The Role of Indian Banks in the Climate Crisis

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Issue Brief

TABLE OF CONTENTS

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October 2022

ISSUE BRIEF

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ABSTRACT

The financial sector is responsible for large-scale investments in the fossil fuel industry. The current global warming and climate change trends demand an urgent scrutiny of the sector's investments. There is a need for the financial sector to invest in projects and companies that adhere to sustainable business practices. In doing so, banking and financial institutions must build on international standards and discourse to suit the Indian context. This issue brief aims to give an overview of the role of the Indian banking sector in the climate crisis while recommending a way forward.

Keywords:
Fossil fuel financing, climate crisis, banking, emissions, ESG

INTRODUCTION - THE ROLE OF THE BANKING SECTOR IN THE CLIMATE CRISIS

India faces a severe threat from the ongoing climate crisis. With the current global temperatures being 1.2°C above pre-industrial levels, the world is moving toward a 3°C temperature rise. Even if the major economies of the world act urgently to keep the atmospheric temperature increase to 1.5°C, as outlined under the Paris Agreement, India will continue facing its share of climate-related issues. The Intergovernmental Panel on Climate Change [IPCC] concluded that emissions from fossil fuels are one of the major causes of global warming and climate change. In 2018, 89% of global carbon dioxide emissions came from fossil fuels and related industrial activities (ClientEarth Communications, 2022).

Fossil fuel companies and financial institutions use a variety of financial instruments and structures to fund fossil fuel projects like coal and natural gas projects. These companies generally obtain financing for their projects from banks and other financial institutions through debt financing or equity financing (Mitchell, 2017). Debt financing refers to a firm raising money by selling debt instruments to individuals and/or institutions. Debt financing includes bonds, lines of credits, and loans, whereas equity financing refers to the sale of shares to raise capital. By selling shares, a company sells ownership in their company in return for cash. Equity financing can be raised through individual investors or initial public offerings [IPOs] (Banton, n.d.). The transactions that fund fossil fuel projects are called fossil fuel financing transactions (Mitchell, 2017). Fossil fuel financing from the 60 largest banks in the world added up to US$4.6 trillion in six years since adopting the Paris Agreement in 2015. US$742 billion were invested in fossil fuel financing in 2021 alone. In the year 2021-2022, these banks funnelled US$185.5 billion into the top 100 companies responsible for the rapid expansion of the fossil fuel industry (Kirsch et al., 2022).

GLOBAL AGREEMENTS ON FINANCING AND BANKING

The Finance Day at COP26 saw banking industry leaders discussing the sector's role in combating climate change under the UN-convened Net Zero Banking Alliance [NZBA]. The NZBA brings together 115 banks from 41 countries, with collective assets worth US$66 trillion, representing 43% of all banking assets globally (United Nations Environment Program Finance Initiative [UNEP FI], 2021). Banks in the alliance are committed to decarbonising their lending and investment portfolios to achieve net zero emissions by 2050. Banks from Malaysia, Singapore, South Korea, Japan, and Bangladesh are members of the alliance of the Asian continent. However, the alliance is yet to onboard a representative from India (UNEP FI, n.d.a.).

The UNEP issued the Principles of Responsible Banking [PRB] in 2019 as a guide for banks to increase awareness about the social and environmental repercussions of the projects and companies they lend to. Currently, 252 banks are signatories to the PRB. YES Bank is the only Indian signatory to the PRB (UNEP FI, n.d.b.).

Equator Principles are another financial industry framework for determining, assessing, and managing environmental and social risk in projects. The equator principles serve as a baseline and risk management framework for financial institutions to identify, assess, and manage environmental and social risks when financing projects. The principles apply globally to a range of financial products.

Currently, 136 financial institutions from 38 countries have officially adopted the Equator Principles, with only IDFC First Bank as an Indian adopter (The Equator Principles Association, n.d.).

Additionally, the European Union has adopted a directive on due diligence to foster sustainable and responsible corporate behaviour through the value chain. Under this regulation, corporations are required to actively address human rights issues and sustainability concerns while adhering to several secondary measures (European Commission, 2022). This directive can play an essential role in the financial sector since banks would be more inclined to extend credit to organisations that follow due diligence.

WHERE DO INDIAN BANKS STAND?

Indian financial institutions and banks, including the State Bank of India [SBI], Axis Bank, ICICI Bank, HDFC Bank, and The Trust Group, are among the largest financial institutions in the world that finance fossil fuel projects. With no targets to phase out coal and fossil fuel investments, Indian banks rank fourth globally in financing coal plants (Lopes & Nandan, 2021). They provided about Rs 11.1 lakh crore in loans between 2012 and 2019. SBI, India's largest public sector bank, is one of the top 12 banks in the world to finance coal plants. It has provided Rs 1.57 lakh crore in fossil fuel finance between 2016 and 2020 and has not made any net zero emissions commitments (Tong & Pirani, 2021).

According to a recent report by Asapur & Fernandes (2022), a large share of India's banking sector lacks mechanisms to combat climate change. Only 2 banks in India—Federal Bank and Suryoday Small Finance Bank—have policies that prohibit financing the construction of new thermal power plants or the expansion of existing ones. Meanwhile, only 7 banks in India have outlined policies that exclude lending to organisations actively involved in deforestation, human rights violations, biodiversity loss, etc. (ibid.).

Carbon emissions by institutions are categorised into 'scopes' based on sources of emissions. Scope 1 emissions include direct greenhouse gas emissions. Scope 2 emissions refer to indirect greenhouse gas emissions, such as the emissions produced by purchasing electricity. Scope 3 emissions include all the emissions the organisation is responsible for in its supply chain. For most businesses, scope 3 emissions account for more than 70% of their carbon footprint. Scope 3 emissions provide the most emissions and footprint data (Deloitte, n.d).

Regarding disclosure of environmental indicators, only 8 out of the 34 largest banks in India disclose their scope 1 and 2 greenhouse gas emissions, with only 6 having verified their emissions by a third party. YES Bank is the only one to have disclosed its scope 3 emissions for loans and investment portfolios for 2020-2021 (Asapur & Fernandes, 2022). None of the banks has a long-term commitment to cover net zero targets with implementation plans for scope 1, 2, and 3 emissions. However, YES Bank and HDFC Bank have set targets for scope 1 and 2 emissions (Economic Times BFSI, 2022).

According to BankTrack, India Exim Bank and SBI are financers for Rampal Coal Power Plant and the Carmichael Coal Mine, respectively. If these projects reach the operation stage, they have the potential to emit high levels of greenhouse gases (BankTrack, n.d.a.). Set in the Sundarbans mangrove area in Bangladesh, the Rampal coal power plant is a proposed 1320 MW power plant. Since most of the land acquired for the project is agricultural land, around 2 million people will lose their livelihood if this plant is constructed (BankTrack, n.d.b.). There are also other human rights issues associated with the project. The government of Bangladesh allegedly displaced local people without prior information or consent and without proper compensation. The construction of the Rampal coal power plant also goes against the Ramsar Convention[1] since it is being built on a forested and sensitive wetland area. The operation of the plant will have severe environmental consequences. The plant is expected to burn 4.7 million tons of coal and emit 7.9 million tons of carbon dioxide and other greenhouse gases annually (ibid.).

In 2014, the Adani Group signed a memorandum of understanding with SBI for a loan of up to US$1 billion to finance the Carmichael Coal Mine Project. The Carmichael project is one of the world's biggest greenfield coal mining projects, with an expected lifetime of 60 years (Paul, 2014). It is estimated to emit around 120 million tons of carbon dioxide annually, comparable to many countries. At peak production, the mine will have higher annual greenhouse gas emissions than Bangladesh, a country with a population of 160 million people (Amos & Swann, 2015). Furthermore, SBI invested US$150 million in coal mining, US$1.542 billion in coal power, US$3.525 billion in offshore oil and gas companies, and US$334 million in Arctic oil and gas companies between 2016 and 2021 (Kirsch et al., 2022).

The Reserve Bank of India [RBI] has initiated projects like the Priority Sector Lending Program to make credit available to vulnerable sectors, like solar energy, biomass generation, and electrification projects. Under this program, the bank has prioritised lending to renewable energy projects. Subsequently, the RBI included off-grid solar energy projects, biomass generation, and electrification projects under this program (Tong & Pirani, 2021). Even though the RBI guidelines support and promote renewable energy projects, the bank has not taken any measures to reduce fossil fuel investments. The RBI's 2019-2020 annual report recognises the need to manage climate-related risks. However, the RBI governor has not prioritised working against climate change (ibid.).

RECOMMENDATIONS

Financial institutions have a critical role in decarbonising economies and developing green economies. The active participation of banks in sectors like renewable energy and their disinvestment from fossil fuels is the only way to transition to net zero by 2050. Indian banks can play their part in this transition by considering the measures discussed below.

First and foremost, Indian banks need to phase out their fossil fuel investment portfolios. Secondly, the larger banks in India need to set an example by adopting a few measures and targets suggested by NZBA and PRB. Since many international standards and agreements are not in line with the current financial and societal ecosystem in India, they need to be adapted to better suit the requirements of the Indian financial sector.

Indian banks and asset managers need to pay attention to business responsibility and sustainability reporting [BRSR]. BRSR disclosures are based on environmental, social, and governance parameters that compel organisations to engage with stakeholders and incentivise voluntary disclosure of business measures. BRSR is based on 9 principles that divide reporting into 3 sections: general disclosures, management and process disclosures, and principle-wise performance disclosures.

1 - Emergent cases refer to situations like a sudden, urgent, or unexpected occurrence or occasion that require immediate action to protect against an imminent threat to the public health, safety, welfare, or to protect against an imminent threat of significant damage to property.

Principle-wise disclosures are further divided into essential indicators, which are mandatory to report, and leadership indicators which are voluntary to report. The Securities and Exchange Board of India has made business responsibility and sustainability reporting mandatory for the top 1,000 companies by market capitalisation for the financial year 2022-2023 (Princewaterhouse Coopers, 2021). Banks need to conduct intensive pre-investment checks to ensure that the companies and projects they are investing in are disclosing the required metrics and are following the required Environmental, Social, and Governance [ESG] parameters.

CONCLUSION

In 2007, the RBI issued guidelines to Indian commercial banks, encouraging them to incorporate sustainability and corporate social responsibility in their business strategy. These guidelines were followed by an increase in lending capacity for the energy sector in 2020. Nevertheless, the RBI is yet to issue guidelines limiting the financing of fossil fuel projects (Lopes & Nandan, 2021). The RBI needs to issue stricter guidelines to commercial and private banks to reduce financing for fossil fuel projects. Furthermore, Indian banks must also implement thorough background checks to ensure that the organisations they are lending to are reporting on the required sustainability and ESG metrics and transforming their investment portfolios.

Considering the current global warming trends and the urgency for immediate climate action, it is imperative for banks in India to disinvest from the fossil fuel sector and transition towards funding the renewable energy sector.

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