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REGULATORY FRAMEWORK AND GREEN BANKING PROMOTION: INSIGHTS FROM INDIA

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Abstract

Green banking has garnered increasing attention as a pivotal mechanism to combat climate change. This research paper investigates the evolution of green banking in India. Drawing on the nexus between financial sustainability, institutions, and government policies, the study attempts to discern the drivers propelling green banking. The paper draws on the existing literature on green banking and government policy documents. It identifies government intervention as a key driver of green banking. It presents a compilation of all the regulatory and policy measures undertaken in India and suggests possible focus directions. The study underscores the importance of regulatory measures.

***Keywords**: Green Banking, Regulatory framework and policy, Sustainable Finance, India, Climate Change, Central Bank.*

2. Introduction

Climate change is a part of the modern reality with human activities causing further acceleration in global warming. Considering that greenhouse gas emissions are thought to be the cause of the natural environment's shift in balance, which has negative effects in many nations, a worldwide response is required. The level of investment necessary to accomplish such a structural transition is tremendous. Given the substantial investment requirements, the financial sector is anticipated to be essential in supplying the funds. Sustainability is thought to foster business innovation and is fast emerging as a business goal. Banks are essential to the expansion and development of the economy. Therefore, they can contribute remarkably to promoting sustainability in investment and finance. The term green banking is a relatively new idea that has gained a lot of traction in the fields of financial services, environmental policy, and socioeconomic development. India's economy is the fifth largest in the world (Forbes India, 2024) in the 2024 GDP list and the third-largest emitter of carbon dioxide (World Resources Institute, 2023). It therefore faces a lot of climate change implications and has scope for adopting sustainable development practices and policies. As a result, it has adopted several policies and regulatory frameworks for reducing risks and promoting green operations in the nation's banking industry. The study is an attempt to analyse the factors driving green banking adoption and the role played by the government in influencing green banking.

3. Literature review

According to academics, green banking is just regular banking, with all operations under the supervision of the same authorities but with an emphasis on environmental sustainability (Karunakaran, 2014). The concept of green banking includes investments in environmentally friendly products and services as well as the mitigation of climate change and environmental protection (Lindenberg & Volz, 2016). Due to its special position in intermediation, which is crucial for directing financial resources toward sustainable goals, the banking division has a primary role in attaining sustainable development (Alexander, 2014). "Go green" has become a catchphrase in every aspect of life. It also influences banks. For the sake of sustainable economic development banks should adopt and practice green banking. If banks go green, they may contribute to both environmental preservation and financial stability, which is a major step toward any nation's sustainable growth (Kapoor et al., 2016). Green Banking is not entirely a new concept. Banks began implementing green banking as early as 1996 (Rajput et al., 2013). Creating and executing green credit policies as well as offering financial incentives for renewable energy generation can be regarded as crucial actions banks could take to enhance green financing (Yuan & Gallagher, 2019). One of the most important things banks can do to enhance green financing is to provide the guidelines required to back green credits and offer financial incentives for the generation of renewable energy (Yuan & Gallagher, 2019). Indian banks have a slow response to global environmental initiatives (Rajput et al., 2013). Although adopting a "go green" stance is imperative for developing nations like India, significant progress has not been achieved (Sudhalakshmi & Chinnadorai, 2014). It is required of banks to incorporate a green element into their lending policies. India must therefore implement policy measures to support green banking. Indian banks are trailing the rest of the world in embracing this green movement. There needs to be a significant response in this regard.

4. Methodology

The study makes use of secondary sources and works of researchers on green banking. The data on the regulatory policies has been compiled by the author from the circulars, press releases, and documents of the Government of India and regulatory bodies like the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI).

5. Drivers of Green Banking

5.1. Internal Drivers

Employees: An organization will not be able to retain or attract capital and human resources if society feels that it is not able to uphold the social norms (Sonpar et al., 2010). Excellent market reputation is attractive to potential employees (Jones, 1995)

Bank's Strategy: There is a strong association between business annual report disclosures and negative media coverage of environmental issues (Linsley & Shrives, 2006). Leading green activities is top management commitment, which is essential for creating organizational strategies and cultivating a sustainable culture (Newton et al., 2024). Research indicates that top management may influence environmental information included in the annual report (O'Donovan, 2002). Green banking as a means of fulfilling the corporate social responsibility of banks was mooted by some researchers (Biswas, 2011). Many banks adopted green banking as an outcome of their ethical code of conduct (Chew et al., 2016).

Profitability: A few times, the implementation of an environmental management system led to increased operating profit, improved environmental stewardship, and decreased risk (Jeucken, 2001). Using green banking techniques enhances brand perception and eventually yields more returns (Nanda & Bihari, 2012). Research indicates a direct relationship between financial and environmental performance (Hamilton, 1995). Banks can avoid lending to riskier projects that could result in environmental damages and associated costs by including environmental risk assessment in lending decisions (Sangeetha et al., 2021). Given the escalating need for sustainable financial offerings, green banking can also offer access to new markets and business prospects (Bukhari et al., 2019).

Operational Efficiency: One of the major advantages of green banking is cost savings (Heim & Zenklusen, 2005). Green banking is mandatory for handling issues with credit, legal, as well as reputation risk (Dharwal & Agarwal, 2013). A "go green" strategy may strengthen brand and marketing perception. Such a strategy reduces fraud and the cost of banking while increasing operational efficiency (Biswas, 2011). It encourages paperless transactions, which lowers the overhead associated with financial operations and supports environmental sustainability (Gupta, 2015).

5.2. External Drivers

Consumers: An increasing number of financial establishments are going green due to customer requests and rising awareness of environmental issues (Biswas, 2011). There is a rise in willingness on the part of consumers to spend on green products and services (McBoyle, 1996). Even when green items are more expensive than non-green or less eco-friendly products, consumers who care more about the environment will still choose to buy them (Dagnoli, 1990).

Government, Central Bank, and Other Regulatory Agencies:

State banks' green banking guidelines also lessen the likelihood that bank borrowers will experience loan default and prevent competitive distortions brought about by selective risk assessment. The expansion of green banking efforts may be impeded by the absence of government policies and assistance, and certain banks may find it difficult to bear the large upfront expenses associated with going green (Khairunnessa et al., 2021). There is a direct relationship between the rise in the number of environmental disclosures, particularly positive disclosures, in the yearly report and the companies that were prosecuted by the Australian state EPAs (Deegan & Rankin, 1996).

Investors: Moreover, stock market investors are also conscious of environmental contamination and would oppose companies or organizations that violate pollution regulations (Gupta & Goldar, 2003). Investors base their decisions keeping in mind the eco-efficiency of firms (Wu & Shen, 2013). A readiness on the part of investors to forfeit a sizeable percentage of their profits in exchange for societal advantages has been observed (Riedl & Smeets, 2017). Consumers and investors weighed the possibility that their money would be utilized to raise social and environmental standards in addition to the security of their deposit or investment when choosing a bank (Muhamat & Nizam bin Jaafar, 2010).

Competitors' Strategy: Numerous studies conducted in Bangladesh have revealed that other banks in the sector have imitated the environmental and social policies of certain banks (Khan et al., 2014).

7. Timeline of Regulatory Policies for Green Banking in India

Financial stability and the financial system are seriously threatened by climate change and other environmental threats (Bank of England, 2015). The responsibility of government and other regulatory bodies like central banks becomes imperative since they are key drivers of green change and institutional pillars that can transform the banking sector, especially in a developing country like India. The Government of India, the Reserve Bank of India (RBI), and the Securities and Exchange Board of India (SEBI) have also introduced policy measures in this regard.

Table 1: Timeline of Policy Framework geared towards Green Banking

Year	Organization	Policy Description
2007	RBI	Circular on Sustainable Development, Corporate Social Responsibility, and Non-Financial Reporting
2012	SEBI	Business Responsibility Reports
2014	Companies Act of 2013	Profits towards Corporate Social Responsibility (CSR)
2015	RBI	Priority Sector Lending
2016	SEBI	Issuance and listing of green bonds norms
2017	SEBI	'Disclosure Requirements for Issuance and Listing of Green Debt Securities'
2021	SEBI	Business Responsibility and Sustainability Reporting
2023	RBI	Green Deposits Framework

Source: compilation of the author

RBI released a circular on Sustainable Development, Corporate Social Responsibility, and Non-Financial Reporting, 2007

RBl's circular was brought about to bring to the attention of banks the concepts of Corporate Social Responsibility, Sustainable Development, as well as Non-Financial Reporting which were increasingly becoming relevant in the global setup. The notice listed the global initiatives in this direction like the project finance principles (the Equator Principles), United Nations Environment Programme Finance Initiative, carbon trading, Global Reporting Initiative (GRI), London Principles, etc. RBI also acknowledged the lack of efforts in this regard in India leading to a pressing need for financial institutions to engage in sustainable development to which banks could be significant contributors. The circular also encouraged the commercial banks to integrate Corporate Social Responsibility, Sustainable Development as well as Non-Financial Reporting by committing to:

Sustainability

Responsibility

Accountability

Transparency

No Harm policy

Sustainability Reporting dealt with by the GRI framework, was explained to ensure transparency in reporting. Internal initiatives to improve daily operations' efficiency, cleanliness, and support for social structures might be beneficial. Banks were requested to stay up to date on advancements in the fields of sustainable development plus corporate social responsibility and to adapt or adjust their lending plans and strategies accordingly.

SEBI mandated for incorporation of business responsibility reports with the listed entity's annual reports, 2012

The National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business, established by the Ministry of Corporate Affairs, served as the basis for the Annual Business Responsibility Reporting (ABRR) reporting system that was enforced by SEBI. The guidelines came out in 2011 and include detailed concepts that businesses should incorporate into their operations as well as a systematic methodology for reporting on corporate responsibility that calls for specific disclosures and outlines the actions businesses have taken to put the guidelines into practice. For the top 100 listed companies as of March 31, 2012, based on market capitalization at the BSE and NSE, Business Responsibility Reports had to be included in the Annual Reports. Reports could be voluntarily disclosed by other listed firms and included in their annual reports.

The Companies Act of 2013 directed 2% of profits towards Corporate Social Responsibility (CSR), 2014

Companies above the specified threshold were mandated to spend 2% of their average past three years' net profit on CSR under Section 135. The act also required companies to constitute CSR committees to formulate a CSR policy. Provisions were put in place for evaluation by the board director after each fiscal year to guarantee compliance. Companies were allowed to carry out CSR operations using a registered trust, society, or separate company.

Renewable energy covered under Priority Sector Lending (PSL) by RBI, 2015

One of the main tenets of India's financial policy is the Priority Sector loans mandate, which obliges banks to direct a proportion of their loans to socially meaningful industries. A significant boost to green financing came in 2015 when the Reserve Bank of India covered loaning out to small-scale renewable energy plans and social infrastructure inside the targets.

SEBI presented issuance and listing of green bonds norms, 2016

The framework and listing requirements for the issuance of green bonds have been established by the SEBI. The move aimed to meet the financing requirements for green banking in India. The new standards also stipulated that the pre-issuance and post-issuance procedures, including project appraisal and selection criteria, must be reviewed, certified, and validated by a third party. The issuer would still need to supply information about the methods and practices that will be utilised to track the proceeds of the issue, including funds invested and designated for projects that qualify. The external auditors would have to confirm the same. The issuer would be required to include disclosures on the use of the proceeds, as well as a list of the projects that the funds from the green bonds have been allocated, in both the yearly report and the periodic filings to the stock exchanges.

SEBI declared the 'Disclosure Requirements for Issuance and Listing of Green Debt Securities', 2017

The circular listed pointers to be disclosed by issuers of green debt securities:

(1) aims of green bonds and the process of determining the eligibility of projects for which funds are raised.

(2) details of proceeds utilised, for which information is to be compiled through tracking, along with details of unutilised proceeds.

(3) qualitative and quantitative performance indicators of the environmental impact of projects.

The guidelines also included an optional provision that allowed the issuer to appoint a third-party reviewer under the regulation tasked with certifying the process for project selection and eligible project categories.

SEBI notified 'Business Responsibility and Sustainability Reporting (BRSR)', 2021

The BRSR required divulgence from listed entities about their operations concerning the nine principles of "National Guidelines on Responsible Business Conduct" (NGBRCs). Reporting in each principle was broken down into essential and leadership indicators. Leadership indicators were optional to report, however, essential indicators should be submitted on a mandatory basis. The goal of the BRSR is to provide quantitative and standardized disclosures on Environmental, Social, and Governance parameters so that they may be compared across businesses, industries, and historical periods.

RBI released the Green Deposits Framework, 2023

To create a green finance ecosystem, the RBI released guidelines for clients to offer green deposits. Entities should institute a Financing Framework approved by the Board to ensure the efficient allocation of green deposits. To determine the impact of the money they lend or invest in green projects and activities; banks must also perform impact assessments on an annual basis using quantitative impact indicators. The allocation of monies obtained for green deposits during a fiscal year would be contingent upon an annual verification or assurance by an impartial third party. RBI provided sectors in which green deposits might be utilized– clean transportation, renewable energy, and biodiversity conservation.

RBI Announced Draft Framework on Climate-related Financial Risks Disclosure, 2024

RBI released draft guidelines applicable to scheduled commercial banks, cooperative banks, financial institutions, and non-banking financial companies. The entities are required to disclose:

(1) Governance:
Including supervision of climate-related risks and opportunities by the board and senior management.

(2) Strategy:
Including identification of climate-related risks and opportunities, determining their impact on business, and formulating a robust strategy thereafter

(3) Risk Management:
Including processes for monitoring and managing financial risks relating to climate and integrating them into overall risk management.

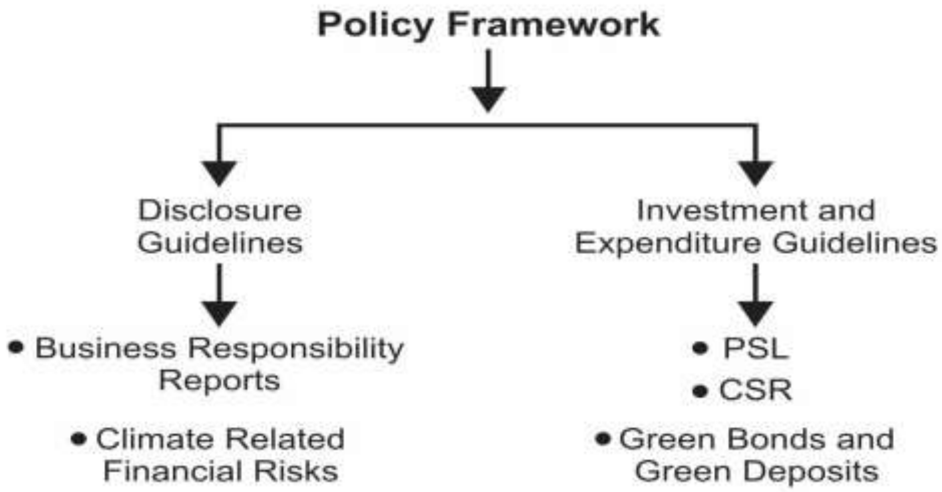
(4) Metrics and Targets:
Including metrics to monitor climate-related risks and opportunities and targets set and achieved related to climate risks and opportunities.

The entities are required to make disclosures on a standalone basis and not a consolidated basis. The disclosures will be examined by a committee of the board of directors and subject to appropriate assessments of internal controls. The disclosures must be part of the financial reports and statements on their website.

8. Conclusion

Green banking practices are still relatively new in India, but there is room for rapid expansion in the next years. The expansion of projects can be hampered by a lack of government policies and assistance, and some banks may find it difficult to bear the substantial upfront expenditures associated with putting green ideas into practice (Khairunnessa et al., 2021). This is particularly true for a developing economy like India where banks may struggle with green banking operations. It thus falls on the regulatory bodies to ease this transition for the commercial banks. An analysis of the regulations and guidelines released so far shows that the major focus areas have been on disclosures and green investment and expenditure.

Figure 1: Focus areas of Policy Framework



Source: Compilation of author

Regulatory measures focused on the following directions can also be adopted:

(1) **Differential Interest Rates**: Central banks can also encourage green banking by fixing lower interest rates for the desired sector and vice versa. This may work to increase credit flow to green projects. RBI can make it mandatory to provide concessions to entities and

(2) **Differential Reserves**: RBI has the power to set reserve requirements to be maintained by commercial banks at all times as a percentage of their deposits. This quantitative measure of monetary control can be used by the central bank to advance green objectives. RBI can set lower reserve requirements for greener portfolios and projects and vice versa. This can redirect credit towards sustainable avenues.

(3) **Moral Suasion**: RBI being the central bank has the power to psychologically influence commercial banks without the use of quantitative measures. Measures like compulsory spending on CSR already adopted by the Indian government though are beneficial and may increase expenditure towards socially responsible practices, yet they act as a burden on commercial institutions and can impact their performance. Central Bank can create and

disseminate knowledge. RBI can use its leadership to take banks into confidence, persuade them about the importance and impact of green banking, and direct them to channel actions in the desired direction.

(4) **Refinance Schemes**: The premier bank can also launch refinancing schemes for eligible products in collaboration with the commercial banks of the country. Such a scheme was launched by the Bangladesh Bank for selected product lines in 2009 with participating banks and financial institutions (Green Finance Platform). It seeks to compensate commercial banks for lending to ecologically conscious arenas.

Regulations can therefore be used to drive green growth in the banking sector of the country.

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