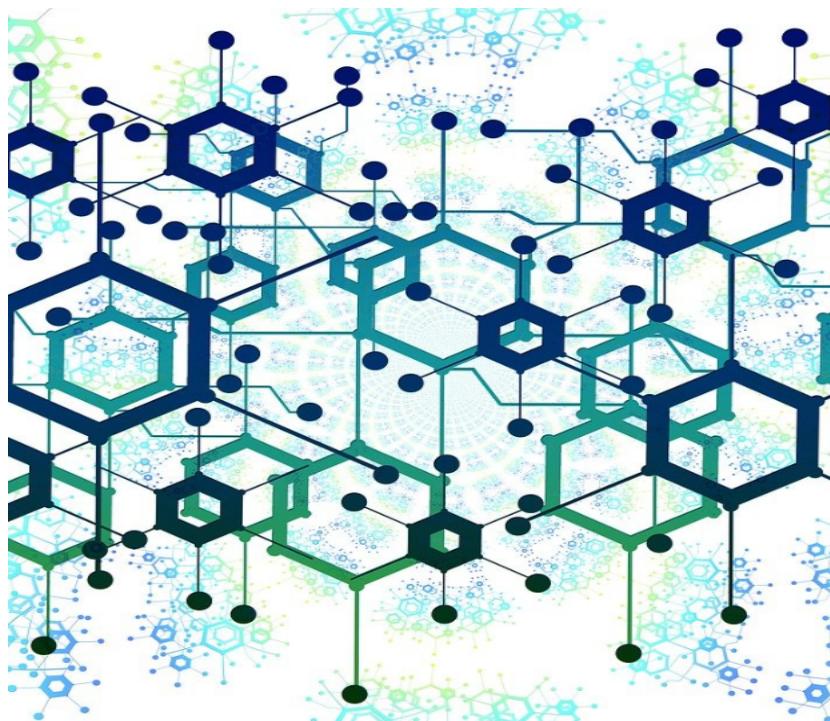


Disclosure framework on

Climate-related Financial

Risks

As climate change continues to pose significant threats to financial stability, Regulated Entities (REs) are at the forefront of navigating these emerging risks. With the transition to a sustainable economy becoming crucial, implementing effective climate-related financial risk management policies is imperative. Recognizing the need for enhanced transparency, a new standardized Disclosure Framework on Climate-related Financial Risks is being introduced to ensure REs can adequately address and disclose these critical challenges.



RBI Issues Landmark Guideline on Climate Risk Disclosure

The Reserve Bank of India (RBI) has issued a ground breaking draft guideline titled "Disclosure Framework on Climate-related Financial Risks, 2024" that will require banks and other regulated entities to make comprehensive disclosures on their climate risk management practices. The guideline recognizes climate change as one of the most significant emerging risks that is expected to have major financial stability implications. It aims to put in place a standardized disclosure framework to foster transparency, enable better risk assessment, and facilitate more efficient allocation of capital.

In a notable step, the RBI guideline aligns closely with the globally accepted Task Force on Climate-related Financial Disclosures (TCFD) framework and refers to the recently released climate disclosure standards by the International Sustainability Standards Board (ISSB). This positions the RBI guideline as a definitive regulatory development that brings India closer to harmonized global standards on climate risk disclosure.

Summary of the Guideline

The disclosure framework laid out in the RBI guideline spans four key thematic areas:

1. Governance - detailing the governance structures and processes for board and management oversight of climate risks and opportunities
2. Strategy - covering the actual and potential impacts of climate-related risks and opportunities on business strategy and financial planning

3. Risk Management - describing the processes to identify, assess, manage and integrate climate risks into overall risk management frameworks

4. Metrics and Targets - specifying the metrics and targets used to assess, monitor and manage climate-related risks and opportunities

The guideline makes a distinction between "baseline" disclosures which are mandatory for all covered entities and "enhanced" disclosures which are more advanced requirements that are voluntary for certain categories of institutions. It also details a phased implementation timeline starting FY 2025-26 for governance, strategy, and risk management disclosures and FY 2027-28 for metrics and targets.

The guideline applies to all commercial banks, large urban co-operative banks, small finance banks, AIFIs, and NBFCs in the upper and top regulatory layers. Disclosures are to be made on a standalone basis.

A Bold Step Beyond SEBI's BRSR

The RBI guideline is a significant step up from the Business Responsibility and Sustainability Reporting (BRSR) norms issued by the Securities and Exchange Board of India (SEBI). While the BRSR does have a section on climate risk, the RBI guideline goes much further in its alignment with TCFD and ISSB standards.

Notably, the RBI guideline provides highly granular and comprehensive guidance on the information to be disclosed under each of the four thematic pillars. It specifies disclosures on board oversight mechanisms, management's role, strategic resilience under different climate scenarios, integration into risk management processes, metrics like carbon footprint across Scope 1, 2 and 3 emissions, and quantified targets.

In contrast, SEBI has so far refrained from making explicit references to internationally accepted frameworks like TCFD or ISSB in its BRSR and the



disclosures are more high-level and generic in nature. The RBI's decisive incorporation of global best practices positions regulated entities to better align with emerging standards and investor expectations around climate risks.

This also comes at a time when SEBI is yet to announce its expected detailed guidance on ESG (environmental, social, governance) disclosures for listed companies which was anticipated to fill some of the gaps in BRSR. The RBI guideline has decidedly raised the bar and set a strong precedent for financial sector climate risk disclosures in India.

Action Items for Banks

To gear up for meeting these extensive new disclosure requirements, banks will need to undertake a range of initiatives across their governance, strategy, risk, and monitoring frameworks. Some key action items emerging from the RBI guideline are:

Governance Actions

- Form a board-level sustainability committee to oversee climate risk, frame its charter defining responsibilities
- Appoint senior executives to drive execution of the climate risk strategy and incorporate into their job descriptions
- Assess skill gaps in the board and management on climate risk, build knowledge through external expert sessions
- Establish formal quarterly board reviews and monthly management reviews on the bank's climate risk program
- Ensure senior executive accountability by designating a climate risk owner and defining oversight by the board committee

- Develop a customized climate risk management training program for the leadership team
- Set business objectives aligned to sustainability commitments, embed climate risk modeling into capital planning decisions
- Introduce climate risk KPIs into senior management performance appraisals and monitor vs. science-based targets
- Ensure updated management policies reflecting latest regulatory developments on climate risk
- Rigorously verify climate risk measurement models and metrics
- Evaluate strategic priorities to reorient toward sustainability objectives, define climate resilience expectations to guide strategy
- Ensure key climate risks like transition risk, physical risk etc. are regularly discussed in board/committee meetings
- Review emerging regulatory expectations on climate risk and track progress toward compliance

Strategy Actions

- Incorporate climate risk considerations into business strategy and financial planning
- Classify time horizons for climate risk planning customized to the bank's profile - short, medium, and long-term
- Project impacts on business model, revenues, costs, and capital under different climate scenarios
- Quantify exposures to high climate risk sectors and estimate erosion of financial position under stress scenarios

- Realign business strategy and capital allocation to increase focus on transition finance and climate-resilient sectors
- Implement an internal carbon pricing mechanism to reflect climate risk sensitivities in decisions
- Assess additional resource requirements to effectively implement the bank's climate strategy
- Develop a climate transition plan outlining pathway, targets, actions and dependencies
- Forecast policy & technology changes over designated horizons, model implications on credit quality and risk premiums
- Identify vulnerable sectors through heat-mapping based on transition risk, estimate orders of physical risk impact across key geographies
- Model revenue impact from policy changes under different climate scenarios, develop customized transition roadmap reflecting resilience expectations
- Project losses from physical & transition climate risks under different scenarios, assess potential erosion of capital buffers
- Embed projected losses and risks under diverse scenarios into strategy and financial planning next refresh cycle
- Set limits on exposure to polluting industries, implement shadow carbon pricing to reflect risk sensitivity
- Tap multilateral funding options for participating in green initiatives, develop expertise to measure and manage climate factors
- Highlight uncertainties around climate policy evolutions and technological advancements, quantify range of potential estimate variations
- Elucidate assumptions regarding expected transition pathways in plans, clearly outline key internal and external dependencies that can impact effectiveness



- Report on investments made exclusively toward climate resilience building, outline further plans and estimated costs
- Quantify investments in activities that help adapt the bank's operations and lending to climate change
- Detail additional initiatives being planned to adapt operations and product portfolio to climate impacts

Risk Management Actions

- Identify and prioritize material climate risks leveraging heat maps, hazard assessments, and sector vulnerabilities
- Integrate physical and transition risk factors into credit assessment models and counterparty risk ratings
- Conduct climate scenario analysis covering orderly and disorderly scenarios across short and long-term horizons
- Enhance due diligence and monitoring frameworks to capture climate risk data and define thresholds/triggers
- Update the bank's risk appetite framework to embed quantitative metrics and limits on exposure to climate risks
- Develop statistical models to size potential climate losses and impacts on capital adequacy
- Leverage climate models to estimate order of impact, score counterparties based on vulnerabilities
- Embed quantitative climate risk metrics into risk appetite statements, define management level climate risk owner
- Incorporate climate factors into credit risk management processes, reflect climate drivers in counterparty risk profiles



- Evaluate impact of climate risk drivers on trading portfolio risks, assess potential increase in volatility of market risk positions
- Model possible liquidity pressures owing to climate events, estimate potential drawdowns in credit lines and deposit withdrawals
- Identify processes vulnerable to both physical climate events and transition activities, define KPIs to monitor climate related operational risk
- Frame procedures to evaluate strategic, litigation and reputation risks under climate impact, design early warning indicators across risk classes
- Embed climate risks into policies covering identification, measurement and mitigation, ensure robust due diligence for onboarding
- Track climate risk parameters via risk dashboards on a monthly basis, put in place procedures for prompt incident reporting
- Define clear criteria for prioritizing climate risks vs. other risks, leverage probability/impact/velocity for prioritization
- Institute differential risk pricing for assets reflecting climate vulnerabilities
- Leverage environmental scorecards and ratings to assess impact vulnerabilities, build statistical models to quantify potential climate losses
- Define quantitative indicators like emission levels, transition metrics as key risk inputs, cover high-risk sectors and carbon intensive portfolios
- Review all risk processes to identify enhancements to capture climate risk, update processes to align with emerging regulatory expectations
- Assess business impact and resilience under varying climate scenarios, develop capabilities for orderly and disorderly scenario analysis
- Enhance screening to capture climate-related opportunities, leverage green taxonomy to identify assets supporting climate objectives

Metrics and Targets Actions

- Lay out a roadmap to measure and disclose the bank's Scope 1, 2 and 3 greenhouse gas emissions
- Calculate and disclose portfolio carbon intensity and financed emissions using established methodologies like PCAF
- Quantify the bank's exposures to physical and transition risks and proportion of portfolio aligned to green finance
- Mobilize dedicated capital toward financing climate mitigation and adaptation and measure its year-on-year increase
- Establish emission reduction targets validated by science-based methodologies in line with India's NDC commitments
- Link a portion of executive remuneration to achievement of the bank's climate risk management objectives
- Establish science based absolute and intensity emission reduction targets covering Scopes 1 & 2 in line with NDC
- Set timebound financed emissions reduction target
- Institutionalize systems for accurate emissions data collection in line with GHG protocol, ensure calculations cover all categories & avoid exclusions
- Define tracking metrics like emissions decline, green finance ratios, climate risk exposures, ensure tight integration between metrics and targets
- Measure absolute Scope 1 & 2 GHG emissions annually as per GHG Protocol, ensure appropriate boundary setting, data collection and disclosures
- Measure Scope 3 emissions covering all relevant categories, make meaningful assumptions to enable computations where data gaps exist
- Benchmark emissions trajectory against science based decarbonization pathways

- Disclose absolute gross exposure to each industry/sector, provide specifics where financed emissions coverage is less than 100% of exposure
- Document detailed computation methodology, allocation approaches and assumptions, disclose source of emission factors used
- Report changes if any in financed emissions computation methodology along with rationale
- Report extensively on progress against each stated target annually, provide multi-year trend analyses on key climate metrics
- Quantify and disclose percentage of assets vulnerable to physical and transition risks
- Disclose total financing mobilized and allocated exclusively toward climate-aligned activities
- Define proportion of senior management remuneration linked to progress on climate targets, institute mandatory climate risk KPIs

With this comprehensive set of strategic, risk management, and metrics-related initiatives, banks can position themselves to effectively identify, assess, manage and disclose their climate risk in line with the RBI's progressive new guideline. As the intensity of climate risk escalates and sustainable finance becomes pivotal, these measures will help build long-term resilience.

The RBI guideline on climate risk disclosure marks a watershed moment for climate action in the Indian financial sector. By decisively harmonizing with global standards, it paves the way for a more rigorous, standardized and decision-useful flow of risk information from banks. This will be crucial to align capital flows with low-carbon pathways and build a climate-resilient financial

system. The onus is now on banks to rapidly build capacity and adapt their practices to usher in a new era of climate risk management and disclosures.