Long form | Post G20 Priorities for Indian Sustainable Finance Roadmap: A Discussion on Instruments, Frameworks and Capacities

Convened on 22 September 2023, at the Maple Hall, India Habitat Centre, New Delhi

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The dialogue "Post-G20 Priorities for India's Sustainable Finance Roadmap: A Discussion on Instruments, Frameworks and Capacities," was co-organised by the India Initiative on Climate Risk and Sustainable Finance, (anchored by Climate Bonds Initiative, ODI and auctusESG), and IEEFA. This conversation brought together government officials, regulatory bodies, corporate leaders, and think tanks, to suggest clear actions in the short to medium term to address the sustainable finance challenges and opportunities.

The discussions focused on two themes, namely - "Instruments and Frameworks for Financing Transition" and "Prioritising Areas for Capacity Enhancement for Green and Transition Finance." Geetu Joshi, Advisor, Department of Economic Affairs, Ministry of Finance, provided an insightful overview of the significant milestones achieved and the path forward for sustainable finance in India. She highlighted the achievements of the Sustainable Finance Working Group (SFWG) led during the Indian Presidency and India's proposals for global collaboration for sustainable development. While recognising these achievements, she emphasised that there is still ample work to be done to translate recommendations into action and collaborate internationally.

She outlined the three main priorities of the SFWG during India's presidency. First, the aim to mobilise finance for climate action by attracting resources, involving multilateral development banks, and encouraging private investment in green and low-carbon technologies. Second, expanding its scope beyond climate to encompass all SDGs (Sustainable Development Goals) by devising an analytical framework aligning financial instruments with social SDGs and improving data related to nature and biodiversity. The SFWG for the first time ventured beyond its initial focus on climate and expanded its scope to include sustainable development goals, marking a significant milestone. They have mapped out how financial instruments can support social SDGs like health and education. But that's not all. They have included nature and biodiversity as well. Their mission? To improve data and reporting on these topics. Why? So that when big decisions and investments are made, we are on track for a nature-positive future.

Lastly, the initiation of a G20 Technical Assistance Action Plan (TAAP) to build capacity for sustainable finance tailored to local needs. These recommendations recognise the risks and acknowledge the necessity to safeguard small and medium enterprises (SMEs) from the disproportionate impact of sustainability reporting obligations. Additionally, UNDP will be organizing meetings for TAAP, where all international organizations will be invited to contribute to the program. The G20 members have shown great appreciation for this aspect garnering widespread consensus and support from all parties involved demonstrating that India is not merely participating but assuming a leading role in global sustainable finance initiatives.

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The conversations then proceeded to the first session which delved on ***Instruments and Frameworks for Financing Transition: Barriers, Solutions and Priority Actions for their Uptake.***

The dialogue commenced with a focus on climate finance, particularly “Blended finance” as an instrument with potential but not meeting the expectations. Experts argued for the strategic repurposing of subsidies to maximize impact while ensuring the sustained commercial viability of sectors which are being supported by subsidies. As an example, the IFC, has endorsed three crucial principles for blended finance. First, avoid market distortion because of subsidies; second, supporting the private sector should aim to stimulate market growth and attract private resources, while reducing the need for concessional resources, and three, focus on achieving long-term commercial sustainability of sectors, a crucial but often overlooked aspect. It was discussed why productivity enhancement as a result of sustainability and climate considerations can make for a good demonstrative case to attract capital too.

A substantial increase in private investments become crucial to finance green transition. When we look at the global markets, we see that private debt investments have been quite active, especially in the areas of thematic bonds fuelling investments in the renewable energy sector. However, when we look at India's bond market, we realize that there is room for considerable expansion to tap into long term debt required for climate investments.

Alongside, the equity investment story seems to face its own obstacles even as it receives sufficient support. The challenge lies in drawing equity investors to India that compete with OECD countries for their investments. To address this, India will need to tackle those soft costs (variable costs) that can make or break an investment. Clear regulations are a must, and cost predictability over the next decade is vital. This underscores the pressing need to develop our local financial markets.

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Private finance is a key player in steering the ship of change. It's not just about social goals; it's a business proposition with real impact potential. A way of doing it is to tweak the financial market incentives possibly through taxes or voluntary markets. It’s effects could be significant, for e.g. Carbon Border Adjustment Mechanism (CBAM), especially for countries like India with ambitious energy transition goals. But pricing is not the only player in this game. Non-pricing factors, like incentives, regulations, and strengthening our financial ecosystem, will also play a pivotal role depending on regional and sector contexts. Therefore, employing both pricing and non-pricing mechanisms will be required to bring about these reforms. The potential to leverage IFSCA to effectively manage foreign investment flows and reforming InvIT structures to accommodate different credit ratings to attract diverse pools of capital came up as potential solutions to get more green projects in the investment pipelines.

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Corporate entities are often confronted with a tightrope walk, especially when economic cycles change. They need to be agile to avoid costly refinancing and find a balance between the supply and demand for funds. Demand-side incentives, like carbon pricing therefore become crucial, especially for larger companies. However, ambiguous policies become hurdles that must be manoeuvred to attract investments. For instance, lack of clear definitions of what qualifies as "green". It might be clear in the power sector, but when we look at other industries, such as steel, cement, buildings, it is a different story. That is where having a clear taxonomy becomes very important. Singapore, for instance, has a unique approach wherein they place great emphasis on the significance of a taxonomy based on scientific principles, as well as the carbon market and carbon services.

That said, there are significant issues in the carbon markets worldwide. Credibility has taken a hit, and that is something that needs global attention. It is essential to restore confidence and market stability, especially when it comes to voluntary carbon markets. These markets can be a powerful force for change only if they are built on trust and credibility.

MSMEs, as we know, have always encountered challenges, particularly access to finance. They very often prefer short payback periods. It makes sense that they want to see results sooner rather than later. So, a significant challenge is, how to align the business case for transitioning to greener practices with their preferences? One way to tackle this challenge is through financial institutions' introducing products designed to facilitate these transitions. It will mean a tailored roadmap for banks also so as to green its MSME portfolio with minimal costs of doing so. Similarly, startups also find themselves struggling to secure capital. This is a reminder of how critical it is to allocate funding appropriately, especially for these budding ventures. It must also be noted that debt is not always the best option, particularly if MSMEs or startups cannot manage it properly. It can lead to the failure of both the potential technologies and the entity and therefore developing financing models with access to small amounts that are manageable and sustainable is necessary. Additionally, MSMEs and startups must leverage India's technology stack to support decarbonisation in value chains with support being provided wherever necessary in terms of education and advocacy.

Every year, a whopping USD 20 trillion gets invested in the hard-to-abate sectors that are major contributors to emissions. However, only a fraction, a mere USD 250 billion is directed towards transition efforts. In India, Niti Aayog is actively working on a national-level energy transition plans and similar plans at the state level recognising that transition in India is still in its early stages. What is the missing link? It is about having the right mechanisms in place to support transition across various sectors, with a particular focus on developing transition finance, especially when we are looking to achieve earlier targets like 2030, 2040, or 2050. Japan serves as an interesting example in this regard by employing sector-specific roadmaps. They are also promoting costly technologies like green hydrogen and offer incentives like zero-cost finance for low-carbon tech to aid their transition efforts. In the grander scheme of things, it is all about finding the right mechanisms, focusing on transition finance, and learning from examples like Japan.

The Multilateral Development Banks (MDBs) can play an important role. They need to step up their game by using their resources more effectively. One way to do this is by aiming for 8 to 10 times leverage. How do they achieve this? They can start by increasing their capital and be willing to take risks. Another key move would be to shift to programmatic interventions, to have a well-thought-out plan rather than making ad-hoc interventions. They can use financial mechanisms like thematic bonds and explore risk-sharing facilities.

The promising area of energy surprisingly has seen limited investment despite being a low-hanging fruit. So far, domestic funding has had a positive impact indicating substantial expansion potential. However, to unlock this potential, we need a formal market-making strategy, possibly collaborating with specialized NBFCs known for their expertise in project origination and aggregation, something traditional banks might not be well-versed in. Demand for renewable energy from open access consumers is also high due to their creditworthiness and risk appetite. But we need strong sponsors to make things happen. They are the driving force behind raising the capital needed to turn energy transition dreams into a reality.

The recent decline in financial savings among Indian households is worrisome signalling that non-financial corporations have become the primary savers. There may be two ways to address this. The first option is to cast our net wider and attract foreign investment, which could infuse much-needed capital into the country. The second suggestion revolves around introducing innovative financial products to alter the savings landscape. But there is more. We also need to consider adding medium-term fixed-income products to the mix. It is like adding a stable foundation to our financial landscape, especially since we lean on international finance due to limited domestic savings and high government borrowing.

An important game-changer is to expand the role of pension and insurance funds in climate finance in India. These funds have the potential to become crucial sources of funding for sustainable initiatives. Not limiting oneself here, there are other paths to explore, like bilateral agreements under Article 6.2 and international carbon markets under Article 6.4 to realize our investment requirements.

While the first session delved on mobilizing sustainable finance through a variety of instruments , the next session themed - "***Prioritising Areas for Capacity Enhancement for Green and Transition Finance"*** aimed to tackle capacity-related questions, offer solutions, identify barriers, and provide insights into what's necessary within the short to medium term.

The initial inquiry revealed potential capacity gaps in the banking sector. Some banks are more advanced in integrating environmental, social, and governance (ESG) considerations, while others are playing catch-up. There's growing awareness of climate-related issues within ESG and sustainability teams; however, this awareness hasn't yet permeated other critical teams like treasury and risk management. To address this, it is recommended that commercial banks invest in building capacities and potentially even collaborate with multinational institutions to enhance their capabilities and address data gaps related to climate risks and opportunities.

One of the biggest hurdles faced by banks and financial institutions lies in managing data and categorizing loans based on ESG criteria. The existing data structures were not originally designed for this purpose, making the task tricky. Additionally, banks are treading carefully to avoid "greenwashing," What everyone is really waiting for is regulatory clarity and precise definitions to classify green and sustainable activities. Until that happens, the waters will remain a bit murky. Similarly, when it comes to transition financing, banks are cautious here, too, largely due to the regulatory uncertainties. However, as the demand for transition financing continues to grow, and as regulations become clearer, banks are likely to roll out more tailored products and solutions.

From a regulatory perspective it was recognised that regulators are taking proactive steps like SEBI enhancing regulations related to ESG and green finance as well as actions by the RBI. However, an aspect that emerged during the discussion was the absence of a well-defined overall sustainable finance framework for India, unlike the well-defined structure in the EU. The EU Green Deal, which comes complete with a structured framework featuring initiatives like the sustainable finance taxonomy, SFDR (Sustainable Finance Disclosure Regulation), and CSRD (Corporate Sustainability Reporting Directive). These tools provide an effortless way to comprehend the interconnections among all the components. On the flip side, India finds itself lacking such a cohesive framework. This absence leads to scattered efforts when it comes to ESG and transition finance. To get things moving in coherence, India needs to establish a clear and interconnected framework, much like what we see in the EU. This would not only help with effective governance but also ensure that sustainability efforts are implemented seamlessly.

While data quality is making strides, there are still hurdles to clear, and it's not all smooth sailing. One major challenge is harmonization. Ensuring that data from different sources align and are reliable is a real puzzle. It is like trying to compare apples to oranges when it comes to determining which companies are doing better than others. Another roadblock is the lack of sectoral contextualization. This means that it is tough to make fair comparisons between emissions and sustainability plans across various companies and industries leading to inconsistencies in how they assess companies both within sectors and globally. Adding to the mix, companies are grappling with turning historically qualitative analyses into quantifiable data. But there seems to be a silver lining, mandatory disclosure regulations hope to significantly positively impact the quality and quantity of data reported by companies' overtime.

Climate education is becoming increasingly crucial for banks and financial institutions. There needs to be emphasis on understanding climate risk, especially unpredictable physical risk. Why does this matter for banks? Banks often focus on short-term asset duration. That means they might not be as concerned about "transition risk." But India's vulnerability to climate-related events, like extreme weather, makes addressing physical risk a top priority. International investors are taking notice, too. They have started asking banks more questions about climate risk. Plus, they are keeping a close eye on sustainable and green bonds to make sure they are credible. Here is where the Indian Banks' Association (IBA), among other institutions, plays a crucial role in building capacity. However, there are some challenges. Data availability, especially when it comes to physical risk data, can be a bit of a hurdle. To tackle this, they are working on creating a common database by teaming up with insurance sector. The IBA is also stressing the need for banks to have consistent risk assessment parameters and to get support in modelling and stress testing.

When it comes to tackling the challenges of climate finance and sustainability, banks must consider adding sector specialists to their teams. It is not just about training; but about having in-house experts who know the ins and outs of specific technologies, understand the science behind them, and can handle all the associated data. The idea is to bolster traditional banking expertise with specialized sector knowledge. Some banks are even hiring climate scientists to bridge the knowledge gap and effectively navigate the complexities of climate finance and sustainability.

In the short term, banks should focus on assessing carbon emissions within their portfolios and comprehending the financial risks associated with climate change. Emphasis should also be placed on transition financing, an area currently underutilized and not well understood, and the establishment of a standardized framework. Looking ahead to the medium term, banks should align their strategies with India's international commitments to Paris and SDGs, reduce funding in high-emission sectors, and actively invest in renewable energy projects. It is equally critical to raise awareness at the board level and integrate transition plans seamlessly with overall business strategies. This comprehensive approach will empower banks to navigate the complex landscape of climate finance effectively.

To summarize, ultimately, it is about bringing a cultural shift within financial institutions. The real focus here is on encouraging these cultural changes and driving engagement. It is not about reaching immediate perfection. Instead, it is about fostering an environment where forward-thinking, sustainability, and climate action become an integral part of the Financial Sector's DNA.

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