Climate Risk - Whether banks are ready for transition

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Introduction

In the past 40 years, the proliferation of extreme temperature, droughts and wildfires has more than doubled, amplifying the frequency and ferocity of environmental catastrophes. The incidence of floods and heavy rain has skyrocketed, quadrupling since 1980 and doubling since 2004. Over the last 140 years, global sea levels have surged by 21 to 24 centimetres, with a staggering 10-centimeter surge occurring since 1992 alone. Since 1900, India alone has weathered 756 natural disasters, with a stark escalation in the past two decades. From 1900 to 2000, the country grappled with 402 disasters, whereas, an alarming 354 calamities unfolded in just the last 20 years, marking a staggering 88% surge in comparison.

The Paris Agreement, adopted at the UN Climate Change Conference in 2015 aimed ambitiously to cap global warming at 1.5 degrees Celsius, yet current emissions trajectories paint a bleak picture, with a projected 2.7 degrees Celsius increase by 2100. Meanwhile, economic losses from climate change have soared sevenfold from the 1970s to the 2010s, ballooning from an average of $49 million to a staggering $383 million per day worldwide. Looking ahead, developing countries face a grim outlook, with estimated loss and damage ranging from $290 billion to $580 billion by 2030, a figure set to skyrocket to $1-1.8 trillion by 2050 under the looming spectre of climate change.

Today, there is growing global recognition that climate-related disasters can pose risks to the stability of financial systems. Recently, the World Bank found that over 45 years from 1980 to 2019, severe climate and environmental disaster episodes lead to an increase in the level of system-wide non-performing assets. Over time, climate disasters can pose significant risks to the solvency and profitability of the banking and financial sector. As such, it becomes imperative for banks to include climate risk in their functioning and financing.

The Ripple Effect: Climate Risk Transmission

While we can grasp the immediate impact of shifting weather patterns and the onslaught of more frequent and severe natural disasters, the bulk of potential costs lie far beyond the scope of typical economic analyses. Because of this, quantifying the economic toll of climate change remains an ongoing battle. But what is certain is that the economic ramifications of climate change are poised to accelerate, albeit in a tumultuous manner. Crucially, the extent of this impending devastation hinges on the policy decisions that are made today.

Increasingly, policymakers and investors are awakening to the stark reality of climate change's implications for the financial sector. Climate change

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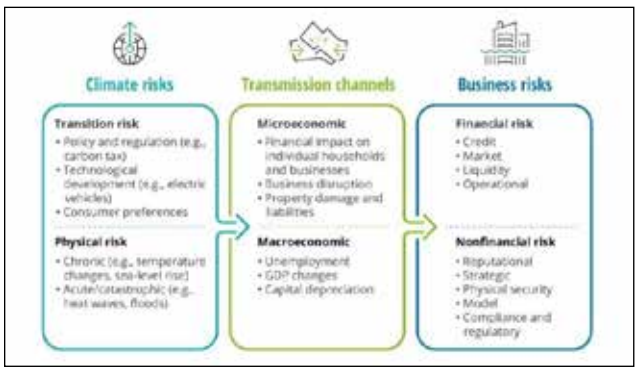
permeates the financial landscape through two primary avenues – physical risks and transition risks (Figure 1). Physical risks stem from damage to property, infrastructure and land. Transition risks are the outcome of shifts in climate policies, technological innovations and shifting consumer and market sentiments amid the transition to a low-carbon economy. Exposures fluctuate dramatically from one nation to the next, lower-and middle-income economies typically bearing the brunt of physical risks.

Figure 1: Climate Risks & Transmission Channels



Source: Deloitte & Touche LLP

For financial institutions, physical risks can materialise both directly and indirectly-directly through their exposure to corporations, households and countries that experience climate shocks and indirectly through the effects of climate change on the wider economy and its after effects within the financial system. Such exposures breed heightened default risks in loan portfolios and asset devaluation. It is possible that in times to come, rising sea levels and an uptick in extreme weather occurrences can result in losses for homeowners and a depreciation of property values, thereby, amplifying the risks within mortgage portfolios. The situation extends to corporate credit portfolios and is demonstrated by the "climate-change bankruptcy" of Pacific Gas and Electric (PG&E), California's largest utility. Swift climatic shifts, including prolonged droughts in California, propelled the risk of wildfires from Pacific Gas and Electric's operations. PG&E's bankruptcy serves as a stark reminder of the genuine economic and financial perils confronting companies and investors amidst shifting climate.

Insurers and reinsurers face significant physical risks on their asset side but liabilities also pose considerable threats as insurance policies yield claims with greater frequency and severity than initially projected. Evidence suggests that losses stemming from natural disasters are already on the rise, potentially rendering insurance costlier or inaccessible in vulnerable regions worldwide. The writing on the wall is clear-insurance may morph into a luxury or, worse still, become altogether unattainable in regions most imperilled by climate change.

Transition risks emerge as a threat to the asset side of financial institutions, exposing them to potential losses due to their exposure to companies operating with business models incompatible with low carbon emissions. In a world increasingly shifting towards a low-carbon economy, fossil fuel companies face the risk of being left with stranded assets, rendering their reserves unusable. Such firms may witness dwindling earnings, operational disruptions and heightened funding costs driven by policy interventions, technological advancements and growing pressures from consumers and investors to align with climate change mitigation policies. For instance, coal producers are already contending with existing or anticipated regulations aimed at reducing carbon emissions, leading several major banks to pledge against financing new coal ventures. The

stock prices of US coal mining companies reflect this "carbon discount" alongside increased financing expenses, resulting in underperformance compared to companies investing in clean energy assets. Moreover, risks may manifest throughout the broader economy, particularly, if the transition to a low-carbon economy occurs suddenly due to past inaction, is inadequately planned or encounters challenges in global coordination. The domino effect of such risks can reverberate across sectors, can disrupt economies globally and can plunge international trade into disarray.

Sustainable Finance Reporting: Opportunities and Challenges

As the regulatory pressure for incorporating climate change policies grows and stakeholders demand greater accountability, banks find themselves at a pivotal point. Sustainable finance reporting standards offer banks the opportunity to bolster their risk management practices, enhance financial performance and foster transparency, all while making a tangible difference in the fight against climate change. For financial institutions, embracing sustainable finance reporting standards is not just a box to tick, it is a game-changer that can revolutionize the banking landscape and provide a plethora of benefits (Figure 2).

Figure 2: Opportunities in Sustainable Finance Reporting

Source: Greenomy

- ***Improved Risk Management and Long-Term Financial Performance***

  By integrating additional financial indicators into their risk management frameworks, banks can gain an eagle-eyed view of ESG risks and opportunities. This means banks will have reduced exposure to environmental and social risks, safeguarding both their bottom line and the planet. Additionally, by identifying sustainable investment opportunities with precision, banks can boost their financial performance while staying true to their values.

- ***Development of Innovative Products and Services***

  By rolling out innovative sustainable finance products like green bonds and sustainability-linked loans, banks can move past their competitors who offer only traditional products. These offerings not only cater to ESG-conscious clients but also help in tapping into new markets while making a meaningful impact.

- ***Enhanced Transparency and Accountability***

  By leveraging regulatory standard definitions of sustainability matters, banks can effectively mitigate the reputational risks associated with greenwashing scandals and redirect their focus towards their core business objectives. This approach not only safeguards the integrity of their brand but also instils confidence among stakeholders, including customers, investors and regulators. By adhering to recognized sustainability standards, banks demonstrate a genuine commitment to responsible practices, earning trust and credibility in an increasingly discerning market. This, in turn, fosters long-term relationships and sustains their competitive advantage in an evolving financial landscape.

- ***Competitive Advantage and Differentiation***

  The strategic alignment with sustainable finance principles enables banks to cultivate a loyal customer base, including younger generations increasingly attuned to environmental and social issues, who expect financial institutions to mirror their values. This proactive approach not only unlocks new revenue streams but also facilitates the expansion of market share. Additionally, embracing sustainable finance practices serves as a magnet for sustainability-conscious talent, a crucial factor in bolstering banks' future competitiveness.

- ***Improved Access to Capital***

  By embracing sustainable finance reporting standards, banks effectively showcase their endeavours to embed ESG considerations across their business operations, risk management practices and investment decision-making processes. This enhances transparency and instills trust and credibility with investors and lenders, consequently, improving access to capital at more favourable rates.

- ***Alignment with Global Sustainable Development Goals***

  Aligning with the Sustainable Development Goals (SDGs) enables banks to showcase their dedication to foster a more sustainable future and underscores their pledge to advancing these universal objectives. These standards furnish banks with lucid and actionable guidance on how they can actively contribute to the attainment of these goals through sustainable funding and investments, all the while mitigating their exposure to unsustainable activities. Moreover, by championing the realization of the SDGs, banks assume a pivotal role in facilitating a just transition towards achieving Net Zero emissions.

Today, sustainable finance reporting standards and frameworks like the EU Taxonomy, the Corporate Sustainability Reporting Directive (CSRD) and the International Sustainability Standards Board (ISSB) are gaining momentum, offering banks a chance to showcase their dedication to sustainability while reaping myriad benefits. Embracing these reporting standards is not just a symbolic gesture; it is a strategic move that can bolster risk management, supercharge financial performance and elevate transparency to unprecedented levels. However, adopting these standards comes with its own challenges.

- ***Data Collection and Management***

  Banks and Financial Institutions (FIs) must become capable of deciphering and reporting on a plethora of client data points to prove their compliance with the standards. However, this demands hefty investments in cutting-edge technology, robust data management systems and the painstaking development of internal policies and procedures. For instance, the EU Taxonomy requires banks to indicate the portion of their financing that aligns with the taxonomy's sustainable activities. This means diving deep into the economic activities of clients, identifying what qualifies as environmentally sustainable and tallying up the loans or investments that fund these activities. It is a huge task, especially for smaller borrowers who may not have the luxury of sophisticated data management systems.

- ***Compliance***

  Compliance with sustainable finance reporting standards demands the establishment of robust governance practices that involve designing and implementing new processes and deployment of state-of-the-art tools that is both time consuming and expensive. Additionally, because

the reporting standards keep evolving, failure to be on track can lead to reputational damage, regulatory fines and even a loss of sustainability-driven clients.

- ***Reporting Implementation***

  The complexity and speed at which sustainability stands evolve makes its implementation a tiresome task for financial market players. The scarcity of experts with the requisite knowledge and the absence of fool-proof solutions to address the amount of information required for reporting are also some of the challenges in implementation. Beyond just collecting and managing data, banks are forced to overhaul their reporting procedures and have to set up systems and tools capable of automating reporting with surgical precision. In essence, it is a race against time, where only those armed with the right expertise, tools and determination can step up to take action.

Credit Risk in a Changing Climate

By transforming their practices, the banking industry has the potential to spearhead the charge against climate change. There are substantial opportunities for them to not only play a pivotal role in advancing the transition to carbon-neutral endeavours, but also to profit from practices that include clean energy generation, clean energy storage and carbon capture technologies. On the flip side, studies indicate that although numerous banks have acknowledged the influence of climate change on their operations, the majority have yet to quantify its impact on their financing portfolios. This suggests that most banks may be undervaluing their vulnerability to climate-related risks. However, world over, the regulatory push for banks to address financial risks linked to climate change is intensifying.

Given the likelihood of climate risk affecting every phase of the credit lifecycle, incorporating climate risk metrics into credit risk management stands as an essential first step toward achieving both robust risk management and a carbon-neutral future. Banks must aim at overhauling their credit risk lifecycle by reorienting credit business strategies; re-evaluating the markets, segments and clientele they serve; the spectrum of products they offer; and the innovative solutions they bring to market. Given that climate risk is poised to infiltrate every facet of the credit lifecycle, integrating climate risk metrics into credit risk management represents a colossal undertaking for most banks, yet it is an imperative stride toward effective risk mitigation and a carbon-neutral future. In its report titled 'Embedding Climate Risk into Banks' Credit Risk Management', Deloitte Center for Financial Services provides a practical roadmap for inclusion of climate risk into the credit lifecycle. The roadmap outlined below is based on current practices of banks as well as improvements that can be made in their credit operations, as a means towards maximising outcomes in a climate-driven environment of financing (Figure 3).

Figure 3: Climate Risk in Credit Lifecycle

Source: Deloitte & Touche LLP

- ***Taxonomy, Strategy and Products***

  Banks need to initiate a comprehensive taxonomy

to map out climate risks and their transmission channels. This entails understanding the macroeconomic implications, capital devaluation and evolving consumer preferences stemming from climate change. By employing scoring systems grounded in emissions or other pertinent metrics, banks can visualize the magnitude of each risk through heatmaps. This allows for insights across various dimensions, including industries, geographic locations and client demographics. Subsequently, banks can align their credit business strategies with appropriate risk appetites, credit risk processes and policies. This alignment involves accelerating product innovation to incorporate climate risk considerations and transitioning toward decarbonizing portfolios. For instance, expanding green-lending offerings, such as green mortgages, incentivizes energy efficiency measures among borrowers.

- ***Origination of Credit***

  Assessing climate risk requires in-depth analysis, especially concerning sector concentration and regional exposure. Banks need to intensify due diligence processes, which includes requesting additional data from clients to understand energy consumption, supply chains and emissions data. Today, some banks across the globe are formalizing strategies to cease financing ventures that harm biodiversity. However, striking a balance between gathering necessary information and not overly burdening clients poses a significant challenge. Relationship managers may lack the expertise to effectively communicate the bank's strategy or identify suitable product offerings. Hence, extensive engagement with high-emission clients is crucial, along with collaboration between credit risk departments and other units to prioritize deals mitigating climate risk.

- ***Credit Underwriting***

  Banks are increasingly developing standalone climate risk scores tailored to individual borrowers. These scores assess exposure to both physical and transitional risks posed by climate change, alongside resilience and mitigation efforts. However, given the technical nature of these assessments, banks may need to recruit specialists with scientific expertise in climate patterns. Innovative technological tools aid in risk assessment, allowing for a more comprehensive understanding of each client's climate risk profile. For instance, big data analytics can identify non-disclosing companies and group them into carbon clusters based on their carbon intensity levels. Some banks are also implementing shadow rating systems in their credit underwriting process, to assess climate-related default probabilities.

- ***Collateral Management***

  Regulatory bodies are advocating for encouraging the integration of climate risk assessments into collateral policies. However, aligning long-term climate change scenarios with loan commitments poses challenges. Banks need to collaborate with counterparties to hedge climate risk effectively. Exploring opportunities to partner with insurance firms and other entities to develop derivative contracts tailored for climate risk mitigation is also essential here.

- ***Portfolio Management***

  Continuous monitoring and innovation in methodologies are essential for quantifying climate

risk in credit portfolios. Techniques such as negative screening, limiting exposure to high-risk sectors and implementing automatic vetoes on credit granting processes in the presence of environmental protection concerns need to be employed by banks. To reconcile the "duration inconsistency" between the longer-term horizon of climate change effects and the shorter-term duration of loan portfolios, banks have to adapt macroeconomic stress tests, as a means of assessing climate risks. Additionally, considering the accelerated emergence of climate risks with shorter-term implications, greater analysis of borrower and counterparty behaviour is to be incorporated.

- ***Default Management***

  Managing defaults influenced by climate risks requires adaptation in recovery processes and data management. Banks should incorporate data on late and default payments resulting from climate change into credit risk appraisals to avoid underestimating risks. While an understanding of root causes for defaults and assessing whether climate is a crucial factor, banks should also be equipped to refine processes for monitoring credit portfolio performance and management of covenants, payments, limits and concentration risks and breaches.

- ***Reporting and Disclosure***

  Regulators are increasingly demanding detailed disclosures of climate-related risks and opportunities. Standard-setters like the Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI) offer guidance on environmental reporting. The Sustainable Finance Disclosure Regulation (SFDR) mandates sustainability categorization for financial products in Europe. Compliance with sustainability-linked covenants is essential for banks committed to net-zero ambitions. These covenants aim to incentivize improved corporate behaviour and environmental performance through indicators like energy-efficient infrastructure or the transition to renewable energy sources.

Embedding climate risk into banks' credit risk management framework is a challenging endeavour, but it is becoming increasingly essential in driving the transition to a net-zero economy. By starting with credit and lending operations and expanding implementation of such strategies across all segments of its operations, banks can empower themselves to navigate the challenges posed by climate change and ensure the sustainability of their operations in the long run.

India's Climate Action Plan

India stands at a critical juncture in its development trajectory, facing the dual challenge of economic growth and environmental sustainability. While India is yet to adopt a formal taxonomy, the Reserve Bank of India (RBI) recently unveiled draft guidelines, aimed at establishing a framework for regulated entities to manage climate-related financial risks effectively. This initiative is indicative of the growing recognition of the potential impact of climate change on the financial sector. In its 2022-23 Report on Currency and Finance, the Reserve Bank of India detailed the various policy initiatives taken up by the country as it endeavours to transition to a greener and cleaner economy. The various initiatives are as follows:

- ***Fiscal Policy Initiatives***

  Fiscal policy plays a crucial role in facilitating the transition to a low-carbon economy by reallocating resources from carbon-intensive to green industries. Green fiscal policy employs

instruments such as taxes, subsidies, grants and expenditures to align fiscal policy with climate and environmental goals. India's Union Budget 2023-24 prioritizes "Green Growth," introducing measures such as infrastructure development for renewable energy, the Green Hydrogen Mission and schemes promoting waste management, alternative fertilizers, mangrove plantation and wetland conservation. The country is also exploring carbon pricing mechanisms to incentivize emission reductions and fund green projects. Carbon taxes and emissions trading schemes are also being considered to internalize the environmental costs of carbon emissions.

- ***Innovation and Technology Adoption***

  Government play a pivotal role in fostering innovation and diffusion of green technologies through R&D investment, supportive policies and creating conducive environment for green innovation. India has made strides in adopting sustainable energy solutions such as solar-powered infrastructure, mass transit systems, smart grids and initiatives like the Faster Adoption and Manufacturing of Hybrid Electric Vehicles (FAME India) scheme. India's Long-Term Low Greenhouse gas Emission Development Strategies (LT-LEDS) further highlights its commitment to a low-carbon future. Additionally, India's Smart Cities Mission promotes the use of technology and innovation to improve urban infrastructure, reduce emissions and enhance sustainability in cities.

- ***Trade Policy***

  International trade can facilitate diffusion of green technologies and improve carbon efficiency through measures such as promoting green energy products in regional trade agreements and setting environmental standards and eco-labelling requirements. India has been advocating for the inclusion of green and clean energy products in regional trade agreements. The country is also exploring the adoption of environmental quality standards and eco-labelling schemes to incentivize sustainable production and consumption practices in international trade.

- ***Regulatory Measures***

  Regulatory frameworks aim to make financial institutions resilient to climate risks and incentivize investments in technologies conducive to a low-carbon economy. The Reserve Bank of India has initiated measures to incorporate climate risk into financial regulations, including disclosure frameworks, climate scenario analysis and stress testing. India's Corporate Social responsibility (CSR) legislation also guides businesses toward environmentally responsible practices.

- ***Market-based Solutions***

  Market forces are increasingly driving sustainability initiatives, with investors and firms aligning strategies with Environmental, Social, and Governance (ESG) principles. Private equity firms are integrating ESG factors into investment decisions and Indian companies are matching ESG concerns with actions to support the green transition, reflecting a growing recognition of the link between ESG performance and long-term sustainability.

- ***Monetary Policy***

  Central banks play a crucial role in addressing climate change through monetary policy operations and frameworks. While some central banks have explicitly incorporated climate

considerations into monetary policy, others remain cautious to avoid diluting their primary mandates. Green quantitative easing, which directs central bank asset purchases toward low-carbon sectors and collateral policies for accessing liquidity are among the monetary policy tools being explored by India to promote green finance. Digital currency systems can be more energy-efficient than traditional payment methods and promote sustainable financial practices. As such, India's CBDC initiative aims to reduce the environmental footprint of currency production and transactions.

- ***Nudging Behavioural Change***

  Behavioural change is essential for mitigating climate change, including responsible consumption, circular economy practices and sustainable resource management. India's Mission LiFE aims to nudge individuals and communities toward environmentally sustainable lifestyles for adopting low-carbon products and practices.

Role of Indian Banks in Climate-Resilient Finance

In recent years, the discourse around climate change has evolved from being solely an environmental concern to a critical financial risk. Indian banking, a cornerstone of the country's economy, is increasingly recognizing the need to address climate-related risks in its operations. As the effects of climate change become more pronounced, the banking sector in India is waking up to the reality that ignoring these risks could have significant implications for financial stability.

A 2022 report released by think tank Climate Risk Horizons (CRH) sheds light on the challenges facing Indian banks regarding climate risk. The report titled 'Unprepared: India's Big Banks Score Poorly on Climate Challenge' evaluates the climate risk readiness of the top 34 banks in India based on market capitalization. The findings are stark-while some banks have taken steps to address climate risk, the majority have yet to incorporate climate considerations into their business strategies. One of the key findings of the CRH report is that most Indian banks have not begun to factor climate change into their operations. This includes the lack of mechanisms to address both physical risks, such as those caused by extreme weather events and transition risks such as policy changes and technological advancements. Additionally, the report highlights the absence of robust scenario analyses to test banks' resilience to climate-related changes.

While the report highlights the importance of proactive measures by banks to mitigate climate-related risks, it also finds that only a few banks in India have policies in place to exclude lending to entities involved in activities such as deforestation and human rights violations. Additionally, while some banks have issued green loans and financing towards climate change mitigation and adaptation, there is a need for broader adoption of sustainable finance practices across the sector. The findings of the report call for urgent action from Indian banks to address climate risk. The consequences of inaction could be severe, not only for banks themselves but also for the broader economy.

Recognizing the need for action, the Reserve Bank of India has taken steps to address climate-related risks in the banking sector. In February 2024, the RBI presented draft guidelines on the disclosure framework for climate-related financial risks. These guidelines aim to provide regulated entities with a framework to assess and manage climate risks effectively. By promoting transparency and accountability, the RBI seeks to enhance the resilience of banks to climate-related shocks.

However, in reality, addressing climate risk in Indian banking requires a collective effort from all stakeholders. Banks, regulators, policymakers and industry bodies must collaborate to develop comprehensive strategies for climate resilience. This includes incorporating climate risk considerations into risk management frameworks, enhancing climate-related disclosures and promoting sustainable finance practices. In addition to regulatory initiatives, there is also a growing recognition among investors and customers of the importance of climate risk management. Banks that proactively address climate risk are likely to attract investment and build trust with customers who prioritize sustainability.

Looking ahead, Indian banks must prioritize climate risk management as a strategic imperative. By integrating climate considerations into their operations, banks can not only mitigate financial risks but also contribute to India's transition to a more sustainable and resilient economy. The responsibility now squarely rests on the shoulders of India's banks to not only be prepared but to take the lead in championing and facilitating the execution of transformative initiatives.

- ***Crafting a Transition Plan***

  Indian banks must spearhead the development of a robust transition plan to navigate the risks associated with climate change and to embrace green finance opportunities. The discourse within the banking sector is evolving beyond mere investment in renewables to encompass broader discussions on supporting the decarbonization of heavy industries. This shift aligns with the global trend of accelerating the transition to net zero, which is increasingly being prioritized by financial regulators worldwide. For instance, the UK's Financial Conduct Authority (FCA) has taken proactive steps by launching the Transition Plan Taskforce and preparing mandatory disclosure rules on transition plans. Indian banks can-not afford to lag behind in adopting such proactive measures. Strengthening disclosure requirements for transition bond issuers by the Securities and Exchange Board of India (SEBI) in early 2023 and those recently issued by RBI, reflects the impact of global trends on the Indian financial landscape.

- ***Embracing Low-Carbon Technologies***

  Bankers need to deepen their understanding of emerging low-carbon technologies and investment opportunities to drive India's decarbonization efforts. Achieving India's net-zero target requires swift financing of innovative technologies such as electric vehicles, green hydrogen, battery storage, and low-carbon steel. While these technologies may seem risky due to their lack of commercial scale in India, experts from the country's climate research institutes can provide invaluable insights into technology readiness, India-specific credit risks and opportunities for financing. Indian banks must proactively engage with these experts to seize the opportunities presented by the transition to a low-carbon economy.

- ***Leveraging Partnerships and Blended Finance***

  Collaboration and innovation are key to address the transition risks effectively. As recommended by the Reserve Bank of India (RBI), banks should leverage partnerships and blended finance mechanisms to fund climate projects. Collaborating through industry bodies like the Indian Banks' Association (IBA), banks can develop guidelines for funding

climate projects, instilling confidence among investors and broadening climate investments as India's Sustainable Finance Taxonomy evolves. Moreover, the G20 expert group's recommendation to engage domestic banks using blended finance instruments is a strategic approach to attract private capital. By combining Indian domestic bank debt with concessional finance, banks can scale up blended finance initiatives, as demonstrated by the World Bank's concessional loan to the State Bank of India for financing rooftop solar systems.

- ***Building Expertise and Capacity***

  As banks gear up to address climate risks, investing in human capital is paramount. Establishing dedicated Environmental, Social, and Governance (ESG) and climate teams and upskilling frontline employees are crucial steps in this direction. Leveraging market-tested resources and best practices from global initiatives like the Net-Zero Banking Alliance can provide valuable insights and guidance to Indian bankers. Additionally, establishing sustainability risk committees and ensuring compliance with reporting guidelines are essential for aligning banking operations with sustainable finance principles. As India's largest corporates commit to net zero, banks must swiftly build expertise to meet the growing demand for green finance services, lest they lose out to foreign lenders and non-bank financial institutions.

In essence, Indian banks have a pivotal role to play in addressing climate-related risks and seizing the opportunities presented by the transition to a sustainable economy. By adopting proactive measures, fostering innovation and building expertise, Indian banks can position themselves as leaders in driving India's transition to a low-carbon future.

Navigating Climate Risks in Banking Policy: Road Ahead

Greenwashing, the deceptive practice of presenting a green image while engaging in environmentally harmful activities, remains a persistent challenge within the banking and financial services industry. Recent reports reveal a concerning uptick in instances of greenwashing globally, with European financial institutions notably implicated. According to data from ESG data firm RepRisk, there was a staggering 70% increase in instances of greenwashing by banks and financial services companies in 2023 compared to the previous year. The surge in greenwashing practices highlights the critical need for greater transparency and accountability within the sector.

The yearly Conference of the Parties (COP) are crucial for setting international climate policy and agreements, including finance-related actions. At the COP26, the Net-Zero Banking Alliance made a ground-breaking pledge to align greenhouse gas emissions from lending and investment portfolios with pathways to net-zero by 2050 or sooner. However, concerns persist regarding the lack of concrete action from central banks, particularly in light of the climate crisis (Figure 4). Despite growing pressure to address environmental risks, some central banks remain hesitant to prioritize climate action, citing competing priorities such as inflation management. This reluctance highlights the intricate relationship between banking policy and public policy, where the decisions of central banks have far-reaching implications for global efforts to combat climate change.

Figure 4: Green Central Banking Scorecard 2022 G20 Countries ranked by Green Monetary and Financial Policies

Rank	Country	Research and Advocacy (out of 10)	Monetary Policy (out of 50)	Financial Policy (out of 50)	Leading by Example (out of 20)	Aggregate Score (out of 130)	Grade (A+ to F)
1 (1)	France	10	12	31	17	70 (52)	B-
2 (6)	Italy	10	12	31	8	61 (45)	C+
3 (7)	Germany	10	12	30	8	60 (44)	C+
4 (4)	European Union	10	12	28	8	58 (47)	C
5 (5)	United Kingdom	10	10	27	9	56 (46)	C
6= (2)	Brazil	10	10	30	7	53 (51)	C
6= (3)	China	10	12	31	0	53 (50)	C
8 (9)	Japan	10	6	14	5	35 (25)	D+
9 (8)	Indonesia	10	1	14	5	30 (26)	D+
10 (14)	Canada	10	2	14	2	28 (15)	D
11= (11)	Mexico	10	4	4	5	23 (17)	D
12 (10)	India	10	0	10	1	21 (18)	D
13 (11=)	South Korea	10	1	6	2	19 (17)	D-
14 (16)	Russia	8	0	8	2	18 (12)	D-
15 (13)	Australia	10	0	4	3	17 (16)	D-
16 (14=)	United States	10	0	6	0	16 (15)	D-
17 (18)	Turkey	10	0	2	2	14 (4)	D-
18 (17)	South Africa	10	0	2	1	13 (10)	D-
19 (19=)	Argentina	6	0	0	0	6 (0)	F
20 (19=)	Saudi Arabia	0	0	0	0	0 (0)	F

Source: PositiveMoney

While COP27 was marked by last-minute disputes over technical details regarding the phase-down of fossil fuels, COP28 in Dubai achieved some notable advancements, such as commitments to replenish the Green Climate Fund and triple global renewable energy capacity. However, its failure to reach a comprehensive agreement on phasing out fossil fuels and establishing a global carbon tax, which experts believe is necessary to effectively combat climate change. According to the International Energy Agency (IEA), global energy-related CO2 emissions grew by 0.9% or 321 million tonnes in 2022, reaching a new high of over 36.8 gigatonnes. This data underscores the urgency of transitioning away from fossil fuels and investing in sustainable energy alternatives. The absence of decisive action on fossil fuels demands a re-evaluation of investment strategies within the financial sector.

Looking ahead, the financial sector's role in combating climate change has never been more crucial. Central banks and financial regulators must prioritize research, advocacy and proactive measures to manage environmental risks effectively. Monetary policy frameworks should be expanded to incorporate green lending facilities and negative screening for environmentally harmful activities. Financial institutions should be held accountable for aligning their operations with the Paris Agreement and environmental goals. It is imperative for Government to collaborate closely with the banking sector to enact policies that facilitate the transition to a low-carbon economy.

In conclusion, the journey toward climate resilience in the banking sector is fraught with opportunities as well as challenges. From navigating sustainable finance reporting standards to grapple with the implications of COP conferences, banks find themselves at the forefront of the battle against climate change. The path to sustainability demands proactive measures, innovative strategies and unwavering commitment from financial institutions worldwide. While initiatives like the Net-Zero Banking Alliance and commitments at COP conferences offer hope for progress, issues related to transmission risks, greenwashing and the absence of universal agreements loom large. The imperative for banks to align their policies with global climate goals becomes ever more urgent. Whether banks are truly prepared to mitigate climate risks and champion a greener future remains to be seen, but one thing is clear - the readiness of banks to effectively manage climate risks will not only define their own resilience but also shape the trajectory of global sustainability efforts for generations to come.

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