Green Deposits: A key instrument in India's journey towards Net Zero

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On 11th April 2023, the Reserve Bank of India (RBI) announced a 'Framework for Acceptance of Green Deposits'. This will be applicable to all commercial banks except for regional rural banks, local area banks and payments banks. It also applies to all deposit taking non-banking financial companies, including housing finance companies. This will come into effect from 1st June 2023.

This is the first regulation announced by the RBI related to Green Finance. Earlier, the Securities and Exchange Board of India (SEBI) has made policy announcements on related issues. The first one was the 'Business Responsibility Reporting (BRR)' in mid-2012, which was revised in late 2015. This was replaced by a 'Business Responsibility and Sustainability Reporting (BRSR)[1]', announced in mid-2021. Four years ago, SEBI had issued the 'Disclosure Requirements for Issuance and Listing of Green Debt Securities[2]' which was updated by another circular issued in mid-2021. Further, in early 2023, SEBI issued a 'Dos and don'ts relating to green debt securities to avoid occurrences of greenwashing[3]'. Also, on 22nd February 2023, SEBI put up a Consultation Paper on the Regulatory Framework for ESG Rating Providers[4] (ERPs) in Securities Market which has a section on the 'Regulatory Framework for ERPs'.

From a global perspective, regulations on green banking have come into force on 1st January, 2022[5] in the European Union, which is generally considered to be most progressive geography in terms of green finance. In the USA, in March 2022, the Securities Exchange Commission published a proposed regulation which would enhance and standardise the climate-related disclosures provided by public companies[6].

Instruments for Green Financing

Green bonds are arguably the most visible instrument of green financing. Much has been written about them and their growth has been closely tracked. At the end of the third quarter of 2022, green bonds issued stood at USD 2 trillion[7]. Green bonds and green loans are subject to globally recognised standards, the parameters of which are set out in the 'Green Bond Principles[8]' and 'Green Loan Principles'[9]. The policies have been developed by the International Capital Market Association (ICMA) and are described as 'Voluntary Process Guidelines' applicable to green bonds and green loans. These documents have been elaborated by a working group, consisting of experienced representatives from leading financial institutions who are active in green loan and bond markets. Thus, their market acceptance is very high across various geographies.

The aim of the green loan and green bond principles is to create a high-level framework of market standards

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[1]SEBI | Business responsibility and sustainability reporting by listed entities

[2]930_India_Disclosure_Requirements_for_Issuance_and_Listing_of_Green_Debt_Securities_SEI_2017.pdf (sbfnetwork.org)

[3]SEBI | Dos and don'ts relating to green debt securities to avoid occurrences of greenwashing

[4]SEBI | Consultation Paper on Regulatory Framework for ESG Rating Providers (ERPs) in Securities Market

[5]Green Finance in Europe – Strategy, Regulation and Instruments - Intereconomics

[6]SEC Climate Disclosure Guidance | Deloitte US

[7]Green Bond Market Hits USD2tn Milestone at end of Q3 2022 | Climate Bonds Initiative

[8]Green Bond Principles » ICMA (icmagroup.org)

[9]LMA_Green_Loan_Principles_Booklet-220318.pdf (icmagroup.org)

and guidelines, providing a consistent methodology for usage across green loan and bond markets. It also allows the individual product to retain its flexibility. Thus, different loan and bond structures which are created as per these principles exist globally. The principles are designed to preserve the integrity of the green loan and bond market while it develops.

However, there is no corresponding document for green deposits. That may be one of the reasons why green deposits have not had as much growth as green loans and green bonds in the past.

In mid-2018, the Yes Bank had launched India's first Green Deposit[10]. Other Banks like the Federal Bank, IndusInd Bank, DBS Bank India and HDFC Limited launched green fixed deposits. With many players getting into the fray, it was deemed necessary to define generally applicable standards.

How the Proposed Green Deposit Framework is supposed to operate

As mentioned, all regulated entities that are covered by the existing rules and regulations on taking of deposits fall within the ambit of this framework. All existing regulations will continue to apply. Thus, the Green Deposit Framework is now an integral part of the existing deposit regulations.

The framework requires the board approved policy and financing framework on accepting green deposits in place. This framework is intended to determine the allocation of green deposit proceeds to green projects. A list of eligible sectors (and exclusions) is outlined in the circular, which serves as a guidance.

The board approved funding framework of the regulated entity will need to lay out the process for selecting and evaluating projects, including eligibility criteria, ongoing monitoring, and validation of sustainability information from the borrower. This is in line with the needs of the Green Bond and Green Loans Framework developed by ICMA.

The RBI regulation also stipulates third-party (independent) verification, impact assessment and reporting. This means that the funding framework itself will need to be reviewed by an independent party. In addition, it needs to be made available online.

Publishing the impact assessment of green deposits is voluntary in the current financial year 2023 - 2024 but will be mandatory from the financial year 2024 - 2025 onwards and needs to be conducted annually. If there are more green deposits than green assets, the temporary holding of assets in money market instruments until they are used must also be regulated and disclosed.

The annual report will make disclosures at the portfolio-level information regarding the use of the green deposit funds.

Some Pioneering features of the proposed Regulation:

- This is the first announcement of its kind by any regulator on green deposits.
- The 'use of proceeds' or what the money accepted as a green deposit can be used for is stated in a fair amount of detail. Also, anything related to fossil fuel, nuclear power and waste incineration is left out. This is remarkable as many pronouncements at the global level have not been cut so clearly. This regulation, in that sense, gives a summary indication about what India's green taxonomy is likely to look like. In parallel, a working group set up by the Ministry of Finance (MoF), Government of India has drafted detailed documents on taxonomy for transportation, energy and agriculture, which are expected to be released soon.
- A third-party verification is mandatory. Typically, providers of third-party opinions are firms like Sustainalytics, DNV GL, amongst others. The Climate Bonds Initiative, which creates standards defining 'what is green' offers certification based on those standards. This should help in restricting greenwashing. Taken in conjunction with SEBI's

[10]YES BANK launches Green Future: Deposit, India's first ever green deposit product - India CSR

pronouncements related to greenwashing, it indicates that regulators in India are taking greenwashing very seriously.

- The 'use of proceeds' has created many possibilities including renewable energy, electric mobility and others. One such example is climate change adaptation. Climate change adaptation has been linked to infrastructure in the 'Green Deposit Framework'. However, as we know, it has applications across various sectors. It is also of great importance in agriculture, on which food security depends. In that sense, the framework is bit restricted. One reason might be that the underlying concepts of adaptation and resilience are very difficult to understand and interpret. While the Climate Bonds Initiative has published the 'Climate Resilience Principles[11]' to clarify the same for investors and others, a lot of dissemination of the same needs to be done before it is widely understood.

Effect on Indian Banking and Day-to-Day Functioning of Bankers

In late July 2022, RBI had come up with a 'Discussion Paper on Climate Risk and Sustainable Finance[12]'. At the same time, a survey to assess climate risks and the sustainable finance status in leading commercial banks was published. There were more than 1,000 responses on the discussion paper.

If we take the actions of MoF, SEBI, and RBI in toto, it is very clear that there will be regulations about the assessment of climate risks and policies which will try to speed up the journey towards sustainable finance.

Both the assessment of climate risks and growth in sustainable finance will mean a shift towards a banking system which is climate-friendly. This shift implies an extensive deployment of the proceeds of the green deposits to a variety of green assets. Most of the green assets present today are related to renewable energy (mostly solar and wind) being fed to the grid. It is likely to diversify substantially from the present situation.

Therefore, bankers will need to understand and quantify climate risks & deal with sustainable assets. They will also need to deal with liabilities like green deposits, green loans and green bonds.

As a consequence, there will be a massive need for capacity building in the banking sector. The Indian Institute of Banking and Finance (IIBF) conducted a pilot training program on Responsible Banking in Mumbai, India, with support from UNEP FI and the GIZ Germany. This is one of the many steps which can help in the required capacity building.

Conclusion

The announcement of the Framework for Acceptance of Green Deposits is a significant step towards significant development of green finance market in India. The Government of India, through various policy measures, has shown its commitment to fight climate change. This regulation is likely to promote the flow of capital to the green causes in the long term. Policy measures to support green causes are likely to continue and further regulations on green finance are expected soon. The regulations in conjunction with various policy measures is likely to create steady progress towards a greener and more sustainable economy.

[11]Climate Resilience Principles | Climate Bonds Initiative

[12]CLIMATERISK46CEE62999A4424BB731066765009961.PDF (rbi.org.in)