SUSTAINABLE FINANCE; WHAT INDIA WANTS NOW

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Abstract

Sustainable financing refers to a financial system which incorporates environmental, social and governance (ESG) aspects to support economic growth, enhance social well-being and reduce the negative impact on the environment through the appropriate governance in the financial sector. It is the set of financial regulations, standards, norms and products that pursue an environmental objective. The aim is to provide financial resources to different financial market players to reinforce sustainable development and mitigate adverse climate change and promote clean energy. As India is one of the fastest growing economies in the world as well as the third-biggest carbon polluter, our contribution to sustainability will have a reflection in the world in its drive towards Sustainable Development Goals (SDGs). Hence, it is important to mobilize additional low-cost and long-term capital for the achievement of inclusive and sustainable growth objectives of our nation. The study aims to present a comprehensive overview of Sustainable Finance in India. This is an exploratory study based on secondary data collected from government, national, and international agencies.

Key words:- Sustainability, Sustainable Finance, Green Finance, Sustainability Development Goals, Sustainable Finance Taxonomy. ESG, Sustainable Finance Strategies.

"Sustainable development is the pathway to the future we want for all. It offers a framework to generate economic growth, achieve social justice, exercise environmental stewardship and strengthen governance."

- Ban Ki-moon, Former Secretary-General of the United Nations.

Sustainable finance is an umbrella term covering all the financing activities that contribute to sustainable development. It is a wide area which includes environmental, social, governance and economic aspects of the financial system. Sustainable finance is evolved from green finance which accounts for the environmental aspect only. But

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sustainable finance takes into consideration environmental, social and governance (ESG) issues and risks. It is a modified version of traditional financing with the integration of ESG and sustainable development in the financial sector. Its objective is to promote long-term investments in sustainable economic activities and projects. But the Public sector alone cannot contribute to this end. Hence, there needs to be an integration of both the public and private sectors for funding projects promoting sustainability. It involves the allocation of funds to environment-friendly projects and initiatives along with the management of financial risk associated with it. It also endorses the reorientation of private capital to sustainable investment in the financial sector. As energy and finance are the two fuels of any economy, India's energy transition to clean and sustainable needs to be calibrated by an unprecedented and perpetual inflow of capital.

Literature review

According to European Commission, Sustainable Finance is 'the process of taking due account of environmental, social and governance (ESG) considerations when making investment decisions in the financial sector, leading to increased long-term investments into sustainable economic activities and projects. Environmental considerations might include climate change mitigation and adaptation more broadly, for instance, the preservation of biodiversity, pollution prevention and the circular economy. Social considerations could refer to issues of inequality, inclusiveness, labour relations, investment in human capital and communities, as well as human rights issues. The governance of public and private institutions including management structures, employee relations and executive remuneration plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.'

The definition of sustainable investment given by the Global Sustainable Investment Alliance emphasizes an investment approach taking into account environmental, social and governance (ESG) factors in portfolio selection and management. South Africa's Code for Responsible Investment in South Africa (CRISA) featured the manifestation of all sustainability aspects (ESG) into the investment analysis and activities along with the superior risk-adjusted returns to the ultimate beneficiaries in sustainable finance. Indonesian Financial Services Authority (OJK) emphasized the achievement of sustainable development through sustainable finance from the holistic support of the financial service industry. Swiss Federal Ministry of Environment (FOEN) highlighted the promotion of responsible investment along with risk management to create positive environmental, social and governance impact through sustainable finance using sustainable financial products and services.

The World Bank which promotes sustainability finance contributes several initiatives such as The Global Program on Sustainability, The Sovereign ESG Data Portal, Climate Support Facility, IFC Edge

ISSN : 2230-8431

and J-CAP. Among these, The Global Program on Sustainability promotes the use of high-quality data and analysis on natural capital, ecosystem services and sustainability to better inform decisions made by governments, the private sector and financial institutions. It consists of 3 key pillars: Information-improving global measurements of natural capital and ecosystem services constitutes pillar1, Building the country's capacity to produce and use natural capital accounting for policy and planning decisions forms pillar 2 and Pillar 3 states the Incentives-Promoting research on how environmental factors impact risk and financial return in fixed income markets. The operational definition of Sustainable Finance in this paper is any financial system that functions to achieve sustainable development by contributing to the ESG objectives through sustainability-oriented financial activities and decision-making processes.

Objectives of the study

1. To explore the current status of Sustainable Finance in India.
2. To understand the relevance of Sustainable Finance, its strategies, and instruments
3. To analyse the initiatives taken by different financial regulatory agencies in the transformation to Sustainable Finance.
4. To identify the challenges of sustainable finance in India.

Significance of the study

To honour our commitment to the Paris agreement, India has set forth development plans to integrate its financial system with SDGs. These sustainability goals constituting environmental, social and governance aspects of economic activities can be achieved through an unprecedented flow of funds from public and private investors within and outside our country. The significance of a study on sustainability finance in India is manifold as we are committed to lowering our carbon footprints, converting to clean energy, and clean transport, invest in sustainability-oriented companies to protect the environment, the planet and the people in it without ignoring the profit aspect of the business.

The Union Budget 2022-23 announced the issue of Sovereign Green Bonds. But India requires tremendous flows of funds; around US$4.5 trillion, to achieve its sustainability goals and renewable energy efficiency by 2040. This emphasises the need for augmenting finance from the private sector which makes it a crucial player in sustainable finance. In India, two third of its conventional forms of energy are owned by the central or state governments. On the contrary, the emerging renewable energy sector rests its ownership primarily in the private sector which facades some challenges in its financing. The support of all financial institutions is needed to achieve the UN SDGs, especially SDG 7 (affordable and clean energy), SDG 8 (decent work and economic growth), SDG 9 (industry, innovation, and infrastructure), and SDG 13 (climate action) as explained by Desalegn and Tangl, 2022.

Importance of sustainable finance

Sustainable finance is the quintessence of the economy which connects the environmental, social and governance aspects. It promotes investments in projects promoting climate change mitigation and the utilization of renewable resources which come under the environment aspect. It finances the projects and organizations supporting Human and animal rights, consumer protection, and varied employment practices which come under social considerations. This fund is for the policy formulation of companies to encourage equality, accountability, equal opportunities, anti-corruption and justice for all which are included in the Governance factor. The transition from traditional finance to this sustainability-oriented finance, though at a low pace, contributes to the well-being of society, the planet and the business sector itself. Sustainable finance involves investment decisions and activities through sustainable financial instruments to fund projects and ventures with the intention to fulfil sustainability criteria. Sustainable finance which also includes green finance and climate finance has given rise to some innovative sustainable financial instruments like green bonds, green loans, sustainability-linked bonds, sustainability bonds, social bonds and sustainability-linked loans.

Sustainable finance in India

To match the global trend, in 2008, the Reserve Bank of India initiated its effort to integrate finance, social and environmental aspects in the Indian financial system to raise awareness in the banking sector about corporate social responsibility (CSR), sustainable development and non-financial reporting (NFR). The Securities and Exchange Board of India (SEBI) launched of S&P ESG India Index in the same year. SEBI introduced a requirement for the top 100 companies by market capitalisation to issue Business Responsibility Reporting (BRR) in 2012. The BRR which is published with the annual report consists of nine principles: ethics, product lifecycle, employee wellbeing, engagement of stakeholders, policies for groups, joint ventures, suppliers and NGOs, environmental strategy, the company's membership of any trade association, how it delivers inclusive growth and its focus on the customer. The S&P BSE CARBONEX was introduced in 2012 and 2013 MSCI ESG India Index was launched.

The Companies Act of 2013 mandates 2% of profits towards CSR. In 2015, renewable energy was included under Priority Sector Lending and Miniratna status was granted to IREDA. In the same year, IBA's guidelines on responsible banking were released and Exim Bank of India issued a five-year US$500 million green bond. In 2015, YES Bank issued the first INR-denominated green bond. Following this, SEBI proposed new norms for the issuance and listing of green bonds in 2016. The FICCI UNEP Inquiry report for India 2016 points out the strategic need for sustainable finance across key sectors of India's economy, such as manufacturing, infrastructure, agriculture and small enterprises. US$1 trillion is required for basic infrastructure every five years. Major

 ISSN : 2230-8431

challenges are bridging the gap between long-term assets and short-term credit provision, and to create an inflow of foreign public and private capital.

Sustainable finance in India has moved forward with voluntary market-led initiatives and policy actions. Some of the major landmarks include the launch of national voluntary guidelines for responsible financing by the Indian Banks Association, the decision by the Reserve Bank of India to include social infrastructure and decentralized renewable energy within the Priority Sector Lending requirements for banks, the issuance by the Securities and Exchange Board of India (SEBI) of requirements for the development of the green bond market, the approval of the Pradhan Mantri Fasal Bima Yojana (PMFBY) initiative to extend crop insurance and the increase in the coal cess, raising funds for the National Clean Energy Fund (NCEF). The India Inquiry recommends actions specifically on six thematic areas such as developing a sustainable capital markets strategy, strengthening keystone financial institutions like the Indian Renewable Energy Development Agency (IREDA), aligning financial regulations with sustainability, building financial sector capacities, increasing access to sustainable finance and mobilizing international financial flows. In 2016 the government of India launched its flagship initiative, Atal Innovation Mission which aims to provide technical and infrastructure support to start-ups promoting positive social and environmental outcomes.

SEBI introduced the concept of 'Green Debt Securities' or 'Green Bonds' 2017 in its circular. SEBI proposed a definition of 'green debt securities as part of its regulations concerning the issue and listing of general debt securities. In 2018, the first green bond in India was issued by SBI. The Ministry of Finance is a founding member of the International Platform on Sustainable Finance (European Commission, 2019), the Reserve Bank of India has joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS, 2019) and the Indian Banks' Association, which represents nearly 250 banks, is a member of the Sustainable Banking and Finance Network (IFC, 2012).To address global climate concerns, the first step by the Government of India was the signing of the International Solar Alliance (ISA) with France on 1st December 2015. Since the UN 2030 agenda was unveiled in 2015, Sustainable Development Goals (SDGs) gets a top priority.

To honour our commitment to the Paris Agreement, India adopted an ambitious Nationally Determined Contribution (NDC) on a 'best effort basis' keeping its developmental imperatives in mind. Its objectives are to reduce the emission intensity of GDP by 33-35 per cent by 2030 as compared to 2015 levels, create an additional carbon sink of 2.5 to 3 billion tonnes of CO2 equivalent through additional forest and tree cover by 2030 and increase the share of non-fossil fuel-based energy resources to 40 per cent of installed electric power capacity by 2030. Based on United Nations Framework Convention on Climate Change (UNFCCC), India upholds the principle of equity and the principle of common but differentiated responsibilities and respective capabilities in the light of national circumstances. The 'just transition' is a part of both the Paris Agreement on Climate Change, 2015 and India's 2022 Long-Term Low-Carbon Development Strategy. This is based on the principles of equity and climate justice, and emphasises the energy transition as "just, smooth, sustainable and all-inclusive". All these lead to a new social dimension to the financial system which has to be addressed by creating new opportunities for all and thus generating positive social outcomes.

The G20's work on sustainable finance brought out the relevance of "orderly, just and affordable" transitions. India also aims to zero out greenhouse emissions by 2070. The International Finance Corporation (IFC) has estimated that India has a climate-smart investment potential of $3.1 trillion from 2018 to 2030 with $667 billion potential in the electric-vehicle segment. Following the global trend, in 2019, RBI instructs financial institutions to adhere to sustainable practices. RBI in its report in April 2020 signified the impact of climate change on food price inflation. Hence, it started infusing environmental factors into its prudential policies. In 2021, India declared the 'Panchamrit' strategy at the CoP26 which focuses on the transformational changes in India's energy systems to take India to net zero by 2070.

A report by Observer Researcher Foundation suggests that though the domestic funding for green finance in India is limited, there is a great avenue for international funding; a collective Asset Under Management (AUM) of $81.7 trillion under the 1,715 signatories to the Principles for Responsible Investment as of April 2018; some 534 sustainability indexed funds overseeing a combined $250 billion as of the end of the second quarter of 2020, and the impact investment market worth $715 billion. Bridge the long-standing climate fiancé gap and gathering investment to achieve our SDGs are two major challenges for India. As per Council on Energy, Environment and Water (CEEW), from 2020 onwards more than $10 trillion is needed for power, green hydrogen and electric vehicles alone to meet India's net zero for the target year of 2070.

In 2022, the Indian Finance Minister announced the prospective issue of 'sovereign green bonds', to finance infrastructure and meet clean energy goals. The RBI has also released a discussion paper on climate risk and sustainable finance in July 2022. On November 9, 2022, the Department of Economic Affairs, and the Ministry of Finance released the Sovereign Green Bond Framework, which outlines the duties of the Indian government as a Green Bond issuer. In 2022, SEBI approved the establishment of the Social Stock Exchange (SSE) which is a ground-breaking platform designed to bridge the gap between investors and social enterprises focused on promoting social welfare and environmental sustainability. In January 2023 SEBI came out with operational guidelines on green bonds asking issuers to make additional disclosure. Reserve Bank of India (RBI) held its first auction of Sovereign Green Bonds (SGrBs), with a total value of Rs 8,000 crore on 25 January 2023.

 ISSN : 2230-8431

India depends primarily on debt financing for funding green and renewable energy projects. 'Task Force for Creating National Infrastructure Pipeline' report estimated an infrastructure funding requirement of $4.5 trillion by 2040 to achieve national renewable energy targets by financing green housing, electric vehicles, and clean energy projects. The Ministry of New and Renewable Energy (MNRE) governs research and development, protection of intellectual property, and promotion and coordination of renewable energy resources. India provides three types of incentive schemes for renewable energy financing such as accelerated depreciation (AD), viability gap funding (VGF) and generation-based incentive (GBI). India, in its latest budget, prioritized green growth with resources allocated to hydrogen, energy storage and renewables, and for making agriculture more nature-friendly. The beginning of the year 2023 was marked by many sustainable finance announcements and the government also issued its first green sovereign bond, raising $1 billion at a lower cost of capital than conventional debt. RBI announced its plan to issue new guidelines on climate stress testing, climate disclosure and green deposits at banks. SEBI has been tracking green bonds and corporate disclosure in the capital markets. SEBI has also released a new framework for blue (ocean) and yellow (solar) bonds. The year 2023 is marked by an important step for accountability on environmental and social performance by the disclosure of India's 1,000 biggest corporates will have to disclose a Business Responsibility and Sustainability Report (BRSR).

Sustainable Investment Strategies

The United Nations Environment Programme to improve the effectiveness in mobilizing capital towards sustainable development has designed Sustainable Financial System in 2014. In the report, Sustainable Investment Market Report 2014 of Sustainable Investments in Switzerland, ('Marktbericht Nachhaltige Geldanlagen 2014' of the Forum Nachhaltige Geldanlagen (FNG)) sustainable investments strategies are classified into eight categories. Exclusion is a sustainable investment strategy which systematically excludes certain investments or investment classes such as companies, countries or industries if they infringe specific criteria. Another strategy is to select leading or 'best performing' in industries, categories or classes based on their ESG weightage. This approach is called Best-in-Class. The engagement strategy is a long–term process involving dialogue and activities with companies to improve their ESG performance. Another Sustainable investments approach suitable for emerging and developed markets to target a range of returns from below market to market rate is Impact Investment Strategy. This strategy involves investments into companies and funds to generate social and environmental impact with financial returns. Integration is a sustainable investment strategy with the explicit inclusion of ESG risks and opportunities into traditional financial analysis and investment decisions after an appropriate systematic financial market research process by asset managers. Sustainability-themed investment involves the investment in assets linked to the promotion of sustainability or related themes with a focus on specific or multiple issues related to ESG. Norms-based screening strategy involves the screening of investments according to their compliance with international standards and norms of ESG criteria. Voting strategy is the exercise of the voting rights of the shareholder during the General Assembly to influence the ESG policies of companies.

Sustainable or green projects are funded by Domestic public finance which is directly funded by the government of a country. Another type of funding is International public finance which is funded by international organizations and international development banks. Private sector finance is the third method of funding which is funded by both domestic and international private players. Corporations can invest in business sectors that are focusing on renewable energy along with their CSR initiatives. Financial institutions like banks and stock exchanges play a major role in the mobilization of funds for these sustainability-oriented companies. Government agencies and regulatory mechanisms in the financial system can support sustainable investment using innovative financial instruments like green bonds, carbon trading and so on in debt and equity markets.

Challenges of Sustainable Finance in India

The lack of sustainable finance taxonomy in the financial system of India with a comprehensive definition of sustainable finance, a classification system, sustainable activities parameters and a well-defined set of eligibility criteria, is a major challenge. This in turn makes it difficult for investors to make informed decisions as there is a lack of standardisation and disclosure of nonfinancial information about companies to evaluate the risks. Sustainable Finance taxonomy provides an accord for equity investors, lenders, policymakers and regulators to identify the economic activities that contribute to a country's sustainability priorities. Another barrier is the creation of a commonly accepted Sophisticated and investment-friendly regulatory framework along with technical infrastructure to measure, assess and analyse sustainable financial strategies and policies in alignment with our economy is highly demanded. The high cost of debt along with the short tenure of loans makes sustainable projects less attractive to investors. Hence, the introduction and designing of Innovative and profitable sustainable financial instruments which are lucrative enough to attract both domestic and international private investors are needed. The lack of sustainable financial literacy must be addressed with training and other awareness programs. Sustainable financing with private investors in a developing country like India is limited by activity-specific and country-specific barriers which may harm investment returns and risk management. Another difficulty is Market infrastructure development to increase the market penetration considering the huge size of the domestic market, which needs to be explored. Fostering the role of high net worth individuals (HNWI) should be prioritized.

 ISSN : 2230-8431

Conclusion

As India considers sustainable finance is an integral part of its financial policy to achieve SDGs, a strategic reorientation of the financial system anchored by sustainability orientation is the need of the hour. Amidst myriad challenges, India has started its way towards sustainability goals with the launch of new sustainable instruments and policy frameworks.

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