submergence zones of hydel power may demand massive land-use changes and acquisitions, leading to the displacement of local communities and disruption of traditional livelihoods. This can result in social conflicts, loss of cultural heritage, and inequalities in access to resources and benefits.
  - **Resource Competition:** Mega-renewable projects often require vast amounts of resources, such as land, water, and materials for infrastructure development. This can lead to competition with other land uses, such as agriculture or conservation, and strain local resources, potentially exacerbating existing resource conflicts.
  - **Financial Risks:** Megaprojects typically involve substantial financial investments, and uncertainties regarding technology, regulatory frameworks, and market conditions can pose risks to investors. Changes in government policies, fluctuations in energy prices, and unforeseen environmental challenges can impact the profitability and long-term viability of such investments.
  - **Reputational Risks:** Banks and financial institutions are increasingly being held accountable for their investments' social and environmental impacts. Involvement in projects that lead to environmental degradation or social injustice can damage a bank's reputation and erode trust among customers, investors, and the broader public.

To mitigate these risks, banks need to conduct thorough due diligence, assess the potential impacts of renewable energy projects, engage with stakeholders, and adhere to internationally recognized environmental and social standards. Additionally, promoting smaller-scale and community-led renewable energy initiatives can help ensure more sustainable and equitable development outcomes.

### **3.2 Ability to assess false solutions**

Banks and lending institutions need to exercise caution against investing in false solutions for several reasons:

- **Financial Risk:** False solutions may promise to address pressing issues such as climate change or environmental degradation but fail to deliver tangible results or sustainable outcomes. Investing in such solutions can lead to financial losses for banks if the projects underperform or face regulatory challenges.
- **Reputational Risk:** Supporting false solutions can damage a bank's reputation and credibility. Stakeholders, including customers, investors, and advocacy groups, increasingly scrutinise financial institutions' environmental and social commitments. Investing in projects that are perceived as greenwashing or ineffective can erode trust and lead to reputational damage.

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- **Opportunity Cost:** Allocating financial resources to false solutions diverts capital away from genuinely effective and impactful initiatives. Instead of investing in projects that genuinely contribute to sustainable development goals, banks may waste resources on projects that provide little to no real benefit or even exacerbate existing problems.
  - **Long-Term Sustainability:** False solutions often offer short-term fixes or superficial approaches to complex challenges. Investing in these solutions can undermine efforts to achieve long-term sustainability and resilience. Banks have a responsibility to support investments that address the root causes of environmental and social issues and contribute to lasting positive change.
  - **Regulatory Compliance:** Increasingly, regulators are imposing stricter requirements on financial institutions to assess and disclose the environmental and social impacts of their investments. Investing in false solutions may expose banks to regulatory scrutiny and legal risks if these investments are found to be misleading or harmful.

To mitigate these risks, banks and lending institutions should prioritise due diligence and risk assessment processes to evaluate the legitimacy and effectiveness of potential investments. They should also align their investment strategies with internationally recognized sustainability standards and principles, such as the UN Principles for Responsible Banking, to ensure that their activities contribute to genuine progress towards sustainability goals.

#### **4. Beyond Disclosures and Financial Risk**

- The full extent of climate, environmental and social accountability of REs can be unleashed by putting in place **oversight and redressal mechanisms** at the level of the RE.
- A permanent institution is needed within the RE to ensure that environmental and social standards are being met at all stages of a project from the pre-approval stage to the operational stage till the loan closure stage.
- Such an institution shall have different arms addressing its scope of activities comprising due diligence, monitoring and supervision of processes to ensure adherence to environmental and social standards during the life cycle of the project till the resolution of loan, environmental and social assessment by independent third parties as well as by its own representatives, production of records as part of public disclosure pertaining to environmental and social assessment reports, diligence reports, records of consultation and meetings with the impacted communities, loan status etc, advising the client on best practices, communicating with the financial arm of the RE, and a grievance redressal mechanism where the project impacted or concerned people can bring to the notice of the bank any possible violations of standards by the client.

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The RBI is best placed to strengthen and mandate a safeguards framework for REs and make them future-ready. Such a framework may comprise actions under the following heads

- Making cumulative impact assessment essential
- Transparency
- Making public a stakeholder
- Capacity building
- Effective Grievance Redressal Mechanisms

#### **4.1 Transparency**

A cornerstone of any measure of accountability in terms of climate goals is transparency. The REs must be made to follow the standards set by the multilateral development banks, a transparency mandate for each and every project and every borrower. Making project-related information public serves to further the cause of accountability of the client as well as the finance institution.

- For any accountability mechanism to be effective, transparency is essential as it allows for participation and inclusion of multiple stakeholders.
- The government too is moving towards this with the proposed National Financial Information Registry.
- For starters, in line with best international practices, in addition to disclosure mechanisms already in place the bank can make such information more accessible.
- Status of loans to individual corporate borrowers.
- Assessment reports.
- Closure reports.

#### **4.2 Development for all: People at the centre**

The REs already see to it that domestic laws as regards public consultation are complied with by project proponents.

The REs can play a pioneering standard-setting role in making

- Consent and consultation a necessary part of the minimum conditions to be fulfilled before approving loans for high-impact projects
- Capacity building: The REs branches are the first interface of a bank with communities, thus a familiarity with environmental and social issues, and the bank's sustainability policy and safeguard mechanisms are necessary even at the branch level to handle public responses to the financed projects.



**CFA**

**Centre for Financial Accountability**